

Sunway Construction SCOG.KL SCGB MK

EQUITY: ENGINEERING & CONSTRUCTION

3Q21 resilient despite lockdowns

Earnings to likely improve with capacity ramp-up; lower TP to MYR1.90 on earnings cut

3Q21 in numbers: SunCon reported 3Q21 net income of MYR19mn, up 132% q-q but down 20% y-y. The quarter was affected by MCO 3.0, which halted construction activities in Malaysia until mid-Aug, post which construction activities were allowed to commence based on the percentage of fully vaccinated workers at site. Construction works are currently ongoing at full capacity.

Cashflow and orderbook: SunCon reported operating cash flows (OCF) of MYR154mn in 3Q21, vs a negative MYR76mn in 2Q21. 9M21 order-book replenishment stands at ~MYR796mn, which implies an outstanding orderbook of MYR4.7bn. Management maintains an order book target of MYR2bn for FY21F (we have a conservative target of MYR1.1bn). The company's tender-book stands at MYR8bn, of which 20% comes from overseas orders. *Recall* that auditors reclassified a large chunk of SunCon's wholesale fund holdings to non-current assets (investments in associates) due to lower effective stakes after the funds took in new contributors. As a result, the cash balance starting FY20 optically falls and the company appears to be in a net debt position on paper—however, note that in substance, the wholesale funds are liquid marketable securities and thus the company's balance sheet remains net-cash.

Earnings cuts: We cut FY21F/22F earnings by 17%/ 5% due to slower construction works in 3Q21, lower replenishment and rising steel bar prices, which we believe will likely affect precast margins. Our orderbook replenishment targets for FY21F/ 22F are lower at MYR1.1bn/ 1.8bn vs MYR2bn each earlier.

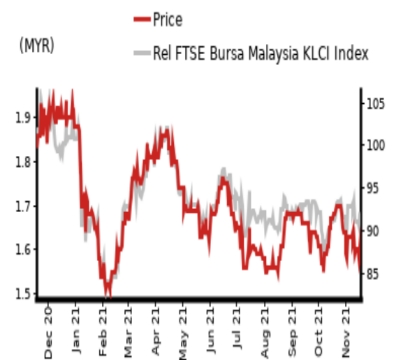
Reiterate Buy with revised TP of MYR1.90: We reiterate our Buy rating on SunCon as: 1) a visible pipeline of projects from the parentco and India should help in orderbook replenishment and earnings visibility; additionally, while the sentiment on Malaysia jobs is very pessimistic, we think government approvals of projects such as MRT3 can improve visibility; 2) we believe SunCon is the best pure-play exposure within our construction sector coverage universe in Malaysia, with strong earnings to cash flow conversion, a liquid balance sheet, and high ROE (FY21F/22F: 12%/ 18%); and 3) we expect its precast business to grow again with the opening of a new precast plant in Singapore. We value SunCon at an unchanged FY22F P/E of 20x (premium valuation for an asset light cash generative business) to arrive at our TP of MYR1.90, implying ~22% upside. The stock is currently trading at 16.6x FY22F EPS of 9.4sen.

Year-end 31 Dec	FY20		FY21F		FY22F		FY23F	
Currency (MYR)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	1,553	1,883	1,693	1,633	2,466	1,838	2,501	
Reported net profit (mn)	73	97	80	128	121	126	132	
Normalised net profit (mn)	73	97	80	128	121	126	132	
FD normalised EPS	5.65c	7.50c	6.21c	9.88c	9.38c	9.78c	10.19c	
FD norm. EPS growth (%)	-43.7	32.8	10.0	31.8	50.9	-1.1	8.7	
FD normalised P/E (x)	27.6	-	25.1	-	16.6	-	15.3	
EV/EBITDA (x)	15.8	-	16.8	-	11.6	-	10.5	
Price/book (x)	3.2	-	3.1	-	2.9	-	2.7	
Dividend yield (%)	2.6	-	2.8	-	4.2	-	4.6	
ROE (%)	11.6	14.9	12.4	18.5	17.9	17.3	18.2	
Net debt/equity (%)	15.8	39.2	38.5	32.2	38.6	27.5	32.5	

