SunCon

RM2.04 - BUY

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Malaysia
Infrastructure

Reuters	SCOG.KL
Bloomberg	SCGB MK

Priced on 17 May 2017
KLSE Comp @ 1,775.7

12M hi/lo RM2.10/1.51

12M price target RM2.55
±% potential +25%

Shares in issue 1,292.9m
Free float (est.) 45.6%

Market cap US$617m

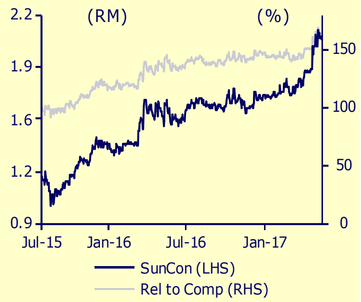
3M average daily volume
RM2.9m (US$0.6m)

Foreign s'holding 9.0%

Major shareholders
Sunway Berhad 54.4%
Sungei Way Corp Sdn Bhd 10.1%

Stock performance (%)

	1M	3M	12M
Absolute	10.9	15.3	22.2
Relative	8.3	10.8	12.4
Abs (US$)	13.1	18.7	13.8



Source: Bloomberg

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Initiating coverage

Into a higher gear

High ROEs meet an ascending order book

With ROEs at 26%, SunCon beats all local contractors and even regional peers on this metric, thanks to its pure-play and asset-light strategy. We initiate coverage with a BUY, as large job wins in recent years have boosted its order book (RM4.9bn) and cemented its credentials for future prospects to ride the wave of Malaysian infrastructure project roll-outs; yet it is trading at a valuation discount to IJM Corp and Gamuda Berhad. We think dividend yields may rise, given its strong cashflow generation. All told, we value SunCon at a PE of 16.7x based on 18CL at RM2.55, translating into a strong TSR of 29%.

Proxy to big-ticket projects reinforced by steady internal flows

SunCon has been a recipient of urban transportation projects, including reprising its role under Klang Valley Mass Rapid Transit (KVMRT) in line 2, and it stands in good stead to win future awards, with the most imminent likely to be the Light Rail Transit 3. We see order wins of RM2.2bn for 17CL. The uncertainty elements of timing or rollout of projects are mitigated by a slew of strategic projects from its parent, Sunway Berhad (30% of order book).

Lucrative pre-cast concrete business looking to expand further

Its lucrative pre-cast concrete business (38% of pre-tax profit) has seen its margins normalised to a still high 20.3% in 2016. Even then, this is still 3x more than what its construction segment rakes in. It intends to increase capacity by bidding for an integrated construction and prefabrication hub in Singapore, which will ensure that SunCon's long-term margins are preserved.

Net cash and excellent cashflow raise dividend prospects

SunCon's net cash position, lean capex needs and excellent free cashflows augment the prospect of higher dividend payouts. Already SunCon paid out 52% of profits in 2016, higher than the 42% the year before (minimum 35%). We think there is room to at least bring this ratio up to 60%, which will translate into stronger yields of closer to 4% from 2.5% currently.

We like SunCon as a better pure-play proxy; BUY

Rising order book and recovering margins (Ebitda margin now at 10% from 8% two years ago) should lead to strong 17CL earnings. We value SunCon at 16.7x, equivalent to 1sd above the mean three-year PE for local construction firms, which is justified by its enviable ROEs, good jobs visibility and excellent cashflows.

Financials

Year to 31 December	15A	16A	17CL	18CL	19CL
Revenue (RMm)	1,917	1,789	2,516	2,928	3,154
Net profit (RMm)	127	124	169	196	205
EPS (sen)	9.8	9.6	13.1	15.1	15.9
CL/consensus (10) (EPS%)	-	-	109	121	126
EPS growth (% YoY)	39.4	(2.9)	36.8	15.7	5.0
PE (x)	20.7	21.3	15.6	13.5	12.8
Dividend yield (%)	2.0	2.5	3.7	4.2	4.4
FCF yield (%)	7.3	2.1	5.7	6.7	6.2
PB (x)	5.8	5.3	4.7	4.0	3.6
ROE (%)	30.6	26.2	31.9	32.2	29.5
Net debt/equity (%)	(56.2)	(66.7)	(69.8)	(72.7)	(72.3)

Source: CLSA

For important disclosures please refer to page 19.

Into a higher gear

With growing credentials in large infrastructure projects, SunCon is a pure-play construction outfit which we see as a suitable proxy to the Malaysian construction industry. The reasons we urge investors to BUY SunCon are:

- **Big-ticket proxy reinforced by internal flows.** Not only does SunCon stake claim to Malaysia's major transportation projects, SunCon also benefits from around RM500m of projects from its parent, with RM450m secured to date for 17CL.

- **Lucrative pre-cast concrete segment to preserve margins.** Pre-cast concrete's segmental pre-tax margins have normalised to 20%, still 3x more than construction activities. Its move to bid for additional capacity in Singapore ensures longer-term earnings growth. Its ROEs remain among the strongest in the region.

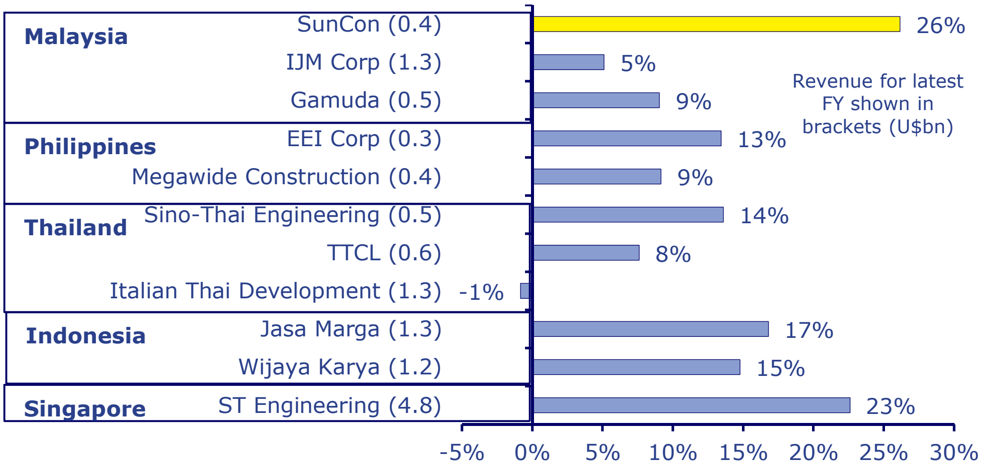
- **Enviable cashflow generation with prospects to up dividends.** SunCon's strong cashflow (negative cashflow conversion cycle for 2016) coupled with low capex requirements raises the prospect for increasing dividend payout. Already payout for 2016 was at 52%, nudged up from 42% a year before.

