

06 January 2016

# Construction

## ContractsFlow Awakens ...

By Adrian Ng | [adrian.ng@kenanga.com.my](mailto:adrian.ng@kenanga.com.my)

# OVERWEIGHT



We maintain **OVERWEIGHT** as the sector's fundamental remains strong backed by: (i) healthy contractors' outstanding orderbooks that provides visibility for the next 2-3 years, and (ii) still bright orderbook replenishment prospects over the medium-term driven by a slew of infrastructure jobs where more construction awards are expected in mid-2016. However, the big caps are becoming less appealing due to their potential earnings risk underpinned by huge exposure to the property sector and rich valuations. As such, we advocate investors to accumulate quality and value construction stocks with qualities such as: (i) strong orderbook visibility of at least 2-3 years, (ii) minimal earnings risk i.e. high probability of meeting new orderbook replenishment expectations and sustainable margins, and (iii) compelling valuations i.e. MITRA, MUHIBAH, and KIMLUN. No change in our target PER for big caps of 18.0x and small-mid cap PER target of 7x – 13x. Our Top Pick for 1QCY16 is KIMLUN (OP; TP: RM2.05).



**The awakening of contract flows and shares performance.** As of our report cut-off date of 23<sup>rd</sup> Dec 2015, we have seen recovery in share prices for the stocks under our coverage with an average gain of 9.8% in 4QCY15 vs. last quarter's average loss of 10.3%. We believe that the pick-up in share prices over 4QCY15 were mainly driven by strong construction award flows where we saw RM4.9b worth of local contracts being dished out in 4QCY15, which was 42% higher than the amount in 3QCY15. RAPID jobs made up 41% of the RM4.9b worth of jobs being dished out in 4QCY15, and WCT is a major winner with most contracts bagged bringing with a total of RM1.2b. In terms of year-to-date performance, KL Construction Index registered a smallish decline of 0.2%, still outperforming FBMKLCI's performance, which registered greater losses of 5.1%.

**Mild improvements in 3QCY15 results.** Out of 10 contractors under our coverage, 5 registered results that were within expectations, 1 above, while the remaining 4 came in below expectations. As highlighted in our previous 2QCY15 strategy report, 3QCY15 has indeed seen mild improvements with lesser disappointments compared to 2QCY15. That said, companies that disappointed in the recent reporting season seen drastic downward revisions in FY15-16E earnings were HSL, WCT, NAIM and SENDAI, ranging from 10% to 74%. The main drag in their performance was mainly due to higher-than-expected operating costs arising from variation orders, especially those who have exposure in Middle East i.e. WCT and SENDAI. Post-our earnings revision; we are still expecting an average growth of 6%-29% for FY15-16E, and the growth expectation in FY16 is significantly higher due to timing differences in the recognition of existing construction orderbook coupled with a low base effect in FY15.

**A year of awards!** Moving into 2016, we are maintaining our view that the construction sector will remain busy for the next few years driven by mega infrastructure projects underpinned by MRT2, LRT3, RAPID, Pan Borneo Highway, SUKE, and DASH. Given the sheer size of these jobs, we will be expecting most of the contractors in town to benefit from these contracts whereby most awards are expected to be out in mid-2016, while the initial packages for MRT2 are likely to be awarded in 1QCY16. For MRT2, we would expect the listed contractors for MRT1, i.e. GADANG, SUNCON, IJM, GAMUDA, AZRB, and MUDAJAYA to stand a higher chance in winning the second package given their track record for MRT1. Other players like WCT would be busy executing their massive outstanding orderbook of RM4.6b while eyeing more infrastructure/earthworks-related jobs and MUHIBAH is expected to remain focus on RAPID projects. As for more specialized works such as segmental box girders (for MRT and LRT), foundation and sub-structure piling works and structural steel works (super structure building), SENDAI, KIMLUN, PTARAS and ECONBHD should be key beneficiaries.

**High-Speed Rail back in the limelight?** Recently, 14 companies have been invited to share their ideas on the high-speed rail. However, we still think that high-speed rail project is still at preliminary stages and it could take at least another 1-2 years before it could take off as it involves G2G collaboration with Singapore. That said, we do opine that the Chinese contractors do stand a higher chance in bagging the contract given their strong financial capabilities to fund and ability to execute such mega projects.

**Big-caps remain unattractive?** In terms of valuation, big-cap players remain unattractive trading at an average of 17.2x since our 1QCY15 review, except for WCT that traded up to 23.5x albeit earnings disappointments due to high contract award news flow. As for small mid-cap players, valuations have seen minor improvements of 1x from the range of 6.0x – 11.0x to 6.0x – 12.0x attributable to better contract news flow in December. Nonetheless, we still believe that value lies deep in mid-cap contractors, especially those that have strong earnings visibility with an orderbook size that could last them for

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the next 2-3 years and strong execution track record, i.e. MITRA, KIMLUN and MUHIBAH.

