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EQUITY: ENGINEERING & CONSTRUCTION

Cloudy outlook for 2H14F and FY15F

Quick Note

Global Markets Research

25 August 2014

Rating Remains	**Reduce**
Target price Remains	MYR 1.90
Closing price 21 August 2014	MYR 2.28

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Analyst briefing indicates further earnings decline ahead

While consensus seems to concede that it has overestimated FY14F earnings and are now reducing their estimates, we highlight several additional takeaways which indicate that FY15F might also be weak.

- Management guided that **construction margins** might be under pressure as the orderbook now has a large mix of low margin building works (~40% of total), and additionally we see the impact of GST kicking in next year.
- Our concerns are mostly on the **property business** where the group's unbilled sales (which will be the driver of near-term earnings) are only ~MYR 537mn, which imply only ~one-year worth of earnings at current recognition rates.
- **New property sales in 2Q were a paltry MYR27mn,** and the sentiment mainly at Medini/Iskandar high-rise projects is very weak. Management also guided that it might have to review its sales target for this year downward from MYR1.2bn (and new launches downward from MYR2.4bn).
- What all these mean is that earnings for FY15F might also be under pressure. Additionally, this year, WCT will also not be able to book fair value gains on investment property, which has supported its headline figures in the last few years (since Gateway@KLIA2 is a concession). **Reiterate Reduce.**

Positives: Construction business

Among the positives, management now seems to be more confident of getting construction jobs in Malaysia, mainly from the West Coast Expressway (WCE), Kwasa Land and RAPID civil works. However, we are not so bullish on the Middle-East jobs which WCT is also tendering for.

2Q14 recap: Construction and property continue to disappoint

WCT's 1H14 net income of MYR74mn (-26% y-y) formed 61% of our full-year estimate (and 38% of the Street's forecasts) for FY14F.

Fig. 1: WCT: 1H14 results snapshot

In line with our estimates

MYR mn	1H14	Nomura FY14F	1H as % of NMR FY14F	Consensus FY14F	1H as % of Cons FY14F
Revenue	869	1,878	46%	1,867	47%
Adj EBITDA	127	255	50%	329	39%
Reported NPATAMI	74	121	61%	193	38%
Adj NPATAMI	74	121	61%	193	38%

Source: Company data, Bloomberg , Nomura estimates

Divisional highlights - All segments weak, delay in investment properties completion

Construction

- The outstanding external construction order book as at end of 1H14 was MYR1.88bn, implying a visibility of ~1.6 years. This includes MYR342mn of road jobs at the RAPID site which WCT won in July 2014.
- Tendering for subcon works in six packages of WCE (total of MYR2.2bn), Kwasa Land and RAPID civil works. No significant visibility on Qatar projects.

Property development

- Cumulative sales at MYR245mn for 1H14 (20% of FY target). WCT will review its full-year sales target of MYR1.2bn, out of the MYR2.4bn new launches, which seems too optimistic, in our view.
- The projects likely to be deferred are mainly in Medini (A-60 Medini @ MYR 500mn GDV). Unbilled sales were at MYR537mn.

Property investment

- Target completion for hotel and mall investments delayed.
- Premiere hotel occupancy rate was at 61%, up from 54% in 1Q14. Average footfalls at Gateway mall @KLIA2 rose from 80,000 per day to 97,000 per day.
- Earnings are likely to get a MYR10mn boost once MAHB (MAHB MK, Reduce) extends its concession agreement for KLIA2 with the government, which would also imply a higher useful life for the Gateway mall, in our view.

