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## Resilient despite slowdown

**Sunway Construction (Suncon) has achieved its new contracts target of RM1.5bn in 2018 and expects to secure another RM1.5bn in 2019. It has submitted RM6bn worth of tenders for local and overseas projects. The construction sector outlook remains challenging, but Suncon's remaining order book of RM5.2bn provides good earnings visibility. Suncon remains our top sector BUY with a RM2.00 target price, based on a 10% discount to RNAV.**

### Revision in contract values

The government's review of public-sector projects will likely lead to a reduction in subcontract values and scope of works for Suncon's RM1.2bn Klang Valley MRT Line 2 (MRT2) and RM2.2bn LRT Line 3 (LRT3) projects. Suncon is looking to complete negotiations with the main contractors of the projects by end-2018 on the revised contract value and designs. We have assumed a reduction of 23% for the MRT2 and 30% for the LRT3 contracts (total reduction of RM0.9bn) in our EPS forecasts.

### Competitive in local contract bids

Suncon remains optimistic of its prospects to win new domestic contracts in 2019 despite the slower roll-out of government and private-sector projects. Its parent company, Sunway, continues to launch new property projects and expand its hospitals. "In-house" jobs are expected to contribute about 30% of the RM1.5bn new contract target in 2019. We gather that Suncon is the frontrunner for the RM0.7bn Tenaga headquarters re-development project as it currently undertaking the piling works at the site. It has also submitted tenders for government hospital projects (no opportunities previously as open tenders were not carried out by the previous administration) and will bid for the RM5.2bn Klang Valley Double-tracking packages.

### Return to international markets

Suncon has started pursuing overseas projects, especially in India and Southeast Asia given the slow domestic infrastructure project roll-out currently. The overseas project bids are mainly for highways and city railway projects, on which Suncon has extensive experience.

### Resilient pure play

We believe Suncon is more resilient than most of its peers as it is in a net cash position (RM0.25/share), has an asset-light model (not involved in the property business), integrated construction capabilities, and is competitive in open tenders with its excellent track record. We reiterate our BUY call with RM2.00 target price, based on a 10% discount to RNAV.

### Earnings & Valuation Summary

FYE 31 Dec	2016	2017	2018E	2019E	2020E
Revenue (RMm)	1,788.8	2,076.3	2,269.1	2,404.6	2,318.4
EBITDA (RMm)	184.1	200.0	221.3	229.4	237.8
Pretax profit (RMm)	153.7	174.2	192.7	200.6	208.0
Net profit (RMm)	123.5	137.8	146.3	152.3	158.0
EPS (sen)	9.6	10.7	11.3	11.8	12.2
PER (x)	15.2	13.6	12.8	12.3	11.9
Core net profit (RMm)	119.0	135.4	146.3	152.3	158.0
Core EPS (sen)	9.2	10.5	11.3	11.8	12.2
Core EPS growth (%)	(12.7)	13.9	8.0	4.1	3.7
Core PER (x)	15.8	13.8	12.8	12.3	11.9
Net DPS (sen)	5.0	7.0	7.0	7.0	8.0
Dividend Yield (%)	3.4	4.8	4.8	4.8	5.5
EV/EBITDA (x)	8.4	7.6	6.6	6.2	6.0
Chg in EPS (%)			(2.1)	(2.5)	(3.5)
Affin/Consensus (x)			1.0	1.0	0.9

Source: Company, Affin Hwang forecasts, Bloomberg

Affin Hwang Investment Bank Bhd (14389-U)

## Company Update

# Sunway Construction

SCGB MK  
Sector: Construction

**RM1.46 @ 11 December 2018**

**BUY (maintain)**

Upside 37%

**Price Target: RM2.00**

Previous Target: RM2.00



## Price Performance

	1M	3M	12M
Absolute	-11.0%	-18.5%	-39.8%
Rel to KLCI	-8.1%	-11.3%	-37.4%

## Stock Data

Issued shares (m)	1,292.2
Mkt cap (RMm)/(US\$m)	1873.8/447.9
Avg daily vol - 6mth (m)	1.0
52-wk range (RM)	1.3-2.64
Est free float	23.1%
BV per share (RM)	0.43
P/BV (x)	3.34
Net cash/ (debt) (RMm) (3Q18)	325
ROE (2018E)	25.6%
Derivatives	Nil
Shariah Compliant	Yes

