

Wan Azhar Mustapha
azhar.mustapha@osk.com.my
Tel : +60 (3) 2333 8373

Executive Summary



- ❖ We view the construction sector for 2007 favourably, premised on the following:
 - (i) Upside in earnings from the roll out of construction projects
 - (ii) M&A in the construction sector
 - (iii) Possible election money to flow in
 - (iv) Upward revision in toll rates for 5 highways.
- ❖ Speculations on the beneficiaries are well documented. The big players are certainly in the picture but do not discount the impact on the smaller construction companies to play significant roles.
- ❖ There major development areas:
 - (i) The Northern Corridor
 - (ii) The Eastern Corridor
 - (iii) The Southern Corridor
- ❖ Election factor cannot be discounted. 12 months prior to the 11th General Election on 21 March 2004, the KL Construction Index rose 30.9% on expectation of project awards. Meanwhile, we noticed spending on construction usually heightens during election year.
- ❖ Valuation for the sector is undemanding. Historically, the KL Construction Index was seen trading at between the 20x and 25x multiples compared to current level at between 14x and 16x. We believe that there is more upside for the construction companies on the back of the optimism surrounding the 9MP.

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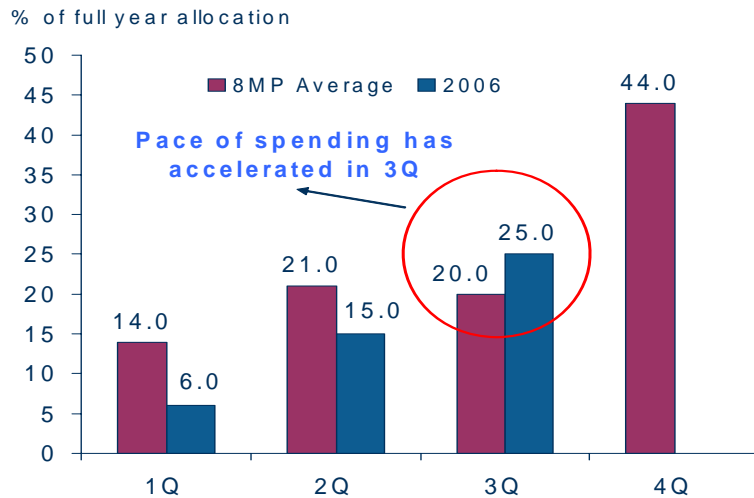
The 9th Malaysian Plan - A Recap

It is apparent that 2007 would be a much better year for the construction sector underpin by positive news flow regarding the award of major projects under the 9MP. Since the launching of the 9MP in March this year, there had been disappointments on the pace over the implementation of the projects.

*Concerns
Alleviated.*

While, it is true that implementation had been slow especially during the 1st half 2006 with only 21% of the allocated expenditure disbursed as compared with 35% during the 8MP, the pace had since accelerated in the 3Q as depicted in graph below with 25%. We expect the pace to pick up further in the 4Q and to be even more intense in 2007. As such, we believe any concerns over the snail pace of the 9MP should eventually fade away.

Chart 1: Federal Government Gross Development Expenditure



Since the announcement of the 9MP, there were three major developments;

*Round One of the
Announcements*

The first was the announcement of some 880 projects under the 9MP worth about RM15.0bn (or 6.8% of the total allocation under 9MP). All the projects mentioned will be going through a tender.

Table 1: Early projects announcement

Ministries/Departments	9MP Projects	PFI's	Total Projects
Prime Minister Dept	68	3	71
Treasury	12	1	13
Plantation Industries and Commodities Ministry	2	1	3
Agriculture and Agro-based Industries Ministry	2	2	4
Rural and Regional Development Ministry	7	0	7
Natural Resources and Environmental Ministry	8	4	12
International Trade and Industries Ministry	2	0	2
Works Ministry	65	1	66
Transport Ministry	24	2	26
Energy, Water and Communication Ministry	12	0	12
Science, Technology and Innovations Ministry	10	0	10
Education Ministry	140	357	497
Health Ministry	27	0	27
Culture, Arts and Heritage Ministry	5	1	6
Youth and Sports Ministry	3	0	3
Human Resources Ministry	0	1	1
Information Ministry	2	8	10
Higher Education Ministry	25	0	25
Defence Ministry	21	17	38
Home Affairs Ministry	2	3	5
Internal Security Ministry	18	24	42
Total	455	425	880

Source: Prime Minister's Department

Round Two

In early September, the Works Ministry as announced that another 39 new projects will be announced before the month end. However, there were no further details on the type and cost of the project. Nonetheless, we believe that these are lesser projects for the smaller construction companies in the country.

