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Headline	Research house keeps construction sector on `positive`
MediaTitle	The Sun
Date	26 Sep 2017
Section	Business
Page No	17
Language	English
Journalist	N/A
Frequency	Daily

Research house keeps construction sector on 'positive'

PETALING JAYA: MIDF Research has maintained its "positive" stance on construction sector despite blips in its expectations, with financial year 2018 (FY18) potentially bearing better results due to higher revenue recognition, coupled with catalysts of subcontracting packages from China's state-owned enterprises (SOEs).

In a note yesterday, its analyst Fadhli Dzulkifly said the government's policy of furtherance for the One Belt One Road Policy enables China SOEs to participate freely in construction projects, to improve its risk-reward profile.

Fadhli noted that large China's construction SOE such as China Railways Engineering Corp and China Railways Construction Corp have made strong developments in local construction sector – shrinking the impact to local companies further.

"The 'Buffett Indicator' or total market cap to GNI (gross national income) of China is 92.5% and its three-year forward earnings are -0.86%. With an anaemic earnings climate in China, it is only natural for its SOEs to look for better opportunities.

"We believe the push factor for China's SOE to Malaysia is the insipid three-year operating margin of CSI300 (Mean:+12.1%) compared to rest of FBMKLCI and Asean."

Generally, Fadhli said Malaysia's stable operating margin proxied by FBMKLCI's average of 19.12% is a boon for China's SOE.

Moreover, he said valuation of KL Construction Index is set to climb higher as the price-to-earnings (PER) and price-to-book (PBR) starts to converge again, to reflect the intensifying news flow on the sector.

He said the sectoral PER climbed to 22.9 times which is closer to its 11-year average of 24.2 times. From PBR standpoint, the sector fetches only 1.26 times PBR below its mean of 1.36 times.

Despite that, 'writings on the wall' such as drop in infrastructure projects and uneven earnings for big caps and small-mid caps construction companies are ominous for the sector, he added.

Meanwhile, Fadhli said the compression and uneven earnings in big-caps is seen through the accretion of infrastructure projects to the construction company's bottom line.

For example, Pan Borneo Highway (Sarawak) was awarded to several companies such as WCT Holdings Bhd and Cahya Mata Sarawak in July 2016.

Despite that, he said the progress is still at an early stage, hence meaningful impact to WCT and Cahya Mata 1HFY17 earnings is still undemonstrative.

Fadhli said the research house believes the trend will persist due to the joint-venture (JV) and project delivery partner (PDP) structure of the mega-projects is regressive to earnings upside.

For instance, he said the revenue per share (RPS) of big caps construction companies (BC) has lagged the RPS of small-mid caps construction companies (SMC).