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Are contractors READY TO RUN?

After a few lean years, companies in the construction sector are beginning to see a pickup in the flow of new contracts. And, many of them are trading below their book value.

BY **SHARANYA PILLAI**

Eric Phua, deputy group managing director of engineering firm **TEE International Group**, remembers well the heady days of the late noughties. The construction of the two integrated resorts, Marina Bay Sands and Resorts World Sentosa, in particular, created a massive boom for the local construction sector, flooding the order books of companies such as TEE International and pushing their prices sky high. TEE International bagged a $109 million contract for electrical installations at MBS.

"For the casino, we only had one chance, and we hit [it big] there. It was a landmark project, and another milestone that we achieved," Phua says. But things did not go smoothly. The US subprime mortgage crisis of 2008 quickly escalated into a global financial crisis that engulfed **Las Vegas Sands**, the US-listed company that owns MBS. Some subcontractors on the project went bust. The construction sector also had to contend with sand embargos from neighbouring countries as well as heavy rainfall and labour shortages, which drove up costs.

Yet, despite their share prices being whipsawed by these trials and tribulations, it was a relatively prosperous period for the construction players. Even after the integrated resorts were completed, the contracts continued to flow. According to the Building and Construction Authority (BCA), the value of construction contracts awarded totalled $34.6 billion in 2008. It fluctuated over the next few years, and peaked at $37.7 billion in 2014, on the back of institutional and civil engineering contracts for projects such as Changi Airport Terminal 4, Sengkang General and Community Hospitals and the Thomson-East Coast Line.

Ironically, over the last two years, as a rare period of synchronised global growth got underway and stocks went into a powerful rally, the construction players seemed to fall on hard times. Last year, only an estimated $24.5 billion worth of contracts were awarded, well below the levels seen in 2008 and 2014. Between 2014 and 2017, the tender price index also fell 10.1 points to 96.7, revealing stiffening competition within the sector. Reflecting a prolonged period of lacklustre profitability across the sector, a large swathe of constructions stocks are currently trading below their book values.

Now, even as monetary policy is tightening, and the broad market is beginning to show signs of fatigue, the operating backdrop for the local construction players appears to be improving. On Jan 11, the BCA said it expects between $26 billion and $31 billion worth of construction contracts to be awarded this year.

The contractors themselves are talking about bidding for work related to upcoming tenders for mega infrastructure projects, such as Changi Airport's fifth terminal, the North-South Corridor (NSC) — an integrated transport network connecting northern Singapore to the city — and the Kuala Lumpur-Singapore High Speed Rail. Another source of new contracts for builders will be the redevelopment of en bloc sites. Since last year, some 52 deals worth $15.6 billion have been completed.

In addition, tender prices could become competitive again as the tender price index "seems to have found a floor", says CGS-CIMB research analyst Colin Tan. If things continue to improve in the months ahead, construction stocks might begin drawing investors again. However, the construction sector is made up of a broad and diverse group of companies, each with particular strengths in different segments of the supply chain. So, it is important for investors to be positioned correctly in order to benefit from the potential upturn.

Civil engineering plays

Out of the 53 construction and engineering stocks listed on the Singapore Exchange, a number have developed expertise in civil engineering projects, which include the construction of transport infrastructure, tunnels and water supply systems. Six such companies (see chart) had a collective order book valued at $2.1 billion last year — a 10% fall from 2016. This number could, however, recover as the results of ongoing tenders are announced, Tan says.

Tan is especially bullish on steelworks specialist **Yongnam Holdings**, despite its past four consecutive years of losses. He has an "add" call on the counter with a price target of 57 cents. Yongnam's stock ran up during the construction boom prior to the 2008 global financial crisis, peaking at $1.88 in June 2007. Throughout 2007, it traded at an average of 2.84 times its book value. Its shares subsequently slid, and its net asset value (NAV) has since improved to 55.9 cents per share. The company made a loss of 3.25 cents per share for FY2017, weighed down by high overheads from the storage of struts. However, the stock is trading below book value.

Seow Soon Yong, CEO of Yongnam, says the company is looking to replenish its pipeline with bids for $1.2 billion worth of projects. "Our historical success rate in [bidding for] Singapore projects is about 50%," he says. "On that basis, we are looking at [securing] about $400 million to $500 million worth of projects for this year." Yongnam's joint venture with Leighton Contractors has been shortlisted for the design and construction of the NSC tunnel between Kampong Java Road and Suffolk Walk. It submitted the lowest bid of $553.8 million.