**KIMLUN remains one of our Top Picks in 1QCY16.** We are maintaining KIMLUN as our TOP PICK in 1QCY16 as we continue to believe that they will be the forerunner for MRT2's Segmental Box Girder (SBG), and Tunnel Lining Segment (TLS) contracts given their strong track record and expertise of which KIMLUN won numerous contract awards both locally and internationally in Singapore, supplying both SBG and TLS. They are the only contractor under our coverage that have been consistently outperforming market estimate and that of ours in terms of earnings performance. That said, the group is looking to bid for more infrastructure jobs, i.e. Pan Borneo Highway, SUKE, and DASH, as compared to building jobs to diversify their income streams from relying on building projects alone due to the recent slowdown in the property market. Valuation-wise, KIMLUN's TP of RM2.05 is valued at PER of 9.0x, in line with its historical average and small-mid cap peers's range of 7x-13x. That said, we also like contractors with strong execution track records like MITRA and MUHIBAH that can deliver consistent earnings performance.

#### How Low Can It Be; How High Can It Go?

Looking at 4QCY15, stocks under our coverage had seen recovery, registering positive gains ranging from of 3.1%-28.4% since our 3QCY15 review. Hence, we have worked out the floor and ceiling valuations for respective stocks under our coverage in order to have a view of the potential low and high stock prices.

#### Contractor Share Prices Quarterly Performance

Contractors	Share Price Changes over 1QCY15 review period	Share Price Changes over 2QCY15 review period	Share Price Changes over 3QCY15 review period	Share Price Changes over 4QCY15 review period
IJM	9.2%	-4.7%	-8.6%	8.6%
GAMUDA	4.2%	-4.3%	-9.1%	3.1%
MMCCORP	3.9%	2.5%	-12.6%	-9.8%
WCT	-2.0%	1.7%	-5.8%	28.4%
<b>Big cap average</b>	<b>3.8%</b>	<b>-1.2%</b>	<b>-9.0%</b>	<b>7.6%</b>
HSL	4.1%	5.1%	-4.8%	5.6%
MUHIBAH	12.1%	8.5%	-13.0%	12.4%
MITRA	74.6%	17.8%	-16.9%	17.5%
SENDAI	52.9%	16.7%	-15.4%	3.2%
NAIM	-7.9%	-15.0%	-8.4%	12.8%
KIMLUN	7.4%	2.3%	-8.3%	15.6%
<b>Small-mid cap average</b>	<b>23.9%</b>	<b>5.9%</b>	<b>-11.1%</b>	<b>11.2%</b>
<b>Overall Average</b>	<b>15.9%</b>	<b>3.1%</b>	<b>-10.3%</b>	<b>9.8%</b>

Source: Kenanga Research

#### Floor and Ceiling Prices for 4QCY15 (Part 1 of 2)

Stock Name	Last Price@ 23/12/15	Floor Price	Ceiling Price	Last price vs. Floor Price	Last price vs. Ceiling Price
	RM	RM	RM		
SENDAI	0.80	0.65	0.89	-18%	12%
GAMUDA	4.63	3.83	5.34	-17%	15%
HSL	1.87	1.51	2.07	-19%	11%
IJM	3.42	2.78	3.72	-19%	9%
KIMLUN	1.41	0.98	1.70	-30%	21%
MITRA	1.21	0.86	1.33	-29%	10%
MMC	1.94	1.70	2.87	-12%	48%
MUHIBAH	2.26	1.87	3.36	-17%	49%
NAIM	2.46	2.03	2.79	-18%	13%
WCT	1.72	1.18	1.82	-32%	6%

Source: Bloomberg, Kenanga Research

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## Floor and Ceiling Prices for 4QCY15 (Part 2 of 2)

Stock Name	Floor Basis	Ceiling Basis
SENDAI	FY16E PER of 6.2x @ 3-yr -1.5SD	FY16E PER of 8.5x @ 3-yr -1.0SD
GAMUDA	FY17E PER of 10.3x @ 5-yr average	FY17E PER of 17.2x @ 5-yr 2.0SD
HSL	FY16E PER of 9.6x @ 5-yr -1.0SD	FY16E PER of 13.1x @ 5-yr 1.0SD
IJM	FY17E PER of 13.8x @ 5-yr -2.0SD	FY17E PER of 23.2x @ 5-yr average
KIMLUN	FY16E PER of 5.5x @ 5-yr -1.5SD	FY16E PER of 9.5x @ 5-yr average
MITRA	FY16E PER of 4.1x @ 3-yr -1.5SD	FY16E PER of 6.4x @ 3-yr 2.0SD
MMC	FY16E PER of 15.0x @ 3-yr -2.5SD	FY16E PER of 25.2x @ 3-yr average
MUHIHAH	FY16E PER of 8.7x @ 2-yr -1.5SD	FY16E PER of 15.6x @ 2-yr 1.5SD
NAIM	FY16E PER of 8.4x @ 2-yr -1.5SD	FY16E PER of 11.5x @ 2-yr average
WCT	FY16E PER of 8.9x @ 2-yr -2.0SD	FY16E PER of 13.7x @ 2-yr -0.5SD

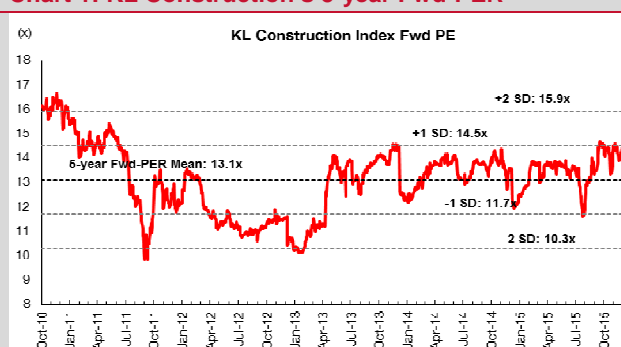
Source: Bloomberg, Kenanga Research

## Outstanding Orderbook

Construction Company	Outstanding Orderbook (RM'm)	Earnings Visibility
Eversendai Corporation Bhd	1,800	2 years
GamudaBhd	800	-
IJM Corporation Bhd	7,000	2 years
Kimlun Corporation Bhd	940 (Construction); 200 (Manufacturing)	1 years
Muhibbah Engineering (M) Bhd	2,800	2 years
Mitrajaya Holdings Bhd	1,480	2 years
Naim Holdings Berhad	>1,000	5 years
WCT Holdings Bhd	4,600	2-3 years
Hock Seng Lee Bhd	770	1 years
MMC Corporation Bhd	5,000	5 years