## Key Shareholder

Sunway Bhd	54.4%
Sungei Way Corp	10.1%
EPF	7.4%
ASB	2.2%

Source: Affin Hwang, Bloomberg

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### Potential reduction in LRT3 and MRT2 contract values

The renegotiation of the LRT3 and MRT2 contracts could lead to reductions in the scope of works and contract values. Hence, we assume that Suncon's MRT2 and LRT3 contracts are reduced by 23% from RM1.21bn to RM0.93bn and 30% from RM2.18bn to RM1.53bn respectively in our earnings forecasts. These reduced contract amounts are based on the overall reduction percentages announced by the main contractors of MRT2 and LRT3.

The reduction in contract values could be lower than our assumptions as Suncon has completed a substantial portion of the works for the MRT2. But its LRT3 project is still at the early stage of implementation and hence there is still room to reduce the scope of works and contract value. Based on financial progress billings, its MRT2 and LRT3 projects are 57% and 7% complete respectively.

**Fig 1: Construction order book as at 30 September 2018**

Project	Completion	Contract value (RMm)	Outstanding value (RMm)
<b>Infrastructure</b>			
MRT V201 (Sg Buloh - Persiaran Dagang)	2Q21	1,213	527
BBCC Piling Works	4Q18	88	12
LRT3: Package GS07-08	2Q21	2,178	2,021
Others		87	14
Piling works	Various	75	64
		<b>3,641</b>	<b>2,638</b>
<b>Building</b>			
Putrajaya Parcel F	1Q19	1,610	287
KLCC (NEC + Package 2 & 2a)	2Q18	646	82
PPA1M project in Kota Bharu	1Q20	582	208
Nippon Express warehouse in Shah Alam	4Q19	70	68
Gas District Cooling (Plant 2)	3Q19	14	14
Others		487	39
		<b>3,409</b>	<b>698</b>
<b>Internal</b>			
Sunway Velocity Medical Centre	1Q19	185	67
Sunway Medical Centre 4 (2 towers)	4Q19	512	449
Sunway Iskandar - Emerald Residences	4Q18	175	6
Sunway Iskandar - Retail Complex/Big Box	4Q19	170	114
Sunway Serene - Serviced Residences	4Q20	449	351
Sunway GeoLake	1Q21	223	190
Carnival Mall Extension	4Q20	286	261
Sunway Medical Centre Seberang Jaya	4Q20	180	176
Velocity Ecodeck	4Q18	11	11
M&E works	4Q18	30	20
		<b>2,221</b>	<b>1,645</b>
<b>Singapore</b>			
Precast	Various	330	98
Precast – New orders in 2018	Various	130	128
<b>Grand total</b>		<b>9,731</b>	<b>5,207</b>

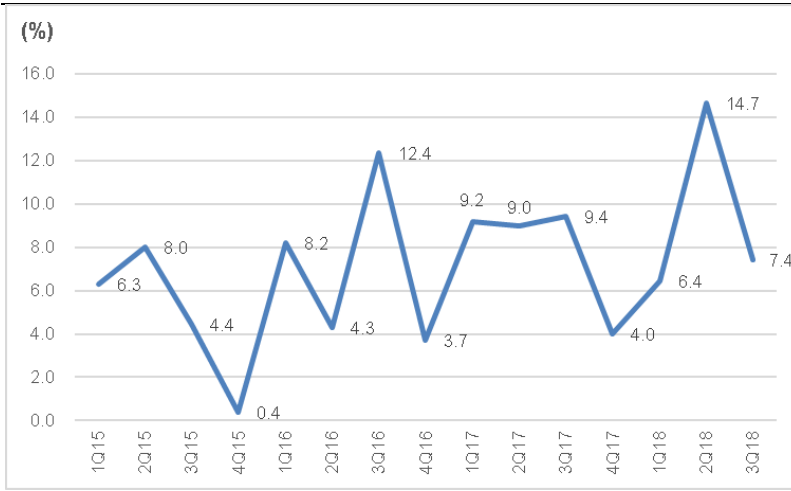
Source: Company

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**Lower building material prices**

