14 June 2024

Construction & Engineering | Construction

Construction

Set To Level Up Further; Stay OVERWEIGHT

Overweight (Maintained)

Stocks Covered	10
Rating (Buy/Neutral/Sell):	10 / 0 / 0
Last 12m Earnings Revision Trend:	Negative

- **Maintain OVERWEIGHT.** Top Picks include Gamuda, Sunway Construction and Kerjaya Prospek. Out of the 10 companies under our coverage that reported results, two were in line, two exceeded expectations and five fell below estimates. Nevertheless, most players charted earnings growth – and we note that our earlier estimates were too optimistic. All in, we view that contractors should continue booking better progress billings, as evidenced by the total value of work done – at MYR36.8bn (+14% YoY), ie the highest in 17 quarters.
- **Contract rollouts (private and government jobs) have generally been active** so far, with MYR69.9bn worth of construction projects awarded in 5M24, 37% YoY higher than the MYR50.9bn recorded in 5M23. Moreover, Deputy Works Minister, Datuk Seri Ahmad Maslan estimated that 40% of the MYR90bn development expenditure allocated under Budget 2024 will be given out in the mid-year.
- **We take comfort from the slew of private sector projects** which may continue to grow (particularly in the industrial space, eg data centres and factories). According to the National Property Information Centre (NAPIC), the value of transactions for industrial properties grew by 28% YoY in 1Q24. In fact, the value of projects awarded for the non-residential property segment (which includes industrial properties) hit MYR52.2bn in 5M24 – which was more than half of the MYR81bn recorded in 2023.
- **A major catalyst** would be a quicker-than-expected rollout of other mega projects such as Mass Rapid Transit 3 (MRT3), which may see its debut towards late in 1H25 as MRT Corp is expected to finalise the land to be acquired in late 1H24, in our view. As for the Kuala Lumpur-Singapore High Speed Rail (HSR), we expect announcements on the shortlisting of consortiums for the request for proposal stage to be by end-3Q24, subject to the Government's approval post evaluation by MyHSR Corp.
- **Valuations.** The Bursa Malaysia Construction Index (BMCI) is trading at a forward P/E of 17x, vs 15-16x recorded during the 2017 construction upcycle (when most large-cap contractors benefit from an uptick in job wins). We view that there is still room for upside for the BMCI, premised on the prevalence of data centre and industrial jobs that were absent during the 2017 upcycle.
- **Top Picks** include Gamuda, Sunway Construction and Kerjaya Prospek, on their commendable earnings visibility over the next two years. Gamuda has a sizeable presence overseas while still remaining relevant domestically. Kerjaya Prospek and Sunway Construction do not only have steady work pipelines from related party transactions, but also ongoing industrial jobs.
- **Key downside risks** to our sector call are an unexpected slowdown in the rollout of construction jobs, and sudden labour shortages.

Company Name	Rating	Target (MYR)	% Upside (Downside)	P/E (x) Dec-24F	P/B (x) Dec-24F	ROAE (%) Dec-24F	Yield (%) Dec-24F
Econpile Holdings	Buy	0.69	33.4	na	2.0	(1.3)	-
Gabungan AQRS	Buy	0.50	32.0	6.9	0.3	4.8	2.2
Gamuda	Buy	7.08	7.3	18.5	1.5	8.5	1.8
IJM Corp	Buy	3.15	4.9	20.4	1.0	5.3	2.7
Kerjaya Prospek	Buy	2.15	12.0	14.9	2.1	14.1	5.2
KKB Engineering	Buy	2.11	14.5	18.0	1.3	7.1	2.8
Malaysian Resources Corp	Buy	0.80	17.0	75.0	0.7	0.9	1.5
MGB	Buy	1.16	33.1	9.3	0.9	9.6	2.1
Pintaras Jaya	Buy	2.09	17.9	30.5	0.7	2.4	1.6
Sunway Construction	Buy	4.12	4.8	28.3	5.7	20.9	2.1

Source: Company data, RHB

Top Picks	Target Price
Gamuda (GAM MK) – BUY	MYR7.08
Kerjaya Prospek (KPG MK) – BUY	MYR2.15
Sunway Construction (SCGB MK) – BUY	MYR4.12

