

Corporate Highlights

New Coverage



RHB Research
Institute Sdn Bhd
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Company No: 233327 -M

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WCT Engineering

*A Local-Turned-Global Construction
Powerhouse Built On The "Insourcing" Model*

Share Price : RM5.45
Fair Value : RM7.00
Recom : **Outperform**
(New Coverage)

Analyst : Joshua CY Ng

Tel : (603) 9280 2151

E-mail : joshuang@rhb.com.my

Highlights

- ◆ WCT is a seasoned player in the construction sector. It has completed local and overseas projects with a total value of RM5.4bn over the last two-and-a-half decades. At present, its outstanding construction orderbook stands at about RM3.4bn, featuring a good mix of 9MP, local private sector as well as overseas jobs.
- ◆ The bases of our investment case for WCT are:
 1. WCT's faithfully guarded self-sufficient "insourcing" business model, crafted primarily to ensure full control and hence minimising completion risks, works extremely well in certain new overseas markets that have yet to build up a pool of reliable sub-contractors;
 2. WCT is a good proxy to the vibrant local construction sector over the medium term on the back of the 9MP, as well as the booming construction sector in the Gulf states; and
 3. Its strong earnings visibility underpinned by RM3.4bn outstanding construction orderbook and a healthy balance sheet.
- ◆ We are initiating coverage on WCT with an **Outperform** recommendation. Indicative fair value is RM7 based on 14x FY12/07 EPS.

Table 1: Investment Statistics (WCT; Code: 9679)

Bloomberg Ticker : WCT MK

FYE Dec	Turnover (RMm)	PBT (RMm)	Net profit (RMm)	EPS (sen)	Chg (%)	PER (x)	C. EPS* (sen)	GDPS (sen)	GD yld (%)
2005	816.5	129.2	81.3	40.2	>100	13.6	-	15.0	2.8
2006f	1,046.2	133.3	79.8	37.4	(7.0)	14.6	40.0	15.0	2.8
2007f	1,439.6	161.2	110.0	50.0	33.8	10.9	54.9	15.0	2.8
2008f	1,958.7	213.6	148.3	67.4	34.8	8.1	58.3	15.0	2.8
Market Capitalisation (RMm)				1,175.4	Major Shareholders				(%)
Daily Trading Volume (m shares)				0.50	Taing Kim Hwa & Wong Sewe Wing				24.8
52-week Price Range (RM / s)				2.20-5.45	EPF				14.4
NTA (RM/share)				2.69					

Main Board Listing /Trustee Stock/Syariah Approved Stock By The SC

* Consensus based on IBES Estimates

Background. WCT is a seasoned player in the construction sector. It has completed more than 300 local and overseas projects with a total value of RM5.4bn over the last two-and-a-half decades (see Table 2 for key completed projects). At present, its outstanding construction orderbook stands at about RM3.4bn, featuring a good mix of 9MP, local private sector as well as overseas jobs (see Table 3).

Table 2: Key Completed Projects

Project	Value (RMm)	Year Of Completion
<i>Overseas</i>		
Bahrain International Circuit, Bahrain	300	2004
Panagarh – Palsit Expressway, India	126	2005
Tada Nellore Highway, India	111	2004
Durgapur Expressway, India	105	2005
Al-Seef flyover, Bahrain	51	2005
<i>Local</i>		
Guthrie Corridor Highway	420	2005
Building jobs at Putrajaya	408	2005
Sepang F1 Circuit	308	1998
The Curve Shopping Centre	227	2004
<i>Source: Company</i>		

Table 3: Outstanding Construction Orderbook

Project	Contract Value (RMm)	Outstanding Value (RMm)	% Of Total	% Completion
<i>Overseas</i>				
Bahrain City Centre, Bahrain	1,280	583	17	54
Dukhan Highway, Qatar	384	311	9	19
New Doha International Airport, Qatar	282	270	8	4
Durrat Al-Bahrain Highway, Bahrain	86	4	0	95
	2,032	1,168	34	
<i>Local (Public Sector)</i>				
Kota Kinabalu International Airport	720	687	20	5
Various facilities at Universiti Teknologi Mara Campus in Kuala Selangor	435	435	13	0
Building jobs at Putrajaya	181	145	4	20
Kudat water supply	151	136	4	10
Bakun dam	469	89	3	81
	1956	1,492	43	
<i>Local (Private Sector)</i>				
Kajang – Seremban Expressway	370	331	10	11
Jusco shopping centre at Bandar Bukit Tinggi, Klang	283	272	8	4
Tijani 2 condominium	163	150	4	8
	816	753	22	
Miscellaneous local jobs	-	22	1	
Total	4,804	3,435	100	
<i>Source: Company</i>				