Fig. 2: WCT: 2Q14 earnings review

MYR mn	2Q14	2Q13	% chg y-y	1Q14	% chg q-q	1H14	1H13	% chg y-y	FY14F	1H % of FY14F
Turnover	**401**	**483**	**(17%)**	**467**	**(14%)**	**869**	**973**	**(11%)**	**1,878**	**46%**
Construction	260	319	(18%)	327	(20%)	587	666	(12%)	1,236	48%
Property Development	124	150	(17%)	126	(2%)	251	274	(9%)	584	43%
Property Investment & Management	17	14	23%	14	22%	30	33	(7%)	58	53%
Operating profit	**56**	**75**	**(25%)**	**67**	**(16%)**	**123**	**158**	**(22%)**	**249**	**50%**
Construction	27	46	(43%)	37	(27%)	63	96	(34%)	101	63%
Property Development	23	18	27%	24	(1%)	47	46	2%	117	40%
Property Investment & Management	6	11	(42%)	7	(10%)	13	16	(18%)	31	42%
Share of profit in associates / JCE	4	4	(0%)	5	(11%)	9	8	8%	24	37%
Adjusted Pretax profit	**45**	**64**	**(28%)**	**57**	**(20%)**	**102**	**135**	**(24%)**	**176**	**58%**
Reported NPAT	34	57	(39%)	40	(14%)	74	100	(26%)	121	61%
Adj. NPAT (ex forex, revaluation)	**34**	**57**	**(39%)**	**40**	**(14%)**	**74**	**106**	**(30%)**	**121**	**61%**
Operating margins (%)	**14%**	**16%**	**-2 ppt**	**14%**	**0 ppt**	**14.2**	**16.2**	**-2 ppt**	**13%**	
Construction	10%	15%	-4 ppt	11%	-1 ppt	10.8	14.3	-4 ppt	8%	
Property Development	19%	12%	7 ppt	19%	0 ppt	18.8	16.9	2 ppt	20%	
Property Investment & Management	36%	78%	-41 ppt	49%	-13 ppt	42.2	47.9	-6 ppt	53%	
Basic Earnings per share (cent)										
Reported basic EPS (cent)	3.14	5.19	(39%)	3.67	(14%)	6.82	9.47	(28%)	11.53	
Normalised basic EPS (cent)	3.14	5.19	(39%)	3.67	(14%)	6.82	10.07	(32%)	11.53	

Source: Company data, Nomura estimates

Fig. 3: WCT: Current orderbook

Gulf States	MYR mn
Government Administrative Office, Qatar	354
New Doha Int'l Airport, Qatar (15%)	2
	356
Malaysia - Civil Engg and Infra	
PLUS Widening	290
Tun Razak Exchange	152
RAPID	342
Others	4
	788
Malaysia - Building	
KK Medical Centre	147
Putrajaya Commercial Office	291
Ministry of international Trade (MITI)	215
Jusco Melaka - AEON	30
UITM	36
Others	13
	732
External orderbook	**1,876**
Outstanding external orderbook	1,876
Orderbook burn rate (FY13)	1,168
IMPLIED CONSTRUCTION EARNINGS VISIBILITY (years)	**1.6**

Source: Company data, Nomura research

Fig. 4: WCT: Potential projects and tenderbook

Major Potential projects	
Tenders Submitted	**Value (MYR mn)**
Local Projects	3,101
Overseas Projects	1,500
Total	4,601
Tenders under preparation	
Local Projects	220
Overseas Projects	1,300
Total	1,520

Construction Contracts Targets 2014

MALAYSIA (Mgmt: ~MYR1bn, NMR: MYR600mn)
West Coast Expressway
Kwasa Damansara Land Civil Works (PDP)
Petronas RAPID Pengerang Civil Works –Phase 2
Tun Razak Exchange (TRX)
Mass Rapid Transit 2
Warisan Merdeka
KK Water Supply Scheme
KL - JB High Speed Rail
Southern Double Track
Hydro Electric Dam in Sarawak
Hydro Electric Dam in Sabah

MIDDLE EAST (Mgmt: ~MYR1bn, NMR: nil)
Qatar Roads and Expressways
Qatar Earthworks and Infrastructure works
Government Office Buildings in Qatar

Source: Company data, Nomura research

Fig. 5: Property target launches in 2014

Project	GDV (MYR mn)
BBT2 - Shop + serviced apartment	394
Bandar Parklands, Klang South	143
Laman Greenville @ Klang South	530
Skyz Jelutong	160
Paradigm Residences	483
A-60 Medini North (under review)	502
Paradigm Johor Bahru	193
One Medini Garden Villa	20
Total	**2,425**