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Bursa Malaysia Construction Index's performance

Source: Bloomberg

1Q24 Results At a Glance

Overall, the construction sector delivered 1Q24 results that were below expectations. Revenue recognition progress of most contractors were in line with what we forecasted earlier, due to labour conditions and manageable building material price trends. However, the residual impact of projects secured prior to or during the pandemic (which had cost overruns) were still experienced by some contractors. Out of the 10 companies under our coverage that reported results, two were in line, two exceeded expectations and six fell below estimates. Companies that underperformed were Malaysian Resources Corp (MRC MK, BUY, TP: MYR0.80), KKB Engineering (KKB MK, BUY, TP: MYR2.11), Econpile (ECON MK, BUY, TP: MYR0.69), Gabungan AQRS (AQRS MK, BUY, TP: MYR0.50) and Sunway Construction (SCGB MK, BUY, TP: MYR4.12). On the other hand, the quarterly performance of Kerjaya Prospek (KPG MK, BUY, TP: MYR2.15) and MGB (MLG MK, BUY, TP: MYR1.16) met expectations while IJM Corp's (IJM MK, BUY, TP: MYR3.15) and Pintaras Jaya's (PINT MK, BUY, TP: MYR2.09) results exceeded projections.

Separately, Gamuda's (GAM MK, BUY, TP: MYR7.08) 2QFY24 (Jul) earnings – reported in March – missed expectations. Its core profit in 2HFY24 was at MYR404m (+5% YoY) and we expect stronger quarters ahead, due to its property arm (lumpy recognition from Singapore and London) coupled with its Sydney Metro West project in Australia.

Figure 1: Quarterly performance vs estimates (RHB universe)

Stocks	Results review (released for Mar 2024 quarter)	Remarks	Results period	FYE
IJM Corp	Above	FY24 (Mar) core earnings of MYR500m (+81% YoY) exceeded expectations, accounting for 125% and 129% of our and Street full-year projections. The positive deviation came from better-than-expected non-core segments, namely the industrial and infrastructure divisions. The last time core profit exceeded MYR500m was during FY17.	4QFY24	March
Pintaras Jaya	Above	9MFY24 (Jun) core earnings of MYR6.9m beat ours and Street estimates – at 93% and 142% of full-year projections, largely driven by reduced cost pressures from previously loss-making projects secured before the Russia-Ukraine conflict, as they are now nearing completion.	3QFY24	June
Kerjaya Prospek	Within	1Q24 core profit of MYR36.9m (+31% YoY) made up 23% and 22% of our and Street full-year projections. We deem its results as in line with expectations, since more contributions may come from ongoing projects in the coming quarters. We forecast a 3-year earnings CAGR of 12%, backed by its steady job replenishment trend, coupled with stronger contributions from its property development business.	1Q24	December
MGB	Within	1Q24 core profit of MYR14.1m (>+19% YoY) met ours and Street estimates, at 25% and 24% of full-year projections. We expect MGB to continue charting solid growth of >10% in FY24F, backed by higher progress billings of certain projects (particularly KITA@Cybersouth) in addition to better property sales growth.	1Q24	December
Gamuda	Below	Gamuda's 1HFY24 core net profit of MYR404m (+5% YoY) missed our and Street estimates – making up 42% and 41% of FY24 forecasts. The negative deviation was from our initial billing estimates being optimistic.	2QFY24	July
Sunway Construction	Below	1Q24 core net profit of MYR27m (+4% YoY) missed our and Street estimates, at 14% and 15% of full-year projections. This was mainly due to the lower-than-expected progress billings of ongoing projects. While we expect Sunway Construction to book 5% YoY core earnings growth in FY24, we think FY25 will be a supercharged year, underpinned by stronger recognition from a mix of data centre projects in Selangor and Johor.	1Q24	December
Gabungan AQRS	Below	15MFY24 (Jun) core profit of MYR32m missed our estimates – accounting for 76% of our 18-month FY24 projection. The negative deviation was due to the weaker-than-expected construction segment.	5QFY24	June (18 months)
Econpile	Below	9MFY24 (Jun) core net loss of MYR17m missed our and Street full-year net loss estimates of MYR16m and MYR6m due to higher-than-expected operating costs, which pressured margins of ongoing jobs.	3QFY24	June
Malaysian Resources Corp	Below	1Q24 core profit of MYR3m (-65% YoY) missed our and Street estimates, making up 6% and 5% of full-year projections. The negative deviation was due to a slower property segment and higher-than-expected tax rate (of 84%).	1Q24	December
KKB Engineering	Below	1Q24 core profit of MYR3.5m (+14% YoY) missed our and Street estimates – at 10% of both full-year projections – due to a higher-than-expected portion of non-controlling interests. Nevertheless, we expect better contributions in the coming quarters to bring overall FY24F earnings growth to 10% YoY, on projects such as the Rosmari & Marjoram (R&M) onshore gas plant in Bintulu.	1Q24	December

