

## Chinese investment boon

We remain Overweight on the Malaysian Construction Sector given the positive outlook on contract awards in 2H17. But we have moderated our bullish stance following the downgrade of IJM Corp, Suncon and MRCB to HOLD in May. This follows the run up in share prices narrowing the potential upside to our target prices. Contract awards should accelerate in 2H17 with major packages for LRT Line 3 to roll out. Our top BUYs are Gamuda, WCT and HSS.

### Contract awards ease in 1Q17 after 1Q16 peak

Based on Construction Industry Development Board (CIDB) data, industry contract awards fell 71% yoy and qoq to RM12.9bn in 1Q17, from a high base in 1Q16 and 4Q16. Property-related contract awards fell to RM9.1bn (-49% yoy; -57% qoq) as the property market remains weak. Infrastructure contract awards fell 87% yoy and 85% qoq to RM3.1bn after peaking at a 13-year high of RM24.4bn in 1Q16. As major projects such as the RM9bn LRT Line 3 and RM13bn Pan Borneo Highway (PBH) Sabah are still at the tender stage in 1H17, we expect contract awards to accelerate in 2H17 when winners are announced for major packages for these projects.

### Mega projects to kick off

The RM55bn East Coast Rail Link (ECRL) and RM60bn KL-Singapore High Speed Rail (HSR) projects are at the preliminary planning stage and tenders could start by end-2017. According to local news (ie, *The Edge*), China's President Xi Jinping will visit Malaysia in October 2017. We believe there could be a ground-breaking ceremony to kick start the ECRL project. Local contractors could be appointed as subcontractors to do at least 30% of the civil works worth c.RM16.5bn. We understand that Gamuda, IJM, AQRS, WCT, WZ Satu and Fajarbaru Builder are vying for subcontracts, while HSS could win detailed design contracts for the ECRL project.

### Sustained earnings growth

Aggregate construction sector core net profit grew 11% yoy in 1Q17 but eased 5.7% qoq from a high base. All the construction companies in our coverage reported better yoy core earnings except IJM. Aggregate sector net profit jumped 99% yoy in 1Q17 mainly due to exceptional gains for IJM. We believe sector core EPS growth is on track to rebound from a 6% yoy contraction in 2016 to grow 16% yoy in 2017E and 18% yoy in 2018E, driven by higher progress billings on burgeoning construction order books.

### Remain Overweight

We are Overweight the construction sector as news flow on contract awards should sustain sector outperformance in 2H17. We see more value in small/mid-cap names like WCT (WCTHG MK, RM1.92, BUY) and HSS (HSS MK, RM0.90, BUY). In large caps, we like Gamuda (GAM MK, RM5.38, BUY) over IJM (IJM MK, RM3.43, HOLD) on Gamuda's better construction/infrastructure mix vs. IJM (79% and 41% of group PBT, respectively). Risk: project delays.

## Sector Update

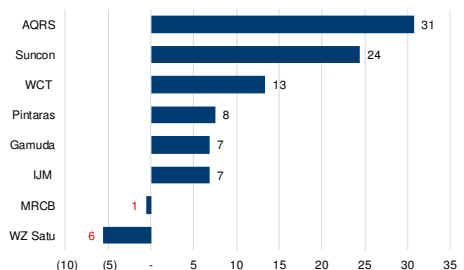
# Construction

## Overweight (maintain)

### Absolute Performance (%)

|          | 1M   | 3M    | 12M  |
|----------|------|-------|------|
| IJM      | 0.0  | 0.2   | 2.2  |
| Gamuda   | -1.1 | 3.2   | 13.4 |
| MRCB     | -9.8 | 18.1  | 7.3  |
| WCT      | -8.7 | -15.2 | 21.2 |
| Suncon   | 5.4  | 6.5   | 30.6 |
| AQRS     | 7.9  | 15.3  | 46.6 |
| WZ Satu  | -5.1 | -9.0  | 1.0  |
| Pintaras | -1.7 | 14.2  | 15.0 |
| HSS      | -2.2 | -6.1  | 82.2 |