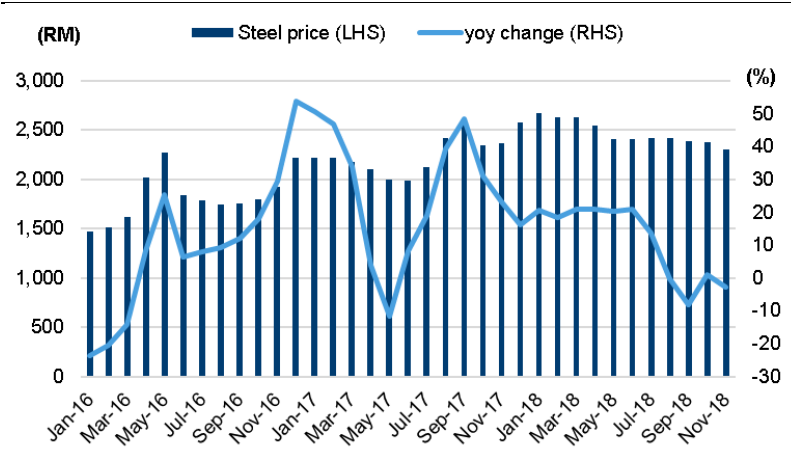
Profit margins are expected to be preserved for both projects as construction costs are reduced in line with the scope of works. Furthermore, the lower steel prices (fallen from a peak of RM2,800/t to RM2,200/t currently) currently will also reduce its costs going forward. The average price rebate for bulk cement has also increased from 31% in 2017 to 44% currently, reducing the cement cost.

**Fig 2: Construction PBT margin**



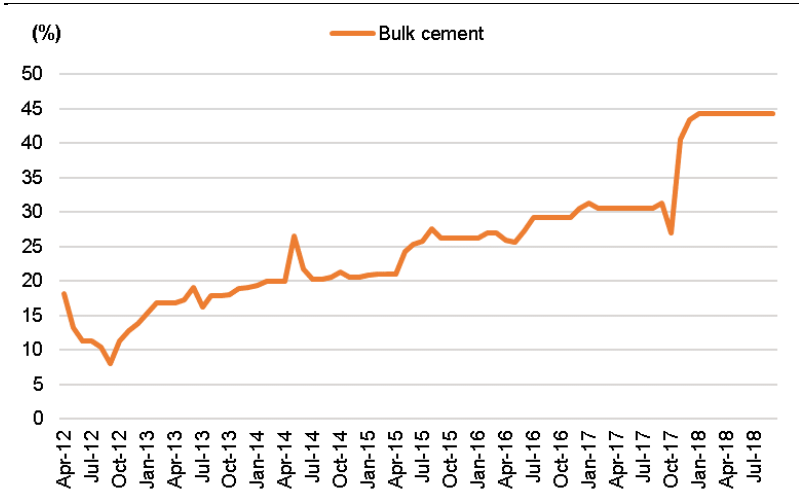
Source: Company

**Fig 3: Average steel price and yoy change**



Source: Company

Fig 4: Average price rebates for bulk cement



Source: Company

**Local and overseas projects pursued**

There are selective opportunities for Suncon to secure construction contracts for external private-sector property projects. This is in addition to works to be clinched from its parent company Sunway. We understand that Suncon is negotiating for piling works in Tun Razak Exchange and building projects in Kuala Lumpur City Centre. It has also submitted bids for infrastructure projects in India and Asean, given the slower domestic infrastructure project roll-out.