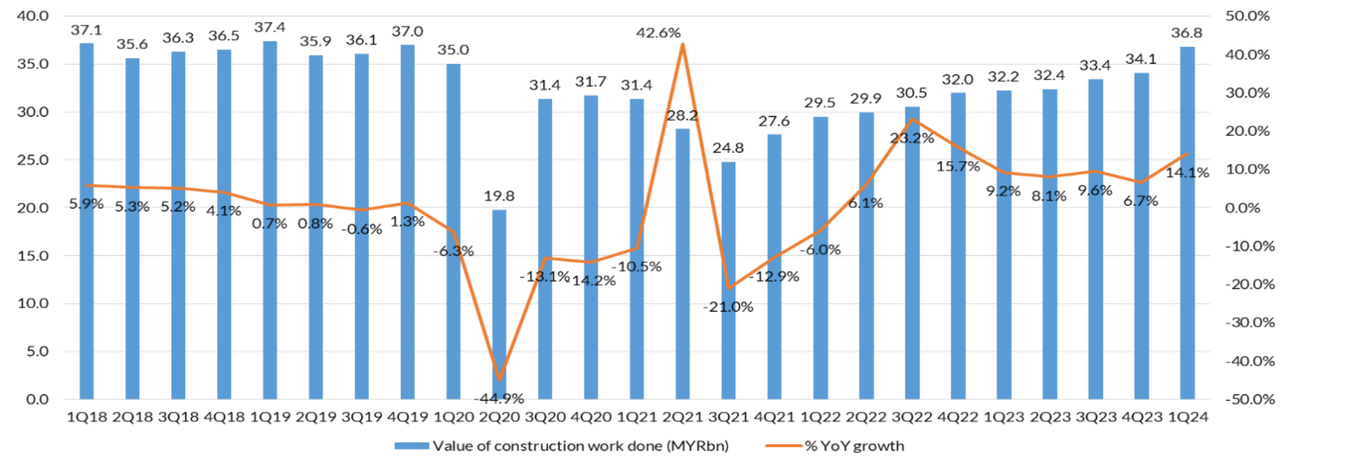
Source: Company data, RHB

Value of construction work done continues to rise. The economic output of the construction sector grew 11.9% YoY (1Q23: +7.4% YoY) in 1Q24. Likewise, the total value of construction work done in 1Q24 grew by 14% YoY or 7.8% QoQ to reach MYR36.8bn – the highest in 17 quarters.

In terms of sub-sector, the value of construction work done in 1Q24 for civil engineering saw the largest rise, up 24.7% YoY. We think this was due to the ongoing infrastructure projects expected to be fully completed within the next 1-3 years, ie the Light Rail Transit (LRT) 3 (c.95% physical completion), Pan Borneo Highway Sarawak Phase 1 and East Coast Rail Link (c.64% completion).

Meanwhile, non-residential buildings was the sub-sector that recorded a 3.8% YoY growth in terms of construction work done for 1Q24 – the smallest among the sub-sectors. The reason for this could be due to many industrial building jobs (warehouses, data centres, semiconductor facilities) still being in their early stages of construction and these may pick up in the coming quarters. The value of construction work done for residential buildings in 1Q24 amounted to MYR7.8bn, 11.5% YoY higher than the MYR7bn seen a year ago – indicating that demand to construct residential buildings remain strong in light of ongoing launches by property developers.