### Relative Performance (%)



Source: Affin, Bloomberg.  
\*HSS was listed only on Aug 26, 2016

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| Stock     | Bbg      | Rating | Sh Pr<br>(RM) | TP<br>(RM) | Mkt cap<br>(RMbn) | Core PER (x) |       | Core EPS gr (%) |       | P/BV (x) | ROE (%) | DY (%) |
|-----------|----------|--------|---------------|------------|-------------------|--------------|-------|-----------------|-------|----------|---------|--------|
|           |          |        |               |            |                   | CY17E        | CY18E | CY17E           | CY18E | CY17E    | CY17E   | CY17E  |
| IJM Corp  | IJM MK   | HOLD   | 3.43          | 3.75       | 12.4              | 20.4         | 17.2  | 19.6            | 18.5  | 1.2      | 6.0     | 2.7    |
| Gamuda    | GAM MK   | BUY    | 5.38          | 5.94       | 13.2              | 20.4         | 17.5  | 12.9            | 16.2  | 1.7      | 10.2    | 2.2    |
| MRCB      | MRC MK   | HOLD   | 1.17          | 1.47       | 2.6               | 29.4         | 17.1  | (30.4)          | 71.8  | 0.9      | 15.6    | 2.4    |
| WCT Hldgs | WCTHG MK | BUY    | 1.92          | 2.46       | 2.7               | 19.1         | 14.5  | 117.6           | 31.6  | 0.9      | 5.0     | 1.0    |
| SunCon    | SCGB MK  | HOLD   | 2.12          | 2.13       | 2.7               | 16.8         | 15.1  | 37.0            | 11.6  | 4.8      | 30.5    | 3.1    |
| Gbg AQRS  | AQRS MK  | BUY    | 1.51          | 1.62       | 0.6               | 19.4         | 12.3  | 60.9            | 57.6  | 1.5      | 10.3    | 1.3    |
| WZ Satu   | WENG MK  | BUY    | 1.10          | 1.52       | 0.4               | 15.2         | 12.3  | 31.1            | 24.3  | 1.2      | 0.0     | 0.0    |
| Pintaras  | PINT MK  | BUY    | 4.02          | 4.62       | 0.7               | 15.7         | 13.0  | 54.2            | 20.7  | 1.9      | 12.3    | 5.0    |
| HSS       | HSS MK   | BUY    | 0.90          | 1.20       | 0.3               | 15.8         | 11.4  | 14.5            | 38.4  | 3.0      | 20.7    | 1.9    |
| Wgt avg   |          |        |               |            |                   | 20.1         | 16.9  | 18.5            | 18.7  | 1.3      | 7.8     | 2.1    |

Source: Affin Hwang forecasts, Bloomberg. Note: Pricing as of close on 1 Aug 2017



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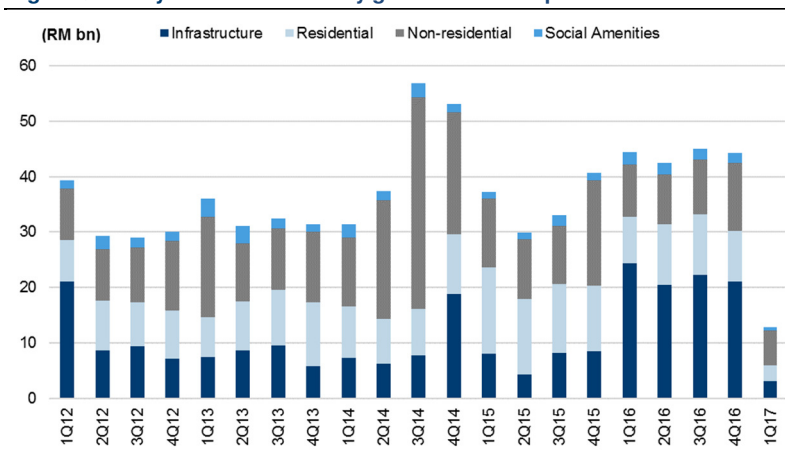
## Contract awards ease in 1Q17 after their 1Q16 peak

### Both infrastructure and property contract awards declined

Construction contract awards saw a slow start in 1Q17 after most major work packages for the Klang Valley Mass Rapid Transit Line 2 (Sungai Buloh-Serdang-Putrajaya Line) (MRT2) project were awarded in 2016. According to the Construction Industry Development Board (CIDB) statistics, industry contract awards fell 71% yoy and qoq to RM12.9bn in 1Q17 from a high base in 1Q16 and 4Q16. Infrastructure contract awards fell 87% yoy and 85% qoq to RM3.1bn after peaking at a 13-year high of RM24.4bn in 1Q16.

Property-related contract awards fell 49% yoy and 57% qoq to RM9.1bn as the property market remains lacklustre. There were fewer launches of new condominium and office projects in 1Q17 based on our discussions with the major property developers. But there were contract awards for ongoing integrated mixed development projects such as the Bukit Bintang City Centre (BBCC) project. IJM was awarded a RM1.16bn contract to build the retail mall in BBCC that is developed by Mitsui Fudosan.

Fig 1: Quarterly contract awards by government and private sector



Source: Construction Industry Development Board

As major projects such as the RM9bn LRT Line 3 and RM13bn Pan Borneo Highway (PBH) Sabah are still at the tender stage in 1H17, we expect contract awards to accelerate in 2H17 when winners are announced for major packages for these projects. Property-related contract awards should pick up in 2H17 as major property developers are planning for more launches of new projects.