Source: Company data, Nomura estimates

Rating Remains	Buy
Target price Reduced from MYR 2.00	MYR 1.90
Closing price 18 November 2021	MYR 1.56
Implied upside	+21.8%
Market Cap (USD mn)	482.5
ADT (USD mn)	0.1

Relative performance chart



Source: Thomson Reuters, Nomura

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Key Data on Sunway Construction

Performance

(%)	1M	3M	12M		
Absolute (MYR)	-7.1	-1.3	-15.2	M cap (USDmn)	482.5
Absolute (USD)	-7.4	0.1	-17.1	Free float (%)	35.4
Rel to FTSE Bursa Malaysia KLCI Index	-2.1	-1.3	-10.3	3-mth ADT (USDmn)	0.1

Income statement (MYRmn)

Year-end 31 Dec	FY19	FY20	FY21F	FY22F	FY23F
Revenue	1,769	1,553	1,693	2,466	2,501
Cost of goods sold	-1,628	-1,462	-1,599	-2,315	-2,335
Gross profit	141	91	94	151	166
SG&A					
Employee share expense					
Operating profit	141	91	94	151	166
EBITDA	181	124	125	188	207
Depreciation	-40	-33	-32	-38	-41
Amortisation					
EBIT	141	91	94	151	166
Net interest expense	11	1	-5	-7	-7
Associates & JCEs	6	10	10	10	10
Other income					
Earnings before tax	158	102	99	154	169
Income tax	-27	-28	-18	-29	-32
Net profit after tax	131	74	81	125	137
Minority interests	-2	-1	-1	-4	-5
Other items					
Preferred dividends					
Normalised NPAT	129	73	80	121	132
Extraordinary items	0	0	0	0	0
Reported NPAT	129	73	80	121	132
Dividends	-90	-52	-56	-85	-92
Transfer to reserves	39	21	24	36	40

Valuations and ratios

Reported P/E (x)	15.6	27.6	25.1	16.6	15.3
Normalised P/E (x)	15.6	27.6	25.1	16.6	15.3
FD normalised P/E (x)	15.6	27.6	25.1	16.6	15.3
Dividend yield (%)	4.5	2.6	2.8	4.2	4.6
Price/cashflow (x)	10.4	22.9	-	22.9	12.7
Price/book (x)	3.2	3.2	3.1	2.9	2.7
EV/EBITDA (x)	8.6	15.8	16.8	11.6	10.5
EV/EBIT (x)	11.0	21.1	21.9	14.3	12.9
Gross margin (%)	8.0	5.8	5.5	6.1	6.6
EBITDA margin (%)	10.2	8.0	7.4	7.6	8.3
EBIT margin (%)	8.0	5.8	5.5	6.1	6.6
Net margin (%)	7.3	4.7	4.7	4.9	5.3
Effective tax rate (%)	17.1	27.4	17.9	18.7	18.8
Dividend payout (%)	69.8	70.9	70.0	70.0	70.0
ROE (%)	21.3	11.6	12.4	17.9	18.2
ROA (pretax %)	11.8	6.9	5.9	7.8	7.6
Growth (%)					
Revenue	-21.6	-12.2	9.0	45.6	1.4
EBITDA	-17.6	-31.6	1.1	50.3	9.6
Normalised EPS	-13.8	-43.7	10.0	50.9	8.7
Normalised FDEPS	-13.8	-43.7	10.0	50.9	8.7

Source: Company data, Nomura estimates

Cashflow statement (MYRmn)

