Construction

A Strong Case for Pump-Priming

OVERWEIGHT

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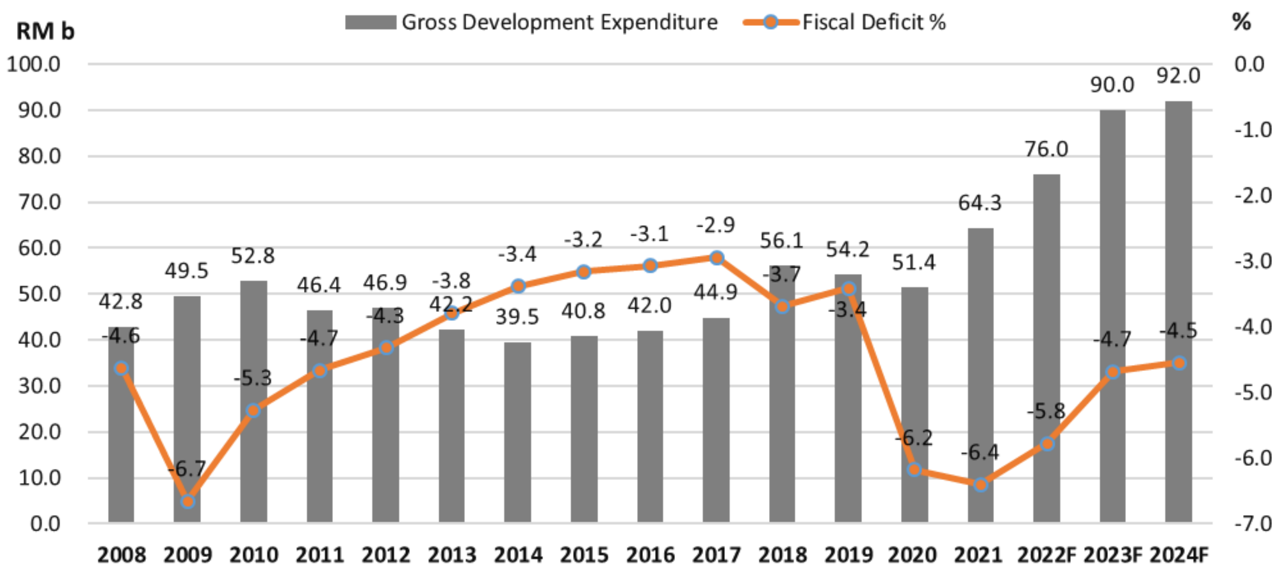
We maintain OVERWEIGHT on the sector. We believe investors should add positions in the sector ahead of the 15th General Election (GE15), although we gathered from the ground that a new wave of awards of public infrastructure projects is more likely to hit the market after GE15, rather than before. There is also a strong case for the government to embark on counter-cyclical fiscal pump-priming to shield the economy from external slowdown. Meanwhile, the sector's headwinds are diminishing with the easing of labour shortage and building material costs. We raise the TP for our top pick GAMUDA by 12% to RM4.70 (from RM4.20) after we roll forward the valuation base year.

Higher gross development expenditure in Budget 2023. In the upcoming Budget 2023 to be announced on the 7th of October, we forecast a higher gross development expenditure of RM90b vs FY22's RM76b thanks to the absence of Covid-related funds in the previous Budget 2022 worth RM23b. Based on our channel checks, we also understand that there is unused gross development expenditure from Budget 2022. We understand that projects have been held back as tender prices put in by contractors did not meet (i.e. exceeded) budgets for most projects (due to soaring labour and material costs). The rollout of new public project will come handy at a time when order-books of most contractors are fast depleting.

Development Expenditure and Fiscal Deficit



Source: Kenanga Research

A new wave of jobs after GE15. We gathered from the ground that a new wave of awards of public infrastructure projects is more likely to hit the market after the GE15, rather than before. These will include MRT3, Pan Borneo Sarawak Phase 2, Pan Borneo Sabah, Central Spine Road and various flood mitigation and hospital projects. It is critical for the government to start rolling out new jobs as most key on-going infrastructure projects are already at their tail-end including MRT2, LRT3, Pan Borneo Phase 1. The tenders for the three civil packages under MRT3 will close Sep 2022 (delayed from Aug 2022) and we anticipate the award of contracts in early next year.

On the private sector front, there are opportunities in the construction of new semi-conductor plants and data centres locally as MNCs diversify their manufacturing bases geographically (away from China) to de-risk. We gathered that these contracts could be sizeable i.e. between RM1b to RM1.5b each. However, the same cannot be said for the office and high-rise residential segments given the persistent oversupply.