## Mega projects to kick off

### LRT3 and ECRL to take off in 2H17

We estimate at least RM146bn worth of infrastructure contracts are pending award from 2H17 onwards, including new projects to be implemented. We gather that major work package for the RM9bn Klang Valley LRT Line 3 (LRT3) will be awarded in 2H17. The RM55bn East Coast Rail Line (ECRL) is expected to take off in 4Q17 with China Communications Construction Co. Ltd (CCCC) appointed as the main contractor and financing from the Chinese government secured.

**Fig 2: Balance of contract value to be awarded from 2H17 onwards**

| Project                                   | Cost (RMbn) | Potential listed co bidders                |
|-------------------------------------------|-------------|--------------------------------------------|
| KL-Singapore High Speed Rail (HSR)        | 60          | Gamuda, HSS, IJM, YTL, George Kent         |
| East Coast Rail Link (ECRL)               | 55          | AQRS, Fajarbaru, Gamuda, HSS, IJM, WZ Satu |
| Pan-Borneo Highway Sabah (PBH)            | 13          | WCT, Suria Capital-GAQRS, Gamuda           |
| LRT Line 3 (Bandar Utama-Shah Alam-Klang) | 9           | Suncon, IJM, Gamuda, Gadang, TRC, WCT      |
| Gemas-Johor Bahru Double-Tracking         | 5           | YTL, Fajarbaru-WZ Satu                     |
| Central Spine Road                        | 4           | UEM-WZ Satu                                |
| West Coast Expressway                     | 1           | Mitrajaya, WCT, WZ Satu                    |
| <b>Total</b>                              | <b>146</b>  |                                            |

Source: Affin Hwang estimates

We gather that subcontract works worth about 30% of estimated total project cost of RM55bn for the ECRL, ie, RM16.5bn, will be awarded to local contractors through a selective bidding process. We gather that Gamuda is negotiating for a subcontract direct from CCCC. **Gamuda** has built a strong track record in railway construction, following the completion of the RM12.3bn Ipoh-Padang Besar Double-tracking project and is targeting to secure RM10bn worth of new contracts in 2017.

Other contractors with experience in railway construction include **IJM Corp**, **Fajar Baru** and **WZ Satu**. We believe **HSS Engineers** is in a strong position to secure a contract to provide detailed engineering designs for the ECRL as it is undertaking preliminary design works currently. Other contractors vying for jobs for the ECRL include **AQRS** for station works in Kota SAS, where it is constructing the new Pahang administration centre.

### Some PBH Sabah packages to be awarded in 2H17

There have been some delays in the award of packages for the PBH Sabah project. The second round of pre-qualification to include consortiums with local contractors from Sabah and Peninsular Malaysia are ongoing. Peninsular Malaysia-based contractors have been roped in as partners due to insufficient Sabah-based contractors with experience in undertaking large-scale projects.

Only 5 out of 32 packages have been awarded to date for the RM12.8bn PBH Sabah project. We gather that **HSS** together with a local engineering consulting firm is in the running for the role as the Independent Checking Engineer (ICE) for the government.

### HSR will move to the detailed planning stage

The Malaysia and Singapore government will jointly call for a tender to identify the privately-financed asset company (AssetsCo) for the RM60bn Kuala Lumpur-Singapore High Speed Rail (HSR) project by year end. AssetsCo will be responsible for designing, building, financing and maintaining all rolling stock, as well as designing, building, financing, Affin Hwang Investment Bank Bhd (14389-U)

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operating and maintaining all rail assets (e.g. track-work, power, signalling and telecommunications). It will also coordinate the system's network capacity for operations and maintenance needs.

We gather that **George Kent** and **YTL Corp** are interested to bid for the AssetsCo role. YTL Corp holds a 45% stake in the Express Rail Link (ERL) concession, which provides a track record in undertaking railway privatisation projects. The other shareholders of ERL are Lembaga Tabung Haji, SIPP Rail Sdn Bhd and Trisilco Equity Sdn Bhd with 36%, 10% and 9% shareholding respectively.

The Malaysian government has also called for an international request for proposal to be the master developer for the 197ha Bandar Malaysia, which will house the terminus station for the HSR in Kuala Lumpur. Seven Chinese firms and two Japanese firms submitted proposals for the project. The Chinese bidders are China State Construction Engineering, China Communications Construction Company (CCCC), China Gezhouba Group, Greentown Overseas, China Resources, China Vanke and Australia's John Holland, which is wholly owned by CCCC. The Japanese bidders were Daiwa House Industry Group and Mitsui Fudosan. The bids received feature development plans valued between USD7bn and USD10.5bn.

