

Malaysia Company Focus

WCT

Bloomberg: WCT MK | Reuters: WCTE.KL

DBS Group Research . Equity

28 Jul 2010

BUY RM2.75 KLCI : 1,351.82

(Upgrade from Fully Valued)

Price Target : 12 months RM 3.60 (Prev RM 2.25)

Reason for Report : Upgrading rating and TP

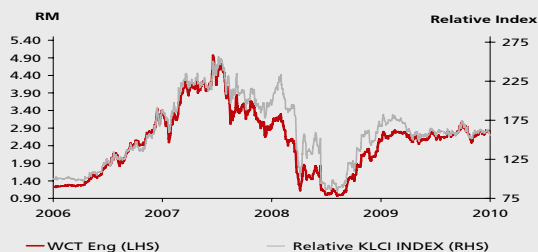
Potential Catalyst: Government pump priming, Middle East contracts

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Price Relative



Forecasts and Valuation

FY Dec (RM m)	2009A	2010F	2011F	2012F
Turnover	4,667	2,132	2,322	2,023
EBITDA	259	267	318	310
Pre-tax Profit	211	198	241	228
Net Profit	147	152	177	183
Net Pft (Pre Ex.)	147	152	177	183
EPS (sen)	16.0	16.5	19.2	19.8
EPS Pre Ex. (sen)	16.0	16.5	19.2	19.8
EPS Gth Pre Ex (%)	45	3	16	3
Diluted EPS (sen)	16.0	16.5	19.2	19.8
Net DPS (sen)	7.5	7.5	7.5	7.5
BV Per Share (sen)	162.9	173.8	186.6	199.0
PE (X)	17.2	16.7	14.3	13.9
PE Pre Ex. (X)	17.2	16.7	14.3	13.9
P/Cash Flow (X)	14.7	12.7	11.0	10.4
EV/EBITDA (X)	11.8	11.5	9.7	9.6
Net Div Yield (%)	2.7	2.7	2.7	2.7
P/Book Value (X)	1.7	1.6	1.5	1.4
Net Debt/Equity (X)	0.2	0.2	0.1	0.1
ROAE (%)	12.1	11.3	11.9	11.1

Earnings Rev (%) :	6.6	6.4	26.9
Consensus EPS (sen):	18.6	22.4	24.1

ICB Industry : Industrials

ICB Sector: Construction & Materials

Principal Business: Construction, property development and operation of toll roads

Source of all data: Company, DBS Vickers, Bloomberg

Unjustified construction laggard

- **Construction laggard, Bakun concerns overblown**
- **Most leveraged proxy to new wins, potential RRIM land participation with EPF's 21.6% stake**
- **Upgrade to BUY with new TP of RM3.60**

Upgrade to BUY, new TP RM3.60. We are upgrading our FV rating on WCT to BUY with a new SOP-derived TP of RM3.60. We also raise our earnings across the board by 6-27% to factor in higher new order wins and property rental income. Our rating upgrade is on the back of 3 reasons

Construction laggard. The stock has been a laggard vs its peers of Gamuda and IJM with premium PE valuations based on FY11 EPS reversing to a discount of 15-19%. This is largely on concerns for additional provisions for Bakun which is at the worst case scenario would be negligible. It is also relatively underowned by foreigners at 12% vs IJM and Gamuda of 37% and 33% respectively.

Most leveraged proxy to contract flows. Visibility of contract awards will improve in 2H10. WCT is the most leveraged proxy to contract wins with every RM500m of new orders raising our EPS by 7% vs IJM of 2% and Gamuda of 3%. Its RM2bn order win guidance will be met towards 4Q10 largely coming from the Sabah dam project and Middle East contracts. Its 2 key contract wins locally – LCCT EW1 and Medini infrastructure works both won via open tender partly from its competitive cost structure should put it on the map to bid for the remaining mega projects such as the LRT extensions and Langat 2 plant.

Leveraging on EPF for property. Third, we think its property arm could surprise on the upside with spill over from the 3,400 acres RRIM land project given EPF owns 21.6% in WCT, the second highest for contractors after MRCB. This will not be a first JV as EPF has a 30% stake in its Paradigm Plaza project. Assuming WCT is able to clinch 1/16 of the 3,400 acres of RRIM land, this could lift our SOP value by 16%. Other catalysts are sooner-than-expected launch for its Platinum Plaza project in District 1, HCMC Vietnam and en-bloc sales of its offices in Paradigm.