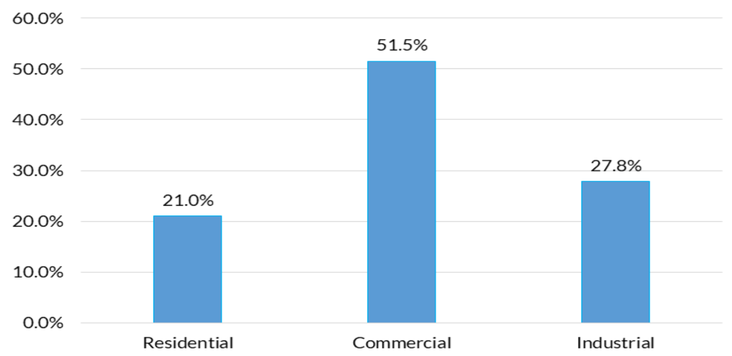
Figure 2: Quarterly construction work done (MYRbn)



Source: Department of Statistics Malaysia (DOSM)

Demand for various classes of properties continues to stay strong. According to data from NAPIC, all categories of properties continued to show a YoY% growth in the value of transactions done. The higher growth in value of transactions was seen in the commercial sub-sector (+51.5% YoY in 1Q24) followed by industrial properties (+27.8% YoY in the same quarter). Such growth in transactional values indicates that the demand for such properties remains robust – which should translate to job opportunities for contractors.

Figure 3: YoY growth in value of transactions in property sub-sectors in 1Q24 (%)



Source: NAPIC

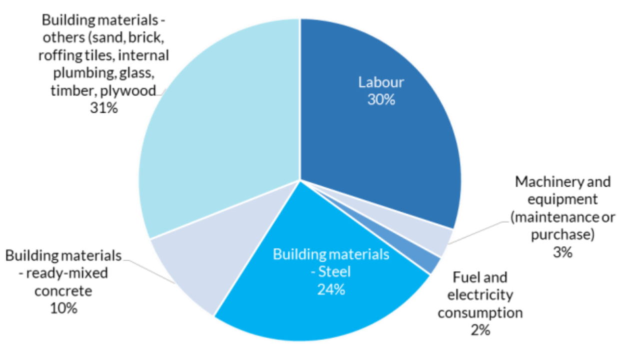
Impact of fuel subsidy rationalisation. Generally, electricity fuel in the form of diesel usually makes up 1-2% of a contractor's total costs. Therefore, any rise in such cost components would have a negligible impact on contractors' total costs.

For the purpose of powering machinery and equipment – contractors have always only been able to purchase diesel at the market price (or unsubsidised price). Hence, any removal of the subsidy in diesel price should not have an impact on contractors in terms of operating machineries at the site.

As for the transportation element in construction, the Subsidised Diesel Control System (SKDS) 2.0 provides fleet cards to eligible logistics vehicles (such as open platform and curtain side rigid lorries, which are able to transport some type of building materials) to mitigate the impact of the diesel rate hike on consumer goods prices, with a price set at RM2.15 per litre (Figure 6). Meanwhile, transportation of machineries and building materials (ready-mixed concrete and quarry products) that usually require trailers and larger-scale lorries (aside from the ones listed in Figure 6) are not eligible for the subsidised diesel price, even before SKDS 2.0 took effect.

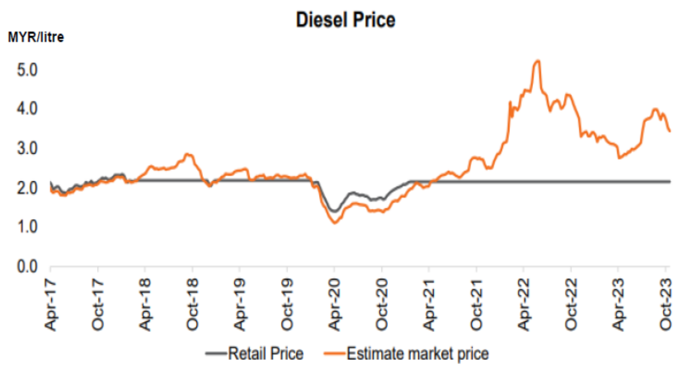
All in, diesel costs make up 0.7% and 0.9% of the total project cost related to high-rise and landed buildings – which are very minor.