- **Trades at discount to local larger contractors.** For CY17, Sunway is currently trading at 15.6x versus Gamuda (19.4x) and IJM (19.1x), the traditional heavyweights.

Pure-play nature with ROEs well ahead of regional comparables

Figure 1

Comparison of ROE with regional peers – most profitable (latest financial year)



Source: CLSA, companies

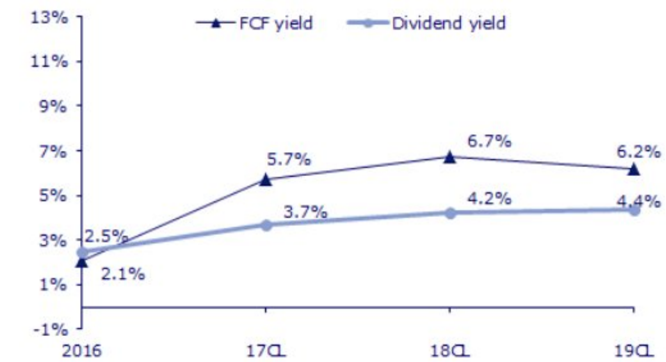
Figure 2

Order book on an ascent

Source: CLSA; order book for 2016 includes projects secured up to February 2017

Figure 3

We think better dividend payout is in store, after already increasing from 42% in 2014 to 52% in 2015



Source: CLSA

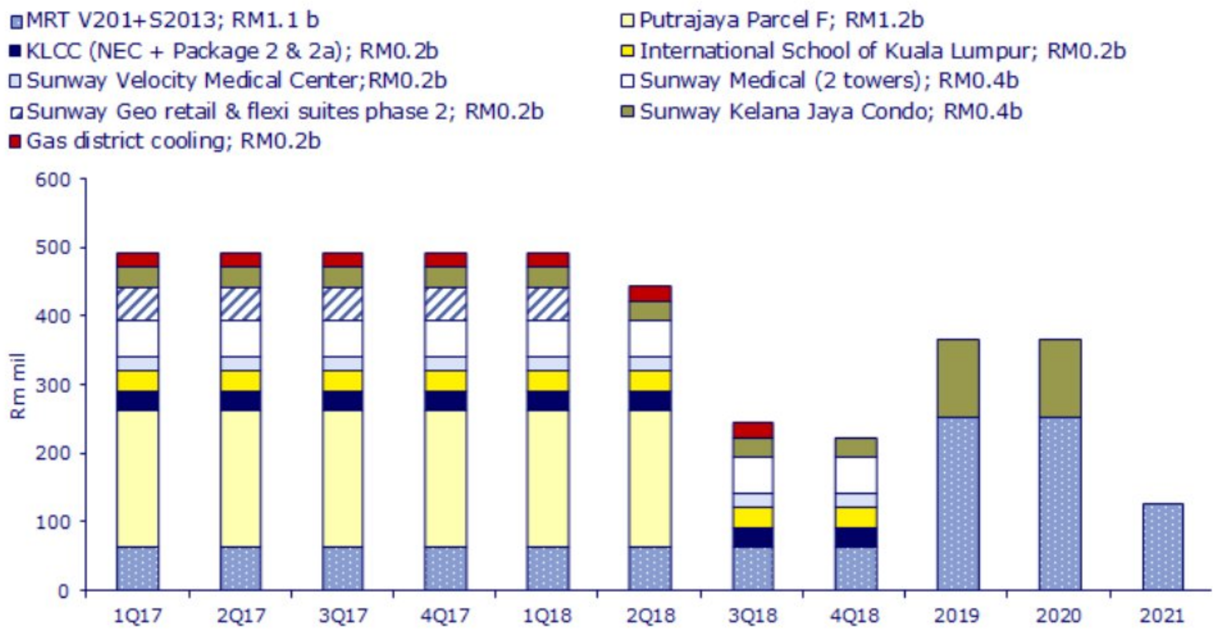
Focus is on the Malaysian construction business

Good proxy reinforced with internal flows

While SunCon had previous projects overseas in India and the UAE among others, its emphasis now for construction is chiefly in Malaysia where opportunities are still ample. A small 5% of its order book is in the pre-cast concrete product business sales mainly to Singapore. Unlike the larger IJM Corporation Berhad and Gamuda Berhad, SunCon does not have to contend with the still-tepid property sales. While SunCon has expressed some intention to expand to neighbouring countries, we understand that it is still in the exploratory stage.

Figure 4

Existing projects (with outstanding value of more than RM100m) plotted over its completion timeline



Source: CLSA, SunCon

KVMRT 2 and Putrajaya Parcel F currently dominates order book; the latter should plump up earnings

Two of its largest works on hand by value are building construction for Putrajaya Parcel F and the Klang Valley Mass Rapid Transit (KVMRT) Line 2 (package V201), with outstanding values of just over RM1.1bn each and combined 49% of its order book. The former project, awarded in September 2015, is its single-largest project won to date. In our view, this project could fetch above-average margins since it encompasses the design and construction and is tasked to complete ten blocks of government office buildings and one block of shared facilities in Precinct 1, Putrajaya.

Figure 5

Putrajaya Parcel F

Source: CLSA, Company

Figure 6

MRT Line 2 package V201

Source: CLSA, Company

Buffers believed to be better in KVMRT Line 2

KVMRT Line 2, which SunCon has reprised, is seen to contain better buffers compared to KVMRT Line 1. On a per KM basis, Sunway's work package (V201) which summed up to RM1.2bn is 35% higher on a per kilometre basis, which should nudge up margins or provide the buffer for unforeseen risks. Worthy to note that the construction work is arguably less challenging compared to Line 1 which spanned a more densely populated area.

Resolution of KVMRT Line 1 claims soon may bring about some upside

KVMRT Line 1, which SunCon successfully delivered in 2016, could potentially bring about some upside risks to earnings, as claims for acceleration of works which dented its overall margins for FY13 are being finalised. As a prudent measure, SunCon has not recognised any revenues on these claims for unforeseen work. As it has already taken on the cost, risks to earnings are to the upside and we expect that over the typical negotiation timeline, which may be up to a year. We have not factored this into our numbers.