At A Glance

Issued Capital (m shrs)	783
Mkt. Cap (RMm/US\$m)	2,154 / 674
Major Shareholders	
WCT Capital (%)	25.0
Employees Provident Fund (%)	21.6
Free Float (%)	61.4
Avg. Daily Vol. ('000)	1,881

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Upgrade to BUY, raising SOP-derived TP to RM3.60

We upgrade our FV rating on WCT to BUY with a new SOP-derived TP of RM3.60. The stock has been laggard vs its peers of IJM and Gamuda while its premium PE valuations has reversed to a discount of 15-19% based on FY11 earnings. Please see Chart 1 for WCT's relative share price performance vs its peers and KLCI over a 3-month period.

Our new SOP value of RM3.60 factors in the following

- i) rolling over our base year to FY11;
- ii) a higher construction target PE multiple of 14x vs 12x previously. This is still at a discount to our target construction PE for IJM and Gamuda of 16x due to its seemingly less established presence locally;
- iii) Additional RM840m (RM0.91/share) in new property NAV coming from its Paradigm project and Platinum Plaza project in Vietnam. For Paradigm, we are assuming it is retaining its 1m GFA mall and valuing it at RM700 psf. For the 4 office towers with a GFA of 1.4m sq ft, we are assuming it will be sold. We have done a NPV of development profits using a discount rate of 10% assuming a GDV of c. RM1bn and profit margin of 28%. For Vietnam, we have done a NPV of development profits using a discount rate of 13% assuming a conservative GDV of US\$700m.
- iv) Higher capital value of RM595m from its 1m sf AEON Mall in Klang based on a NPV of lease income over 25 years at a discount rate of 10% plus the projected increase in land value over the lease horizon. This is the conservative as it values the mall at just RM595 psf inclusive of 5,000 car parks which is at a steep discount to Sunway Pyramid mall of RM1,365 psf and MidValley Mega Mall of RM1,050 psf.

We also raise our FY10-FY12 earnings by 6-27% to factor in :-

- i) higher orderbook assumptions of RM2bn for FY11 as we expect WCT to clinch their fair share of the mega projects locally and to capitalize on improving contract flows in the Middle East. Our orderbook assumptions for FY10 and FY12 are unchanged at RM2bn and RM1bn respectively.
- ii) Higher rental income of from AEON mall for FY10-FY12.

Bakun provisions overblown

WCT is holding on to its view that there should not be any more provisions in relation to the Bakun hydroelectric dam project. It went to the extent of making an official announcement on Bursa.

WCT has a 7.7% stake in the Malaysia-China Hydro JV consortium (MCHJV), the JV company which is building the dam. The rationale is that the MCHJV accounts until 30 June 2009 showed no further losses apart from a provision of RM358m (WCT's 7.7% stake RM28m) in 2004 and in 2006 the government also approved RM700m of additional costs which included the earlier RM358m. The MCHJV construction progress has already reached 96-97% of completion.

WCT also explained there should not be any LADs as this project is peculiar and had no fixed completion or sectional completion dates. Hence, if Sime Darby's claim that an additional RM450m cost overrun was incurred; a cash call would have to be called at the JV level. There have been on-going meetings with Sime Darby together with other consortium members and subcontractors but nothing conclusive was resolved as yet.

We estimate the worst case scenario is a provision of 2.5 sen/share which is for cost incurred for work done to date at the JV level but has not been approved by the government.

Construction franchise gaining more respect locally

Prior to the cancellation of its RM4.6bn Dubai race course project in December 2008, WCT was riding high and was comfortably positioned as Malaysia's construction proxy to the oil-rich Middle East. It has managed to reinvent itself since and clinched several high profile projects locally via open tender such as the RM766m Medini Iskandar infrastructure works and RM363m LCCT earthworks (EW1).

WCT is guiding the market for RM2bn of new orders by end-2010 with an equal split coming from Malaysia and Middle East. So far, it has only clinched RM111m which is its 50% share of Bahrain City Centre Fit-Out works. Its current external orderbook is RM2.1bn We understand there are 4 projects being negotiated in Abu Dhabi and Qatar collectively worth RM2bn. Of which, 2 are more advanced. The Abu Dhabi projects will be done jointly with long time partner Cebarco while in Qatar there is a new JV partner.