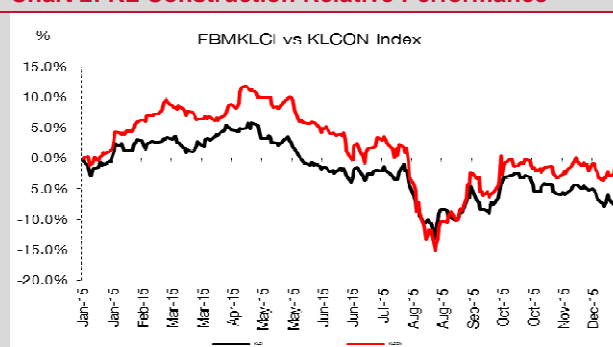
Source: Kenanga Research

## Chart 1: KL Construction's 5-year Fwd-PER



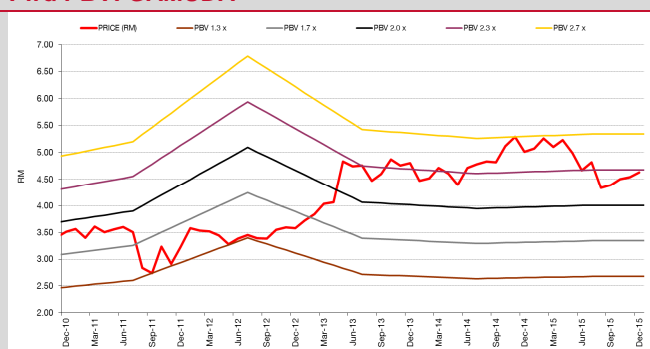
Source: Kenanga Research

## Chart 2: KL Construction Relative Performance



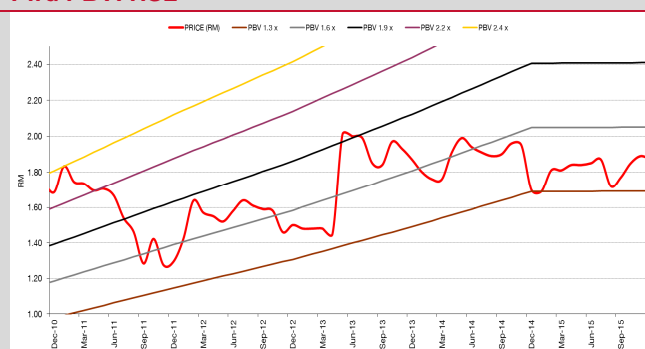
## CONTRACTORS FWD PBV

## Fwd PBV: GAMUDA



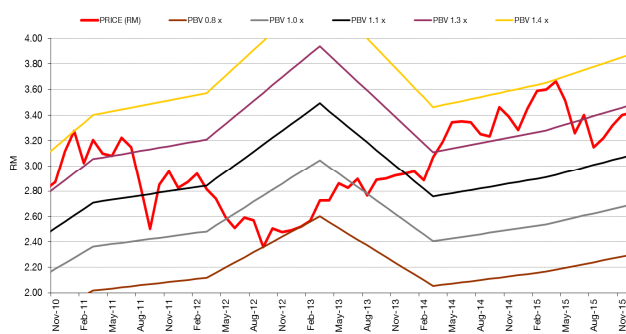
Source: Kenanga Research

## Fwd PBV: HSL

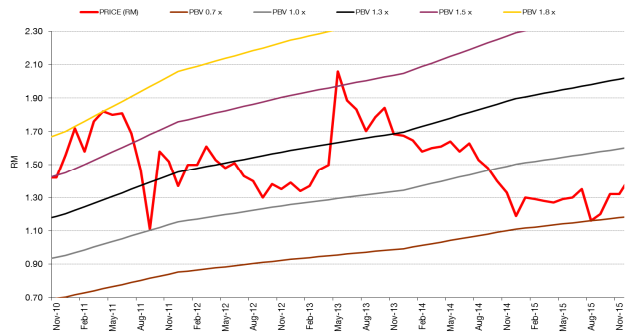


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Fwd PBV: IJM

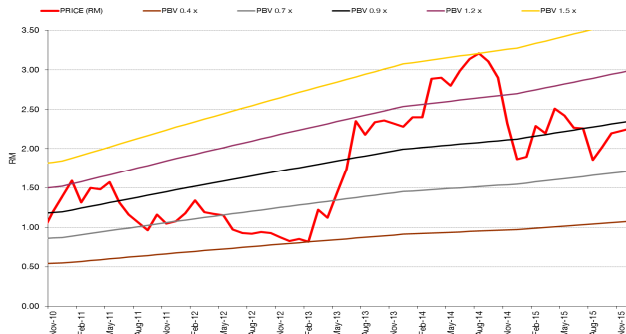


Fwd PBV: KIMLUN