Seen to be strong contender for imminent LRT3 rollout

Among imminent big-ticket project awards that SunCon should stand a high chance of securing is the Light Rail Transit (LRT) 3 project, for which it has been prequalified. Awards for system and depot works have already begun to roll out, the strongest indication yet that awards of major civil and construction parcels should flow through, estimated by July. The total value of the project is estimated at RM9bn. SunCon's involvement in the major urban transportation projects in the Klang Valley – namely the Bus Rapid Transit, KVRMT Line 1 and Line 2 – underpins its credentials for such an undertaking.

Figure 7

Details of LRT 3 project	
Overall distance	37 kilometers between Bandar Utama in Petaling Jaya to Johan Setia in Klang
Stations	31 (including 5 integrated stations)
Expected completion	2020
Park and ride facilities	10

Source: CLSA

Order book ascending - equivalent to 2.7 years of revenue with no shortage of future jobs

Subsequent to clinching RM2.6bn of jobs in 2016, SunCon has to date clinched RM635m, en route to its RM2bn target. SunCon's order book of an estimated RM4.9bn offers revenue visibility of 2.7 years. Further into the future, there remains a strong pipeline of headline-grabbing projects that SunCon will be eyeing. These include hospital expansion jobs from its parent, the east coast rail link (potentially piling and specialist work under its geotechnics division), and Gemas-Johor Southern double track project, and the Pan Borneo Highway (Sabah).

We bake in RM2.2bn of order book for 17CL which is the five-year historical average

With these, we think reprising RM2.2bn of jobs is within reach, particularly since it can also count on internally sourced jobs. For comparison, the average total job order wins for the past five years have been RM2.2bn annually, with only one of the years coming below RM1bn – underlining its solid job win track record.

Upper hand as an integrated construction provider for more complex undertakings

SunCon operates with an integrated business model which is an advantage. Aside from contracting for work externally, SunCon is able to reduce reliance on external subcontractors for its foundation, geotechnical engineering, mechanical and electrical engineering and plumbing (MEP) works, thereby retaining greater control in project delivery. Elsewhere, SunCon has also obtained the experience as a project delivery partner from its involvement for mall enhancement work for Sunway Putra Mall.

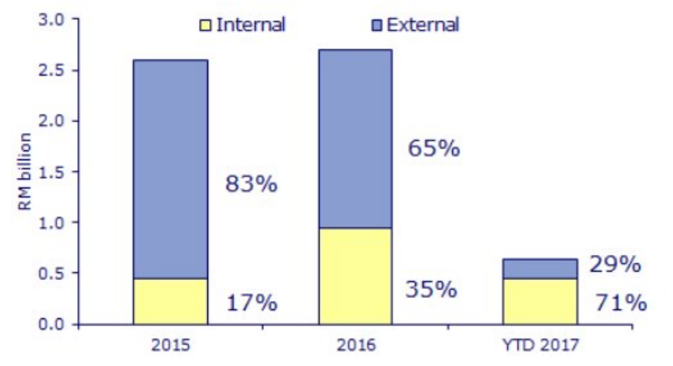
Can count on repeat clients, both internally and externally

30% of jobs are internal but contribute to about 40% of revenue

Revenues from internal jobs are a significant source for SunCon as they form about 40% of topline. We believe SunCon is able to achieve its intention of bagging at least RM500m worth of jobs (on average) a year from Sunway Berhad, or close to 25% of yearly job replenishment.

Figure 8

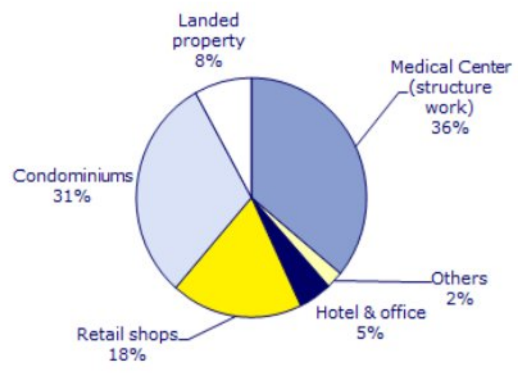
Breakdown of internal and external jobs secured



Source: CLSA

Figure 9

Internal work – nature of involvement in various townships/projects (2016)



Source: CLSA

Strategic projects of Sunway Berhad flow to SunCon

Internally, SunCon vies for projects under Sunway Berhad, its parent, where we believe it has a competitive advantage for projects of a strategic nature. Key township projects of Sunway Berhad, in Bandar Sunway, Sunway Velocity and Sunway Iskandar (Johor) had all led to SunCon's close involvement. Sunway Berhad continues to own 51% of SunCon subsequent to the latter's listing in 2015.

Sunway Berhad's growth plans include expansion in hospitals

Sunway Berhad's plans for its property business include RM5bn worth of property launches in the northern state of Penang slated over the next eight years, which presents itself as a funnel of potential jobs for SunCon, as would Sunway Berhad's intention to expand its healthcare facilities. This includes a private teaching hospital with more than 1,000 beds.

External repeat customers – track record and stringent requirement

Outside Sunway Berhad, SunCon also has other repeat customers under the umbrella of KLCC Group of companies and Putrajaya Holdings, to name a few. Repeat orders from these customers can be largely attributable to satisfactory delivery of work by SunCon in meeting their more stringent demands in terms of project monitoring and safety aspects.

Figure 10

Selected external repeat customers for SunCon

	Relationship	Number of projects	Value RM bn	Examples over the past few years
Putrajaya Holdings	> 10 years	8	>RM2.9bn	i) Putrajaya Parcel F (RM1.6bn)
KLCC Group of companies	> 10 years	5	>RM1.3bn	i) KLCC Package 2 (RM0.2bn) ii) KLCC North East Carpark (RM0.3bn)