Figure 4: General cost structure of construction companies



Source: CIDB, RHB

Figure 5: Diesel price (MYR per litre)

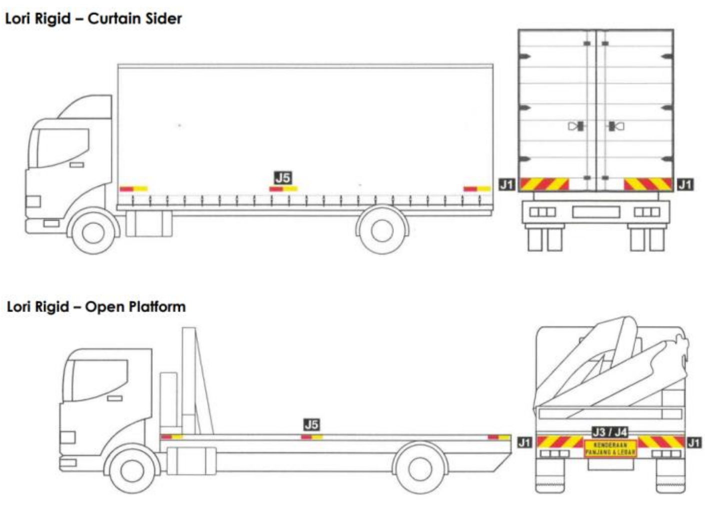


Source: SME Bank, Petrol Dealers Association of Malaysia

Figure 6: Types of vehicles eligible for subsidised diesel price

Source: Ecentral

Figure 7: Rigid lorries eligible for diesel subsidies



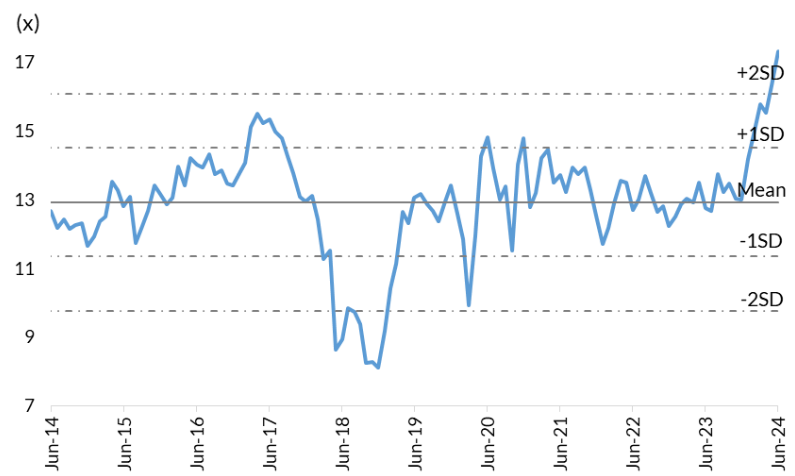
Source: Puspakom

Valuations. The BMCI is trading at a forward P/E of 17x, exceeding the 15-16x level seen during the 2017 construction upcycle (when most large-cap contractors saw an uptick in job wins). We view that there is still room for upside for the BMCI, premised on the prevalence of data centre and industrial jobs which were not present during the 2017 upcycle.

Moreover, Deputy Minister of Works Datuk Seri Ahmad Maslan estimated that 40% of the MYR90bn development expenditure allocated under Budget 2024 will be given out in the middle of this year. According to data from the Construction Industry Development Board – the value of construction projects awarded in 5M24 stood at MYR69.9bn, 37% YoY higher than the MYR50.9bn recorded in 5M23.