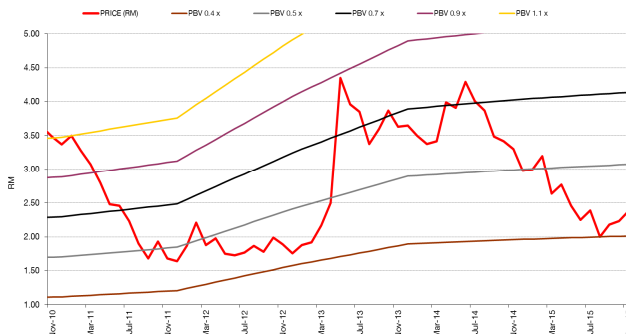


Source: Kenanga Research

Fwd PBV: MUHIBAH

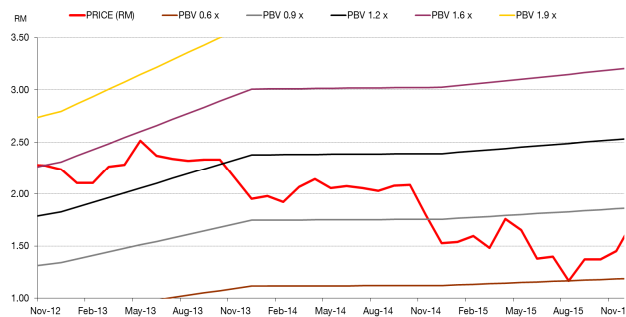


Fwd PBV: NAIM

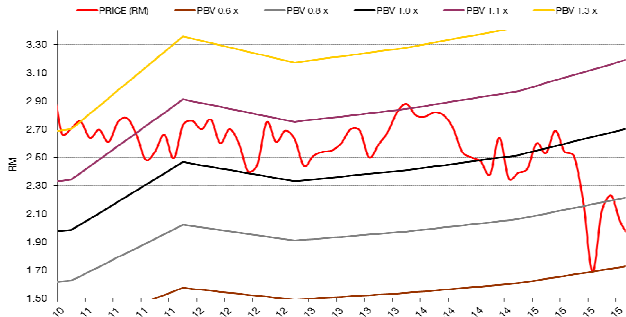


Source: Kenanga Research

Fwd PBV: WCT

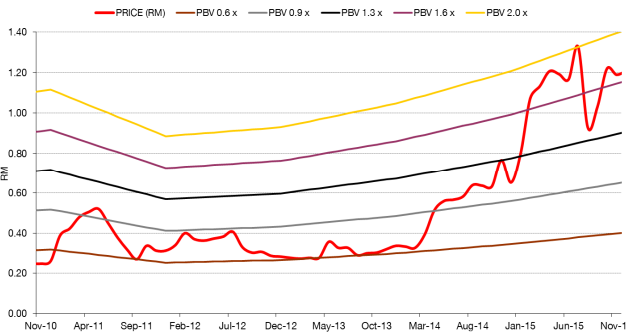


Fwd PBV: MMCCORP

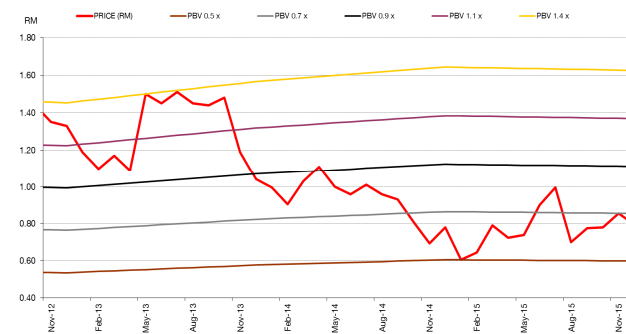


Source: Kenanga Research

Fwd PBV: MITRA



Fwd PBV: SENDAI

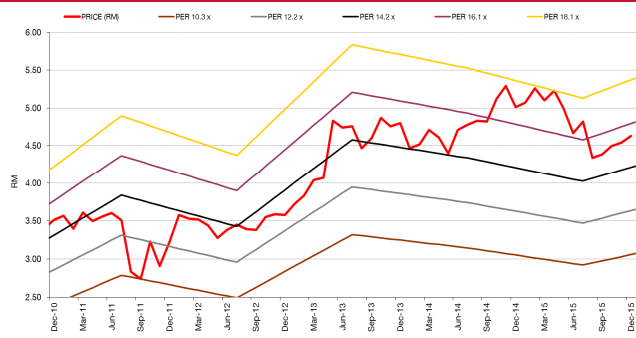


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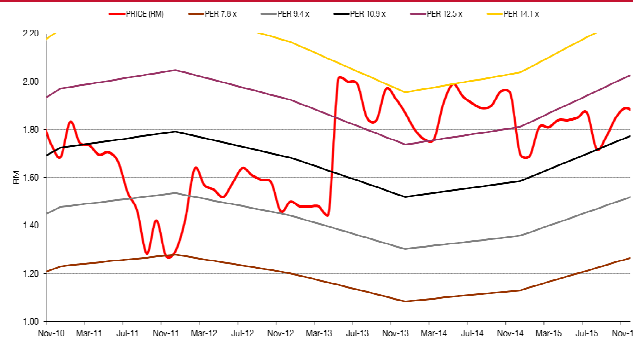
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## CONTRACTORS FWD PER