Round Three

In November, the Minister of the PM Department has indicated an allocation of RM100.0bn for 20 high impact projects, which includes the allocation for the South Johor Economic Region (SJER).

Slowly but Surely

To date, the only confirmed projects under the 9MP are:

Confirmed Projects

Project	Value	Company
2 nd Penang Bridge	RM3.0bn	UEM World
Iskandar Development Region	>RM15.0bn	UEM Group, Gamuda, MMC, Ranhill, Ranhill Utilities
East Coast Expressway Phase 2 – Package 10	RM1.4bn	ACP Industries
East Coast Expressway Phase 2 – Package 12	RM98.0m	TSR Capital
Kota Kinabalu Airport upgrade works	RM750.0	WCT Engineering

Mega projects in the pipeline are:

Those Still Pending...

Major Infra Projects	Est. Value
Penang Outer Ring Road (PORR)	RM1.0bn
Penang Monorail	RM1.1bn
West Coast Expressway	RM2.0bn
Electrified Double Tracking Railway	RM15.0bn
East Coast Expressway Phase 2	RM3.0bn
Pahang-Selangor Interstate Raw Water Transfer Project	RM4.0bn
Langat 2 Water Treatment plant	RM4.0bn
Flood mitigation projects	n/a
Water distribution network (Incl. new dams, water intakes, water treatment plants and distribution system)	n/a
Sewerage & pipe replacement	RM3.1bn
Sarawak coastal road upgrading	n/a

Looking Ahead to 2007

Expectations Running High

The 9MP holds much promise for the domestic construction companies after a lacklustre 2004/05. Expectations are high for a much stronger earnings prospect fuelled by the promise of speedy implementation of the projects.

For 2007, we expect better earnings visibility from:

Replenishment of Order Books

(i) Replenishment of order books. In the past 2 years, the domestic construction sector suffered from the limited roll out of major projects. We expect a much stronger order book growth in the upcoming periods when implementation of the 9MP takes centre stage.

Better Margins?

(ii) Potentially better margins for the domestic projects vis-à-vis overseas construction works. Gross margin within the domestic market was trimmed significantly in the past couple of years, from around 25%-30% to less than 10% presently attributed to intense competition on the back of project scarcity. We expect 9MP coupled with PFI funding will facilitate construction companies to ease the pressure on margins going forward.

Toll Hikes!

(iii) Toll rake hikes. The 5 toll roads scheduled for upward revisions in 2007 as per their concession agreements are:

(iv)

Table 4 : Toll Rates for the 5 Highways

Toll Highway	Concession Holder	Current rate	New rate
LDP Highway	Litrak*	RM1.00	RM1.60
Kesas Highway	Gamuda	RM1.50	RM2.20
Cheras-Kajang Highway	Grand Saga Sdn Bhd	9 th mile - RM0.70	RM1.00
KL-Karak	MTD Infra	11 th mile – RM0.60	RM0.90
Guthrie Corridor Expressway	Kump. Guthrie	Gombak – RM4.00 Bentong – RM2.50 RM1.00	RM5.00 RM3.00 n/a

Note: * Gamuda owns 41.9% of Litrak

How About M&As?

(v) M&A potential. IJM and RBH has started the ball rolling in this regard and we could see further M&A activities down the road especially on GLC-related companies. The domestic construction landscape is dynamic and very competitive hence the lingering concerns over the prospect post-9MP. As we have seen in the past years, the construction sector was in a depressed state due to limited jobs prospect and unhealthy competition. Overseas markets provide the way out but the challenges are far greater where fortune favours the strong and efficient players. We are seeing more of this overseas trend thus it is not surprising if more companies opting to go into the M&A route to create a more competitive, cost-efficient company and to achieve greater efficiency.