Year-end 31 Dec	FY19	FY20	FY21F	FY22F	FY23F
EBITDA	181	124	125	188	207
Change in working capital	-24	-12	-126	-65	-9
Other operating cashflow	36	-25	-23	-36	-39
Cashflow from operations	194	88	-23	88	158
Capital expenditure	-8	-3	-65	-38	-41
Free cashflow	185	84	-88	50	117
Reduction in investments	-4	-441	-10	-10	-10
Net acquisitions					
Dec in other LT assets	1	-3	0	0	0
Inc in other LT liabilities	4	-101	0	0	0
Adjustments	2	115	10	10	10
CF after investing acts	188	-345	-88	50	117
Cash dividends	-91	-62	-64	-71	-89
Equity issue					
Debt issue	172	15	0	0	0
Convertible debt issue					
Others	-62	-100	0	0	0
CF from financial acts	19	-147	-63	-70	-88
Net cashflow	208	-493	-151	-20	29
Beginning cash	485	693	200	49	30
Ending cash	693	200	49	30	59
Ending net debt	-407	101	252	272	243

Balance sheet (MYRmn)

As at 31 Dec	FY19	FY20	FY21F	FY22F	FY23F
Cash & equivalents	693	200	49	30	59
Marketable securities					
Accounts receivable	847	905	987	1,437	1,457
Inventories	25	34	33	47	48
Other current assets	145	163	163	163	163
Total current assets	1,710	1,302	1,232	1,677	1,727
LT investments	49	489	499	509	520
Fixed assets	139	107	140	140	140
Goodwill	4	0	0	0	0
Other intangible assets	0	0	0	0	0
Other LT assets	4	7	7	7	7
Total assets	1,905	1,906	1,878	2,333	2,394
Short-term debt	233	234	234	234	235
Accounts payable	868	940	894	1,295	1,306
Other current liabilities	18	20	20	20	20
Total current liabilities	1,120	1,194	1,149	1,549	1,561
Long-term debt	53	67	67	67	67
Convertible debt					
Other LT liabilities	107	6	6	6	6
Total liabilities	1,280	1,267	1,222	1,623	1,634
Minority interest	2	2	2	6	12
Preferred stock					
Common stock	259	259	259	259	259
Retained earnings	399	410	427	477	520
Proposed dividends					
Other equity and reserves	-34	-31	-31	-31	-31
Total shareholders' equity	623	637	654	704	748
Total equity & liabilities	1,905	1,906	1,878	2,333	2,394

Liquidity (x)

Current ratio	1.53	1.09	1.07	1.08	1.11
Interest cover	-	-	18.5	22.3	23.7

Leverage

Net debt/EBITDA (x)	net cash	0.81	2.01	1.44	1.18
Net debt/equity (%)	net cash	15.8	38.5	38.6	32.5

Per share

Reported EPS (MYR)	10.02c	5.65c	6.21c	9.38c	10.19c
Norm EPS (MYR)	10.02c	5.65c	6.21c	9.38c	10.19c
FD norm EPS (MYR)	10.02c	5.65c	6.21c	9.38c	10.19c
BVPS (MYR)	0.48	0.49	0.51	0.54	0.58
DPS (MYR)	0.07	0.04	0.04	0.07	0.07

Activity (days)

Days receivable	182.0	206.5	203.9	179.4	211.2
Days inventory	6.2	7.4	7.6	6.3	7.4
Days payable	195.3	226.3	209.3	172.6	203.2
Cash cycle	-7.1	-12.4	2.2	13.1	15.4

Source: Company data, Nomura estimates

Company profile

Sunway Construction (SunCon) a pure-play construction company that provides a full range of integrated design and construction services including building, infrastructure, foundation and geotechnical engineering, mechanical, electrical and plumbing (MEP) services, manufacturing and sale of precast concrete products as well as sustainable energy services. It has presence in seven countries – Malaysia, Singapore, Philippines, UAE, Trinidad & Tobago and Myanmar. It has 2 precast plants in Malaysia and its Integrated Construction and Prefabrication Hub (ICPH) precast plant in Singapore will complete in 2022. SunCon's orderbook is also supported by its parentco Sunway Bhd (SWB MK, not rated).

Valuation Methodology

We value SunCon at a target P/E of 20x on FY22F earnings. Using net income of MYR121mn for FY22F and a target P/E of 20x, we arrive at our TP of MYR1.90. The benchmark index for the stock is FTSE Bursa Malaysia KLCI Index.