We believe the development of the HSR and Bandar Malaysia projects will involve substantial building and civil works that will boost the order books of local contractors. We expect tenders for the detailed design for the HSR to be called in 2H17. We believe **HSS** is in a strong position to bid for a detailed design package as it secured the RM13m preliminary design package for 160 km out of the total 335 km of the HSR alignment this year.

## Sustained earnings growth

### New contract procurement slowed in 1H17

The construction companies under our coverage had good results in terms of new contract procurement in 2016. But this has eased in 1H17 as most of the packages for the MRT Line 2 were awarded in 2016. IJM was the most successful in securing new contracts in 1H17, ie, RM1.3bn for the lifestyle retail mall in Bukit Bintang City Centre and Dewas Bypass Tollway in India. This was followed by Suncon, which clinched RM0.9bn worth of new contracts including the additional works for its MRT Line 2 package and a condominium project for its parent Sunway. We believe contract awards will accelerate in 2H17 with the expected award of packages for the LRT Line 3 project and initial subcontract packages for the ECRL.

**Fig 3: Annual new contract awards for selected contractors**

| Company  | 2012<br>(RMbn) | 2013<br>(RMbn) | 2014<br>(RMbn) | 2015<br>(RMbn) | 2016<br>(RMbn) | 1H17<br>(RMbn) |
|----------|----------------|----------------|----------------|----------------|----------------|----------------|
| Gamuda * | 11.5           | 0.0            | 0.0            | 0.0            | 17.0           | 0.0            |
| IJM Corp | 1.0            | 0.2            | 3.7            | 2.2            | 2.0            | 1.3            |
| Suncon   | 2.4            | 2.2            | 0.9            | 2.6            | 2.6            | 0.9            |
| WCT      | 1.9            | 0.7            | 1.0            | 3.0            | 1.3            | 0.2            |

\* Includes MRT2 project delivery partner project.  
Source: Companies, Affin Hwang

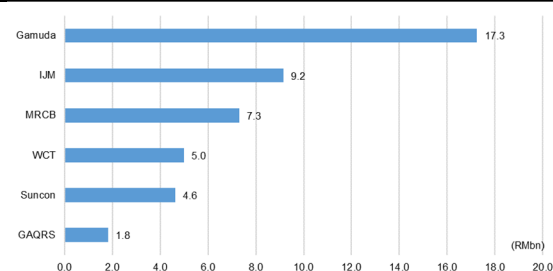


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### Record high order books

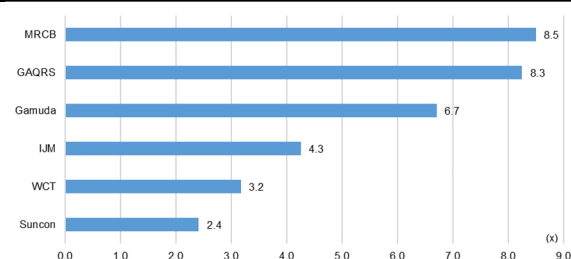
Most of the contractors in our universe have built up record high order books due to strong new contract procurements in 2016. Only IJM has expanded its orderbook to about RM9.2bn at end-1H17 from RM8bn at end-2016 with new contract wins. Gamuda still has the largest order book among the construction companies in our universe at over RM17.3bn due to the MRT Line 2 project secured in 2016. MRCB has the highest order book/revenue ratio at 8.5x, indicating the highest earnings visibility supported by a large order book.

**Fig 4: Construction order book at end-1H17**



Source: Companies

**Fig 5: Order book/Revenue at end-1H17**

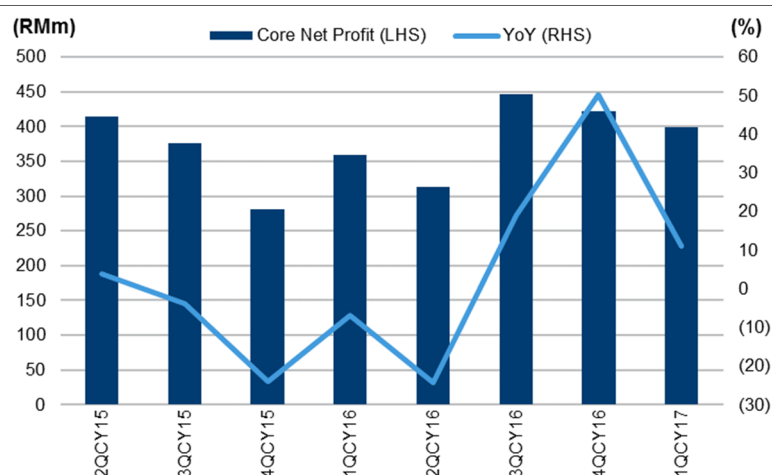


Source: Companies

### Sustained core earnings growth in 1Q17

Aggregate construction sector core net profit grew 11% yoy in 1Q17 but eased 5.7% qoq from a high base and seasonal factors. All the construction companies under our coverage reported better yoy core earnings except IJM. Aggregate sector net profit jumped 99% yoy in 1Q17 mainly due to exceptional gains and higher plantation earnings for IJM. We believe sector core EPS growth is on track to rebound from a 6% yoy contraction in 2016 to grow 16% yoy in 2017E and 18% yoy in 2018E, driven by higher progress billings on burgeoning construction order books.