Land Value Could Appreciate

Fuelled by Land Acquisition

Land owners are viewed as amongst the immediate beneficiary of the 9MP due to land acquisitions for infrastructure developments. However, the impact would be far reaching as it could act as growth catalysts in the surrounding areas. The main areas of particular interests are:

Southern Corridor	The development of Iskandar Development Region is a great boost to the land value. For example, UEM Land has 24,000 ha in Bandar Nusajaya at a cost of RM4.20/sf and as at April '06, the value has risen to at least RM6.40/sf. Expect more should the southbound hi-speed train proposed by YTL Corp. is given the go ahead
Northern Corridor	Five major projects are due to take off, namely 2nd Penang Bridge, Penang Outer Ring Road, Penang Monorail, West Coast Expressway and Double Tracking Railway project. Potential upside in land prices within the development areas is tremendous
Eastern Corridor	The main project is East Coast Expressway Phase 2 from Kuantan to Kuala Terengganu. This should provide great commercial benefit for Terengganu hinterland over the long term, especially the expansion in the oil & gas activities in the state
Central region	The construction of Kajang-Seremban Highway would provide the much needed growth catalyst for community along the Cheras-Kajang-Nilai corridor

Picture 1: Development Corridors



Source: EPU

Rather Quiet on Sarawak Front

A Sleeper..

No news on the Sarawak mega projects. Previously, Sarawak was touted as one of the biggest beneficiary of 9MP, underpinned by mega project proposed to be carried out in the state, namely:

- (i) Bakun Dam project,
- (ii) The aluminium smelting plant and
- (iii) The coastal highway project.
- (iv) RM9.0bn proposed undersea cable project

Don't be Caught Offguard

At this juncture, the rumour mill is quiet on Sarawak with the projects mentioned above are kept in the freezer for the time being, possibly due to the imminent change in the administration should the current Chief Minister decides to call it a day. Nonetheless, ignore Sarawak at your own peril as they said, still water runs deep.

Table below depicts a list of Sarawak-based companies that may benefit or be involved in the construction or infrastructure projects given the potential higher spending budget. We would not be at all surprised if buying interest would spill over to those politically linked companies for obvious reasons.

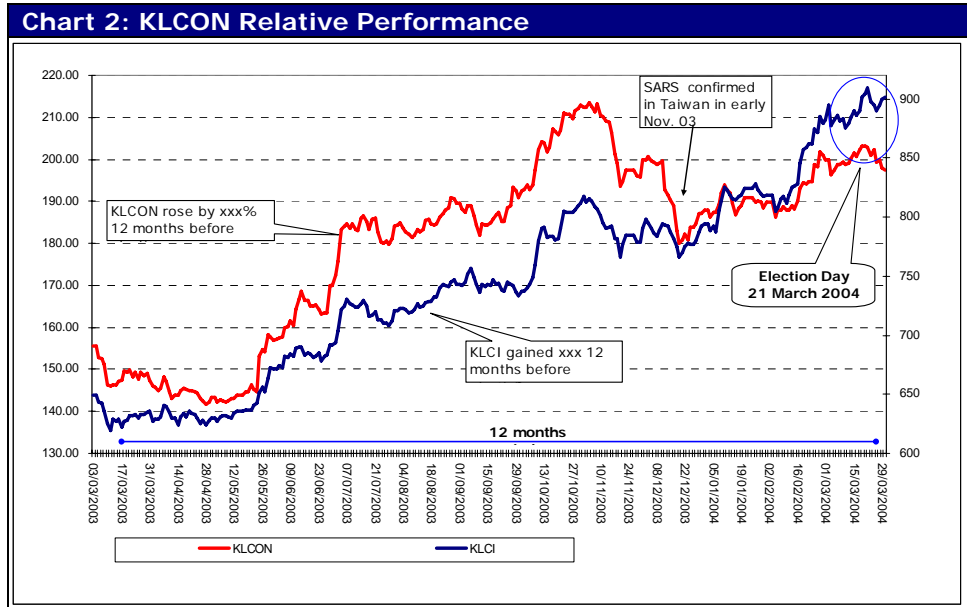
Table 5: Listed Sarawak Companies

Public Listed Companies	
Bintulu Port Holdings Bhd	Quality Concrete Holdings Bhd
Cahaya Mata Sarawak Bhd	Sarawak Concrete Industries Bhd
Ekran Bhd	Zecon Engineering Bhd
Hock Seng Lee Bhd	Weida Malaysia Bhd
Naim Cendera Holdings Bhd	Sarawak Enterprise Corp

12th General Election – Will it be a factor?

A Repeat?