On the local front, the key catalyst is the formalisation of a letter of award for the KK 3 Water Scheme water supply project in Sabah worth in total RM2.8bn. We understand there are on-going meetings with the Minister and State where WCT is hopeful of clinching at the onset at least

RM1bn of the works before the end-2010. As this is a larger size project but on smaller scale as compared to the Pahang Selangor Water Transfer project, the balance may be awarded to WCT in 2011.

WCT is also been prequalified for the RM7-8bn LRT extensions and RM5bn Langat 2 water treatment plant. A potential surprise could come from a transport hub project for the LCCT.

Please see Figure 1 for a breakdown of its current outstanding orderbook

Table 1: Current outstanding orderbook

	RMm
Current orderbook	
Middle East projects	321
BCC Hotel Fit Out	302
Yas Marina Royal Yacht Club	24
Durkhan highway	11
Local	
LCCT EW1	265
Medini Iskandar	617
KKIA	42
Bakun Hydro Dam	84
Kudat Water Supply	6
Putrajaya Lot 4G9	169
Putrajaya Lot 4G8	132
AEON Melaka	28
UiTM Campus	36
Tijani 2 Condos	23
Others	43
Total	2103

Source: DBS Vickers

Most leveraged proxy to contract flows

In our view, contract flows will accelerate in 2H10 with the 10MP already setting the foundation. WCT is the most leveraged proxy to capitalize on new order wins vs Gamuda and IJM. For every RM500m increase in new order wins will raise our FY11 earnings by 7% vs IJM of 2% and Gamuda of 3%. In terms of construction contribution to FY11 earnings, WCT is 49% vs IJM of 23% and Gamuda of 55% while for percentage of SOP value coming from construction, WCT is 37% vs IJM of 23% and Gamuda of 45%. Please see Table 2.

Table 2 : Most leveraged to new contract wins

	WCT	IJM	Gamuda
% increase in FY12 EPS assuming RM500m additional wins	7	2	3
% of FY11 earnings from construction	49	23	55
% of SOP value from construction	37	23	45

Source: DBS Vickers

Property arm could surprise

Sales at its maturing township in Bandar Bukit Tinggi/Bandar Parklands have been resilient at RM3.5m per week. For its 1 Medini Residences project in Iskandar, the maiden launch will involve 300 units of apartments priced at US\$150 psf. With pricing comparable to the Klang Valley and in a State where landed property is preferred and cheaper, this project is largely for the foreign market. WCT has marketed 100 out of the 300 units in the Middle East and has received preliminary bookings for 47 units.

Its Paradigm project in Kelana Jaya, which is a WCT-EPF JV project comprising of 1.0m sq ft GFA shopping mall and 1.4m sq ft GFA of office towers are progressing as planned. The mall is slated to open in November 2011 and based on an average rental rate of RM9 psf could generate yearly revenue of RM73m, nearly triple of AEON mall's revenue. This is based on a NLA of 680,000 sq ft. The mall will open for leasing in August 2010 and is expected to secure a few anchor tenants by then. The en-bloc purchase of some of the office towers will be after the opening of the mall to capitalize on the full capital value.

With EPF's 21.6% stake in WCT, the second highest in a contractor/developer after MRCB, we think WCT has a high probability of clinching a substantial portion of the RRIM land. Based on our scenario of WCT clinching 1/16 of the total development of RRIM land of 3,400 acres or 213 acres, land utilization of 60%, plot ratio of 3x, ASP of RM300 psf which are similar assumptions we used for MRCB, this could enhance our SOP value by 16% or RM0.58/share. EPF's 30% stake in its Paradigm project in Kelana Jaya may lend some weight in its involvement in the RRIM land.