Alternative funding model for mega projects. Given the fiscal constraints, mega projects could be implemented via public finance initiative (PFI) or deferred payment models. For instance, contractors of MRT3 may fund the project during the first two years of construction, only to be paid the entire amount in equal monthly instalments during the third and fourth years. Other projects that are likely to be carried out via these models are a flood mitigation project in the west of Klang Valley (reportedly with a price tag of RM5b to RM15b, depending on proposals by various bidders), PJD Link, Bangi Putrajaya Highway and Kuala Lumpur Northern Dispersal Expressway also known as KL Node).

Headwinds are easing. We believe the sector has seen the worst and should be poised for improved earnings in 2H given the gradual return of foreign workers and recent easing in commodity prices. Since end-June, certain key building material prices such as steel and aluminium have come off substantially due to the slowdown in China. So are diesel and bitumen on the back of weaker oil prices. Meanwhile, most new contracts being negotiated currently would have priced in the current market prices (which are higher) and have an element of price variations built in – to protect contractor's margins in the event of the huge swing in material prices. Hence, we believe the overall margins should gradually improve as the low-margin old jobs tail off and the new projects adjusted for higher input costs start to contribute.

Our top pick for the sector is **GAMUDA** given: (i) its strong chances of emerging as the tunnelling contractor for MRT3, (ii) its recent job wins in in Australia and Singapore that speak eloquently for its competitiveness in the international market, and (iii) the lumpy proceeds from the disposal of its toll highway assets, putting it in a strong position to participate in public infrastructure projects on a PFI or deferred payment model, or even giving out a special dividend. We raise our TP for GAMUDA by 12% to RM4.70 (from RM4.20) after rolling forward our valuation base year.

Key Infrastructure Projects

Projects	Value (RM b)	Status: Ongoing	Status: Pending
Federal Government Projects:			
MRT3	31	√	
Pan Borneo Sarawak Ph2	n.a.		√
Pan Borneo Sabah	15.3	√	
JB-SG RTS	4.3	√	
Central Spine Road	10.7	√	
Sabah Sarawak Link Road	5.2	√	
Flood Mitigation Projects	n.a.	√	
Duke Phase 2A	6.3 (PFI)		√
Waste to Energy (Kepong)	n.a. (PFI)		√
PJD Link	n.a. (PFI)		√
Bangi Putrajaya Highway	n.a. (PFI)		√
KL Node	n.a. (PFI)		√
State Government Projects:			
Penang Transport Masterplan	46		√
Rasau Water Treatment Plant	4.5		√
Iskandar BRT	2.56	√	
Kuching Autonomous Rail Transit	6	√	

Source: Kenanga Research

Peer Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen) 1-Yr. Fwd.	Core EPS (sen) 2-Yr. Fwd.	Core Earnings Growth 1-Yr. Fwd.	Core Earnings Growth 2-Yr. Fwd.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) 1-Yr. Fwd.	ROE (%) 1-Yr. Fwd.	Net Div. (sen) 1-Yr. Fwd.	Net Div.Yld. (%) 1-Yr. Fwd.
GAMUDA BHD	OP	3.96	4.70	6.06%	10,260.6	Y	07/2022	30.5	24.7	28.0%	-19.2%	12.9	16.0	1.1	8.7%	12.0	3.0%
IJM CORP BHD	MP	1.64	1.75	6.71%	5,778.6	Y	03/2023	8.6	9.2	26.2%	6.9%	19.2	18.0	0.6	3.8%	6.0	3.7%
KERJAYA PROSPEK GROUP BHD	OP	1.15	1.42	23.48%	1,450.2	Y	12/2022	9.3	12.2	19.1%	30.9%	10.5	9.4	1.3	11.2%	4.5	3.9%
KIMLUN CORP BHD	OP	0.660	1.10	66.67%	233.2	Y	12/2022	7.9	12.7	2600.0%	59.3%	8.6	5.4	0.3	4.0%	1.5	2.3%
SUNWAY CONSTRUCTION GROUP BHD	MP	1.50	1.60	6.67%	1,934.0	Y	12/2022	9.8	9.8	0.4%	-0.8%	15.2	15.3	2.9	19.4%	5.0	3.3%
WCT HOLDINGS BHD	OP	0.415	0.620	49.40%	588.2	Y	12/2022	6.3	5.0	214.3%	-20.5%	6.6	8.4	0.2	4.4%	0.0	0.0%
Simple Average								**12.1**	**12.2**	**481.3%**	**9.4%**	**12.2**	**12.1**	**1.1**	**8.6%**		**2.7%**

Source: Bloomberg, Kenanga Research

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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