- ◆ Like most other construction companies in Malaysia, WCT is also involved in property development. Via 73.5%-owned WCT Land, it is developing three township projects in Klang, Selangor, namely, Bandar Bukit Tinggi 1, Bandar Bukit Tinggi 2 and Bandar Parklands (Bandar Bukit Tinggi 3) (see Table 4). It is also developing a high-end residential project in Sutera Harbour, Kota Kinabalu,

Sabah, as well as two commercial centres called Kelana Jaya City Centre near Petaling Jaya and BBT_One Commercial in Klang (also see Table 4).

Table 4: Key Property Projects

Project	Bandar Bukit Tinggi 1	Bandar Bukit Tinggi 2	Bandar Parklands	Sutera Harbour	Kelana Jaya City Centre	BBT_One Commercial
Type	Township	Township	Township	High-end residential	Commercial	Commercial
Land area (acres)	347	562	427	21.5	12.4	-
GDV (RMm)	1,191	1,523	908	196	900	147
Sales to-date (RMm)	994	1,081	86	-	-	-
Sales to-date (%)	83	71	9	-	-	-

Source: Company

- ◆ WCT also owns minority stakes in three BOT highway concessions in India, namely, the Tada Nellore Highway (21.6%), Panagarh – Palsit Expressway (30%) and Durgapur Expressway (30%).
- ◆ For 9MFY12/06, the construction division contributed about 56% of group EBIT with the balance 44% coming largely from the property division. For FY12/07-08, we project the EBIT contribution from the construction division to go up to 69-75% as construction activities in Malaysia as well as the Gulf states pick up steam.
- ◆ **The investment case.** The bases of our investment case for WCT are:
 1. WCT's faithfully guarded self-sufficient "insourcing" business model, crafted primarily to ensure full control and hence minimising completion risks, works extremely well in certain new overseas markets that have yet to build up a pool of reliable sub-contractors;
 2. WCT is a good proxy to the vibrant local construction sector over the medium term on the back of the 9MP, as well as the booming construction sector in the Gulf states; and
 3. Its strong earnings visibility underpinned by RM3.4bn outstanding construction orderbook and a healthy balance sheet.
- ◆ **An "insourcing" business model.** In the construction sector, a contractor for a particular job may physically complete the job itself, or just act as a project manager, farming out the job in portions to various sub-contractors to complete. In most cases, it is a combination of both, i.e. the contractor does part of the job and sub-contracts out the rest. The most common reason for sub-contracting is the unattractiveness of certain low-valued portions of the job. Others include capacity constraints or the lack of certain skills or expertise to complete certain parts of the job.
- ◆ From a business standpoint, it makes perfect sense for a contractor to hive off low-valued portions of a job to sub-contractors, assuming the capacity spared can be deployed for higher-valued jobs elsewhere, generating higher returns to the contractor. This, coupled with the availability of a pool of highly reliable sub-

contractors in the local construction sector, have set the stage for the transformation of the roles of key construction firms from that of a builder to largely a project manager.

- ◆ However, WCT has faithfully guarded its “insourcing” business model. It has continued to complete jobs in-house with minimal assistance from third-party contractors. *Ceteris paribus*, WCT may be seen as not maximising returns with its “insourcing” business model. Nonetheless, this self-sufficient business model does have key strategic attributes, i.e. full control in terms of work quality and timeliness, and hence minimising completion risks. This model helped WCT to complete the Bahrain International Circuit project within a record time of 16 months, propelling it to the forefront of the international construction scene.
- ◆ **Best of many worlds.** WCT is a highly dynamic construction company. It has managed to bag 9MP projects, emerge winners of highly competitive private sector jobs locally, as well as secure overseas contracts.
- ◆ It is among the earliest beneficiaries of the 9MP, bagging major 9MP projects such as the upgrading of Kota Kinabalu International Airport worth RM720m and the RM435m contract for the construction of various facilities at Universiti Teknologi Mara, Selangor (see Table 3).
- ◆ On the private sector front, standing testimony to its competitiveness, WCT has also won major contracts such as the RM370m sub-contract for the construction of the Kajang – Seremban Expressway from highly demanding blue-chip client IJM (who sometimes is also a competitor) and the RM163m construction contract for the *Tijani 2* luxury condominium project in the highly exclusive Bukit Tunku area in Kuala Lumpur (also see Table 3).
- ◆ On the overseas front, WCT has established itself in India and the Gulf states, two of the world’s major centres of construction boom over the medium term. In India, WCT has completed jobs worth a total of RM342m for the construction of the Tada Nellore Highway, Panagarh – Palsit Expressway and Durgapur Expressway (see Table 2). In the Gulf states, WCT has delivered contracts worth a total of RM351m including the Bahrain International Circuit project (also see Table 2). In addition, WCT also has some RM1.2bn outstanding orderbook in the Gulf states consisting largely the construction of Bahrain City Centre in Bahrain, and Dukhan Highway and New Doha International Airport in Qatar (see Table 3).
- ◆ **Strong earnings visibility and a healthy balance sheet.** WCT’s earnings visibility is strong, underpinned by RM3.4bn outstanding construction orderbook. Against a backdrop of the booming construction sector in Malaysia and the Gulf states, we assume in our earnings model that WCT will secure RM2bn worth of

