

20 December 2012

Construction

NEUTRAL


Consolidating before the long-awaited election



We are maintaining our **NEUTRAL** recommendation on the construction sector in 1Q13 period as we see heightened risk from the upcoming 13th General Election. As expected, the 2013 budget announcement has few catalysts to excite the construction sector, at least for the medium term. Despite some positive mainstream news flows on projects like Gemas-JB EDTP, WCE highway, MRT line 2, High Speed Railway (HSR) and RAPID, we doubt that their awards will be out before the elections. Our **NEUTRAL** recommendation is also premised on the assumption that the 13th general election will be held somewhere between end-March to early-June 2013. We still prefer fundamentally strong contractors that have manageable balance sheets and sufficient capacities to counter the mundane period like GAMUDA (OP; TP: RM4.29) and WCT (OP; TP: RM3.17). We foresee that both these companies will likely be the winner in case of any rebound in appetite for the construction sector. For the smaller capitalisation contractors, we like BENALEC (OP; TP: RM1.71) as its EIA report and off-taker agreement for its Johor land project is likely to be finalised during the period.

9M12 results within expectations. The big cap construction companies' earnings came in within our expectations, although the smaller caps came in mainly below. However, MRCB results surprised us as it had recognized the EDL compensation in its earnings, contrary to the management's guidance earlier. This was due to the certainty of the government taking over its EDL highway, although the negotiation phase is still ongoing on the pricing and other terms and conditions. The underperformers were mainly due to the lag impact of the LRT revenue recognition due to the delays in the issuance of Development Orders (D.O) by the Selangor state government. Going forward, the contractors' 1H13 earnings will be better QoQ and YoY essentially due to the pick-up in the MRT and LRT work-in-progress jobs. Our top pick for the sector is GAMUDA (OP; TP: RM4.29), underpinned by its sizeable order book size of RM4.8b and tender book of RM10.0b.

What to expect in 1Q13? In general, mid to small size contractors earnings are expected to rebound on a QoQ and YoY basis due to the progress of the ongoing contracts, i.e. the LRT extension and MRT projects. However, the upcoming 13th general election will likely dent the sentiment due to the election risk. At present, we noticed that the flows of contract award have started to slow down as we believe the government had opted for a status-quo stance before the election.

Stay on the sideline. Nonetheless, it would still not be entirely negative for the construction sector in 1Q13 as we believe that fundamentally strong contractors like WCT (OP; TP: RM3.17) and GAMUDA (OP; TP: RM4.29) will likely be able to withstand the uncertainty of the election outcome via their ability to leverage on their ample capacity and strong balance sheet position. In addition, we see WCT and GAMUDA benefiting from the potential rebound in appetite for the construction sector post-election. Some of the contracts which are in the pipeline and could benefit the two are (1) Gemas-JB EDTP (RM8b), (2) RAPID earthwork (RM1b), MRT Line 2, TRX earthwork (RM1b), high-speed rail (HSR) project (c. RM25b) and Langat 2 (RM3.1b).

Potential upgrade? We will closely monitor the performance of the construction sector in 1Q13 as the sector could be attractive for bargain hunting should share prices overreact towards the election period. We see that the sector is poised for a re-rating post-election as we believe that the government would be more decisive then on awarding projects to contractors. Thus, we believe that positive contract flows will only be seen after the election with more news on the MRT Line 2 and HSR progress, i.e. government assessment on its feasibility study, public viewing and the alignment.

The pick for niche play. 2013 will be an exciting year for Benalec as it is likely to roll out its Tanjung Piai (3,485 acres) and Teluk Pengerang (1,760 acres) projects. To recap, Benalec has obtained the concession to reclaim and develop both lands from the Johor state government and is expected to wrap up its EIA report by 1HCY13. We understand that there are already a few oil majors (off-takers) interested.

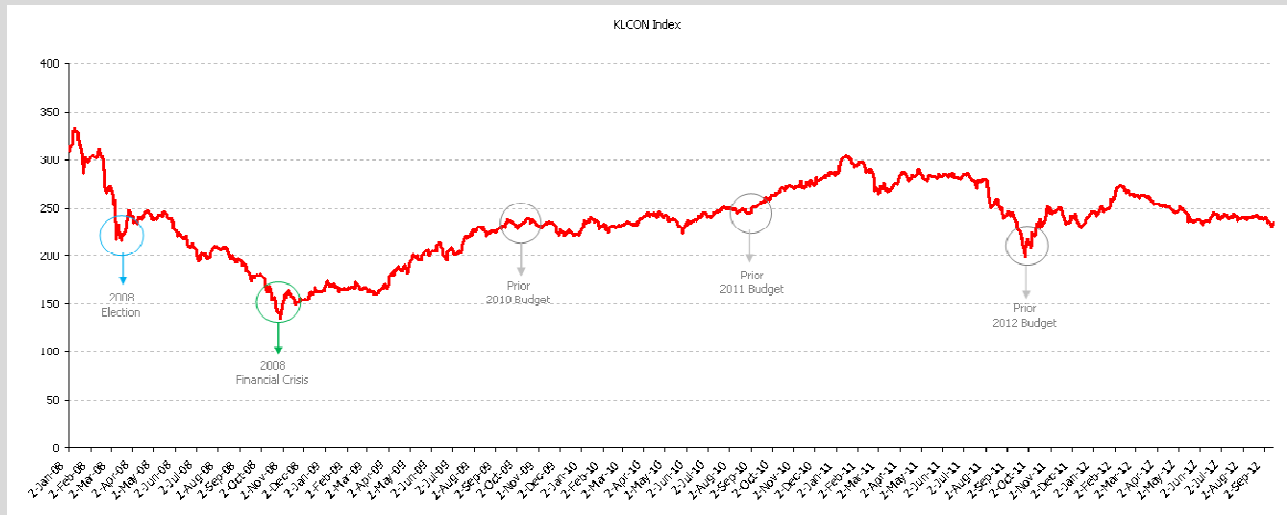
We are maintaining an overall NEUTRAL recommendation on construction sector and our Top Buys are GAMUDA (OP; TP RM: 4.29) and WCT (OP; TP RM: 3.17).