**Fig 6: Aggregate construction net profit and yoy change**



Source: Affin Hwang estimates, Companies

## Maintain Overweight

### Top BUYs are Gamuda, WCT, and HSS

We remain Overweight on the Malaysian Construction Sector given the positive outlook on contract awards in 2H17. But we have moderated our bullish stance following the downgrade of IJM Corp, Suncon and MRCB to HOLD in May. This follows the run up in share prices narrowing the potential upside to our target prices.

We believe the sector's core EPS growth of 18.7% yoy in 2018E, on our forecasts, will outpace the market average of 6.6% yoy. The weighted-average construction sector fully-diluted core 2018E PER of 17x is above the market average of 16x. We believe the positive earnings delivery in 2017-18 and sustained news flow on the award of major infrastructure projects will support the sector outperformance. Our top sector picks are Gamuda (for large-cap exposure), WCT (for mid-cap stocks), and HSS (for small-cap exposure).

We replaced Gabungan AQRS with HSS as our small-cap pick. The strong run up in AQRS' share price has narrowed the potential upside to our target price of RM1.62, based on 10% discount to RNAV. HSS, the largest domestic engineering consulting company, will likely benefit from the implementation of large-scale infrastructure projects such as the ECRL, HSR and PBH Sabah. HSS has secured preliminary design contracts for the ECRL and HSR, giving it the competitive advantage to bid for detailed design contracts in the medium term.

**Fig 7: Valuations and core EPS growth for the Malaysian sectors and market**

| Sector                 | Rating | Mkt cap (RMm)    | Core EPS gr (%) |            | Core PE (x) |             | Yield (%)  | P/BV (x)   | ROE (%)    |
|------------------------|--------|------------------|-----------------|------------|-------------|-------------|------------|------------|------------|
|                        |        |                  | 2017E           | 2018E      | 2017E       | 2018E       |            |            |            |
| Banks                  | OW     | 331,831          | 7.8             | 3.0        | 12.1        | 11.8        | 4.3        | 1.3        | 10.3       |
| Auto & Autoparts       | UW     | 8,264            | (44.2)          | 42.7       | 19.4        | 13.6        | 2.6        | 1.1        | 4.5        |
| Building Materials     | N      | 4,852            | (14.9)          | 191.9      | 102.4       | 35.1        | 0.6        | 2.4        | 2.3        |
| Construction           | OW     | 35,570           | 18.5            | 18.7       | 20.1        | 16.9        | 2.2        | 1.3        | 7.8        |
| Consumer               | N      | 56,808           | 8.5             | 5.3        | 25.9        | 24.6        | 3.7        | 16.5       | 20.5       |
| Gaming                 | OW     | 76,296           | 8.8             | 14.2       | 14.4        | 12.6        | 1.4        | 0.5        | 4.1        |
| Healthcare & Pharma.   | OW     | 53,586           | 10.5            | 33.8       | 119.8       | 89.5        | 0.3        | 5.3        | 5.8        |
| Insurance              | OW     | 9,223            | (85.7)          | 6.4        | 14.4        | 13.5        | 4.2        | 1.4        | 12.3       |
| Media                  | N      | 17,141           | 3.2             | 8.5        | 18.9        | 17.4        | 5.0        | 4.9        | 18.4       |
| MREIT                  | N      | 29,313           | 6.1             | 4.2        | 16.7        | 16.1        | 5.6        | 1.1        | 6.5        |
| Oil & Gas              | N      | 125,396          | 57.6            | 10.6       | 21.3        | 19.2        | 2.7        | 2.7        | 8.7        |
| Plantation             | N      | 138,084          | 21.0            | 9.4        | 19.6        | 17.9        | 3.0        | 2.1        | 9.2        |
| Property               | OW     | 37,586           | (4.2)           | 8.1        | 11.6        | 10.8        | 4.6        | 0.8        | 7.8        |
| Rubber Products        | OW     | 26,349           | 17.6            | 19.0       | 26.6        | 22.3        | 1.6        | 4.4        | 15.2       |
| Small & Mid caps       | OW     | 1,134            | 1.3             | 12.4       | 51.9        | 46.5        | 6.2        | 7.8        | 43.0       |
| Technology             | N      | 14,722           | 15.1            | 9.9        | 11.8        | 10.7        | 3.5        | 2.2        | 21.1       |
| Telecoms               | N      | 147,862          | (0.8)           | 0.9        | 30.6        | 30.3        | 2.7        | 4.7        | 15.1       |
| Timber                 | OW     | 3,125            | 13.0            | 6.9        | 16.4        | 15.3        | 1.8        | 1.1        | 5.2        |
| Transports & Logistics | N      | 73,389           | (5.2)           | 1.0        | 21.1        | 20.8        | 3.0        | 1.2        | 7.2        |
| Utilities              | OW     | 119,842          | (6.9)           | 8.4        | 10.9        | 10.0        | 3.8        | 1.2        | 9.3        |
| <b>Coverage</b>        |        | <b>1,310,373</b> | <b>1.5</b>      | <b>6.6</b> | <b>17.0</b> | <b>15.9</b> | <b>3.3</b> | <b>2.0</b> | <b>9.0</b> |