new orderbook every year. As at 30 September 2006, WCT was in a net debt of RM131.1m, translating into a net gearing of 0.23x that is highly manageable.

- ◆ **Valuations and recommendation.** We have arrived at a fair value of RM7.00 for WCT based on 14x FY12/07 EPS, in line with our 1-year forward PER for Gamuda and IJM. We believe WCT should trade at par with Gamuda and IJM given its strong footholds in both the local and overseas construction markets. We are initiating coverage on WCT with an **Outperform** recommendation.

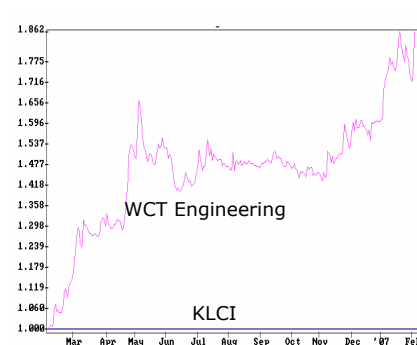
Table 5: Earnings Review And Forecasts

FYE Dec	2004	2005	2006F	2007F	2008F
Turnover	796.3	816.5	1,046.2	1,439.6	1,958.7
Construction	447.3	464.8	761.5	1,202.3	1,711.9
Property	305.3	323.8	237.2	189.8	199.3
Others	43.7	27.9	47.5	47.5	47.5
EBITDA	127.7	154.3	185.4	193.3	240.8
Depreciation and amortisation	(7.4)	(26.4)	(31.4)	(31.4)	(31.4)
EBIT	120.3	127.9	153.9	161.9	209.4
Construction	57.4	37.9	82.7	112.4	157.6
Property	60.4	88.7	68.4	47.4	49.8
Others	2.5	1.3	2.8	2.0	2.0
Net interest expenses	(3.6)	(23.8)	(23.6)	(5.7)	(0.8)
Associates	(49.7)	25.1	3.0	5.0	5.0
Pretax profit	67.0	129.2	133.3	161.2	213.6
Taxation	(39.8)	(34.1)	(29.2)	(41.9)	(55.5)
Minorities	(1.9)	(13.7)	(24.4)	(9.3)	(9.8)
Earnings	25.3	81.3	79.8	110.0	148.3
Chg (%)	-	220.9	(1.9)	37.9	34.8
EPS (sen)	15.3	40.2	37.4	50.0	67.4
Chg (%)	-	>100	(7.0)	33.8	34.8
PER (x)	35.7	13.6	14.6	10.9	8.1
Gross dividend per share (sen)	37.0	15.0	15.0	15.0	15.0
Gross dividend yield (%)	7.0	2.8	2.8	2.8	2.8
Weighted shares (m)	166.1	202.4	213.5	220.0	220.0
Effective tax rate (%)	59.4	26.4	21.9	26.0	26.0

Share Price Chart



Relative Performance To KLCI



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Outperform = The stock return is expected to exceed the KLCI benchmark by greater than five percentage points over the next 6-12 months.

Trading Buy = Short-term positive development on the stock that could lead to a re-rating in the share price and translate into an absolute return of 15% or more over a period of three months, but fundamentals are not strong enough to warrant an Outperform call. It is generally for investors who are willing to take on higher risks.

Market Perform = The stock return is expected to be in line with the KLCI benchmark (+/- five percentage points) over the next 6-12 months.

Underperform = The stock return is expected to underperform the KLCI benchmark by more than five percentage points over the next 6-12 months.

Industry/Sector Ratings

Overweight = Industry expected to outperform the KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Neutral = Industry expected to perform in line with the KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

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