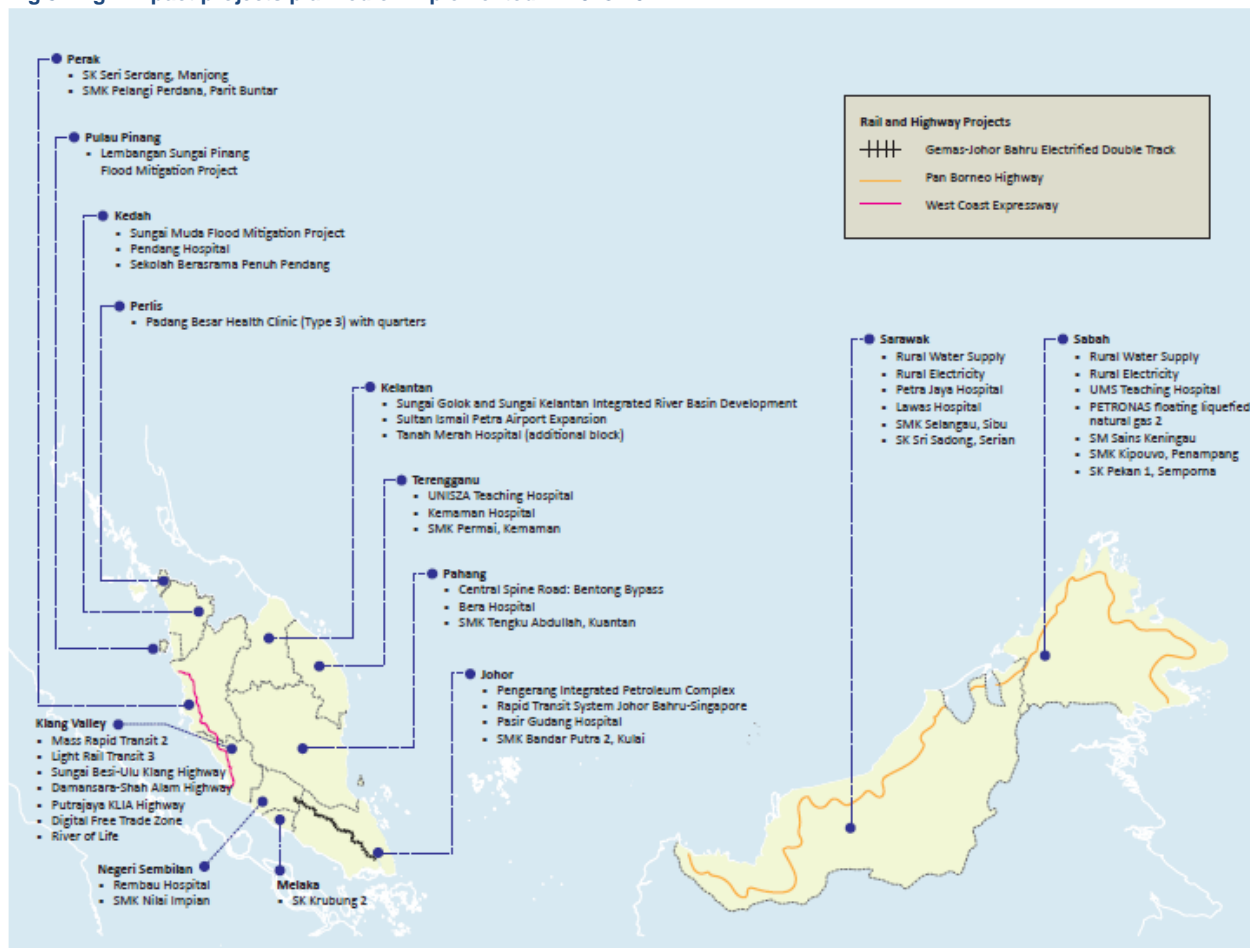
**Potential new government hospital projects**

Prospects for Suncon to win new government hospital projects are good given its extensive experience in hospital construction for the private sector. The Malaysian government has increased the allocation for healthcare spending by 8% yoy to RM29bn in Budget 2019. The allocation includes RM10.8bn to restore clinics and hospitals, as well as the purchase of medicine and medical equipment.

We believe Suncon is competitive for government hospital projects awarded through open tenders. There are new hospital projects to be built under the 11<sup>th</sup> Malaysia Plan. Before the general election, most of the government hospital projects were awarded by the previous government through direct negotiations with private companies. Suncon is also exploring potential affordable housing projects that involve land swaps in collaboration with Sunway. It is also bidding for renewable energy projects such as a solar farm construction with an estimated contract value of over RM100m, given its expertise in mechanical and electrical works.

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Fig 5: High-impact projects planned or implemented in 2018-20



Source: Economic Planning Unit

**Singapore investment**

Suncon has injected RM43.9m in 3Q18 into a 49%-owned joint venture (JV) with Hong Leong Asia Ltd) to build the Integrated Construction Precast Hub (ICPH) in Pulau Punggol Barat costing Suncon S\$80m over the 3-year construction period. We increase our investing cash outflow to reflect its investment in ICPH. We cut our core EPS forecasts by 2-3% in F18-20E to reflect the lower net cash balance and interest income post-investment. We see good long-term prospects for the JV given the sustained development of public housing by the Singapore government and strict rules requiring the use of precast concrete products.