Will the market maintain its momentum? During the run-up to the 11th General Election held on the 21 March 2004, it did (Chart below). Therefore, it is widely speculated that the same may occur for the 12th General Election purportedly to be held late next year or early 2008.



Judging purely from relative index performance, from 14th March 2003, the KL Construction Index was at the 155.55 level and reached its peak (prior to Election Day) at 203.22, an increase of 30.6%.

Similar trends were also observed during the 8MP years. The timing of the 8MP (2000-2005) was spot on as it preceded the recovery mode on the country's economic performance as the country rebounded off from the lows due to the Asian Financial Crisis. We are expecting similar inclination for 2007 with the 9MP projects expected to be gradually rolled out next year and onwards, amid improving economic numbers and healthier consumers' sentiment.

Expect More News Flow

As mentioned, we are expecting a similar trend towards the run up to the 12th General Election as the precedent are already in place as evidenced by the encouraging news flow regarding the 9MP projects and anticipate there to be more positive news flows from time to time. We are beginning to see more jobs opening up for tenders and the fast tracking of mega projects should help shore up expectations.

The Beneficiaries....

Same Names Mentioned

The main construction companies are still the best bet to be involved in the development of projects under the 9MP, amongst the frontrunners are Gamuda, IJM Corp., Road Builder, and of course the UEM Group.

Table 6: Potential Beneficiaries

Major Infra Projects	Est. Value	Potential Beneficiary(s)
Penang Outer Ring Road (PORR)	RM1.0bn	Peninsular Metro Works
Penang Monorail	RM1.1bn	MMC, ACPI, UEM World, Muhibbah
West Coast Expressway	RM3.0bn	IJM, K.Europlus, ACPI
Electrified Double Tracking Railway	RM15.0bn	MMC, Gamuda, ACPI
East Coast Expressway Phase 2	RM3.0bn	MTD Capital, TSR Capital, Ahmad Zaki
Pahang-Selangor Interstate Raw Water Transfer Project	RM4.0bn	Gamuda, KPS, Jaks, Puncak
Langat 2 Water Treatment plant	RM4.0bn	Gamuda, KPS, Jaks, Puncak
Flood mitigation projects	n/a	Gamuda, Loh & Loh
Water distribution network (Incl. new dams, water intakes, water treatment plants and distribution system)	n/a	Gamuda, Sime Darby, Ahmad Zaki, Loh & Loh
Sewerage & pipe replacement	RM3.1bn	DRB Hicom, Weida, PJBumi, YLI Holdings, Engtex Group
Sarawak coastal road upgrading	n/a	Zecon, Cahya Mata Sarawak, Naim Cendera, Hock Seng Lee

GLCs to the Fore

Being the largest GLC construction company, UEM Builders is one of the big winners under the 9MP. In 2005, UEM Builders was one of the major beneficiaries after securing RM1.3bn worth, namely Institut Jantung Negara building extension (RM226m) and North-South Expressway expansion/upgrade (RM1.0bn).

For 2006, the UEM Group has secured the RM3.0bn 2nd Penang Bridge and also one of the main players in the development of the South Johor Economic Region via Bandar Nusajaya.

Smaller Player to Benefit as Well

Apart from the major projects, there are plenty of smaller scale projects to benefit the smaller contractors. The government is also looking to:

- (i) expand and upgrade existing federal and state trunk roads;
- (ii) construction of hospitals, schools and universities;
- (iii) development of agricultural growth centres; and
- (iv) various airports/seaports upgrading works, to name a few.

Top Picks

Ahmad Zaki Resources

(BUY; TP: RM2.54)

Has vast experience in civil construction works ranging from the construction of roads and highways to hospitals, colleges and universities. Its exposure in the East Coast also keeps us upbeat on its competitive position in bidding for the 5 packages of the East Coast Expressway Phase 2 worth at least RM60m-90m each. With large projects anticipated in the pipeline, AZRB could possibly join the ranks of the bigger boys soon

Crest Builder

(BUY; TP: RM1.70)

From a pure construction player to a contractor-cum-developer, with a proven track record in the construction of non-standard infrastructure and building constructions, namely commercial, residential buildings, roads, bridges, universities, colleges as well as hospitals. We are excited of CB's process in negotiating for a PFI project for the construction of a government complex worth at least RM350m-400m in the Klang Valley.