Risks that may impede the achievement of the target price

Downside risks include: 1) delays in construction project awards; 2) lower-than-expected margins; 3) lower pre-cast earnings persisting; 4) a lack of new projects; 5) risk of project cancellation or arbitration.

ESG

We ascribe a score of 3.0 (out of 5.0) for SunCon's Environment-related (E) achievements and risks due to the nature of construction business which leads to some environmental impact. That said, the company is moving towards adding renewal energy projects as part of its orderbook. We ascribe a score of 4.0 (out of 5.0) for SunCon's Social-related (S) achievements and risks. We ascribe a score of 4.5 (out of 5.0) for SunCon's Governance-related (G) achievements and risks. The company is well managed with good shareholder return policy and asset-light business model which enhances return on capital and has a high dividend payout ratio. It has good long-standing customer relationships with key Malaysian project owners in both the public and private sector, which is testament to its execution capabilities.

3Q21 results review

- 3Q21 was affected by movement restrictions which disrupted construction activities. In mid-Aug 2021, Malaysia allowed construction activities to commence under Phase 1 of the National Recovery Plan (NRP), based on the percentage of fully vaccinated workers, on a project-to-project basis. At that time, ~55% of SunCon's site workers were fully vaccinated; this has now increased to 100%. As a result, construction works have also ramped up since mid-Aug and are now ongoing at full capacity, as per management. As a result, we expect better earnings in 4Q21.
- SunCon received commencement permission for one of the highway jobs in India (Meensurutti Chidambaram project in Tamil Nadu) in Aug 2021 and expects works to start after the current monsoon season. Therefore, this project should contribute meaningfully to its earnings in FY22F and beyond, in our view. For its other highway job in India, land acquisition is currently only ~70% complete, as per management.
- Management maintains its orderbook target of MYR2bn for FY21F (NMR target: MYR1.1bn). We believe that given the fiscal constraints the Malaysian government faces, relying only on Malaysian mega-projects for orderbook replenishment is a risky strategy. As a result, we believe contractors like SunCon will likely have to commit to international diversification going forward. In 9M21, SunCon has secured new orders worth MYR796mn, which implies an outstanding orderbook of MYR4.7bn. Of the total MYR796mn replenishment, 60% was from internal projects, 3% from external projects in Malaysia and 37% from overseas projects. Tenderbook outstanding currently stands at MYR8bn, of which 20% is from overseas.
- Singapore pre-cast plant is expected to commence production by 2H22, and SunCon aims to build up its orderbook for this new plant's capacity utilization in 2021 itself.
- SunCon reported operating cash flows (OCF) of MYR154mn in 3Q21 vs negative OCF of MYR76mn in 2Q21.
- **Construction:** In 3Q21, construction revenue was down 27% q-q but PBT was up >100% q-q due to better margins from projects nearing completion.
- **Precast:** Division reported LBT of MYR2mn due to higher steel prices. In new precast contracts, management expects to factor-in the higher steel prices; as a result, its margins from the precast division will likely increase, in our view.

Fig. 1: SunCon – 9M21 results snapshot

MYR mn	9M21	NMR FY21F new	as % of NMR new	Cons FY21F	as % of cons
Revenue	1,103	1,693	65%	1,719	64%
Adj PBT	61	99	62%	103	60%
Adj NPATAMI	48	80	60%	78	62%
Reported NPATAMI	48	80	60%	78	62%