"Given the major infrastructure works that are coming up, particularly the NSC, Yongnam is very optimistic on getting some of these works relating to steel struts, [as] they have a large inventory of struts," says Tan of CIMB-CGS. "We probably expect them to take on more subcontractor work."

Another stock worth watching in this segment of the construction sector is **CSC Holdings**, which provides ground engineering solutions for both general construction and infrastructure projects. Its customers include the Housing and Development Board (HDB) and **City Developments**. Similar to Yongnam, CSC has seen three consecutive years of losses. For 9MFY2018 ended Dec 31, the company posted a $2.6 million loss, weighed down by distribution and administration expenses. However, the loss is 62.5% lower compared with the previous year. And, the stock is trading at just 0.4 times its book value.

As at Feb 6, CSC's order book stood at $210 million, up from just $150 million as at May 23, 2016. In 2014, the company had an order book of $250 million, and its stock was trading at 0.61 times its NAV. In an unrated April 9 report, Tan notes that CSC aims to improve the quality of its order book this year: "CSC believes that more contracts requiring foundation and geotechnical engineering works will come its way this year, and that the quality of its order book is improving. CSC expects that projects that were won previously with low prices will likely be cleared off its order book by 1H2018 and that it will have a significant pickup in net margin from 2Q2019 onwards."

Beyond the new Punggol district, CSC also hopes to win new projects in the long term from the Tuas Mega Port and the relocation of the Paya Lebar airport. The Tuas Terminal will be developed in four phases over 30 years. The first phase, involving reclamation works, kicked off in April 2016 and is expected to be completed by the early 2020s. The relocation of the Paya Lebar airport will only be realised from 2030.

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Construction stocks on the SGX

COMPANY	WHAT IT DOES	PRICE AS AT APRIL 24 (CENTS)	MARKET CAP ($ MIL)	PER (TIMES)	P/B (TIMES)	YIELD (%)	1-YEAR RETURN (%)
BBR	Construction, specialised engineering, property development, green technology	23.5	75.8	10.4	0.6	1.7	9.3
Boustead Projects	Design-and-build of industrial property, sale of properties	79.0	244.4	6.7	1.0	1.9	-9.7
Chip Eng Seng	Property development, construction, hospitality, property investments	98.5	611.7	17.3	0.8	4.1	32.2
CSC Holdings	Foundation and geotechnical engineering, sale and lease of equipment	2.5	55.2	NA	0.4	NA	4.2
Hock Lian Seng	Civil engineering, property development, investment properties	46.0	235.6	11.9	1.2	3.9	-24
Keong Hong Holdings	Construction, property development, investment property, investment holding	57.0	132.5	2.1	0.7	3.5	11.8
Koh Brothers Group	Construction and building materials, real estate, leisure and hospitality	32.5	142.4	6.8	0.5	1.9	6.6
KSH Holdings	Construction, property development and management	65.5	373.2	11.0	1.1	3.8	-5.3
Lian Beng Group	Construction, building materials and machinery, investment holding and dormitories	62.0	309.8	6.3	0.5	3.6	5.1
Lum Chang Holdings	Construction, property development and investment, investment holding	36.0	137.6	6.2	0.6	4.2	2.9
OKP Holdings	Construction, maintenance	36.5	112.6	8.8	0.9	1.9	-11.0
Pan-United Holdings	Concrete and cement	39.5	276.8	14.6	0.8	3.3	-23.0
Sin Heng Heavy Machinery	Equipment rental, trading	49.5	56.4	NA	0.5	3.0	33.8
Soilbuild Construction	Construction	15.0	100.9	NA	1.22	NA	-34.8
TA Corp	Construction, real estate investment, real estate development, distribution of automobile products	24.5	122.5	NA	0.7	4.1	-15.5
TEE International	Engineering, real estate (via TEE Land), infrastructure	19.9	99.9	NA	1.1	NA	-5.2
Tiong Seng	Construction, property development, rental, sale of construction technology	38.0	175.8	5.8	0.6	3.8	51.9
Tiong Woon Corp Holding	Heavy lift and haulage, marine transportation, engineering services, trading	31.0	72.0	NA	0.3	NA	17.0
TTJ Holdings	Structural steel, dormitories	30.5	106.6	12.9	0.8	2.3	-18.7
Wee Hur Holdings	Building construction, investment property, property development, investment holding, student accommodation, fund management	23.0	211.4	11.4	0.6	2.6	-4.2
Yongnam Holdings	Structural steel, mechanical engineering, specialist civil engineering, design-and-build of industrial property	32.0	167.2	NA	0.6	NA	56.1

