

The local factor in MRT job

Analysts say spin-offs greater if Gamuda wins tunnelling contract

By his own admission, Gamuda Bhd group managing director Datuk Lin Yun Ling said that the group made its mark in infrastructure development.

"It's been wave after wave. After the North South Expressway, we were really blazing the trail," he tells *StarBizWeek* in an interview.

This track record is perhaps why Gamuda and its 50% joint-venture (JV) partner MMC Corp Bhd, are tipped to win the tunnelling works for the Klang Valley My Rapid Transit (MRT) - the single largest portion in Malaysia's most expensive infrastructure project to date.

The winner would be announced in late March or April by Mass Rapid Transit Corp Sdn Bhd, the MRT's project and asset owner.

MMC-Gamuda is the project delivery partner (PDP) for the MRT, but should it bag the tunnelling contract, which is said to be worth RM8bil, it would relinquish its PDP role for the tunnel works.

There are several reasons why MMC-Gamuda is likely to get the job. Gamuda was the builder for the Sprint and Damansara-Puchong highways, and has experience in both railway and tunnel construction, most notably the Stormwater Management and Road Tunnel.

Having worked on the latter also means it has a good understanding of the soil conditions in Kuala Lumpur.

Moreover, the Government has reiterated its preference for the job to be kept in local hands.

"Gamuda will definitely win the bid," says an analyst from Hong Leong Investment Bank Research. "They have an edge over the other local players due to their technical expertise."

MMC-Gamuda, being the only fully local party with bumiputra interests, has a 7.5% tender pricing advantage. Under the Swiss Challenge method, it would also be accorded the first right of refusal to match the lowest bid.

There are four other parties vying for the lucrative tunnelling contract, namely China Railway Corp and Sinohydro Group from China, Japan's Taisei Corp, and a JV comprising Korea's Hyundai and Gadang Holdings Bhd, the only other local bidder.

But Gadang does not possess the same credentials as MMC-Gamuda, an industry observer points out.

"Gadang has a market capitalisation of RM123mil compared with Gamuda's RM8bil. Who would you trust to take on a RM8bil job?" he asks.

Gadang, like Gamuda, is in the business of construction as well as property development. It was loss-making in its financial year ended May 31, 2011, posting a net loss of RM4.25mil from a profit of RM14.87mil in the previous year.

In the six months to Nov 30, 2011, Gadang returned to the black with a net profit of RM4.31mil on revenue of RM108.8mil.

Boost to orderbook

In comparison, Gamuda recorded a 31.74% increase in net profit to RM425.41mil on revenue of RM2.76bil in its financial year ended July 31, 2011.

About 9.5km of the 51km Sungai Buloh-Kajang line MRT will be underground, and of the total 31 stations, seven are underground and 24 above ground.

Doubtless, winning the MRT's tunnelling portion would be a shot in the arm to Gamuda's orderbook,



Maybank Kim Eng estimates a multiplier impact of 6.8 times on the domestic economy should a local player snag the tunnelling works.

which currently stands at RM2bil.

This is made up mostly by its Ipoh-Padang Besar double tracking project and the nearly-completed New Doha International Airport and Yenso Park sewerage treatment plant.

"Its tenderbook currently stands at zero," says a source. "Rather than bidding for projects, its style is to propose new ones, like the MRT."

Assuming MMC-Gamuda does win the tunnelling portion, Gamuda will recognise half of that, or RM4bil, in its orderbook, owing to its 50% stake in the JV, the source says.

In other words, the company's orderbook could triple to RM6bil come April. But the benefits are not Gamuda's alone.

Already, analysts are looking at re-ratings across the construction sector, and the bullish tone in analyst reports on the industry is unmistakable.

Steady outlook

Analysts have also priced in the award win into Gamuda's share price, which has been on a steady uptrend. The stock was near its highest level year-to-date (YTD) on Friday, which might suggest that investors too see the award as an eventuality.