Source: Company data, Bloomberg consensus, Nomura estimates

Fig. 2: SunCon – 3Q21 results review

MYR mn	3Q21	3Q20	% chg y-y	2Q21	% chg q-q	9M21	9M20	% chg y-y	FY21F new	as % of FY21F new
Revenues	272	419	(35%)	375	(27%)	1,103	925	19%	1,693	65%
Construction	256	403	(37%)	349	(27%)	1,026	870	18%	1,595	64%
Precast concrete	16	16	2%	26	(38%)	76	55	38%	98	78%
Operating profit	22	33	(33%)	6	246%	55	52	6%	94	58%
Construction	24	32	(24%)	6	292%	53	52	1%		
Precast concrete	(2)	1	NM	0	NM	2	(1)	NM		
Adjusted Pretax profit	24	36	(32%)	10	157%	61	60	3%	99	62%
Construction	27	35	(23%)	10	182%	60	61	(2%)	96	63%
Precast concrete	(2)	1	NM	(0)	NM	1	(2)	NM	3	40%
Core PAT	20	24	(19%)	6	229%	46	43	6%	81	57%
Core PAT - equityholders	19	24	(20%)	8	132%	48	43	12%	80	60%
Other one-off charges	0	0	NM	0	NM	0	0	NM	0	NM
Headline NPAT - equityholders	19	24	(20%)	8	132%	48	43	12%	80	60%
Adj Pretax margins	9.0%	8.6%	0 ppt	2.5%	6 ppt	5.6%	6.4%	-1 ppt	5.8%	
Construction	10.5%	8.6%	2 ppt	2.7%	8 ppt	5.9%	7.0%	-1 ppt	6.0%	
Precast concrete	(14.9%)	7.5%	NM	(0.1%)	NM	1.6%	(2.8%)	NM	3.0%	

Source: Company data, Nomura estimates

Fig. 3: SunCon's outstanding orderbook

end-Mar'21

MYR mn	Contract Sum		Outstanding order book	
Infrastructure/Piling				
LRT3: Package GS07-08	2,178	1,295	1,589	295
Sentual West Station		57		16
Chan Sow Lin KVMRT UG St (MEP)		54		16
Jalan Tambun		14		14
Bangsar Rising - Piling		5		5
Building				
Putrajaya Parcel F		1,610		16
TNB HQ Campus		781		373
Petronas Leadership Center		305		104
Oxley Tower		68		51
IOI Mall		68		16
Renewable energy		29		16
India				
Thorapalli Agraharam - Jittandahalli		508		508
Meensurutti - Chidambarm 32km		315		310
Internal				
Sunway Medical Centre Phase 4 + VO		612		387
Sunway Serene - Serviced Residences		413		120
Velo 2		352		137
3C4		100		46
SMC IPOH		150		150
Carnival Mall Ext		286		81
SMC Seberang Jaya		180		90
SMC Seberang Jaya - VO		16		16
South Quay CP2 - Piling		198		87
SIS		121		92
SIS - VO		19		19
CP2		265		265
Belfield residential condo		403		374
Sunway Velocity TWO		253		239
Sunway resort hotel & Spa renovation		81		36
BKE (Seberang Jaya)		4		4
Big Box Office		51		47
SMC Damansara		240		238
Drainage works		1		1
Singapore				
Precast		331		206
External - New order 2021		298		298
Total		9,482		4,669
Orderbook burn rate (FY20, including internal)				2,057
Implied earnings visibility (years)				2.3

Source: Company data, Nomura research

Fig. 4: YTD 2021 orderbook replenishment

Project	Duration	Contract Sum (MYR mn)
Jalan Tambun	18 months	14
SMC Seberang Jaya - VO	6 months	16
SIS - VO	30 months	19
Big Box Office	14 months	51
Sunway Damansara Medical Centre	24 months	180
Bangsar Rising - Piling	6 months	5
SMC - IPOH	27 months	150
Tengah Park C2	23 months	114
Tengah C7	27 months	35
DD Plastic	3 months	0.4
Ang Mo Kio	27 months	36
Bidadari C15	27 months	36
Woodlands N9C4	27 months	63
Clementi N8C1	12 months	15
Sunway Damansara Medical Centre	24 months	60
Solar	various	1
Drainage works	3 months	1
Total		796