Hock Seng Lee

(BUY; RM3.66)

Its exposure in the construction of roads, highways plus its niche in land reclamation and marine engineering in Sarawak could put it as one of the main beneficiaries in the state. HSL is currently undergoing negotiations of infrastructure contracts worth RM1.2bn under the PFI projects, as well as flood mitigation works in Kuching and Sibu worth about RM1.1bn

Protasco

(BUY; TP: RM1.00)

Another prime beneficiary especially the construction and maintenance of roads and highways. Its current 2 long-term concession for the maintenance of federal roads in the Peninsular and Sarawak are testimonies to the government's confidence in Protasco's expertise in the field. No doubt that the Group has been rather slow in replenishing its orderbook of late but we reckon most of Protasco's catalysts actually lie ahead in year 2007 and onwards

Gamuda

(BUY; TP: RM5.45)

We are upbeat on its prospect under the 9MP given its exposure in the South Johor and expertise in the water projects via Splash and SMART Tunnel. In addition, the scheduled hike in some of its toll operations would be positive for its earnings. The group is expected to bolster its concession once the Laos Hydro power project is up and running

ACPI

(BUY; TP: RM1.55)

Joined the major league after the acquisition of MTD Construction Sdn Bhd with order book ballooning to as high as RM4.5bn from RM0.8bn. The company is strong in the building material segment with 70% market share in the manufacturing and supply of segmental box girder, 50% market share in tunnel lining and 15% market share in concrete pipes. ACPI is set to benefit from the development of the 2nd Penang Bridge, double tracking railway project and the Pahang-Selangor Water Transfer project.

IJM Corp
(NEUTRAL; TP: RM7.35)
Road Builder
(TRAD. BUY: TP RM3.35)

The RM3.0bn West Coast Expressway is in the cards but pending approval from the cabinet. The WCE concession is originally given to Kumpulan Europlus via Konsortium PLB Sdn Bhd. The go ahead for the WCE would also be the key of IJM to finalise the deal to acquire 25% stake in Kumpulan Europlus and given the deadline (30 Nov. '06) have now been extended. The recent decision by the EPU to pull back the WCE proposal could scupper the deal but we await further announcement regarding this matter.

*We Are Also Keen
On...*

The potential of **UEM Group** cannot be discounted in view of its strong presence in the development of SJER via the massive Bandar Nusajaya development.

Other notable companies that we are keen on are **Naim Cendera (NR)**, the main biggest player in Sarawak; and **WCT Engineering (NR)**, which is driven by its expanding construction order book and greater presence in the market.

Spilling Over to Others...

Properties and Utilities to Benefit...

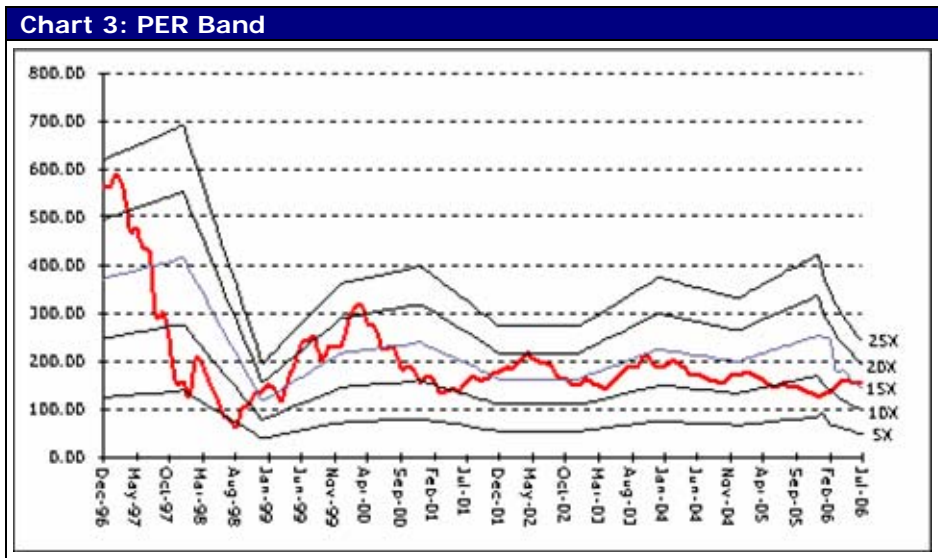
The development of 9MP could also benefit other players from other sectors as well. Property developers with landbanks surrounding the development corridors are poised to reap the rewards from the development especially in terms of land value.