Source: CLSA, SunCon

Figure 11

Outstanding order book for SunCon as at end-Dec 2016 and announced projects for 2017

a) Infra/Piling	Completion date	O/s work (RM mil)	Estimated margins	Description
MRT V201 + S201 (Sg Buloh - Persiaran Dagang)	2Q2021	1,141	5%	Complete the viaduct gateway and other associated works for a 4.9km stretch of the SSP's line elevated alignment from Sg Buloh to Serdang.
MRT V201 advance works	3Q2017	50	5%	Advanced work between Kampung Muhibbah and Serdang Raya 4 of MRT Line 2.
Others		16		
b) Johor				
Coastal Southern Link	1Q2017	31	5%	Proposed design, construction, testing and completion of the Coastal Highway Southern Link in Johor.
c) Building				
Putrajaya Parcel F	3Q2018	1,198	8%	Proposed design, construction and completion of government office buildings consisting of office towers, podium parking and external works for Parcel F, Precinct 1, Putrajaya.
KLCC (NEC + Package 2 & 2a)	4Q2018	231	8%	Construction of KLCC carpark. Includes excavation works, construction and installation of diaphragm wall, foundation and piling works and 6-levels basement carpark.
Hospital Universiti Kebangsaan Malaysia (MEP works)	2Q2018	66	8%	Supply, installation and maintenance of electrical services and air conditioning & mechanical ventilation system.
International school of Kuala Lumpur	2Q2018	242	8%	Main building works for the proposed development.
Others		8		
d) Internal				
Sunway Velocity Hotel + Office	1Q2017	51	6%	
Sunway Velocity Medical Center	4Q2018	154	7%	
Sunway Medical Center 3 (Sub & superstructure)	1Q2017	31	8%	
Sunway Medical Center 4 (2 towers)	4Q2018	401	8%	
Sunway Geo Retail Shops & Flexi Suites Phase 2	1Q2018	137	5%	
Sunway Iskandar - Emerald Residences	1Q2018	118	5%	
Sunway Iskandar - 88 units shoplots	1Q2018	57	5%	
Sunway Iskandar - Retail complex / Big box	4Q2017	100	5%	
others		55	5%	
Precast		245		
Total		**4,332**		
e) Secured in 2017				
Gas District Cooling (Plant 1)	3Q2018	152	8%	EPCC at Gas District Cooling Plant 1, Precinct 1, Putrajaya, involving chilled water supply system and power generation system.
Sunway Property - Kelana Jaya Condo	4Q2020	449	5%	Residential project with a total GDV of RM1.8bn is planned for a 17-acre plot of land in Kelana Jaya.
Suke highway - Bore Piling	2Q2018	18	6%	Subcontracted by Cergas Murni Sdn Bhd for bore piling
Dash highway - Bore Piling	1Q2018	16	6%	Subcontracted by Usahasama Monza-Latimer for bore piling
Total		**635**		

Source: CLSA

Expanding pre-cast will preserve margins

High margins business – with medium-term expansion plans

Despite making up 16% of revenues in 2016, its pre-cast concrete division contributed a substantial 38% of earnings, thanks to its high margins. It is not resting on its laurels, committing to increase its capacity for the medium term by expanding its capacity in Singapore (more below), where its market is predominantly. Pre-cast concrete products are sold to property developers in Singapore developers constructing Housing Development Board (HDB) flats, and this renders SunCon also a play on the housing industry in Singapore.

Fragmented but among larger players in Singapore

SunCon has a licence from Singapore's Building Construction Authority as a "L6" contractor, allowing it to bid for pre-cast concrete works of an unlimited value. According to Smith Zander, the pre-cast concrete component industry is fragmented with 43 industry players and SunCon has 3.2% of market share (info from 2013). Nevertheless, we gather that SunCon is ranked third, behind the top-2 largest players in Singapore in terms of volumes sold.

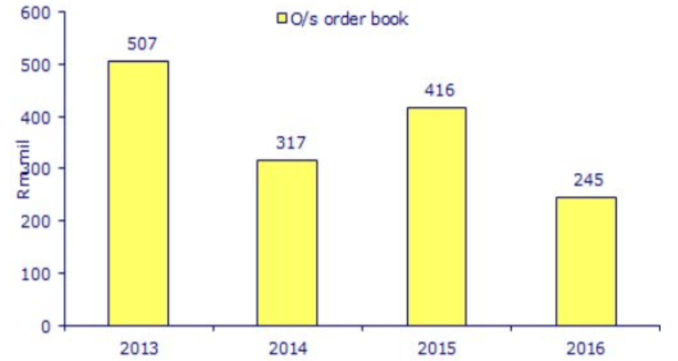
Figure 12

SunCon's sales on an increasing trend despite units under construction for industry mildly dipping in 2016

Source: CLSA, Suncon. Note: high margins in 2014 and 2015 were due to finalisation of accounts and effects of competition.

Figure 13

Order book and replenishment trend for SunCon's pre-cast concrete segment



Source: CLSA, SunCon

Topline Cagr of 9% from 2012 to 2016

Sales leapt 13% in 2016 to RM287m. Given the high base and the shifting of operations out of Singapore (anticipated lease expiry) to Johor this year, we project flat sales for 17CL before reverting to a longer-term Cagr of 9% (between 2012 and 2016) as our topline growth estimate. Shorter contract durations than construction projects is a norm and the outstanding order book for this business as at end-December 2016 was RM245m, equivalent to about one year of revenues. Replenishment for 2016 was lower YoY at RM115m (2015: RM317m) but the industry remains resilient with an expected 17,000 units of HDB built-to-order launches in 2017 (2015: 15,100 units; 2016: 17,891 units).

Not entirely dependent on HDB as sales to private residences have risen to about 15%

HDB made up 85% of total sales for 2016 and forms the lion's share of the market given requirements for using pre-cast materials. That said, sales to private residences have also increased to 15% in 2016 (below 5% in 2014); we understand only some components of private residences require pre-cast components and SunCon has also commenced pre-fabricated bathroom units which attracts better average selling prices.

Shifted manufacturing activities to Malaysia – won't hurt margins

After the end of its lease for its plant in Tampines (Singapore), SunCon has increased its Iskandar plant capacity by another four lines to increase capacity to more than 90,000 m^3. Although the transport costs are higher given the need to serve Singapore clients from Iskandar, this is offset by lower rentals (for its Iskandar plant). We understand that the Iskandar and Senai plants are running at around 60% utilisation which equates to having room to ramp up sales.

Figure 14

SunCon's existing plants

	Max capacity (m3)	Remarks
Iskandar	90,000	4 lines added to 5 which increases capacity from 52,000 after Tampines plant closed in April 2017
Senai	76,000	To undergo mechanisation to lift production capacity in 2017

Source: CLSA, SunCon

Could explore more Malaysian based orders – even in-house projects

Having operations in Malaysia, in our opinion, is timely in fulfilling potential orders for Malaysian jobs. Boost to demand may stem from industry-driven push towards greater adoption of industrialised building systems (IBS), reportedly with the intention to make IBS techniques compulsory by 2018. Meanwhile, some of the opportunity to supply pre-cast components could also stem from its parent's Sunway Iskandar developments - so far we note one of its projects is using pre-cast components from SunCon.