Source: Company data, Nomura research

Fig. 5: SunCon – changes to our estimates

MYR mn	Old			New			% change		
	FY21F	FY22F	FY23F	FY21F	FY22F	FY23F	FY21F	FY22F	FY23F
Orderbook replenishment	2,000	2,000	2,000	1,100	1,800	1,800	(45%)	(10%)	(10%)
External	800	1,000	1,000	200	800	800	(75%)	(20%)	(20%)
Internal	1,000	700	700	600	700	700	(40%)	0%	0%
Precast	200	300	300	300	300	300	50%	0%	0%
Revenue	1,883	1,633	1,838	1,693	2,466	2,501	(10%)	51%	36%
Adj PBT	121	161	162	99	154	169	(18%)	(4%)	4%
PBT margins	6.4%	9.9%	8.8%	5.8%	6.3%	6.7%	(0.6 ppt)	(3.6 ppt)	(2.1 ppt)
Adj NPAT	97	128	126	80	121	132	(17%)	(5%)	4%

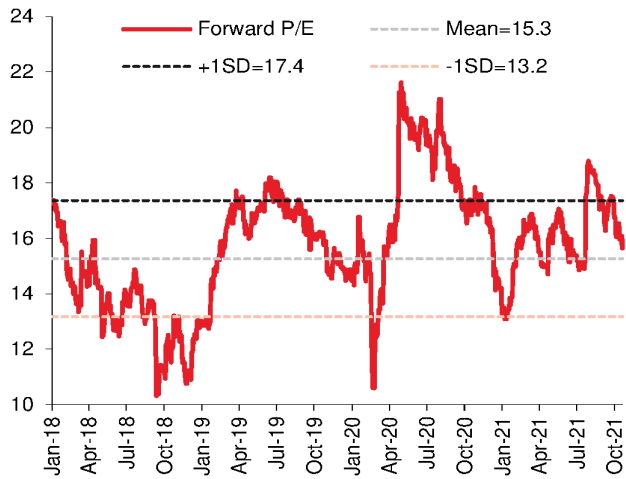
Source: Nomura estimates

Fig. 6: SunCon – Target price valuation methodology

	Dec-22
	FY22F
Normalised net profit (MYR mn)	121
FD number of shares outstanding (mn)	1,289
FD EPS (MYR/ sh)	0.09
Target FY22F P/E	20.0 x
Price target (MYR/ sh)	1.90

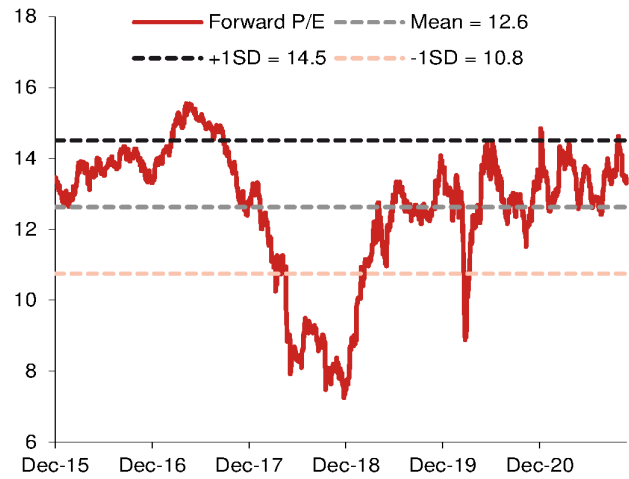
Source: Nomura estimates

Fig. 7: SunCon's forward P/E (consensus)