Source: Bloomberg, Affin Hwang forecasts, based on prices as of 1 August 2017



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Fig 8: Valuations for Malaysian construction companies

| Stock          | Bbg      | Rating | Sh Pr<br>(RM) | TP<br>(RM) | Mkt cap<br>(RMbn) | Core PER (x) |             | Core EPS gr (%) |             | P/BV (x)   | ROE (%)    | DY (%)     |
|----------------|----------|--------|---------------|------------|-------------------|--------------|-------------|-----------------|-------------|------------|------------|------------|
|                |          |        |               |            |                   | CY17E        | CY18E       | CY17E           | CY18E       | CY17E      | CY17E      | CY17E      |
| IJM Corp       | IJM MK   | HOLD   | 3.43          | 3.75       | 12.4              | 20.4         | 17.2        | 19.6            | 18.5        | 1.2        | 6.0        | 2.7        |
| Gamuda         | GAM MK   | BUY    | 5.38          | 5.94       | 13.2              | 20.4         | 17.5        | 12.9            | 16.2        | 1.7        | 10.2       | 2.2        |
| MRCB           | MRC MK   | HOLD   | 1.17          | 1.47       | 2.6               | 29.4         | 17.1        | (30.4)          | 71.8        | 0.9        | 15.6       | 2.4        |
| WCT Hldgs      | WCTHG MK | BUY    | 1.92          | 2.46       | 2.7               | 19.1         | 14.5        | 117.6           | 31.6        | 0.9        | 5.0        | 1.0        |
| SunCon         | SCGB MK  | HOLD   | 2.12          | 2.13       | 2.7               | 16.8         | 15.1        | 37.0            | 11.6        | 4.8        | 30.5       | 3.1        |
| Gbg AQRS       | AQRS MK  | BUY    | 1.51          | 1.62       | 0.6               | 19.4         | 12.3        | 60.9            | 57.6        | 1.5        | 10.3       | 1.3        |
| WZ Satu        | WENG MK  | BUY    | 1.10          | 1.52       | 0.4               | 15.2         | 12.3        | 31.1            | 24.3        | 1.2        | 0.0        | 0.0        |
| Pintaras       | PINT MK  | BUY    | 4.02          | 4.62       | 0.7               | 15.7         | 13.0        | 54.2            | 20.7        | 1.9        | 12.3       | 5.0        |
| HSS            | HSS MK   | BUY    | 0.90          | 1.20       | 0.3               | 15.8         | 11.4        | 14.5            | 38.4        | 3.0        | 20.7       | 1.9        |
| <b>Wgt avg</b> |          |        |               |            |                   | <b>20.1</b>  | <b>16.9</b> | <b>18.5</b>     | <b>18.7</b> | <b>1.3</b> | <b>7.8</b> | <b>2.1</b> |