20% pre-tax margins in 2016 seen as normalised

Broad margins due to demand in Singapore, normalised to a still-strong 20%

Serving the Singapore market fetches healthy margins for SunCon, as regulations dictate IBS components need to be used for construction of HDB, in contrast to Malaysia where such demand is smaller. In 2016, margins fell from 31% previously to 20.3%. While the decline is steep, we understand that this in essence this is a timing issue, with profits booked upon finalisation of projects which amplified margins in 2015. Thus, the 20% margin recorded in 2016 is to be read as a more steady-state margin. All told, the precast concrete business commands margins that are still 3x better than construction.

Less asset-intensive profits – aids SunCon's high ROEs

We have a favourable view on this business. Compared to its construction division, its return on asset (pre-tax profit over division assets) of 26% is superior to the construction segment's 7%. Growth in this segment would be helpful in preserving SunCon's high ROEs.

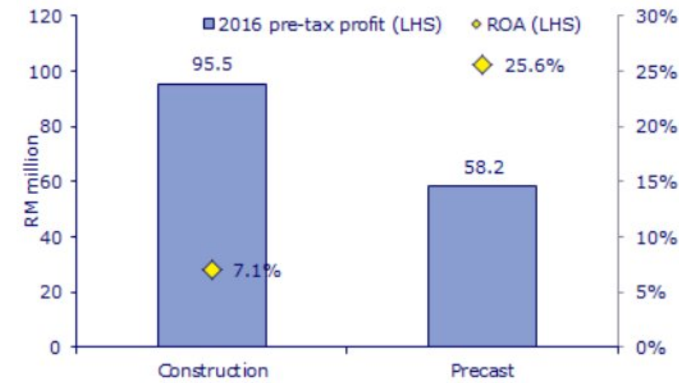
Figure 15

Pre-tax profit margins for its pre-cast business still much broader than construction

Source: CLSA

Figure 16

Asset-light business - return on assets of per-cast business versus construction for 2016



Source: CLSA, SunCon

Propelling future growth via bid for ICPH

Securing Singapore's Integrated Construction and Prefabrication hub - could double capacity

SunCon intends to bag one of the remaining six ICPH tenders in Singapore. This will enable its capacity to expand by an estimated >100,000 m^3 which will cater to its medium-term growth needs. We think SunCon's long operating track record in Singapore (since 1994) and being among the larger players in Singapore should stand it in good stead for this win. Nevertheless, benefits will accrue only in the future.

4 ICPHs have been awarded – gunning for 1 of remaining 6

Singapore's Building and Construction Authority intends to have ten ICPHs by 2020. Aimed at reducing manpower, ICPHs are complexes where building components can be assembled in a factory environment, typically equipped with storage and retrieval facilities that can be automated. Winners of the earlier four tender awards include SEF Group (2013), Straits Construction (2014) and Soil Build Pte Ltd (2015).

Outlay needs to be reduced by entering into a JV

Should SunCon be successful, we understand that there is likely to be a long-term 30-year lease, with capital expenditure for the three-year construction of the facility. To lighten the initial outlay, SunCon has shared that they could explore a joint venture.

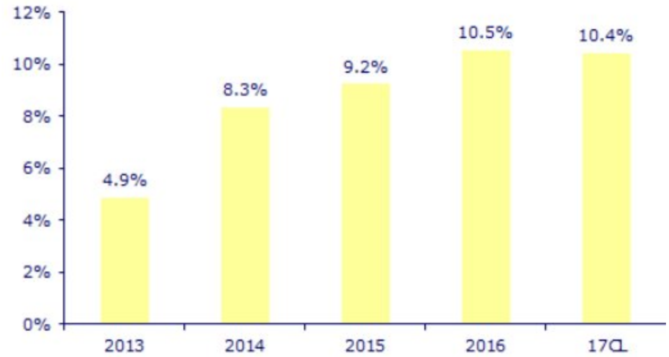
Ebitda margin to stay above 10% with earnings for 17CL expected to jump

Enviable financials with net cash position

SunCon's margins have been on the rise, with its Ebitda margin now having risen past 10%. On the back of the growing order book coupled with rebounded margins, we expect 17CL to bring about strong EPS growth of 36%. On an ROE basis, SunCon is still superior to local peers, given its asset-light setup requires very minimal debts.

Figure 17

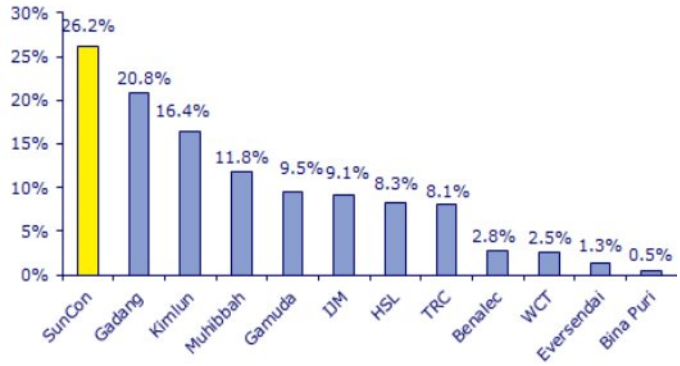
Ebitda margin for SunCon



Source: CLSA

Figure 18

ROE comparison with local construction peers

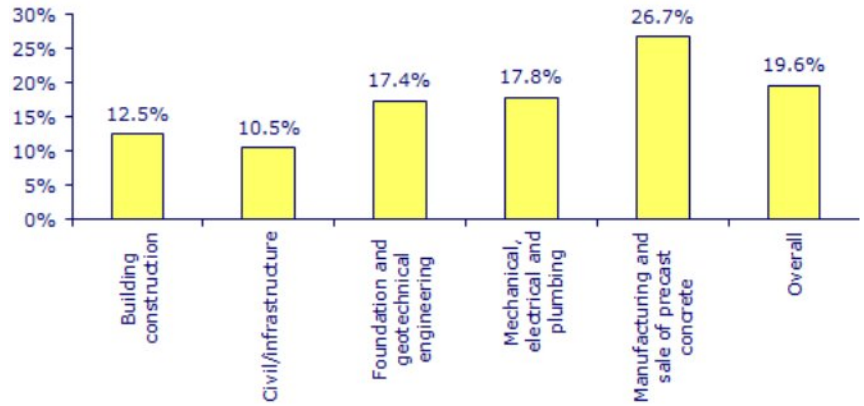


Source: CLSA

Historically pre-cast concrete and foundation and geotechnical engineering have highest profitability

Figure 19

Gross profit margins for various divisions (average of 2012 to 2014)



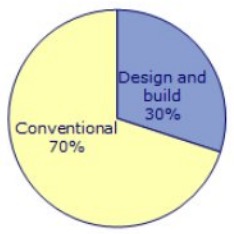
Source: CLSA, SunCon's IPO prospectus

Prefers specialty buildings and design-and-build projects

SunCon's strength in being able to take on a project from the design stage also is a plus to margins. Instead of run-of-the-mill residential buildings, it prefers specialty buildings and design-and-build projects. Traditionally, its exposure to foundation and geotechnical engineering as well as mechanical, electrical and plumbing is a kicker to margins, with both garnering gross profit margins of 17.4% and 17.8%, respectively (average for 2012-2014).