Source: Bloomberg consensus, Nomura research

Fig. 8: KLCON's 12M forward P/E - consensus



Source: Bloomberg consensus, Nomura research

Appendix A-1

Analyst Certification

I, Tushar Mohata, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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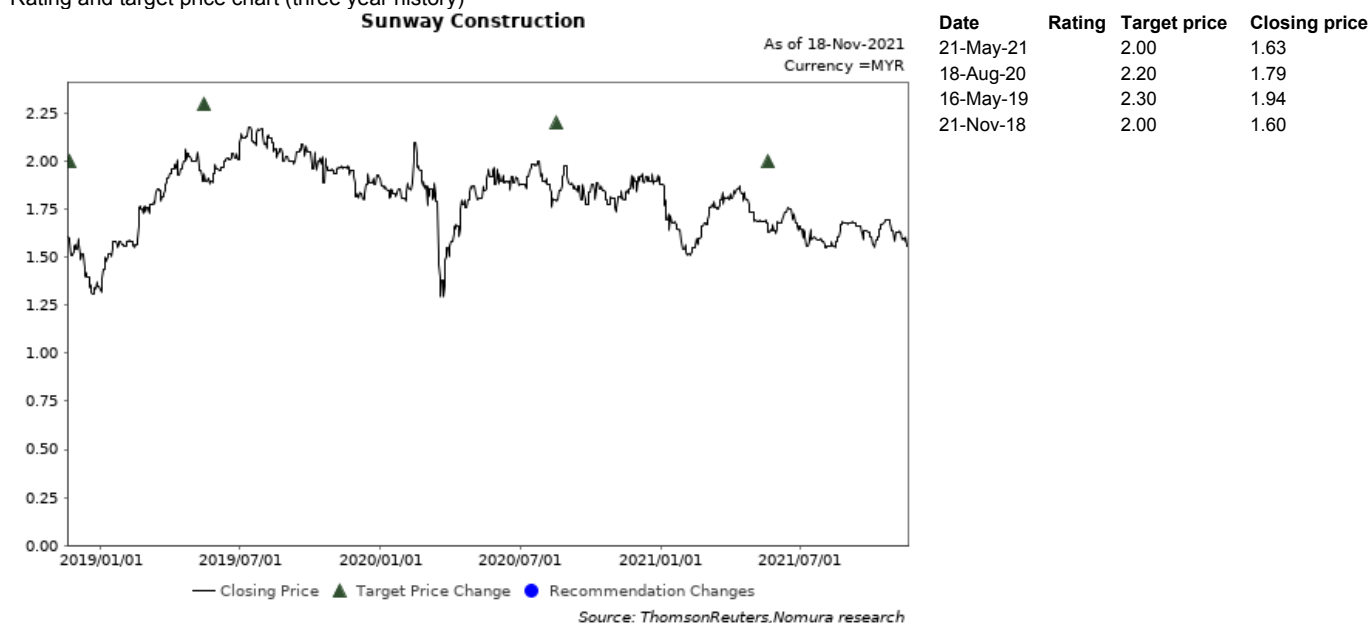
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Sunway Construction	SCGB MK	MYR 1.56	18-Nov-2021	Buy	N/A	

Sunway Construction (SCGB MK)

MYR 1.56 (18-Nov-2021) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

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 As at 30 September 2021.

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Definition of Nomura Group's equity research rating system and sectors

The rating system is a relative system, indicating expected performance against a specific benchmark identified for each individual stock, subject to limited management discretion. An analyst's target price is an assessment of the current intrinsic fair value of the stock based on an appropriate valuation methodology determined by the analyst. Valuation methodologies include, but are not limited to, discounted cash flow analysis, expected return on equity and multiple analysis. Analysts may also indicate expected absolute upside/downside relative to the stated target price, defined as (target price - current price)/current price.

STOCKS

A rating of **'Buy'**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of **'Neutral'**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of **'Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of **'Suspended'**, indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies. Securities and/or companies that are labelled as **'Not rated'** or shown as **'No rating'** are not in regular research coverage. Investors should not expect continuing or additional information from Nomura relating to such securities and/or companies. Benchmarks are as follows: **United States/Europe/Asia ex-Japan**: please see valuation methodologies for explanations of relevant benchmarks for stocks, which can be accessed at: <http://go.nomuranow.com/research/globalresearchportal/pages/disclosures/disclosures.aspx>; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia, unless otherwise stated in the valuation methodology; **Japan**: Russell/Nomura Large Cap.

SECTORS

A **'Bullish'** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months. A **'Neutral'** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months. A **'Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months. Sectors that are labelled as **'Not rated'** or shown as **'N/A'** are not assigned ratings. Benchmarks are as follows: **United States**: S&P 500; **Europe**: Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia. **Japan/Asia ex-Japan**: Sector ratings are not assigned.

Target Price

A Target Price, if discussed, indicates the analyst's forecast for the share price with a 12-month time horizon, reflecting in part the analyst's estimates for the company's earnings. The achievement of any target price may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

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