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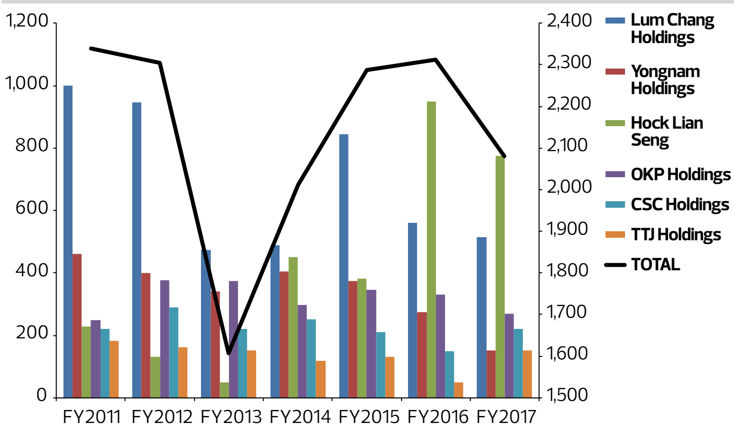
Civil engineering stocks order book ($ mil)



Good omens for residential builders

The BCA expects private construction demand to rise to between $10 billion and $12 billion, from $9 billion last year, thanks to the upbeat residential property market. Tan is similarly optimistic. "In our view, a good portion of the demand would come from awarded en bloc sales," he says. "Furthermore, the government has said it aims to keep the total supply of private residential units for 1H2018 at a similar level to the supply of units in 2H2017. This could lead to growth in construction demand from the private residential space."

Tan expects at least five projects from en bloc sites to be launched in 2018, namely Shunfu Ville, Raintree Gardens, Rio Casa, Serangoon Ville and the Nim Collection (for which the first phase launched in March). These have a total estimated construction value of between $940 million and $1.2 billion.

Among general builders, **Lian Beng Group** currently has one of the largest order books of $924 million, boosted by two residential building contracts worth $336.3 million in Serangoon North and Potong Pasir, as well as its largest building contract of $435 million awarded by HDB. The projects are expected to stretch to 2022.

Lian Beng recently listed its property development arm, **SLB Development**, which is expected to lighten its balance sheet. Lian Beng is currently trading at 0.5 times its book value. In 2014, the stock had traded as high as 1.01 times book value. The company's order book was $1.2 billion as at end-May that year.

Unlike residential builders, companies focused on industrial projects may still face a tough year, amid a spike in the supply of industrial land in recent years, CIMB-CGS' Tan says. But some players are in a stronger position than others. **Boustead Projects**, which was spun off from **Boustead Singapore** and listed in 2015, is among those likely to retain an edge in the industrial build-and-design segment. Tan has an "add" call on Boustead Projects, with a price target of 81 cents. The stock is trading at book value. It traded at as much as 1.57 times book value in 2015.

Thomas Chu, managing director of Boustead Projects, believes that exuberance in the private residential construction segment could indirectly ease competitive pressures in the construction of industrial properties. "In the last couple of years when construction demand in the public sector was lower, we had a lot of [competitors] from that space coming into the industrial segment to tender for projects. That increased the competition," he says. "You can see the buoyancy in en bloc sales. That will certainly create the demand for new residential projects. So hopefully, they will move out from the industrial segment [back to residential]."

Lum Chang Holdings, which does both construction and civil engineering, recently clinched a $136.9 million contract for the construction of a new 20-storey office tower and an adjacent four-storey block, as well as addition and alteration works at the Pasir Panjang Terminal Building 3. This brings its order book to $679.5 million as at Jan 22.Lum Chang is trading at 0.6 times book value, slightly down from 0.7 times last October.