Figure 20

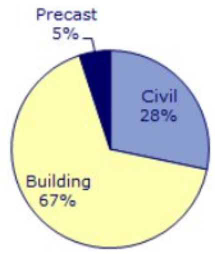
Breakdown between design and build versus conventional



Source: CLSA

Figure 21

Breakdown of jobs by segment



Source: CLSA

Six-month hedging in steel prices – somewhat mitigates the risk of steel-price fluctuations

While the price of rebar steel have risen about 25% in the past half year to RM2,177/mt (as at March 2017), SunCon is partially mitigated from existing contracts by locking in steel requirements six months in advance or when prices are favourable; SunCon has hedged its requirements for the first half of 2017. Meanwhile, it is effectively insulated from steel-price fluctuations in its involvement in the large MRT project given a pass-through clause in its contract. Elsewhere, the direct impact of imposition of foreign worker levy of RM1,850 on its 576 foreign workers (end-Dec 2016) will add up to a small RM1.1m, or equivalent to 1% of bottomline for 17CL.

Efficient cash management - conversion cycle hard to top

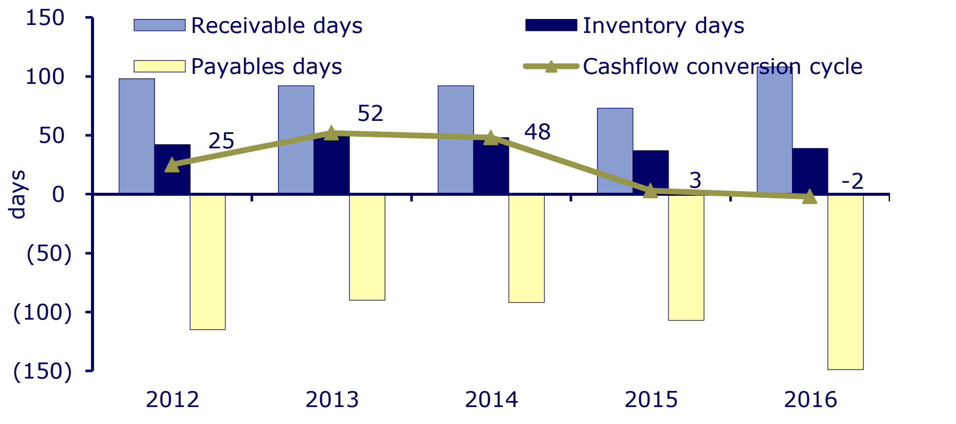
Negative cashflow conversion cycle for 2016

Cashflow management is paramount to companies. Although lumpy cashflow could sometimes distort analysis, over the past few years SunCon has improved in its cash conversion cycle, from 52 days in 2013 to even recording a negative cashflow conversion cycle in 2016. Unlike contractors with property development, SunCon does not hold property inventory. Its low inventory comprises mainly construction raw materials and spares.

Cash conversion cycle is strong – negative territory in 2016

Figure 22

SunCon's cash conversion cycle trend



Source: CLSA, SunCon. Receivable days increased in 2016 due to one project which is structured with a bullet repayment.

GLCs proof timely paymasters – part of its strategy

One of SunCon's strategies is to welcome jobs from government-linked entities. We understand that these counterparties have been timely paymasters with no difficulties in cashflow collection, notwithstanding possibly perception to the contrary. In terms of counterparty for its outstanding orderbook, 58% is from public entities, 11% private and 31% to Sunway Group.

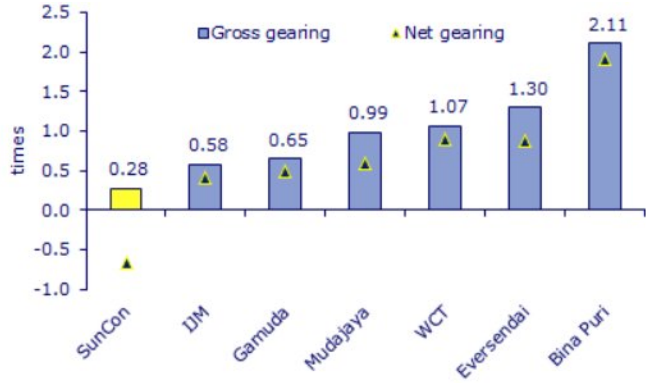
Net debt and cash pile could support better dividend payout

Net cash and low gearing even at gross level

Suncon has been in a net cash position (cash is 30% of total assets). Even on a gross gearing basis, it is among the more conservative in its peer group (at 0.28x), with its borrowings all in the short-term variety. Coupled with its strong free cashflow generation (average of RM160m over the next three years), its ability to pay dividends is strong.

Figure 23

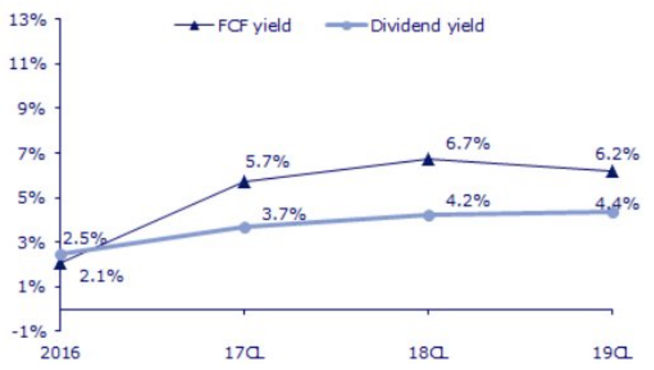
Gearing and net gearing level versus selected peers



Source: CLSA

Figure 24

Free cashflow yield versus dividend yield



Source: CLSA

Dividend payout ratio has increased in 2016, and should have room to increase

While its dividend policy is to pay out a minimum of 35% of its net profits, SunCon has upped the ante in 2016, paying out 52% of its net profits (2015: 42%). We believe that a stronger dividend payout ratio is not wishful thinking given its strong accumulation and small borrowings need (all in short-term borrowings). For now we think that its dividend payout ratio would increase to 60%. From a yields perspective, SunCon yields a modest 4%, which still checks in ahead of peers (weighted average of 2.2%).