Figure 1: Assumptions assuming RRIM land

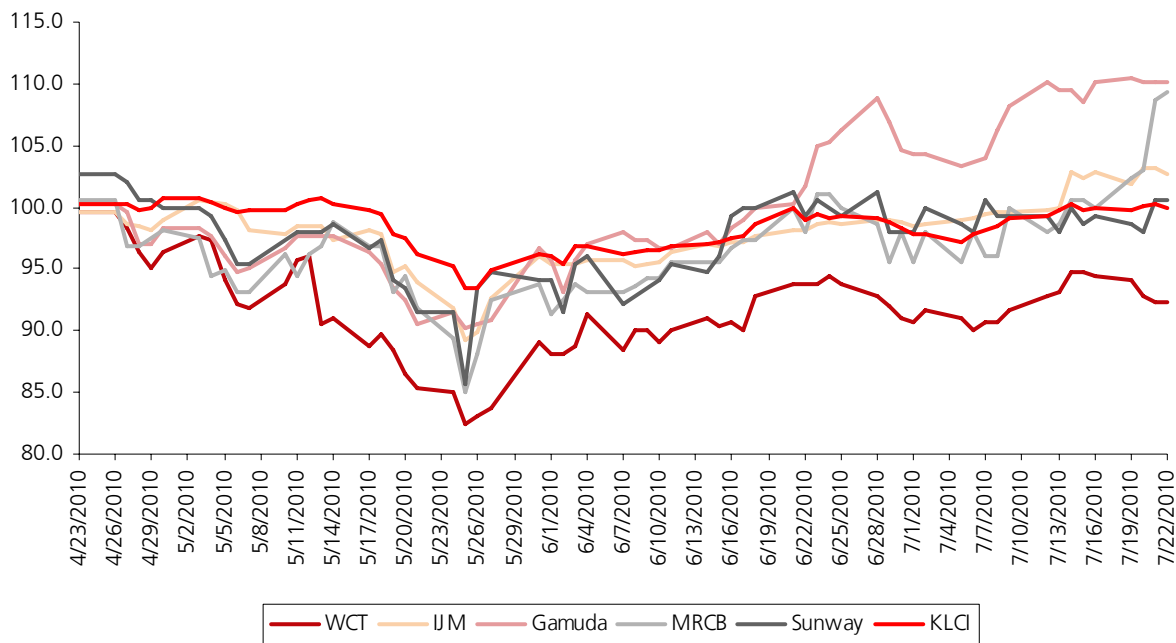
Acres	212.5
Plot ratio (x)	3
GFA (sq ft)	27,769,500
NLA (sq ft)	16,661,700
ASP (RM psf)	300
GDV (RMbn)	4,999
Margins (%)	20
Development duration (years)	10
Construction cost (RM psf)	180
BEV/PSF (RM)	243
NPV of development profits (RMm)	536
Discount rate	10%
% increase in SOP value	16
increase in SOP value on a per share basis	58

Source: DBS Vickers

2Q results preview

2Q10 results are due out on 19 August. We expect 2Q10 net profit to be relatively flat from 1Q10's RM35m bringing 1H10 net profit to RM70m. This accounts for 46% of our revised FY10F net profit implying a stronger 2H. We expect 2Q10 to show higher recognition of profits for newer projects such as LCCT EW1 and Medini infrastructure. This is in spite of more normalized construction margins of 5-6% vs 11.8% in 1Q10 which was due to writeback of profits from Abu Dhabi F1. Given its rather lean cost structure, we understand that WCT is reaping better margins than the 5% guided for these newer contracts.

Chart 1: WCT has underperformed the KLCI and other construction stocks – 3 Month Period



Source: DBS Vickers

SOP Value

Division	Stake %	Sub total RMm	SOP RMm	SOP/share Basis RM/share
Construction	100		1235.8	1.34 PE
Property				
Local Property				
Development projects				
Bandar Bukit Tinggi 2	100	64.1		NPV of profits
Bandar Parklands	100	137.1		NPV of profits
Kota Kinabalu	100	43.4		NPV of profits
BBT One Commercial	100	26.9		NPV of profits
Paradigm - 4 Towers of 1.8m sq ft	70	241.6		NPV of profits
Book value for development property		394.2		
Investment Property				
AEON Mall	100	595.0		NPV of lease income over 25 years
Paradigm - 680,000 sq ft mall and car parks	70	420.7		Market value
Sub total - local property	100	1923.2		
Vietnam	67	177.7		NPV of profits
Total - Property			2100.8	2.28
Tolls				
Durgapur Expressway	30	63.9		DCF
Panargarh-Palsit Expressway	30	89.5		DCF
Swarna Tollway	21.6	100.8		
Total - tolls			254.2	0.28
Less net debt FY11			-246.4	-0.27
Total SOP			3344.4	
Fully diluted number of shares outstanding (m)			921.4	
SOP/share (RM)			3.63	