Ronald Leo, chairman and CEO of **Keong Hong Holdings**, is also focusing on commercial and industrial contracts. "There are a lot of mega factories from Jurong Town Corp coming up, like the JTC Automotive Hub and Woodlands North Coast," he says. As at Dec 31, Keong Hong's order book was $299.7 million. On March 14, the company secured a contract for the construction of a building for the National Skin Centre, as well as the reconstruction of a five-storey building for the National Healthcare Group. Keong Hong was once a pure construction play, but recently diversified into the development of hotels in The Maldives. The stock is trading at 0.7 times book value. It traded at book value in 2015, when its order book stood at $462 million.

Materials and machinery

Beyond civil engineering specialists, building materials suppliers could see revenue growth from the uptick in construction, Tan says. One beneficiary could be **Pan-United Holdings**, the largest supplier of cement and ready-mixed concrete in Singapore. According to its 2016 annual report, it has a market share of 40% in the supply of RMC.

In February, the company completed the demerger of its port business in China, which has left it as a pure play on building materials. It also completed a rights issue in July last year that raised its share capital by $59.7 million. As at Dec 31, Pan-United had debt of $122.9 million, compared with debt of $298.3 million a year ago. The company's net gearing ratio fell from 0.73 in FY2016 ended Dec 31, to 0.46 in FY2017. The stock is trading at 0.8 times its book value. Its price-to-book ratio had hit 1.36 times in 2014.

For FY2017, Pan-United's earnings from continuing operations fell 13% y-o-y to $5.8 million, partly owing to softer demand for building materials. It is, however, anticipating "demand for high volumes of multiple-use concrete solutions". With a cleaner balance sheet and more streamlined operations, Pan-United also plans to double down on its overseas operations in Malaysia, Indonesia and Vietnam, and eventually grow overseas revenue to 30% to 40% of its total revenue. It is currently trading at 14.6 times earnings, slightly above its historical seven-year average of 13.4 times.

Elsewhere, a pickup in construction activity could also aid machinery suppliers such as **Sin Heng Heavy Machinery** and **Tiong Woon Corp Holding**. Sin Heng specialises in the rental and trading of cranes, aerial lifts and other lifting equipment, while Tiong Woon provides heavy lift and haulage equipment for the oil and gas and construction industries. However, both these companies foresee a "challenging" and "competitive" outlook ahead as competition remains stiff.

For FY2017 ended Dec 31, Sin Heng reported earnings of $436,000, compared with a $2.9 million loss a year ago. Revenue from the equipment rental business rose 4.7% y-o-y due to the increase in the average fleet size rented out. Meanwhile, Tiong Woon's earnings for 2QFY2018 ended Dec 31 fell 71% y-o-y to $520,000 amid a slowdown in demand. It is, however, somewhat optimistic that the property market could aid recovery: "The Group expects that the ongoing public sector infrastructure development in Singapore will provide support for more business opportunities," Tiong Woon says in a commentary accompanying its results.

Sin Heng and Tiong Woon are trading at 0.5 times and 0.3 times their book value respectively. They traded as high as 0.84 times and 0.62 times their respective book values in 2014.

Long-term risks remain

While industry prospects look good, it is important to keep in mind that many players are still facing headwinds, CIMB-CGS' Tan says. Project delays, for one, remain a concern for mega projects. "When there are delays, they still need to pay their employees, so they will have to hold out during a delay and that would be the downside risk for them," he says.

"There has also been an influx of foreign players vying for the same projects that these local players are bidding for," he says, in reference to firms such as Dragages Singapore, a member of French firm Bouygues Construction, Obayashi Group and McConnell Dowell. "Perhaps in view of that, the market does not fully appreciate these [local] stocks, valuation-wise," he adds.

While many of these foreign firms have been scooping up main contractor roles in big projects, Tan believes local listed plays will still be able to clinch subcontractor jobs. "I think this year will be more of a gradual recovery; we are not ready to see [a peak like the one when] the integrated resorts were coming up. [But] I still think this year is definitely a good year to enter into [construction stocks], as companies like Yongnam are ready to turn around," Tan says.

In the meantime, Phua of TEE International says competition is the least of his worries this year. "Perhaps some years ago, we were worried. At one stage, we [stopped bidding for projects at Changi Airport] as there were not enough jobs for the companies to share," he says. The company has been engaged in projects at the airport since 1997. In fact, while the sector is a long way from the boom of the late noughties, Phua is now banking on Changi Airport's Terminal 5 to replenish TEE International's order book. "There are more than enough jobs. So, we don't have to participate in every tender. We can just select what we are good at." E