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Our NEUTRAL recommendation is premised on two latest developments. Based on the latest developments in two notable infrastructure projects, i.e. Eastern Dispersal Link Highway (EDL) and West Coast Expressway (WCE), the risk of the upcoming elections has actually started to affect corporate earnings through the delay of the Concession Agreement awards. These negative developments could spill over to the ongoing PPP and other infrastructure projects in the pipeline and eventually lead to a negative outlook for the capital market as a whole. We opine that the risk is likely higher for contractors who intend to enter into any concession business at this juncture based on above developments. This will lead to a "status quo" situation up to the general election with a clearer outlook to emerge only for contractors in the post-election period.

HSR cost balloons. Based on recent news, the EDTP Gemas-JB and HSR project will cost up to RM8.0b and RM25.0b respectively. This is higher than the amount reported in previous news at RM8.0b for EDTP and RM14.0b for HSR. We believe that the government will likely adopt a PPP model to roll out the project. The Suruhanjaya Pengangkutan Darat (SPAD) is eyeing mid-2013 as the date for pre-qualification bids.

KL Construction Index performance as at 15th Sept 2012



Source: Bloomberg, Kenanga Research

Conclusion

Due to uncertainties of the upcoming 13th General Election, we opine that it will be wiser for investors to limit their exposure in the sector. However, **WCT (OP; TP: RM3.17)** and **GAMUDA (OP; TP: RM4.29)** should be able to withstand the uncertainties due to its proven track record and its expertise in earthwork and tunnelling works. In terms of earnings diversification, both companies have successfully nurtured their property development incomes over the past years by continuously replenishing their strategic land banks. GAMUDA (OP; TP: RM4.29) is likely to be in the news due to the rising rumour of it disposing its stake in Litrak (45%) to some strategic investors, which we think could act as an immediate catalyst for GAMUDA (OP; TP: RM4.29) should the sale crystallise.

Peer Comparison

NAME	Price	Mkt Cap	PER (x)			Est. Div. Yld.	Est. ROE	P/BV	Net Profit (RMm)			1 Yr Fwd NP Growth	2 Yr Fwd NP Growth	Target Price	Rating
	(RM)	(RMm)	Actual	1 Yr Fwd	2 Yr Fwd	(%)	(%)	(x)	Actual	1 Yr Fwd	2 Yr Fwd	(%)	(%)	(RM)	
BENALEC HOLDINGS BHD	1.43	1150.5	13.9	10.3	8.8	2.4	20.5	2.1	82.7	111.7	131.4	35.1	17.6	1.71	Outperform
BINA PURI HOLDINGS BHD	0.82	101.4	16.4	18.8	9.1	1.8	3.2	0.6	6.2	5.4	11.1	-12.9	105.6	0.48	Underperform
EVERSENDAL CORP BHD	1.32	1021.7	8.5	8.5	7.3	0.9	14.5	1.2	119.5	120.0	139.4	0.4	16.2	1.44	Market Perform
FAJARBARU BUILDER GROUP BHD	0.66	123.8	-5.8	11.1	6.3	1.3	8.4	0.9	-21.3	11.2	19.6	-152.6	75.0	0.51	Underperform
GAMUDA BHD	3.64	7587.8	13.9	13.1	11.7	3.3	12.8	1.7	547.3	577.5	647.5	5.5	12.1	4.29	Outperform
IJM CORP BHD	4.93	6811.6	20.6	14.7	11.6	3.1	7.9	1.2	331.2	462.3	585.2	39.6	26.6	4.72	Market Perform
KIMLUN CORP BHD	1.40	336.6	7.9	7.1	5.7	3.0	18.9	1.3	42.7	47.3	59.4	10.8	25.6	1.77	Outperform
MALAYSIAN RESOURCES CORP BHD	1.54	2137.2	27.6	32.8	31.5	0.8	4.7	1.5	77.5	65.2	67.9	-15.9	4.1	2.22	Outperform
MMC CORP BHD	2.70	8221.7	25.6	31.2	19.4	1.4	3.9	1.2	321.2	263.1	423.1	-18.1	60.8	2.80	Market Perform
MUHIKBAH ENGINEERING (M) BHD	0.86	351.1	5.7	4.7	4.6	5.2	12.6	0.6	61.1	74.2	76.5	21.4	3.1	0.83	Market Perform
NAIM HOLDINGS BERHAD	1.87	467.5	9.7	4.9	4.2	3.8	10.8	0.5	48.4	95.9	112.0	98.1	16.8	2.62	Outperform
TRC SYNERGY BHD	0.56	264.3	20.3	25.9	7.4	1.0	1.3	0.3	13.0	10.2	35.8	-21.5	251.0	0.63	Market Perform
WCT BHD	2.35	2227.2	13.7	12.5	8.9	3.7	9.2	1.2	163.1	177.9	249.4	9.1	40.2	3.17	Outperform

Source: Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

- OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
- MARKET PERFORM: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
- UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

Sector Recommendations***

- OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
- NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of 3% to 10%
- UNDERWEIGHT : A particular sector's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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