Construction

OVERWEIGHT

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4QCY22 Results Review: Turning the Corner

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We maintain OVERWEIGHT for the sector premised on better order book replenishment and earnings prospects in CY23. The 4QCY22 results for companies in our coverage universe were flat against last quarter. The margins realised by most contractors in CY22 were still below pre-Covid levels due to labour shortages and the soaring cost of building materials, particularly steel. However, we believe the sector has seen the worst and should be poised for improved earnings in CY23 given the gradual return of foreign workers and recent easing in base metal prices. We also foresee better job replenishment prospects with the imminent rollout of MRT3 and Pan Borneo Highway (Phase 2), plant expansion in the semi-conductor space as well as the proliferation of new data centres. Our top pick for the sector is GAMUDA (OP; TP: RM5.15) given it being the front-runner for the tunnelling job for MRT3, its recent job wins in Australia and Singapore, as well as a strong war chest after the disposal of its toll highways.

A flat performance. Construction counters under our coverage saw unchanged sequential performance in 4QCY22 earnings with 33% and 67% coming in above and within our forecasts, respectively. **SUNCON (OP; TP: RM2.13)** came above expectation on lumpy fourth quarter performance derived from cost savings for projects nearing completion while **KIMLUN (OP; TP: RM1.12)** outperformed thanks to positive tax returns.

Margins still below pre-Covid levels. The margins realised by most contractors in CY22 were still below the pre-Covid levels due to the soaring cost of building materials, particularly steel, cement, and labour shortages that hampered work progress. **GAMUDA** and **SUNCON** are the only exceptions which saw construction margins being stronger than pre-Covid levels due to cost savings from projects nearing completion.

Mixed outstanding order book levels. Amidst a slow public job market in Malaysia for CY22, **IJM (MP; TP: RM1.70)** and **WCT (OP; TP: RM0.60)** have experienced drawdown exceeding replenishment in their order books, depleting the outstanding order book further to a 4-year low. Nonetheless, **GAMUDA, SUNCON and KERJAYA (OP; TP: RM1.50)** managed to lift their outstanding order books to record high levels thanks to geographical diversification and penetration into new building jobs such as data centres and semiconductor factories.

CY23 to be better. With an all-time high development expenditure allocation in the revised 2023 National Budget, we foresee better job replenishment prospects coupled with the imminent rollout of MRT3 and Pan Borneo Highway (Phase 2). Meanwhile, as MNCs diversify their manufacturing bases geographically (away from China) to de-risk, there are opportunities in the construction of new semi-conductor plants and data centres locally where the contract sizes are relatively larger, ranging between RM1b to RM1.5b each.

We believe earnings prospects should improve in CY23 given the gradual return of foreign workers and the lower base metal prices (steel and aluminium) and other key building material prices such as diesel and bitumen on the back of weaker oil prices. Meanwhile, most new contracts currently under negotiation would incorporate the latest prices (which are higher) and also with an element of price variation built in - to protect margins in the event of huge swing in material prices. Hence, we believe overall margins should gradually improve as the older low-margin jobs trail off and replaced by new projects adjusted for higher input costs kick in.

Reiterate OVERWEIGHT. Aside from the better earnings trajectory projected, we believe a sector re-rating is in the making on expectation of awards of public infrastructure jobs after a long drought. Our top pick for the sector is **GAMUDA** given: (i) it being the front-runner for the tunnelling job for MRT3, (ii) its job wins in in Australia and Singapore that speak eloquently for its competitiveness in the international market, (iii) its strong war chest after the disposal of its toll highways, (iv) its strong earnings visibility underpinned by a record high outstanding order book of RM22b, and (v) its efforts to expedite growth in the renewable energy space in line with global sustainability goals.

Quarterly Results Performance

	2QCY22						1QCY22					
	KENANGA			CONSENSUS			KENANGA			CONSENSUS		
	Above	Within	Below	Above	Within	Below	Above	Within	Below	Above	Within	Below
GAMUDA		1			1		1			1		
IJM		1			1			1			1	
KERJAYA		1			1			1			1	
KIMLUN	1			1				1			1	
SUNCON	1			1				1			1	
WCT		1			1		1				1	
Total	**2**	**4**	**0**	**2**	**4**	**0**	**2**	**4**	**0**	**1**	**5**	**0**
Total (%)	**33**	**67**	**0**	**33**	**67**	**0**	**33**	**67**	**0**	**17**	**83**	**0**

Source: Kenanga Research, Bloomberg

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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	4.08	5.15	26.23%	10,847.0	Y	7/2023	35.0	43.6	7.4%	24.7%	11.2	9.0	1.2	10.4%	50.0	12.3%
IJM CORP BHD	MP	1.65	1.67	1.21%	6,018.0	Y	3/2023	8.6	9.2	26.2%	6.9%	19.4	18.1	0.6	3.8%	6.0	3.6%
KERJAYA PROSPEK GROUP BHD	OP	1.15	1.50	30.43%	1,457.0	Y	12/2023	12.2	14.0	31.0%	14.6%	9.4	8.2	1.3	14.6%	6.0	5.2%
KIMLUN CORP BHD	OP	0.705	1.12	58.87%	249.1	Y	12/2023	12.9	15.6	18.9%	20.5%	5.7	4.7	0.3	6.6%	2.0	2.8%
SUNWAY CONSTRUCTION GROUP BHD	OP	1.60	2.13	33.13%	2,069.0	Y	12/2023	9.9	12.6	14.3%	28.1%	16.2	12.6	3.1	19.5%	5.0	3.1%
WCT HOLDINGS BHD	OP	0.410	0.600	46.34%	581.4	Y	12/2023	2.5	3.7	-28.6%	48.6%	16.3	11.1	0.2	2.7%	0.5	1.2%
Simple Average					**21,221.6**					**12.2%**	**20.9%**	**13.6**	**11.2**	**0.9**	**6.4%**		**4.7%**

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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