

18 February 2020

Construction & Engineering | Construction

Sunway Construction (SCGB MK)

Neutral (Maintained)

Prolonged Slowdown Softens Earnings; NEUTRAL

Target Price (Return): MYR1.95 (-4%)
 Price: MYR2.04
 Market Cap: USD636m
 Avg Daily Turnover (MYR/USD): 1.00m/0.24m

- Maintain NEUTRAL and MYR1.95 TP, 4% downside with c.4% FY20F yield.** Sunway Construction is eyeing a bigger replenishment target of MYR2bn for FY20, indicating optimism for the year ahead. Its share price has appreciated by 8.6% YTD, signalling strength. While the downside to our TP warrants a NEUTRAL call, the resumption of local mega projects present near-term re-rating opportunities. Our TP is derived after ascribing an ex-cash target P/E of 14x – in line with the larger-cap contractors.
- FY19 earnings likely weak.** SunCon reported a 10.9%YoY decline in 9M19 core profit, at MYR96.5m. We believe this was from mismatched expectations, whereby improved billings for construction were forecasted. The latter was left unrealised, due to low earnings of early-stage works and the persistent delay of the LRT3 project, with the quarterly progression only worth MYR65m. After imputing our 4Q19F core profit of MYR32.5m (-3% QoQ, -11% YoY), we believe FY19 earnings are likely to drop by 11.7%YoY.
- Our estimates now appear achievable.** Our FY19F revenue reflects a 18.9% YoY decline, and takes into account the prolonged slowdown in construction activities. The concern over the LRT3 project continues to hinge on execution, as the change in scope and structure has yet to be concluded. We believe the reduction in contract value could be proportioned to SunCon's initial scope, involving works from Bandar Utama to Johan Setia. With redesign works still ongoing, we believe that details on the final value remain sketchy. Based on our estimates, the downside risk points to a tentative c.2.5-3.1% loss in yearly earnings for every 10% value reduction.
- Existing orders should support our forecasts.** Based on the historical depletion rate, SunCon's MYR5.6bn in outstanding orders should last for at least two and half years. Prospects for new jobs look healthy, with support coming from recurring internal as well as external job flows. The company's active tenders now stand at c.MYR7.4bn, comprising bids for hospital, building and infrastructure projects. SunCon continues to compete outside of Malaysia as well, as it adjusts to trim home-bias risks. Its strategy includes securing mandates in India and Myanmar, which offer fresh contracts for infrastructure and mixed development jobs.
- Better year ahead for precast segment.** Precast orders make up less than 10% of SunCon's outstanding orders, which we translate to MYR150m-200m in annual topline. In our view, this could potentially engender encouraging mid-teens YoY growth, reversing the drop in FY18. That said, the blended utilisation rate is likely to recover to 50% in FY20, assuming that it wins contracts worth MYR200-300m in FY20.
- Key downside risks** include failure to secure new contracts, and prolonged downturns in the retail and property markets.

Analyst

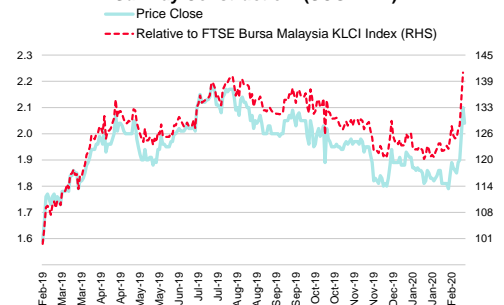
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	6.8	11.5	3.6	(1.5)	29.9
Relative	9.6	14.7	6.8	1.9	38.5
52-wk Price low/high (MYR)				1.59	– 2.18

Sunway Construction (SCGB MK)



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (MYRm)	2,076	2,257	1,830	2,388	2,655
Recurring net profit (MYRm)	132	146	129	161	181
Recurring net profit growth (%)	6.5	11.0	(11.5)	24.5	12.2
Recurring P/E (x)	20.04	18.06	20.40	16.38	14.60
P/B (x)	4.9	4.5	4.1	3.8	3.4
P/CF (x)	41.98	13.94	76.72	18.68	12.83
Dividend Yield (%)	3.4	3.4	3.0	3.8	4.2
EV/EBITDA (x)	11.80	10.40	11.78	9.55	8.37
Return on average equity (%)	25.7	25.5	21.0	24.0	24.6
Net debt to equity (%)	(64.8)	(62.7)	(42.1)	(36.5)	(38.3)