## Fwd PER: GAMUDA

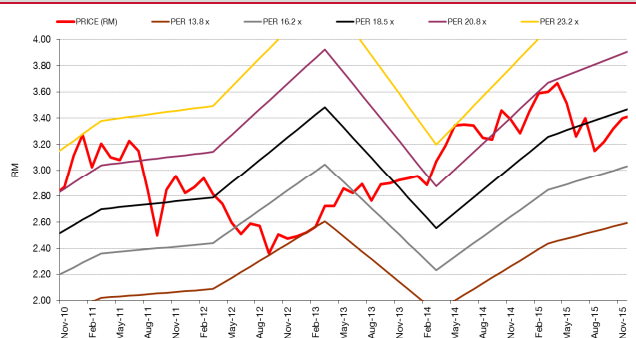


## Fwd PER: HSL

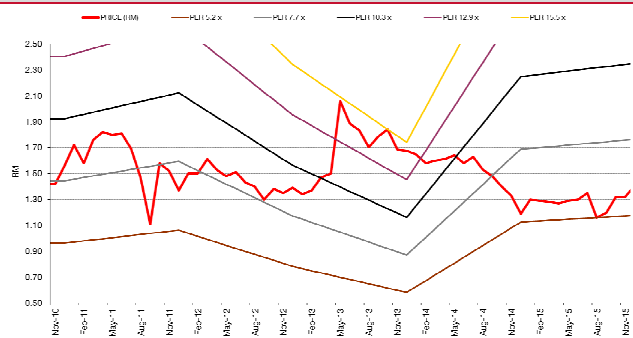


Source: Kenanga Research

## FwdCore PER: IJM

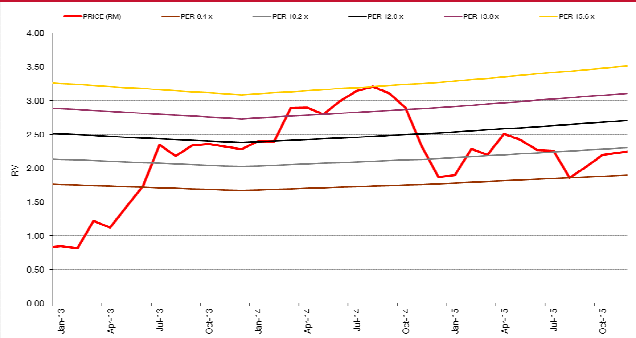


## FwdCore PER: KIMLUN

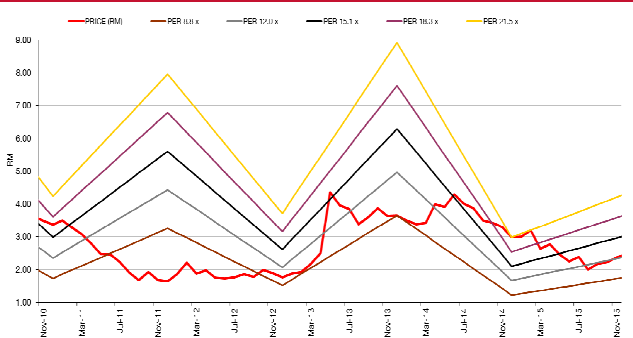


Source: Kenanga Research

## Fwd PER: MUHIBAH

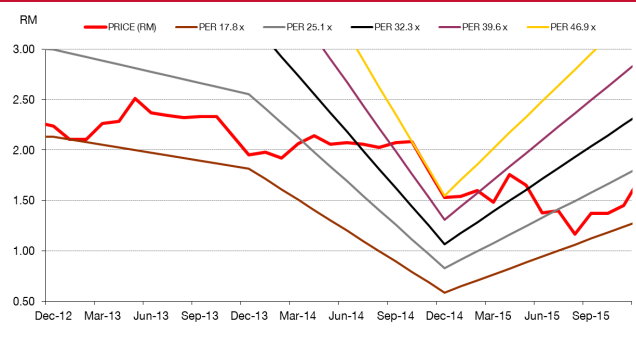


## Fwd Core PER: NAIM

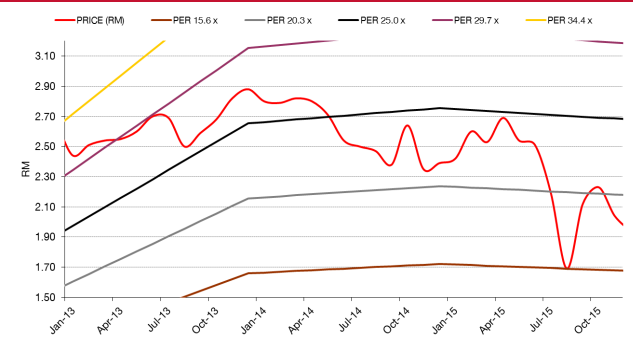


Source: Kenanga Research

## Fwd PER: WCT

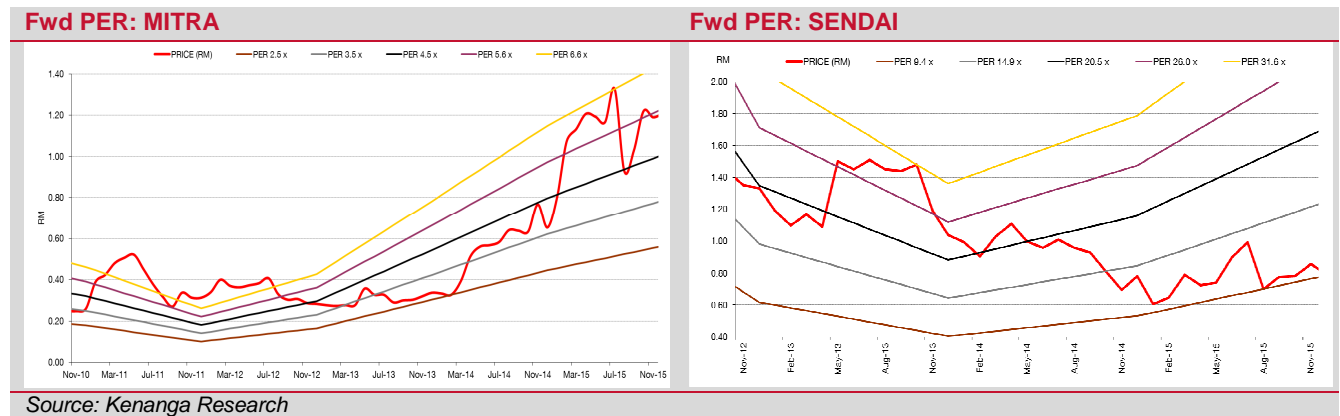


## Fwd PER: MMCCORP



Source: Kenanga Research

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## Valuation &amp; Justification For Calls

NAME	Price (RM)	Mkt Cap (RMm)	Old Target Price (RM)	Valuation Basis (Old)	New Target Price (RM)	Valuation Basis Change?	Rating (Old)	Rating (New)
EVERSENDAI	0.795	615.2	0.92	FY16 PER of 11.0x, in line with its target PER of mid-small cap peers of 9-13x	0.92	No change	Outperform	Outperform
GAMUDA	4.63	11139.3	4.67	SOP (Construction PER of 18). Our TP implies FY16 PER of 16.3x in line our target PER for big cap of 16-18x	4.67	No change	Market Perform	Market Perform
IJM CORP	3.42	12220.5	3.50	SOP (Construction PER of 18x). Our TP implies FY17 PER of 18.0x, in line our target PER for big cap of 16-18x	3.50	No change	Market Perform	Market Perform