Utilities companies, especially water concession holder are also seen as the main beneficiary under the 9MP, not only from the massive allocation for the sector. In the southern region, with the development of IDR, **Ranhill Utilities** could see its consumption projection to rise significantly should the annual population rises more than the projected 3% at the moment. The long term development of the IDR would see influx of businesses and workers that would translate in booming demand for water in the state. In Johor, the water consumption is expected to rise by about 4.5% per annum from IDR on top of the 3% growth at the moment.

Undemanding Valuation

Ripe For Pickings

At present, the construction sector is trading at about 14.7x FY07 multiples which is a major improvement over the past 2 years where the KLCON Index was range bound between 5x-10x PER. Compared to the late 1990s, where the KLCON Index was seen traded at a much higher range of between 20x-25x PER. We believe more upside is looming for construction stocks on the back of the optimism surrounding the 9MP.



Water Sector to Play a Role too...

Among the Big Winners

The allocation to the sector has increased by 113% against the 8MP. Under the plan, National Water Services Commission (SPAN) will be established to supervise and regulate the water supply services and sewerage services in Peninsular Malaysia. On top of that, the Water Asset Management Company (WAMCO) will also be launched to develop future water supply infrastructure. The Water Bill is expected to be implemented in early 2007 after it was given the go ahead by the Cabinet.

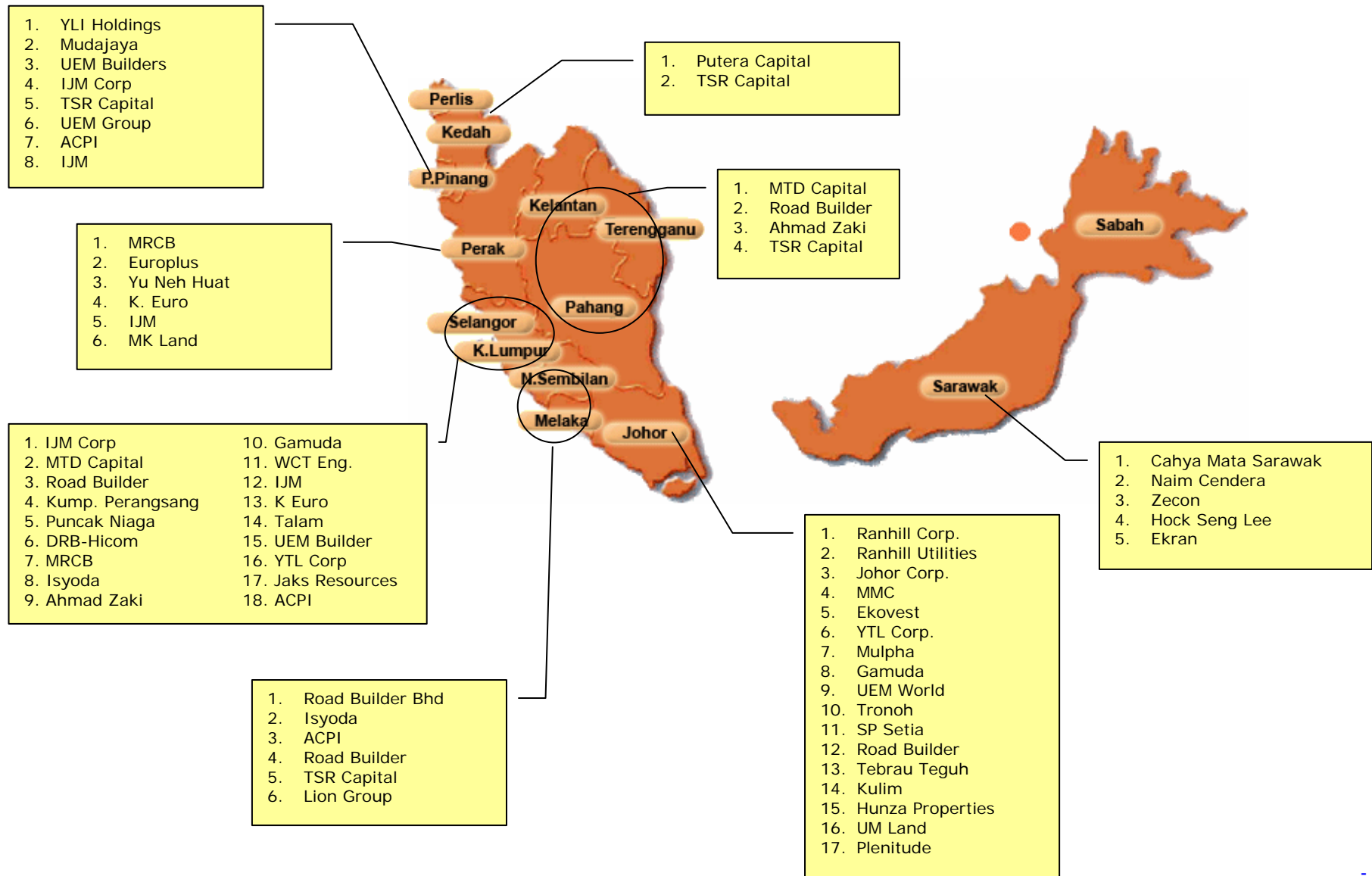
Main Growth Drivers...