Source: Affin Hwang forecasts, Bloomberg, based on prices as of 1 August 2017



Fig 9: Top picks in Malaysian construction sector

| Top picks                                                                                                                                                                                     | Rating | Analysts' Comments                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>GAMUDA (GAM MK)</b><br><br>Target Price : RM5.94<br>Share Price as at : RM5.39<br>1 Aug 2017<br>          | BUY    | Gamuda is our top BUY among the large-cap Malaysian construction stocks, with a RNAV-based 12-month target price of RM5.94. Gamuda and its partners have been appointed as the project delivery partner for the RM32bn Klang Valley Mass Rapid Transit Line 2 (MRT2) and RM27bn Penang Transport Master Plan (PTMP). The MMC Gamuda Joint Venture was also awarded the RM15.47bn underground works contract for MRT2, while Naim-Gamuda JV clinched the RM1.57bn Pan-Borneo Highway (Sarawak) (PBH) package. Gamuda is targeting to secure RM10bn p.a. worth of new contracts in 2017 and 2018 to grow its order book. Its current record high order book should spur the long-term earnings growth of its construction division. Key risk to our call would be project delays.                                                                                                                                                                                             |
| <b>WCT (WCTHG MK)</b><br><br>Target Price : RM2.46<br>Share Price as at : RM1.89<br>1 Aug 2017<br>          | BUY    | WCT is one of our top BUYs among the mid-cap construction stocks with a 12-month target price of RM2.46 based on a 10% discount to our end-2017E RNAV. WCT clinched RM1.4bn in new contracts to replenish its order book to about RM5bn currently. We believe WCT's prospects to garner more local contracts have improved after it secured its first MRT civil-works package. WCT is pre-qualified to bid for the LRT3, WCE and PBH projects. The change is a major shareholder could accelerate its plans to monetise its assets such as the potential injection of two malls into the planned listing of WCT REIT by year end. This would reduce its high net gearing of above 0.8x currently. We look for a strong core EPS CAGR of 50% in 2017-19E. Key risks to our call would be slower property sales and execution risks on its construction projects.                                                                                                             |
| <b>HSS Engineers (HSS MK)</b><br><br>Target Price : RM1.20<br>Share Price as at : RM0.91<br>1 Aug 2017<br> | BUY    | We reiterate our BUY call on HSS with a 12-month TP of RM1.20, based on a target CY18E PER of 15x, a 20% discount to global peers' weighted average PER of 18.6x. HSS provides engineering consultancy and project management services for companies and governments. Some of their projects include MRT1 and MRT2, LRT Ampang Line extension, RAPID Pengerang, Westports, Kuantan Port and West Coast Highway. We like HSS for its long and established relationship with clients like Prasarana, MRT Corp, and myHSR, and its recent appointment as a consultant for ECRL. Being a well-positioned company with predominantly Bumiputera engineers allows them an upper hand in bidding for governmental projects. We believe it could potentially secure more contracts from existing clients. HSS usually earns an engineering fee of 2-5% on the total project value, while its only cost is manpower, which makes it highly profitable (FY16: 10% net profit margin). |

Source: Bloomberg, Affin Hwang

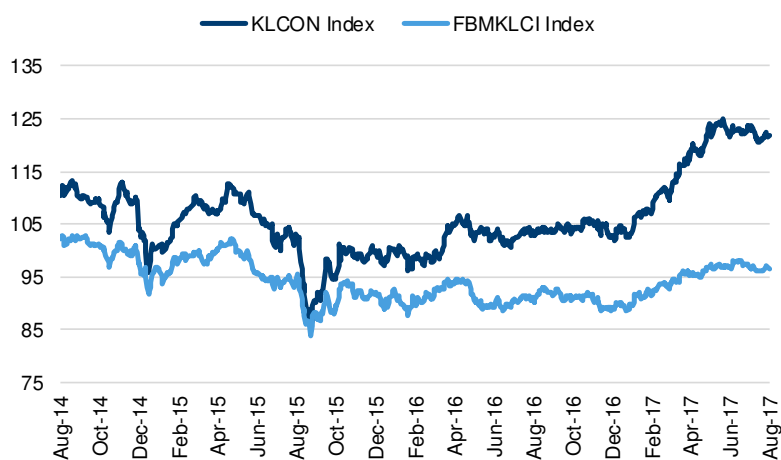




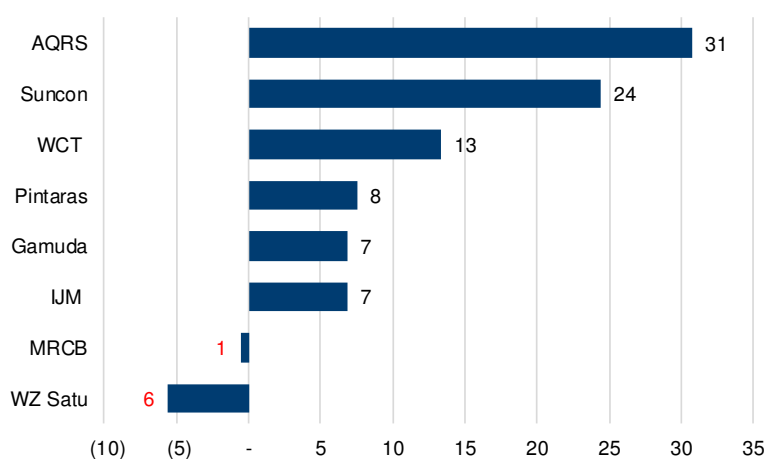
Outthink. Outperform.