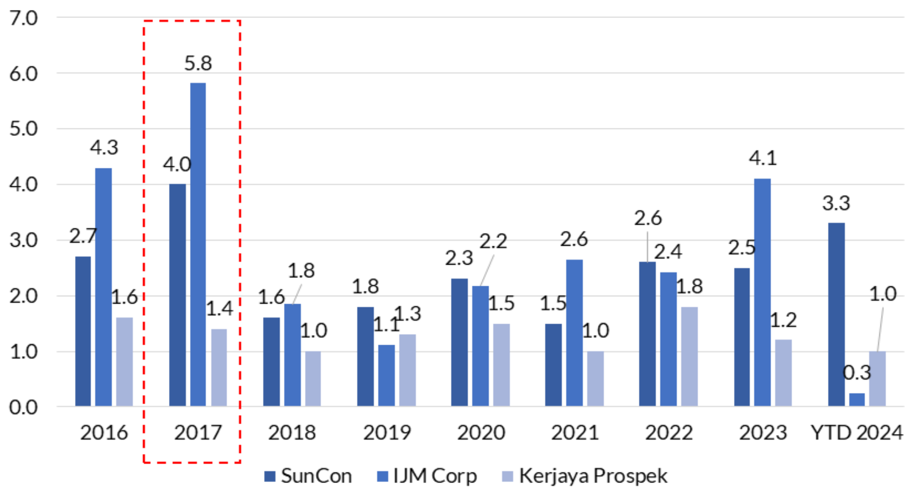
Upcoming anticipated projects include Penang Light Rail Transit (LRT) Mutiara Line, remaining packages of Pan Borneo Highway Sabah phase 1B, phase 2 of Pan Borneo Highway Sarawak and flood mitigation projects together with new data centres across Selangor and Johor. While the MRT3 project may likely be awarded some time in 1H25, we believe that there would be ample jobs for contractors to vie for.

Figure 8: Bursa Malaysia Construction Index's 10-year P/E band



Source: Bloomberg

Figure 9: Annual new job wins of large-cap contractors (excluding Gamuda)



Note: IJM Corp's annual job wins has been calendarised due to its March FYE
Source: Company data

All in, we remain OVERWEIGHT on the construction sector. We advocate investors to be selective on players that have credentials in local public infrastructure projects while still having decent exposure either in overseas markets or private industrial jobs, in addition to having a lean balance sheet (net cash or manageable net gearing positions). Such attributes are crucial to weather any downside risks that may arise in the form of unexpected labour shortages, a slow rollout of public infrastructure projects in Malaysia, and unexpected heightened volatility in building material costs. Contractors that suit these criteria are Gamuda, Sunway Construction and Kerjaya Prospek.

We favour Gamuda due to its ongoing regional expansion (>50% of profit from overseas) while still retaining relevance domestically by venturing into projects such as the Upper Padas Hydroelectric Dam in Sabah and remaining as a contender for the MRT3 tunnelling package. While Gamuda's margins have been trending south due to the prevalence of overseas projects, the commencement of the Penang LRT Mutiara Line construction by the end of 2024 should help to boost its overall margin.

Kerjaya Prospek and Sunway Construction are both in a sweet spot to leverage on the growth of industrial buildings in the country. Kerjaya Prospek, under its partnership with Samsung C&T, is looking to secure more industrial building jobs such as factories and warehouses. The group's net cash pile of >MYR100m should also enable it to easily gear up for larger jobs in the future, if required. On top of securing industrial building jobs in 2023 worth c.MYR500m in total, Sunway Construction's prospects continue to be backed by its >MYR5bn tenderbook in addition to the steady flow of internal jobs from its parent which contribute 30-35% of the group's construction orderbook.

Downside risks to our OVERWEIGHT stance on the construction sector include:

i. Slower-than-expected rollout of mega projects;

ii. The rollout of projects with larger-than-expected cuts to their overall costs;

iii. An unexpected shortage of labour supply for the construction sector.

Figure 10: Construction projects already/expected in the pipeline (not comprehensive, updated as of June)