Source: DBS Vickers

Sector Comparison

Company	Price	Target	Rating	Diluted P/E (x)		Mkt cap	Est. Order Bk	Mkt cap/ ord bk	Net tangible asset	P/NTA
	(RM)	(RM)		CY10	CY11	(RMb)	(RMb)	(x)	(RM)	(x)
Gamuda	3.36	4.35	Buy	22.0	17.7	6.8	4.7	1.4	1.37	2.5
IJM	5.11	6.00	Buy	19.1	17.0	6.8	3.9	1.7	3.86	1.3
WCT	2.75	3.60	Buy	16.7	14.3	2.1	2.1	1.0	1.63	1.7
MRCB	1.72	2.25	Buy	46.5	36.6	2.3	2.6	0.9	0.69	2.5
Sunway	1.59	2.10	Buy	11.0	9.7	1.0	2.5	0.4	1.07	1.5
TRC Synergy	1.08	0.94	Fully Valued				0.4		1.65	0.7
				12.0	11.5	0.2		0.4		
Average				21.2	17.8			1.0		1.7

Source: DBS Vickers, Company

Note: Gamuda's orderbook represents its executable portion only

Income Statement (RM m)

FY Dec	2009A	2010F	2011F	2012F
Turnover	4,667	2,132	2,322	2,023
Cost of Goods Sold	(4,314)	(1,880)	(2,022)	(1,734)
Gross Profit	352	252	300	289
Other Opng (Exp)/Inc	(136)	(41)	(49)	(55)
Operating Profit	217	211	251	234
Other Non Opng (Exp)/Inc	0	0	0	0
Associates & JV Inc	17	9	13	16
Net Interest (Exp)/Inc	(23)	(22)	(22)	(22)
Exceptional Gain/(Loss)	0	0	0	0
Pre-tax Profit	211	198	241	228
Tax	5	(24)	(31)	(26)
Minority Interest	(69)	(22)	(34)	(19)
Preference Dividend	0	0	0	0
Net Profit	147	152	177	183
Net Profit before Except.	147	152	177	183
EBITDA	259	267	318	310
Sales Gth (%)	25.7	(54.3)	8.9	(12.9)
EBITDA Gth (%)	62.0	3.0	18.9	(2.4)
Opg Profit Gth (%)	39.9	(3.0)	19.3	(6.8)
Net Profit Gth (%)	45.2	3.3	16.5	3.2
Effective Tax Rate (%)	N/A	11.9	12.8	11.5

Cash Flow Statement (RM m)

FY Dec	2009A	2010F	2011F	2012F
Pre-Tax Profit	211	198	241	228
Dep. & Amort.	42	57	66	76
Tax Paid	(6)	(24)	(31)	(26)
Assoc. & JV Inc/(loss)	(17)	(9)	(13)	(16)
Chg in Wkg.Cap.	(17)	(42)	(61)	22
Other Operating CF	65	55	62	69
Net Operating CF	279	235	265	353
Capital Exp.(net)	(76)	(150)	(156)	(161)
Other Invt.(net)	0	0	0	0
Invt in Assoc. & JV	0	0	0	0
Div from Assoc & JV	0	0	0	0
Other Investing CF	4	0	0	0
Net Investing CF	(73)	(150)	(156)	(161)
Div Paid	(55)	(60)	(63)	(65)
Chg in Gross Debt	(151)	80	80	80
Capital Issues	44	42	42	42
Other Financing CF	(76)	(55)	(62)	(69)
Net Financing CF	(238)	7	(2)	(12)
Net Cashflow	(32)	91	107	180

Quarterly / Interim Income Statement (RM m)