KIMLUN CORP	1.41	423.8	2.05	FY16E PER of 9x, line with small-mid-cap size peers' target PER range of 9-13x	2.05	No change	Outperform	Outperform
MUHIBBAH	2.26	1059.5	2.79	SOP (Construction PER of 10x). Our TP implies FY16 PER of 12.4x, in line with its small-mid-cap size peers' PER range of 9-14x	2.79	No change	Outperform	Outperform
HOCK SENG LEE	1.87	1027.6	2.03	FY16 PER of 13x, in line with its small-mid-cap peers' PER of 9-13x	2.03	No change	Market Perform	Market Perform
NAIM HOLDINGS	2.46	582.9	1.66	SOP (Construction PER of 7x). Our TP implies 8.3x FY16 PER, discount to small-mid-cap peers' average of 9.3x	1.66	No change	Under Perform	Under Perform
WCT HOLDINGS	1.72	2052.6	1.51	SOP (Construction Fwd-PER of 12x). Our TP implies 20.9x FY16 PER, which is rich among other big cap contractors	1.51	No change	Market Perform	Market Perform
MMCCORP	1.94	5907.4	2.86	SOP (Construction Fwd-PER of 18x). Our TP implies 26.8x FY16 PER, which is just slightly higher than its 5 year historical average fwd PER of 25x	2.86	No change	Outperform	Outperform
MITRAJAYA	1.21	776.3	1.63	SOP (Construction Fwd-PER of 12x). Our TP implies 10.9x FY16 PER, which is inline with small-mid-cap peers range of 9-13x	1.63	No Change	Outperform	Outperform

