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Construction

Highway Trust A Good Idea

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OVERWEIGHT



We think the proposal put forth by Gamuda to have their four tolled highways acquired by a highway trust for RM5.2b through monies raised from bond issuances is a good idea which would benefit (i) Gamuda, (ii) the Federal Government, and (iii) to a lesser extent the businesses and citizens concentrated in KL and Selangor. By undertaking this proposal, we see the government being the greatest beneficiary as they get to save on toll compensations worth RM5.3b over the toll concessions' remaining tenures while also indirectly help Gamuda raise PFI (private funding initiative) equity to jump start the intended MRT3 project. This means less fiscal burden while stimulating the economy at the same time. We also think that this new proposal is better than the 2019 model proposed which required the government to be a guarantor and suggested a congestion charge model (i.e. 30% lower toll rates) which could be disruptive towards traffic flow on competing highways/public transport. Keep OP and RM4.17 TP for Gamuda and maintain Overweight on the sector.

Highway trust to take over Gamuda's tolled highways. According to details revealed by The Star and The Edge over the weekend, Gamuda has put forward a proposal to the government to sell four of their highway concessions to a trust known as Amanah Lebuhraya S/B. This trust will fund the acquisitions by raising monies from bond investors with a promised annual return of 4-5% backed by cash flows from the tolls without any need for government guarantees.

Tentative price tag of RM5.2b for the four tolled highways. These four highways' enterprise value (EV) is estimated to be RM5.2b, lower than the RM6.2b valuation accorded in 2019 after accounting for two years of less cash flows – in line with our estimates. Dissecting the RM5.2b EV valuation, we estimate the four highways having an equity value of RM3.7b with remaining debt of RM1.5b (refer table below). Consequently, Gamuda's effective equity stake would be valued at c.RM1.9b – of which they would record a gain of c.RM0.7b based on their FY20 effective net asset value of RM1.2b for the highways.

Longer concession period for no toll hikes. In exchange for no toll hikes moving forward, the concessions would be extended by tentatively 5 years with an option of another 2-3 years' extension to cover any deficits to repay the trust bonds.

Table: Our valuation estimates for Gamuda's four toll concessions from 2022 onwards

Highway	Total Stake	Enterprise Value, EV (RM m)	Estimated debt (RM m)	Equity Value = EV - debt	Gamuda Effective Stake	Valuations (RM m)	Concession end date
LDP	100%	2021	106	1915	44%	842	2030
Kesas	100%	1071	114	957	70%	670	2028
Smart	100%	343	287	56	50%	28	2047
Sprint	100%	1719	965	754	52%	392	2031 (Penchala), 2034 (D'sara and Kerinchi)
		5154	1473	3681		1932	

Source: Kenanga Research

Our thoughts. If the government intends to continue freezing toll hikes, we think this highway trust proposal could be the best way forward, instead of opting for a compensation method given their weak fiscal position. We believe this deal would greatly benefit: (i) Gamuda, (ii) the Federal Government, (iii) and to a lesser extent the businesses and citizens concentrated in KL and Selangor.

Lump sum cash can be used for MRT3. The upfront cash obtained by Gamuda can be invested into other new growth areas, while at the same time liberate them from policy, traffic and regulatory risks. Given the government's recent intention to have more private funding initiatives (PFI) for public projects such as the MRT3, we think such lump sum cash would be ideal for Gamuda to help jump start this initiative – indirectly also benefitting the government by alleviating their cash flow burdens for this mega project. Should such sale go through, Gamuda's net gearing position would improve to 0.06x (from 0.28x as of Jan 2021).

Meanwhile, the government would also save on c.RM5.3b of toll compensations (from the toll hike freeze) for the remaining concession period for the tolls. As for the businesses and citizens in KL and Selangor, while they get to enjoy zero toll hikes, though they will have to pay tolls for a longer tenure – hence we are only mildly positive from their perspective.

Better alternative than the 2019 model. Unlike the 2019 model which requires the government to acquire the tolls and be the ultimate guarantor, we believe this proposal is much better for the government's books as it is risk-free for them. Also, the previous 2019 model also suggested a congestion charge which would (i) reduce toll rates by 30% during non-peak hours and (ii) free travel during off peak hours. This could be disruptive to traffic flows on competing highways/existing public transport – causing imbalance to the traffic network. Lastly, should this proposal go through, this opens the doors for other existing toll concessionaires to sell their matured highways (provided attractive terms are offered to bond investors) to channel the proceeds for new areas of growth – should there be opportunities.

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Peer Comparison

Name	Last Price (RM) 13/04/21	Market Cap (RM'm)	Shariah Compliant	Current FYE	PER (x) - Core Earnings			PBV (x)		ROE (%)		Net Div Yld (%) 1-Yr. Fwd.	Target Price	Rating
					Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.				
<u>STOCKS UNDER COVERAGE</u>														
GAMUDA BHD	3.50	8,797.3	Y	07/2021	16.6	16.1	14.6	1.0	1.0	6.2%	1.7%	4.17	OP	
GEORGE KENT (MALAYSIA) BHD	0.805	420.8	Y	03/2021	12.0	8.4	9.7	0.9	0.8	10.1%	4.2%	0.560	UP	
HOCK SENG LEE BERHAD	0.965	530.3	Y	12/2021	16.6	9.5	9.1	0.6	0.6	6.7%	2.5%	1.20	OP	
IJM CORP BHD	1.84	6,653.0	Y	03/2021	19.8	25.6	20.9	0.7	0.7	3.4%	1.6%	2.20	OP	
KERJAYA PROSPEK GROUP BHD	1.32	1,633.3	Y	12/2021	18.0	12.5	10.3	1.7	1.5	12.7%	2.8%	1.75	OP	
KIMLUN CORP BHD	0.890	314.5	Y	12/2021	19.9	6.2	5.5	0.5	0.4	7.3%	3.4%	1.45	OP	
MITRAJAYA HOLDINGS BHD	0.285	234.5	Y	12/2021	24.4	14.4	25.9	0.3	0.3	2.3%	0.0%	0.215	UP	
MUHIBBAH ENGINEERING (M) BHD	1.01	488.3	Y	12/2021	N.A.	18.7	12.3	0.4	0.4	2.2%	1.0%	1.25	OP	
SUNWAY CONSTRUCTION GROUP BHD	1.69	2,179.0	Y	12/2021	26.4	16.6	14.7	3.4	3.2	20.1%	4.1%	2.10	OP	
WCT HOLDINGS BHD	0.530	743.7	Y	12/2021	N.A.	5.9	8.1	0.3	0.2	5.6%	0.0%	0.675	OP	
Simple Average					19.2	13.4	13.1	1.0	0.9	7.7%	2.1%			

Source: Bloomberg, 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%
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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