FY Dec	2Q2009	3Q2009	4Q2009	1Q2010
Turnover	1,178	1,312	1,208	400
Cost of Goods Sold	(1,070)	(1,226)	(1,124)	(331)
Gross Profit	108	86	83	69
Other Oper. (Exp)/Inc	(29)	(24)	(60)	(9)
Operating Profit	79	62	23	60
Other Non Opng (Exp)/Inc	0	0	0	0
Associates & JV Inc	4	4	5	2
Net Interest (Exp)/Inc	(13)	(12)	(11)	(12)
Exceptional Gain/(Loss)	0	0	0	0
Pre-tax Profit	71	54	17	51
Tax	2	(5)	9	(13)
Minority Interest	(31)	(15)	7	(3)
Net Profit	42	33	33	35
Net profit bef Except.	42	33	33	35
Sales Gth (%)	21.6	11.4	(8.0)	(66.9)
Opg Profit Gth (%)	(0.5)	(21.6)	(62.8)	161.4
Net Profit Gth (%)	7.0	(20.5)	(2.5)	7.4
Gross Margins (%)	9.2	6.6	6.9	17.2
Opg Profit Margins (%)	6.7	4.7	1.9	15.1
Net Profit Margins (%)	3.6	2.5	2.7	8.7

Balance Sheet (RM m)

FY Dec	2009A	2010F	2011F	2012F
Net Fixed Assets	603	696	785	871
Invt in Associates & JVs	204	214	226	242
Other LT Assets	455	455	455	455
Cash & ST Invt	714	805	913	1,093
Inventory	344	319	327	314
Debtors	2,148	1,516	1,632	1,524
Other Current Assets	5	5	5	5
Total Assets	4,473	4,010	4,343	4,502
ST Debt	206	206	206	206
Other Current Liab	1,955	1,256	1,319	1,219
LT Debt	792	872	952	1,032
Other LT Liabilities	9	9	9	9
Shareholder's Equity	1,277	1,411	1,567	1,727
Minority Interests	233	255	289	308
Total Cap. & Liab.	4,473	4,010	4,343	4,502
Non-Cash Wkg. Capital	543	584	646	624
Net Cash/(Debt)	(285)	(273)	(245)	(146)

Rates & Ratio

FY Dec	2009A	2010F	2011F	2012F
Gross Margins (%)	7.6	11.8	12.9	14.3
Opg Profit Margin (%)	4.6	9.9	10.8	11.6
Net Profit Margin (%)	3.2	7.1	7.6	9.0
ROAE (%)	12.1	11.3	11.9	11.1
ROA (%)	3.3	3.6	4.2	4.1
ROCE (%)	8.3	7.0	7.6	6.6
Div Payout Ratio (%)	40.0	40.1	35.6	35.7
Net Interest Cover (x)	9.4	9.6	11.2	10.6
Asset Turnover (x)	1.1	0.5	0.6	0.5
Debtors Turn (avg days)	162.8	313.7	247.5	284.7
Creditors Turn (avg days)	153.5	321.2	240.2	279.3
Inventory Turn (avg days)	28.1	66.3	60.2	70.6
Current Ratio (x)	1.5	1.8	1.9	2.1
Quick Ratio (x)	1.3	1.6	1.7	1.8
Net Debt/Equity (X)	0.2	0.2	0.1	0.1
Net Debt/Equity ex MI (X)	0.2	0.2	0.2	0.1
Capex to Debt (%)	7.6	13.9	13.4	13.0
Z-Score (X)	1.5	2.0	1.9	1.9
N. Cash/(Debt)PS (sen)	(36.3)	(33.7)	(29.2)	(16.8)
Opg CFPS (sen)	32.1	30.0	35.4	35.9
Free CFPS (sen)	22.0	9.2	11.9	20.8

Segmental Breakdown / Key Assumptions

FY Dec	2009A	2010F	2011F	2012F
Revenues (RM m)				
Construction	5,016	1,751	1,824	1,583
Property	171	256	374	315
Trading	0	124	124	124
Others	(521)	0	0	0
Total	4,667	2,132	2,322	2,023
Pretax profit (RM m)				
Construction	304	121	118	123
Property	45	83	127	104
Trading	0	6	6	6
Others	(139)	(13)	(10)	(6)
Total	211	198	241	228
Pretax Margins (%)				
Construction	6.1	6.9	6.5	7.8
Property	26.4	32.4	34.0	33.1
Trading	N/A	5.1	5.1	5.1
Total	4.5	9.3	10.4	11.3
Key Assumptions				
New order wins		2,000.0	2,000.0	1,500.0

Source: Company, DBS Vickers

DBSV recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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