The main drivers for the sectors going forward are as follow:

- (i) **Water Supply.** Water supply is the major beneficiary in water allocation, enjoying biggest slice of allocation in water sector of RM8.2bn or 111% increase versus 8MP. Generally, water demand for domestic & infrastructure expect to grow at 6.6% p.a. and reaching 16,270 mld in 2010. To achieve this the massive Pahang-Selangor Interstate Water Transfer project is given the go ahead with works scheduled to commence in late 2007.
- (ii) **NRW Programs.** The main initiative is the asset replacement mainly in pipes and meters. In general, we are upbeat on this prospect with the Works Ministry looking at RM10.0bn to replace the 86,000km pipe network in the country, especially more than half are made from hazardous old Asbestos Cement (AC) pipes. This program will be under the supervision of SPAN.
- (iii) **Flood Mitigation.** In 9MP, the measures to ease the threat of flash flood include construction of flood retention ponds, river improvement works and flood diversion as well as non-structured measures. As the flood issue has been getting serious recently such as recent flash flood in Shah Alam and the persistent flash flood in Kuala Lumpur that created a hazard to the surrounding communities.
- (iv) **Roll-out of projects.** We are expecting more development in the water-related projects in the upcoming periods starting with the pipes replacement works.

Overall, we are **OVERWEIGHT** on the Water Sector but prospect is greatly dependent on the New Water Bills implementation to provide further insights into the mechanism for the development on the sector. Nonetheless, we are upbeat on the water sector mainly in the pipe replacement programs and reduction in NRW efforts that could translate into a much more activities than in 2006.

Appendix 1: List of Construction-related Companies Exposures in Respective States



OSK Research Guide to Investment Ratings

Buy: Total return of the stock may exceed 10% OR outperform the relevant benchmark index over the next 12 months, whichever is higher

Trading Buy: Total return of the stock may exceed 10% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Total return of the stock may fall within the range of +/- 10% (inclusive) over the next 12 months OR is not expected to outperform or underperform the relevant benchmark index by the same quantum over the same period

Take Profit: Target price has been attained. Look to accumulate at lower levels.

Sell: Total return of the stock may fall more than 10% OR underperform the underlying benchmark index over the next 12 months

* Total Return (capital gain + dividend yield)

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Shin Kao Jack

Kuala Lumpur**Hong Kong****Singapore****Malaysia Headquarters**

OSK Securities Bhd.
20th Floor, Plaza OSK
Jalan Ampang
50450 Kuala Lumpur
Malaysia
Tel : + (60) 3 2333 8333
Fax : + (60) 3 2175 3333

Malaysia Research Office

OSK Research Sdn. Bhd. (206591-V)
6th Floor, Plaza OSK
Jalan Ampang
50450 Kuala Lumpur
Malaysia
Tel : + (60) 3 2333 8333
Fax : + (60) 3 2175 3202
E-mail : research2@osk.com.my

Hong Kong Office

OSK Asia Securities Ltd.
1201-1203, 12/F,
World-Wide House
19 Des Voeux Road
Central, Hong Kong
Tel : + (852) 2525 1118
Fax : + (852) 2537 1332

Singapore Office

DMG & Partners Securities Pte. Ltd.
#22-01 Ocean Towers
20 Raffles Place
Singapore 048620
Tel : +(65) 6438 8810
Fax : +(65) 6535 4809