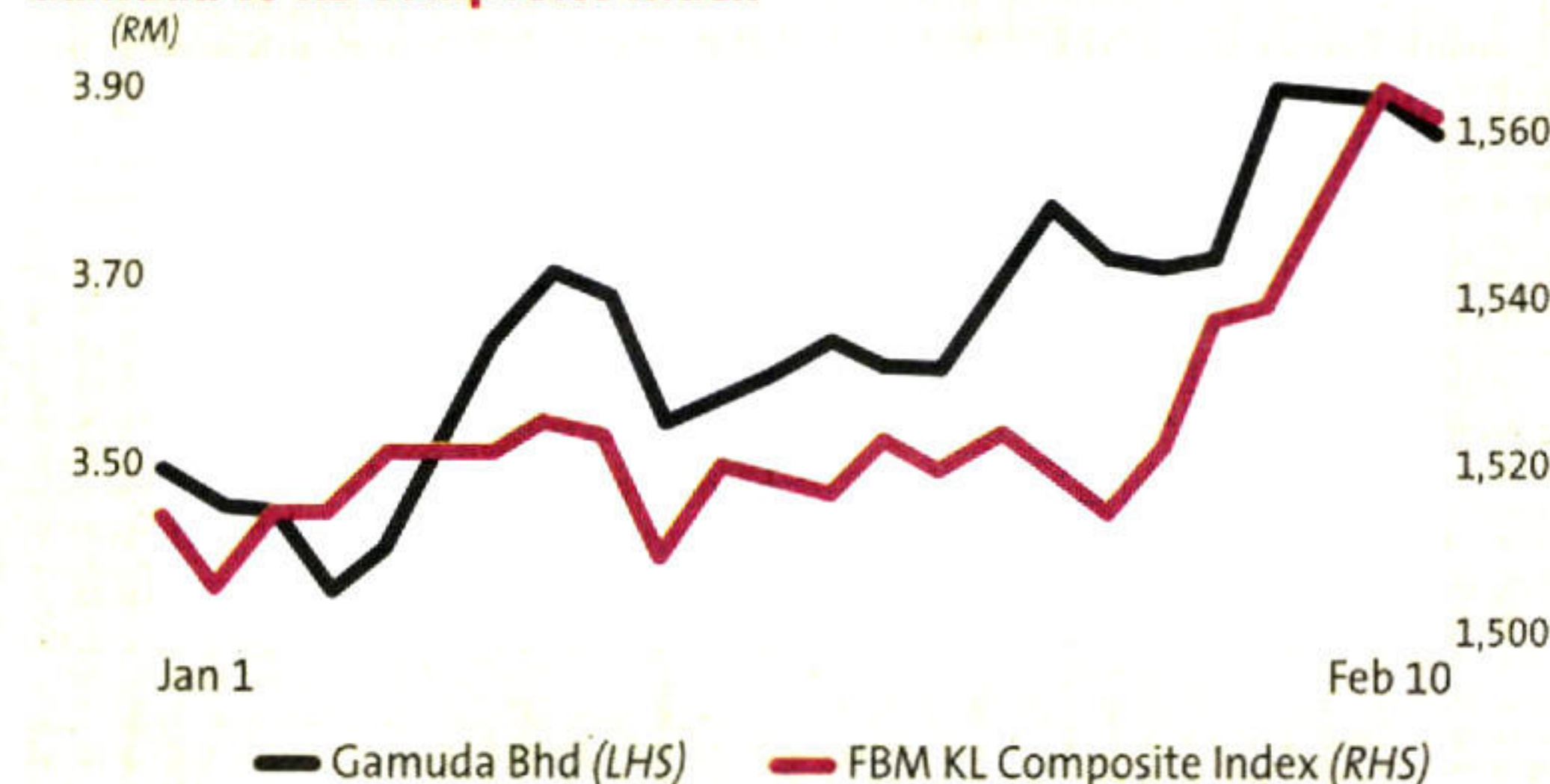
Gamuda lost four sen, or 1%, to RM3.85 yesterday, with 10 million shares changing hands.

On a YTD basis, Gamuda has outperformed its benchmark indices, gaining 11.46% against the KL Construction Index's 10.95% rise and the KL Composite Index's 3.27%.

Of course, Gamuda's Lin - who founded the construction and property concern in the 1970s - would like to keep the tunnelling contract local.

"For the underground works, we will only do RM3bil (ourselves), out

Gamuda vs KL Composite Index



STARGRAPHIC © 2012

of RM8bil," he says.

"The remaining RM5bil is outsourced to the local supply chain. There are 300 SMEs (small-to-medium enterprises) following us, if we get the tunnelling portion.

"If the foreign contractor gets (the contract), he will bring in his supply chain, because he doesn't know the fabricators and contractors here. The multiplier effect in the country, if we were to get it, would be five to six times, according to analysts. If it is given to a foreigner, the effect (on the local economy) will be less than two times."

Lin is not alone in thinking this. Maybank Kim Eng says in a report: "The start of works for the MRT project by mid-2012 will have positive spin-offs for the building material industry and the economy at large - more so if the entire construction work goes to the locals."

The brokerage estimates a multiplier impact of 6.8 times on the domestic economy should a local player snag the tunnelling works.

This means that every RM1bil output could translate into almost RM7bil worth of spin-offs to the economy. Put another way, based

on a contract sum of RM8bil for the tunnelling, an additional RM54.4bil worth of economic activity could be generated.

"We expect the Government, who has the final say, to strike a balance between 'cost effectiveness' and the 'economic spin-offs'. The latter is an important consideration as the global economy heads to another slowdown," it says.

Economic impact

"Awarding the project to locals should therefore optimise and maximise the internalisation of the economic benefits, whereas a foreign party will cut the multiplier effect due to leakages in the form of higher imports and outflows," Maybank Kim Eng explains.

CIMB Research has a more conservative projection of a two times multiplier effect.

"The emergence of four foreign contractors during the pre-qualification rounds of the 9.5km tunnelling works sparked concerns over the MMC-Gamuda JV's chances of bagging the project.

"However, we believe that pricing should not be the sole criterion for

the award. The other crucial one is the economic impact of the tunnelling works," it says in a note.

Credit Suisse also concurs that the Government's ramping up of infrastructure spending and fiscal stimulus would be especially crucial as Malaysia is the most vulnerable within Asia to economic weaknesses in the United States and eurozone.

"We understand that over 1,500 skilled jobs (out of which 45% is allocated for bumiputra) could be created if the tunnel work is undertaken by local contractors.

"More importantly, we believe that the project would provide training to some 500 skilled workers and help groom local contractors to compete in international markets," the research house says.

But there is still a chance, however remote, that MMC-Gamuda may not win the project.

Maybank Kim Eng had acknowledged in a previous sector update that the Chinese contractor would pose the biggest challenge in terms of pricing due to their scale economies and cost advantage from China-made heavy equipment.

The other bidders for the MRT's tunnelling portion are, in fact, global heavy-hitters. China Railway was the first large Chinese enterprise to win a public tender to build a 50km highway in Europe.

Sinohydro is one the world's biggest hydroelectric companies, and it took part in the construction of the Bakun Dam. Taisei built Japan's first subway in 1927, and is working on 14km railway tunnel under the Bosphorus strait which will link the European and Asian sides of Istanbul, Turkey.

And Gadang's JV partner, Hyundai, is one of South Korea's foremost construction companies with projects spanning the world.