Projects	Estimated job value (MYRbn)	Latest updates	Announced/potential winners
Reinstatement of five LRT3 stations	c.1.5bn (for stations)	As of end-1Q24, the LRT3 project (initial stations) had achieved 94% completion, with the commencement of the LRT Shah Alam line operations targeted for 1 Mar 2025.	Any reinstatement of the previously omitted five stations could be awarded to Malaysian Resources Corp as the main contractor. Subcontractors may comprise Gabungan AQRS and SCGB.
Sabah-Sarawak Link Road (SSLR)	1.1 (for Phase 1)	Phase 1 of SSLR has reached 13.6% completion as at Apr 2023 with expected completion by Jan 2026. The Phase 2 of SSLR estimated at (c.MYR7.2bn) has been awarded to Maltimur Aktif Unggul JV.	Phase 2 of SSLR could likely be secured by Kimlun Corp (KICB MK, NR) on a subcontractor level, as the main contractor has been appointed.
Pan Borneo Highway Sarawak	16.2 (Phase 1)	Phase 1 of Sarawak Pan Borneo Highway project is c.98.9% complete as at Dec 2023.	Second phase of PBH Sarawak likely to be secured by either KKB Engineering, Zecon (ZEC MK, NR) or Naim Holdings (NHB MK, NR).
Pan Borneo Highway Sabah	15.7 (Phase 1B)	Phase 1A of the Sabah Pan Borneo Highway project, spread over 15 packages, is 88% complete as of Jan 2024 and on track for completion by Jan 2025. Meanwhile, for Phase 1B of Pan Borneo Highway, the remaining 16 packages out of 20 will be rolled out by end-1H24.	Phase 1B of PBH Sabah is eyed by Gamuda, Malaysian Resources Corp and Gabungan AQRS. So far there are two non-listed contractors that secured packages under this project.
East Coast Rail Link	50.3[>]	Linewide progress stood at 64% as at March. The line from Kota Bharu, Kelantan to Gombak is set to be completed in late 2026, while the line from Gombak to Port Klang is expected to be completed by late 2027.	Remaining portions to be secured by contractors could be for the southern portion which connects to Port Klang. Potential beneficiaries include IJM.
Penang Light Rail Transit Mutiara Line	c.10bn	Approved by the Federal Government in March and comprises three segments – Silicon Island to Komtar (Segment 1), Komtar to Penang Sentral (Segment 2) and rolling stocks and systems package (Segment 3).	Gamuda for Segment 1 and IJM, Malaysian Resources Corp and Sunway Construction for Segment 2.
Upper Padas Hydroelectric Dam	4.0	187.5 MW hydroelectric plan developed under a 45:40:15 partnership between Gamuda, Sabah Energy Corp and Kerjaya Kagum Hitech JV.	Gamuda to undertake the majority of construction works.
Johor Bahru Light Rail Transit	16-20	Johor Government has identified three lines for the LRT that stretches 30km – the Tebrau line, Skudai line and Iskandar Puteri line, which will stretch up to the Senai International Airport in Kulai, The project is subject to whether or not the LRT or autonomous rapid transit (ART) is implemented in Johor.	Potential winners: Sunway Construction, Kimlun and MGB.
Johor Bahru Autonomous Rapid Transit	7	Johor Government is opting to build an ART system. Additionally, the Johor ART would have a shorter construction timeline (compared to the JB LRT – enabling ART services to coincide with commencement of the Johor Bahru Rapid Transit System (RTS) Link in 2027.	Potential winners: Sunway Construction and Kimlun
Nationwide flood mitigation project	11.8	MYR11.8bn was allocated under Budget 2024 for the nationwide flood mitigation project.	MRC has been shortlisted for a flood mitigation project in Selangor.
Sungai Klang Link elevated highway	8-10	Award of contracts should take place in 2H24.	Various contractors such as Econpile (ECON MK, BUY, TP: MYR0.69) and MTD Construction S/B have inked MoUs with the Sungai Klang Link S/B for the development of the project
Juru-Sungai Dua elevated highway	1.8	PLUS Malaysia presented the proposal to the Public-Private Partnership Unit (of the Prime Minister's Department) in February. Once confirmed, the next step would involve seeking Cabinet approval.	Pintaras Jaya.
Kuala Lumpur-Singapore High Speed Rail	60-100	MyHSR Corp is currently evaluating concept proposals by seven consortiums (after the deadline to submit concept proposals on 15 Jan) before proceeding to the request-for-proposal stage.	Potential winners: MRC and IJM (via consortium with Berjaya Rail and Keretapi Tanah Melayu) and YTL Corp (YTL MK, NR)
MRT3	34.3[>]	Land acquisition process to start in 2Q24 with the finalisation of land to be acquired expected to be in 3Q24, based on MRT Corp's timeline. We believe that contract awards for MRT3 could likely happen after this, ie in 1H25.	Potential winners: Sunway Construction, IJM, Gamuda, TRC Synergy (TRC MK, NR)

*Note: *Project value reduced post revision*
Note 2: [>]Civil works
Source: Various media, Company data, RHB

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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