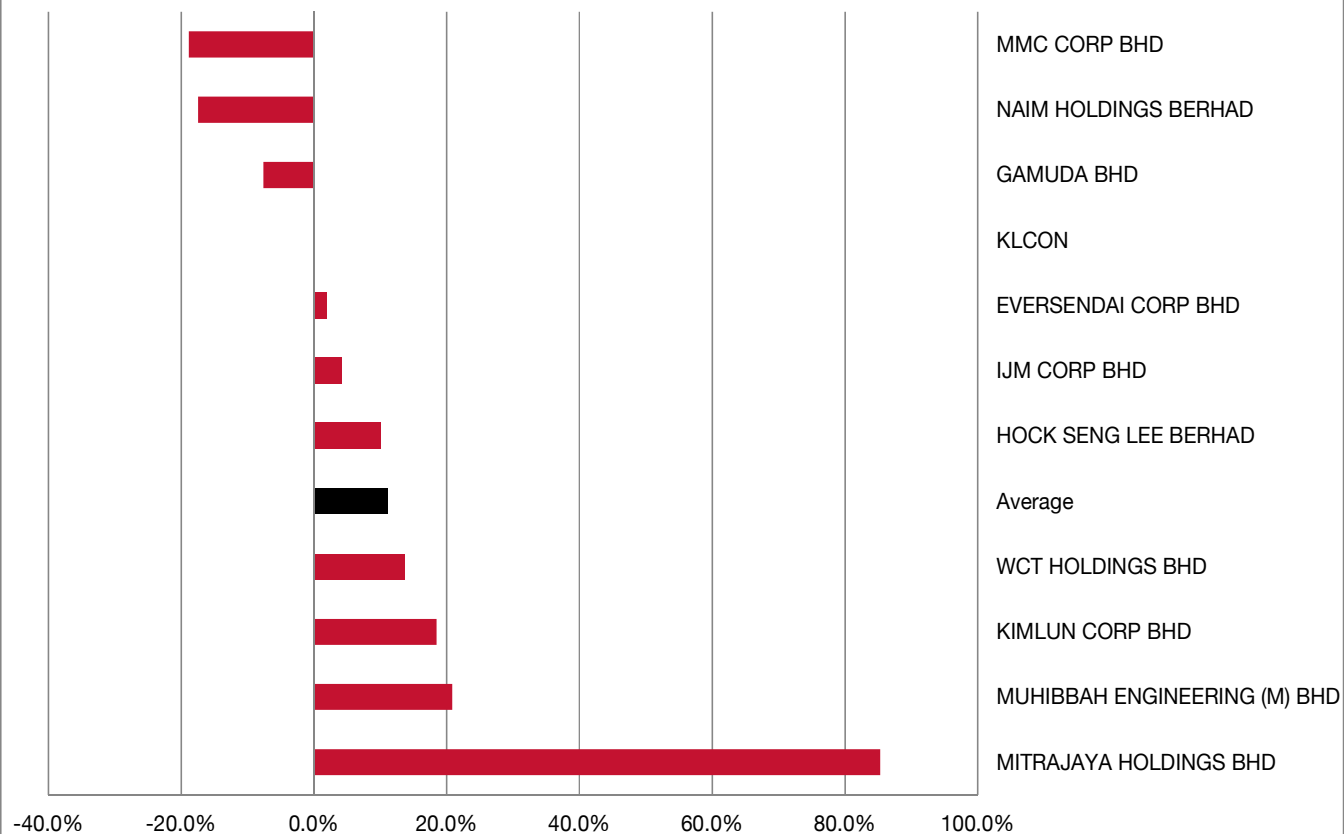
Source: Kenanga Research



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## YTD Performance of Core Coverage

Share Price YTD Gain CY15 (Core Coverage)



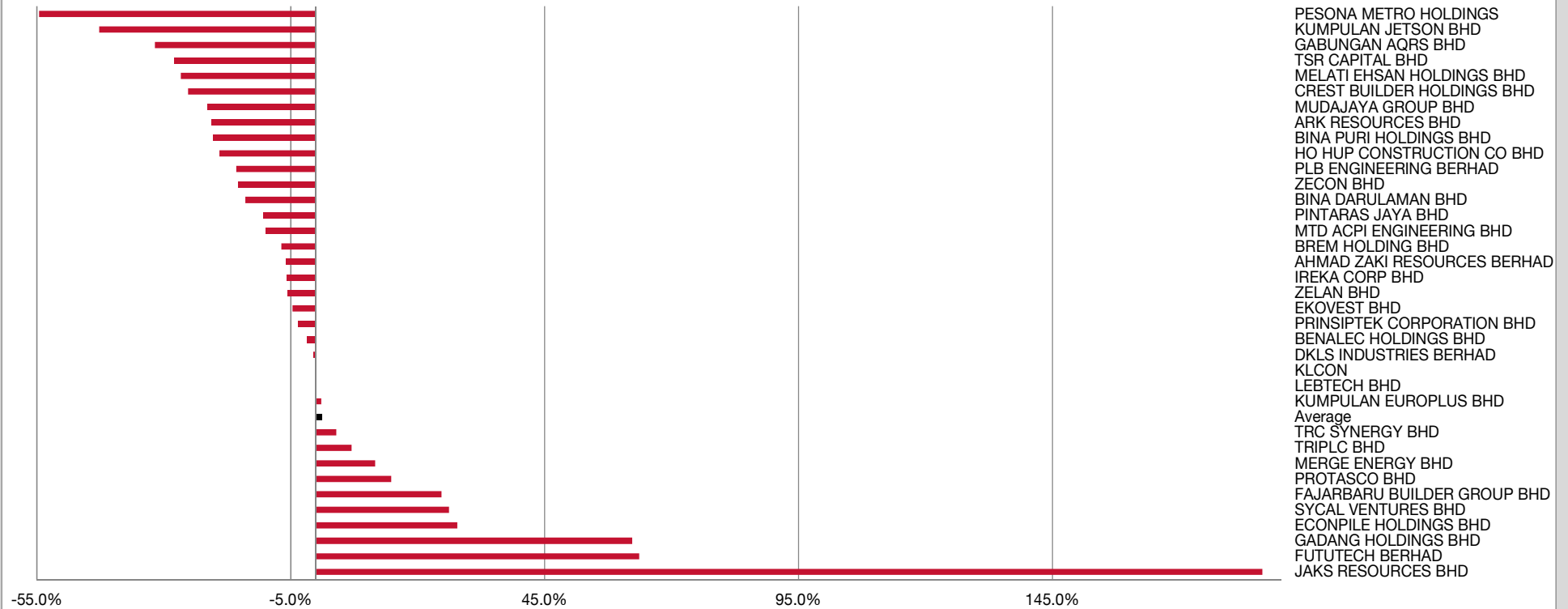
Source: Company, Kenanga Research



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## YTD Performance of Non-Core Coverage