Trades at discount to larger, more diversified, IJM and Gamuda

We like SunCon as a cheaper proxy

Given Suncon's growing track record of complex undertakings, we opine that the competency to secure jobs versus the larger IJM and Gamuda would be narrowing and we urge investors to BUY SunCon as a less expensive proxy to the Malaysian construction sector. For CY17, Sunway is currently trading at 15.6x versus Gamuda (19.4x) and IJM (19.1x).

Figure 25

Peer comparison: Gamuda's forward PE

Source: CLSA

Figure 26

Peer comparison: IJM's forward PE

Source: CLSA

Valuing SunCon at +1 sd above 3-year mean sector PB

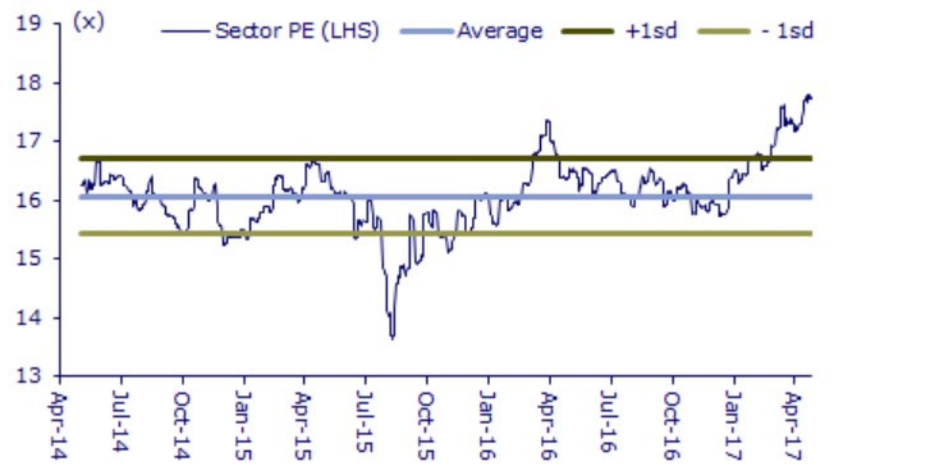
Valuing SunCon at 1sd above sector average

We value SunCon by applying a multiple on 18CL's profit. Given its superior ROEs and safety of strong cashflow generation against low debt, a premium to sector average is warranted in our view, where we value SunCon at 1.67x, equivalent to 1sd above sector 3-year mean PB. We think that premium to mid-sized peers is justified due to its far stronger ROEs, steadiness in securing order book (with steady mix of internal and external jobs) and strong cashflow generation. This is also still lower than the 3-year mean PB of Gamuda and IJM of 17.3x and 17.9x, respectively.

Mean of 16.1x for sector average

Figure 27

Three-year forward PE for selected Malaysian construction companies (weighted by market cap)



Source: CLSA

Figure 28

Valuation for SunCon

PE method of valuation	Remarks	Value (RM m)
Earnings (18CL)	16.7x, ie, PE multiple at 1sd above 3-year sector mean forward PE on 18CL earnings	195.9
Multiple applied		16.7x
Total		3,267
Number of shares (unit million)		1,292.2
Price per share (RM)		**2.55**
Current price (RM)		2.04
Upside		25%
yield		4%
TSR		**29%**

Source: CLSA

Cash pile makes up another 18% of market value

We value SunCon by applying a 16.7x multiple on 18CL's profit. Nevertheless, we have yet to factor in its hefty cash pile, which as at end-December 2016 made up 18% of its market value. This translates to an additional up to 35 cents per share.

Figure 29

Peer comparison

Company	Bbg	Price	Mkt cap	ADT	PE		EPS Growth		PB	
					CY17	CY18	CY17	CY18	CY17	CY18
		(RM)	(US$m)	(US$m)	(x)	(x)	(%)	(%)	(x)	(x)
Benalec	BHB MK	0.5	95.9	1.1	16.7	13.5	53.7	23.8		
Eversendai	EVSD MK	0.9	168.0	0.8	11.2	10.9	16.7	2.4	0.7	0.6
Bina Puri	BIN MK	0.4	26.5	0.1	7.3	7.3	20.0	0.0		
HSL	HSL MK	1.7	218.2	0.1	12.9	10.4	10.8	24.8	1.3	1.1
Kimlun	KICB MK	2.3	164.8	0.3	9.9	9.0	(7.2)	9.9	1.2	1.1
Mudajaya	MDJ MK	1.1	141.7	0.4	11.9	9.5		25.0	0.5	0.5
Muhibbah	MUHI MK	2.9	317.2	0.7	11.8	11.3	10.0	5.0	1.4	1.2
SunCon	SCGB MK	2.1	612.0	0.7	15.6	13.5	36.8	15.7	4.5	4.0
TRC	TRC MK	0.6	68.2	0.4	9.5	N.M.	38.3			
WCT	WCTHG MK	2.3	720.8	2.2	21.2	19.2	22.7	10.2	1.1	1.0
Gadang	GADG MK	1.3	196.4	1.9	9.5	8.4	3.1	14.1	1.5	1.2
IJM	IJM MK	3.4	2747.4	3.2	18.4	14.9	(2.0)	25.7	1.3	1.2
Gamuda	GAM MK	4.9	2670.4	4.0	17.6	18.9	2.3	(7.3)	1.5	1.4
Wgt avg					**16.9**	**15.8**	**5.8**	**9.4**	**1.5**	**1.4**
Wgt avg ex IJM & Gamuda					**15.3**	**13.6**	**17.1**	**10.6**	**1.8**	**1.6**

Source: CLSA, Bloomberg

Figure 30

Earnings and balance-sheet risk scores (lower the better)

	Score	Comments
Earnings-quality flags		
Capex indiscipline	1	Capex needs are manageable at a historical average of RM34m over the past three years
Cash burn	0	
Rising non-core or intangibles	0	
Rising working capital	1	Higher receivables due to bullet repayment in one of the projects where the cashflows are back-loaded in 2016.
Poor cash conversion	0	
Earnings-quality risk score (EQRS)	2	
Balance-sheet-quality flags		
Cash burn	0	
Excessive leverage	0	
Frequent fundraising	0	
Liquidity concerns	0	
Operational stress	0	
Balance-sheet-quality risk score (BQRS)	0	
Risk score proportion	40%	

Source: CLSA

Valuation details

We value SunCon using the price-earnings multiple approach. Its target price is derived from 16.7x 18CL earnings, which is based on 1sd above the 3-year construction sector mean forward PE ratio; this is still below the same ratio for heavyweights Gamuda and IJM, but above its mid-cap peers. We accord premium valuations over mean in our calculations to reflects its robust ROEs of more than 20%, strong cashflow generation backed by steady job orders from both internal and external sources. We further note that in our valuations, we have not incorporated benefit from its consistent net cash position.