**KLCON outperforms FBMKLCI**

The KL Construction (KLCON) Index has outperformed the FBMKLCI by 25% over the last three years, which we attribute to positive news flow on new contract awards. Over the last 12 months, AQRS was the top outperformer in our construction universe, outperforming the FBM KLCI by 31%. The current 12-month forward PER of 15.9x for the KLCON Index is above the long-term mean PER of 13.6x, while the current PBR of 1.46x is above the long-term mean PBR of 1.36x. This is justified, in our view, by the current cyclical upturn for the sector with good new contract procurement prospects to drive strong earnings growth.

**Fig 10: KL Construction Index vs FBMKLCI Index performance**

Source: Bloomberg

**Fig 11: Construction stocks relative performance vs. FBMKLCI YTD**

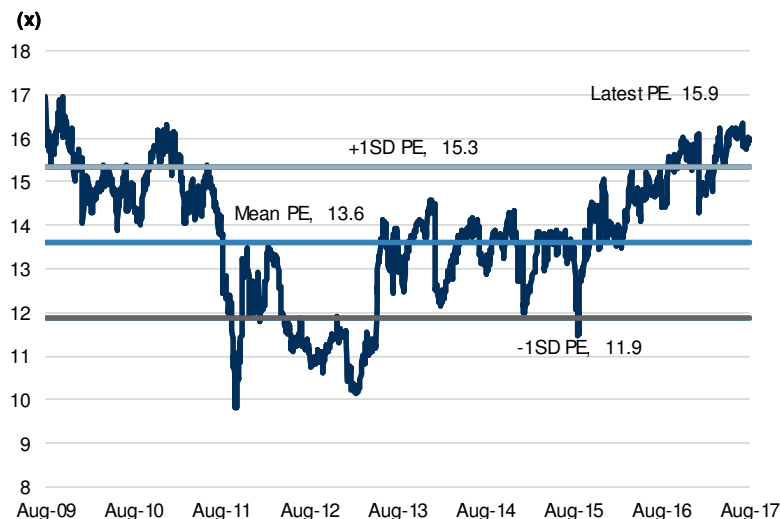
Source: Bloomberg

\*HSS was listed only on Aug 26, 2016



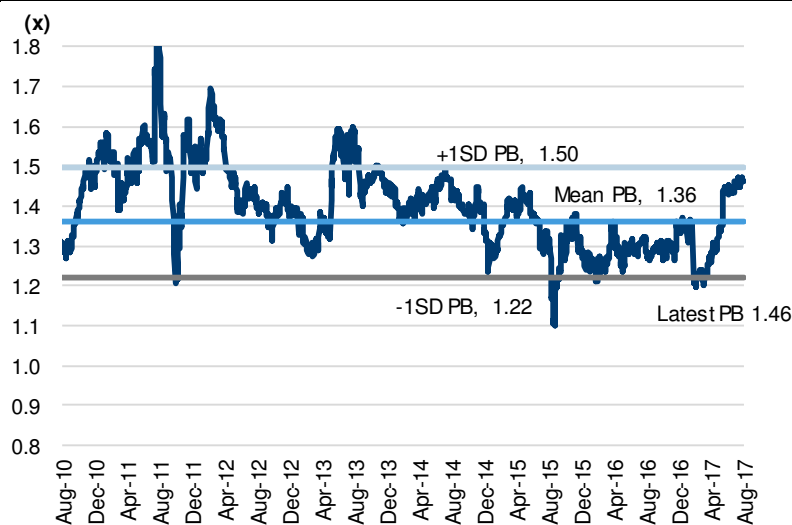
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Fig 12: KL Construction Index 12-month-forward PER



Source: Bloomberg

Fig 13: KL Construction Index 12-month-forward PBR



Source: Bloomberg

The key risks to our Overweight view on the construction sector would be 1) higher building material and labour costs, which would erode profit margins; and 2) project execution risks.

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**Equity Rating Structure and Definitions**


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|                  |                                                                                                                                                                      |
|------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>BUY</b>       | Total return is expected to exceed +10% over a 12-month period                                                                                                       |
| <b>HOLD</b>      | Total return is expected to be between -5% and +10% over a 12-month period                                                                                           |
| <b>SELL</b>      | Total return is expected to be below -5% over a 12-month period                                                                                                      |
| <b>NOT RATED</b> | Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation |

*The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.*

|                    |                                                                                                                                        |
|--------------------|----------------------------------------------------------------------------------------------------------------------------------------|
| <b>OVERWEIGHT</b>  | Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months          |
| <b>NEUTRAL</b>     | Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months |
| <b>UNDERWEIGHT</b> | Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months        |

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