Share Price YTD Gain CY15 (Non-Core Coverage)



Source: Company, Kenanga Research

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## Peer Comparison

CORE COVERAGE																
NAME	Price	Mkt Cap	PER (x)			Est. Div. Yld.	Est. ROE	P/BV	Net Profit (RMm)			1 YrFwd NP Growth	2 YrFwd NP Growth	Target Price	Rating	YTD (%)
	(RM)	(RMm)	Actual	1 YrFwd	2 YrFwd	(%)	(%)	(x)	Actual	1 YrFwd	2 YrFwd	(%)	(%)	(RM)		
EVERSENDAI CORP BHD	0.80	615.2	18.4	14.0	9.5	2.5	4.7	0.7	33.4	43.9	64.8	31.4	47.6	0.92	Outperform	1.28
GAMUDA BHD	4.63	11139.3	16.2	17.5	15.7	2.6	13.2	2.3	687.2	636.8	709.7	-7.3	11.4	4.67	Market Perform	-7.58
IJM CORP BHD	3.42	12220.5	25.0	19.6	18.0	4.4	3.4	0.7	488.6	622.4	680.0	27.4	9.3	3.50	Market Perform	3.20
KIMLUN CORP BHD	1.41	423.8	12.5	6.5	6.2	2.8	14.9	1.0	33.8	65.5	68.7	93.8	4.8	2.05	Outperform	19.33
MUHIHBAH ENGINEERING (M) BHD	2.26	1059.5	13.0	12.3	11.4	2.2	8.2	1.0	81.5	86.4	92.9	5.9	7.5	2.79	Outperform	21.39
HOCK SENG LEE BERHAD	1.87	1027.6	13.4	14.2	11.9	2.1	10.3	1.5	76.9	72.2	86.4	-6.1	19.7	2.03	Market Perform	11.76
NAIM HOLDINGS BERHAD	2.46	582.9	5.9	17.7	12.2	1.6	2.5	0.4	98.3	32.9	47.6	-66.6	44.8	1.66	Under Perform	-16.78
WCT HOLDINGS BHD	1.72	2052.6	16.7	52.2	23.5	2.9	1.9	1.0	122.9	39.3	87.4	-68.0	122.4	1.51	Market Perform	7.05
MMC CORP BHD	1.94	5907.4	18.3	17.6	18.1	0.0	4.2	0.7	322.4	334.7	325.6	3.8	-2.7	2.86	Outperform	-19.25
MITRAJAYA HOLDINGS BHD	1.21	776.3	14.4	9.8	7.8	2.1	20.5	2.0	53.8	78.9	99.8	46.7	26.5	1.63	Outperform	86.73
Average			15.4	18.2	13.4											
NOT RATED/ON OUR RADAR																
NAME	Price	Mkt Cap	PER (x)			Est. Div. Yld.	Est. ROE	P/BV	Net Profit (RMm)			1 YrFwd NP Growth	2 YrFwd NP Growth	Target Price	Rating	YTD (%)
	(RM)	(RMm)	Actual	1 YrFwd	2 YrFwd	(%)	(%)	(x)	Actual	1 YrFwd	2 YrFwd	(%)	(%)	(RM)		
MUDAJAYA	1.14	613.8	-8.7	368.2	16.4	1.8	0.2	0.6	-70.2	1.7	37.4	-102.4	2145.5	n.a.	Not Rated	-21.38
PROTASCO	1.63	547.6	-11.4	n.a.	n.a.	n.a.	n.a.	n.a.	-47.9	n.a.	n.a.	n.a.	n.a.	2.25	Trading Buy	16.90
PINTARAS JAYA	3.34	543.7	10.5	12.4	9.4	4.5	n.a.	n.a.	51.9	44.0	58.0	-15.2	31.8	4.78	Trading Buy	-11.53
GABUNGAN AQRS	0.85	330.0	6.2	-30.0	10.8	2.2	n.a.	n.a.	52.9	-11.0	30.5	-120.8	-377.3	n.a.	Not Rated	-31.72
GADANG HOLDINGS	2.19	514.9	8.8	7.5	7.5	2.1	15.4	1.1	58.8	69.0	68.9	17.3	-0.1	2.00	Take Profit	60.74
AZRB	0.64	306.1	24.1	n.a.	n.a.	n.a.	n.a.	n.a.	12.7	n.a.	n.a.	n.a.	n.a.	n.a.	Not Rated	-6.67
TRC SYNERGY	0.40	189.8	53.2	7.9	9.2	2.5	7.1	0.6	3.6	23.9	20.6	570.4	-13.8	n.a.	Not Rated	3.95
BINA PURI	0.43	98.8	16.1	11.9	7.2	4.7	n.a.	n.a.	6.1	8.3	13.7	35.3	65.1	n.a.	Not Rated	-19.44
Average			10.7	63.0	10.1											
*as at 23 <sup>rd</sup> December 2015																
Source: Kenanga Research																

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**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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**KENANGA INVESTMENT BANK BERHAD (15678-H)**

8th Floor, Kenanga International, Jalan Sultan Ismail, 50250 Kuala Lumpur, Malaysia  
Telephone: (603) 2166 6822 Facsimile: (603) 2166 6823 Website: [www.kenanga.com.my](http://www.kenanga.com.my)



Chan Ken Yew  
Head of Research