Source: Company data

Fig. 6: Shopping malls and hotel occupancy

Paradigm Mall	
Retail space leased	99%
Avg footfalls per day	
Weekday	36,000
Weekend	64,000
Gateway Mall @KLIA2	
Retail space leased	80%
Avg footfalls per day	97,000
Premiere Hotel, Klang	
Occupany	61%
Avg Room rate per day	MYR 260
Room to F&B Revenue	60 : 40

Source: Company data

Appendix A-1

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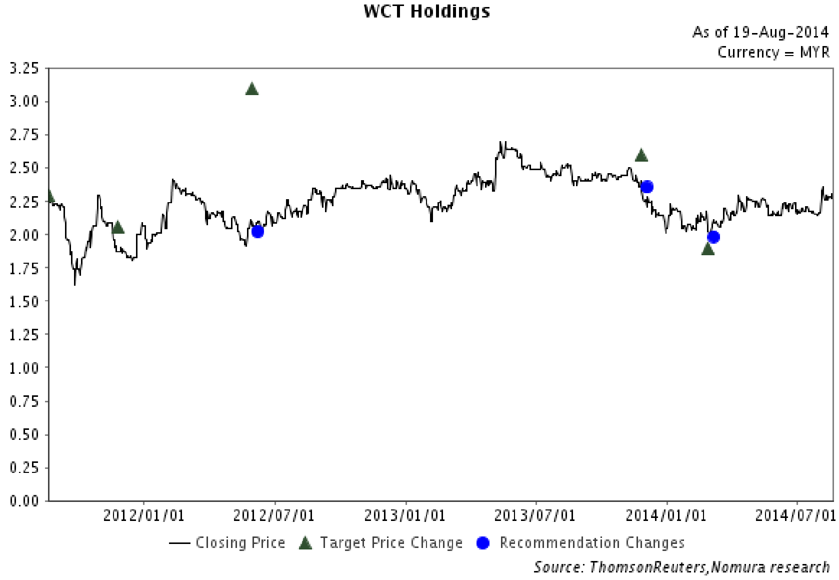
Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
WCT Holdings	WCTHG MK	MYR 2.28	21-Aug-2014	Reduce	N/A	

WCT Holdings (WCTHG MK) **MYR 2.28 (21-Aug-2014)** Reduce (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
27-Feb-14	Reduce		2.03
27-Feb-14		1.90	2.03
25-Nov-13	Neutral		2.40
25-Nov-13		2.60	2.40
30-May-12	Buy		2.07
30-May-12		3.10	2.07
25-Nov-11		2.06	1.87
19-Aug-11		2.30	2.322

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value WCT using a sum-of-the-parts (SOTP) methodology derived from 1) Construction segment valued at 8.5x PE CY14F 2) NAV of property segment at a 13.4% discount rate; 3) the NAV of investments in malls and hotels at 11% discount rate; 4) NAV of India expressways at 9.2% discount rate; and 5) NAV of KLIA2 IC at 9.4% discount rate. Our SOTP calculation implies a valuation of MYR2.0bn for WCT's businesses. To this we add cash from warrants (~MYR700mn) to arrive at our price target of MYR1.90/share.The benchmark index for this stock is MSCI Malaysia.

Risks that may impede the achievement of the target price Key upside risks to our view stems from 1) New project awards larger than our estimates: We currently build in MYR600mn of total new projects in FY14F/15F/16F each. In case WCT is able to secure projects exceeding our assumed value (like the Kwasa Damansara land civil works, with both having EPF as a major shareholder), there might be upside risk to the stock. 2) Higher-than-expected margins for construction and property development: We have cut our margin assumptions on cost and labour pressures in Malaysia and the Middle East. However, if these were to reverse, it could pose an upside risk. 3) Higher-than-expected property sales 4) Arbitration wins (e.g. the Meydan Racecourse arbitration).

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