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Malaysia	Recurring EPS	0.10	0.11	0.10	0.12	0.14
Construction & Engineering	DPS	0.07	0.07	0.06	0.08	0.09
Sunway Construction	BVPS	0.42	0.46	0.49	0.54	0.60
SCGB MK	Return on average equity (%)	25.7	25.5	21.0	24.0	24.6
Neutral						
	Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Valuation basis	Recurring P/E (x)	20.04	18.06	20.40	16.38	14.60
Ex-cash target P/E of 14x.	P/B (x)	4.9	4.5	4.1	3.8	3.4
	FCF Yield (%)	0.3	5.0	(0.8)	3.3	5.7
Key drivers	Dividend Yield (%)	3.4	3.4	3.0	3.8	4.2
Sunway Construction's earnings are backed by:	EV/EBITDA (x)	11.80	10.40	11.78	9.55	8.37
i. An outstanding order backlog of MYR5.6bn, of which >90% is from construction, which may keep the firm busy for the next three years;	EV/EBIT (x)	14.43	12.63	15.07	11.91	10.42
ii. Recurring orders from its parent company.						
	Income statement (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Key risks	Total turnover	2,076	2,257	1,830	2,388	2,655
Upside risks include better-than-expected margins at the construction segment and new job wins coming in ahead of our estimates. Downside risks include possible cost overruns and higher material costs.	Gross profit	428	446	367	487	537
	EBITDA	194	214	197	245	275
	Depreciation and amortisation	(35)	(38)	(43)	(48)	(54)
	Operating profit	158	176	154	196	221
	Net interest	7	8	8	6	6
	Pre-tax profit	169	183	163	203	227
	Taxation	(36)	(38)	(33)	(42)	(47)
	Reported net profit	132	145	129	161	181
	Recurring net profit	132	146	129	161	181
Company Profile	Cash flow (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
SunCon is one of the largest construction companies in Malaysia. Apart from civil & infrastructure construction services, the company also provides the more specialised:	Change in working capital	(112)	(10)	(138)	(68)	(29)
i. Foundation & geotechnical engineering services;	Cash flow from operations	63	189	34	141	206
ii. Mechanical, electrical & plumbing services. In addition, it runs a highly profitable precast concrete product manufacturing operation in Malaysia and Singapore. Aside from fulfilling local requirements, it also largely supplies house concrete products for Housing & Development Board projects in Singapore.	Capex	(55)	(56)	(55)	(55)	(55)
	Cash flow from investing activities	35	(74)	(55)	(55)	(55)
	Dividends paid	(71)	(97)	(80)	(100)	(112)
	Cash flow from financing activities	(74)	(118)	(50)	(80)	(122)
	Cash at beginning of period	466	487	485	414	420
	Net change in cash	24	(3)	(71)	6	29
	Ending balance cash	487	485	414	420	449
	Balance sheet (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Total cash and equivalents	487	485	414	420	449
	Tangible fixed assets	150	163	175	182	183
	Total investments	0	45	45	45	45
	Total assets	1,810	1,754	1,666	1,958	2,122
	Short-term debt	135	114	144	164	154
	Total liabilities	1,266	1,162	1,024	1,255	1,350
	Total equity	544	593	642	703	772
	Total liabilities & equity	1,810	1,754	1,666	1,958	2,122
	Key metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Revenue growth (%)	16.1	8.7	(18.9)	30.5	11.2
	Recurrent EPS growth (%)	6.5	11.0	(11.5)	24.5	12.2
	Gross margin (%)	20.6	19.8	20.1	20.4	20.2
	Operating EBITDA margin (%)	9.3	9.5	10.8	10.2	10.3
	Net profit margin (%)	6.4	6.4	7.1	6.7	6.8
	Capex/sales (%)	2.6	2.5	3.0	2.3	2.1
	Interest cover (x)	26.0	21.2	26.6	28.4	30.9

Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2019-11-20	Neutral	1.95	1.97
2019-10-09	Neutral	2.03	1.95
2019-08-20	Neutral	2.09	2.05
2019-05-17	Neutral	2.12	1.90
2019-02-26	Buy	2.12	1.76
2019-02-14	Buy	2.12	1.55
2018-11-21	Buy	2.12	1.60
2018-11-02	Buy	2.00	1.61
2018-08-17	Buy	2.30	1.99

Source: RHB, Bloomberg

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