Investment risks

The investment risks for SunCon mainly stem from construction risk. Specific risk to our estimates would be lower-than-expected margins (below 5-8%) or amount of projects secured falls below our expectation, either due to inability to secure projects or caused by delay on project roll-out. The increase in steel prices beyond anticipated will also creep into margins as SunCon hedges steel needs for a future 6-month period. On the pre-cast segment, risks to our earnings will be erosion of its currently-strong margins of 20% and/or the inability to retain customers due to the shift in its plant location (from Singapore to Malaysia) causing a slowdown in orders. SunCon is also susceptible to risk facing the construction industry in general, which includes the risk of disputes and ensuing lengthy negotiations which is not uncommon, not to mention the fluctuations in raw materials and availability of labour.

Company outline

The business

Sunway Construction, 54.4%-owned by Sunway Group, is the largest listed pure-play construction company in Malaysia with a market cap of RM2.45bn, providing a full-range of design and construction services, mechanical, electrical and plumbing services as well as supply and installation of pre-cast concrete products. The group has ventured overseas to India and Abu Dhabi.

Competition & market franchise

An integrated construction company, SunCon is one of the leaders in Malaysia's fragmented construction industry with over 38,000 registered contractors and dominated by small operators. It has a vast experience in infrastructure projects and a strong brand name in the construction industry, with repeat customers from several major Government construction projects. SunCon is also one of the largest precast concrete suppliers in Singapore.

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Summary financials

Year to 31 December	2015A	2016A	2017CL	2018CL	2019CL
Summary P&L forecast (RMm)					
Revenue	**1,917**	**1,789**	**2,516**	**2,928**	**3,154**
Op Ebitda	178	188	261	298	313
Op Ebit	136	149	204	237	247
Interest income	8	10	12	13	15
Interest expense	(4)	(6)	(5)	(5)	(5)
Other items	-	0	-	-	-
Profit before tax	**141**	**154**	**211**	**245**	**257**
Taxation	(13)	(30)	(42)	(49)	(51)
Minorities/Pref divs	(1)	0	0	0	0
Net profit	**127**	**124**	**169**	**196**	**205**
Summary cashflow forecast (RMm)					
Operating profit	**136**	**149**	**204**	**237**	**247**
Operating adjustments	(3)	(22)	0	0	0
Depreciation/amortisation	42	39	57	61	66
Working capital changes	65	(59)	(32)	(38)	(63)
Net interest/taxes/other	(8)	(33)	(48)	(54)	(57)
Net operating cashflow	**232**	**75**	**181**	**205**	**193**
Capital expenditure	(39)	(19)	(30)	(30)	(30)
Free cashflow	**193**	**56**	**151**	**175**	**163**
Acq/inv/disposals	40	13	-	-	-
Int, invt & associate div	(57)	89	12	13	15
Net investing cashflow	**(56)**	**83**	**(18)**	**(17)**	**(15)**
Increase in loans	2	0	-	-	-
Dividends	(70)	(84)	(97)	(110)	(116)
Net equity raised/other	0	-	0	0	0
Net financing cashflow	**(68)**	**(84)**	**(97)**	**(110)**	**(116)**
Incr/(decr) in net cash	**107**	**74**	**67**	**79**	**62**
Exch rate movements	5	2	0	0	0
Opening cash	**278**	**390**	**465**	**532**	**611**
Closing cash	**390**	**465**	**532**	**611**	**673**
Summary balance sheet forecast (RMm)					
Cash & equivalents	390	466	532	611	673
Debtors	579	732	841	979	1,054
Inventories	17	24	0	0	0
Other current assets	230	220	233	233	233
Fixed assets	162	138	112	81	45
Intangible assets	4	6	6	6	6
Other term assets	14	11	11	11	11
Total assets	**1,397**	**1,597**	**1,735**	**1,920**	**2,022**
Short-term debt	137	137	137	137	137
Creditors	796	955	1,032	1,131	1,144
Other current liabs	9	11	-	0	0
Long-term debt/CBs	-	-	-	-	-
Provisions/other LT liabs	4	1	1	1	1
Minorities/other equity	1	1	1	1	1
Shareholder funds	451	493	565	651	740
Total liabs & equity	**1,397**	**1,597**	**1,735**	**1,921**	**2,023**
Ratio analysis					
Revenue growth (% YoY)	1.9	(6.7)	40.6	16.4	7.7
Ebitda growth (% YoY)	10.2	5.7	38.6	14.2	4.9
Ebitda margin (%)	9.3	10.5	10.4	10.2	9.9
Net profit margin (%)	6.6	6.9	6.7	6.7	6.5
Dividend payout (%)	40.6	52.3	57.3	56.2	56.7
Effective tax rate (%)	9.2	19.5	20.0	20.0	20.0
Ebitda/net int exp (x)	-	-	-	-	-
Net debt/equity (%)	(56.2)	(66.7)	(69.8)	(72.7)	(72.3)
ROE (%)	30.6	26.2	31.9	32.2	29.5
ROIC (%)	59.1	65.5	97.4	108.6	103.2
EVA®/IC (%)	48.2	54.6	86.5	97.7	92.3

Source: CLSA

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SunCon (SCGB MK - RM2.04 - BUY)
Benalec (N-R)
Bina Puri (N-R)
Cergas Murni (N-R)
EEI (N-R)
Eversendai (N-R)
Gadang (N-R)
Gamuda (GAM MK - RM5.45 - SELL)
Hock Seng Lee (N-R)
IJM Corp (IJM MK - RM3.50 - UNDERPERFORM)
Italian Thai Development (N-R)
Jasa Marga (JSMR IJ - RP4,800 - BUY)
Kimlun (N-R)
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Latimer (N-R)
Megawide (MWIDE PM - P18.90 - BUY)
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