**Premium valuation justified**

At CY19E PER of 12.3x, Suncon is currently trading at a premium to the weighted-average construction sector CY19E PER valuation of 10.7x. We believe this is justified as earnings risk for Suncon is relatively low, given it is a more pure construction play in our universe of construction-related stocks. Most peers are involved in other businesses such as property development, which is facing a prolonged market weakness.

Furthermore, Suncon is one of the few construction companies that is in a net cash position. Ex-cash CY19E PER of 10.2x (deducting net cash of RM325m as at 30 September 2018 from the current market capitalisation to derive PER) is below peer average whilst its CY19E ROE of 23.8% is

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higher than the peer average of 5.7%. Current net cash of RM325m or RM0.25/share comprises 17% of its market capitalisation. Suncon is our top construction sector pick with a RM2.00 target price, based on a 10% discount to RNAV.

Fig 6: Construction peer comparison

Company Name	Rating	Share Pr (RM)	TP (RM)	Upside (%)	Mkt Cap (RMb)	Year end	Core PE (x)		Core EPS growth (%)		BV/sh (RM)	P/BV (x)	ROE (%)		Div Yield (%)		RNAV/share
							CY18E	CY19E	CY18E	CY19E			CY18E	CY19E	CY18E	CY19E	
UJM CORP	HOLD	1.59	1.97	23.9	5.8	Mar	14.4	12.6	(4.2)	14.3	3.2	0.5	3.7	3.9	3.8	2.46	
GAMUDA	HOLD	2.33	2.70	15.9	5.8	Jul	8.6	9.3	2.5	(7.1)	3.1	0.8	9.7	8.3	5.2	3.86	
MRCB	BUY	0.64	0.90	41.7	2.8	Dec	64.7	26.3	(78.5)	146.0	1.1	0.6	0.9	2.2	2.8	2.01	
WCT	HOLD	0.68	0.92	36.3	0.9	Dec	5.9	5.7	20.7	4.0	2.3	0.3	4.8	4.8	4.4	1.85	
SUNWAY CONSTRUCTION	BUY	1.45	2.00	37.9	1.9	Dec	12.8	12.3	8.0	4.1	0.5	3.1	25.2	23.8	4.8	2.22	
GABUNGAN AQRS	BUY	0.80	1.64	105.0	0.4	Dec	6.1	4.4	83.6	39.5	0.8	1.0	18.9	18.5	3.8	2.35	
WZ SATU	SELL	0.18	0.14	(20.0)	0.1	Aug	(2.6)	9.5	436.5	(127.2)	0.4	0.5	(21.5)	5.1	1.0	0.17	
PINTARAS	HOLD	2.49	2.41	(3.2)	0.4	Jun	19.4	11.3	(10.5)	58.5	1.9	1.3	6.7	11.4	8.0	NA	
HSS ENGINEERING	BUY	0.84	1.18	40.5	0.4	Dec	17.8	16.4	1.6	8.5	0.6	1.4	7.9	8.3	2.8	NA	
<b>Average</b>					<b>18.4</b>		<b>11.8</b>	<b>10.7</b>	<b>(5.0)</b>	<b>12.0</b>	<b>1.0</b>	<b>1.0</b>	<b>4.6</b>	<b>5.7</b>	<b>4.1</b>		

Source: Company, Affin Hwang estimates

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Fig 7: RNAV and target price

Segments	Stake (%)	RNAV (RMm)
Construction @ PE 14x avg earnings of RM150m	100	2,100
Pre-cast concrete @ PE 14x avg earnings of RM30m	100	420
Net cash/(debt)		353
<b>RNAV</b>		<b>2,873</b>
No. of shares (m shrs)		1,293
<b>RNAV/share (RM)</b>		<b>2.22</b>
<b>Target price at 10% discount to RNAV/share</b>		<b>2.00</b>

Source: Affin Hwang estimates

### Key risks

Key downside risks are: (i) delays in the implementation of public infrastructure projects due to the new government's plan to review major projects; and (ii) slow progress billings for Singapore precast concrete supply contracts.

**Equity Rating Structure and Definitions**


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<b>BUY</b>	Total return is expected to exceed +10% over a 12-month period
<b>HOLD</b>	Total return is expected to be between -5% and +10% over a 12-month period
<b>SELL</b>	Total return is expected to be below -5% over a 12-month period
<b>NOT RATED</b>	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

*The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.*

<b>OVERWEIGHT</b>	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
<b>NEUTRAL</b>	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
<b>UNDERWEIGHT</b>	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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