

20 November 2019

Construction & Engineering | Construction

## Sunway Construction (SCGB MK)

## Neutral (Maintained)

### Looking Past Near-Term Headwind; NEUTRAL

Target Price (Return)	MYR1.95 (-1.5%)
Price:	MYR1.98
Market Cap:	USD614.1m
Avg Daily Turnover (MYR/USD)	1.1m/0.3m

- **Maintain NEUTRAL, new MYR1.95 TP from MYR2.03**, 1.5% downside, 3.9% FY20F yield. 9M19 earnings fell short of expectations. Having secured MYR1.7bn worth of new contracts in FY19, Suncon is eyeing a larger orderbook replenishment target of MYR2bn, indicating optimism for the year ahead. Its share price remained relatively flat over the past two quarters, indicating downside risk to earnings is already priced in, hence our NEUTRAL. The resumption of mega infrastructure projects in Malaysia should also present near-term re-rating opportunities.

- **Dragged by lower construction billings.** 3Q19 revenue of MYR402.6m was down 8.5% QoQ and 28% YoY. 3Q19 core net profit came in at MYR34.4m (+2.7% QoQ, -6.4% YoY). This brings 9M19 core net profit to MYR96.5m, representing 71% of our forecast and 68% of Street's. The miss in earnings expectation was due to optimism as to the group's overall construction activities in the quarter. We understand that the decline in construction billings was due to several reasons – early stages of several ongoing projects, and persistent delays in the LRT 3 project, progressing only MYR65m in the quarter.

- **9M19 construction EBIT margin robust at 9.2%.** While 3Q19 construction revenue weakened to MYR365.1m (-10% QoQ, -30.3% YoY), EBIT margin continued to show improvement – up 0.1ppt QoQ to 9.2%. That said, despite 9M19 construction revenue and EBIT of MYR1.18bn and MYR108.3m declining 22.9% and 13.8% YoY, EBIT margin improved 1ppt to 9.2%.

For the precast concrete segment, 3Q19 revenue and EBIT recorded MYR37.5m (+10.7% QoQ, +12.7% YoY) and MYR0.8m (+5.1% QoQ, +>100% YoY) respectively. The improvements can be attributed to the lower contribution from previously secured lower-margin-projects, which are towards their tail end.

- **Minor tweak to earnings forecast.** We trim FY19F earnings by 6%, reflecting lower progress billings for certain construction projects. Nevertheless, our FY20F-21F net profit remain unchanged, as we take the view of a recovery in FY20F, premised on higher construction activities and contribution from the precast segment.

We also keep our FY19F-20F orderbook replenishment assumption of MYR1.8bn and MYR2bn. Nevertheless, our TP declines to MYR1.95 from MYR2.03 after imputing the 9M19 net cash figure. We value Suncon based on an ex-cash target P/E of 14x – in line with that of larger-cap contractors.

- **Key downside risks include** failure to secure new contracts, and prolonged downturns in the retail and property markets.

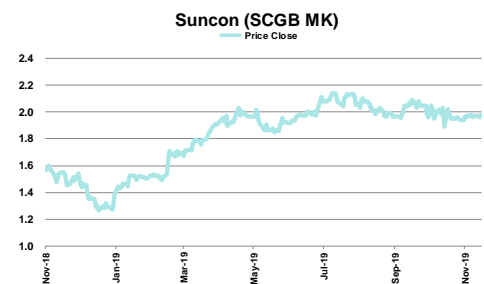
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	48.9	4.8	(2.0)	4.2	23.0
Relative	53.9	2.6	(2.5)	4.2	29.1
52-wk Price low/high (MYR)	1.30 – 2.20				



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
Net profit (MYRm)	132	146	129	158	177
Net profit growth (%)	6.5	11.0	(11.9)	23.2	11.4
Recurring EPS (MYR)	0.10	0.11	0.10	0.12	0.14
Recurring P/E (x)	19.2	17.3	19.6	15.9	14.3
P/B (x)	4.7	4.3	4.0	3.7	3.3
P/CF (x)	5.3	5.3	7.6	11.0	10.8
Dividend Yield (%)	3.6	3.6	3.2	3.9	4.3
EV/EBITDA (x)	14.8	13.6	14.2	10.7	9.4
ROAE (%)	25.5	25.8	20.9	23.6	24.1
Interest cover (x)	26.0	21.2	26.6	28.4	30.9

Source: Company data, RHB

## Financial Exhibits

Asia	Financial summary	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Malaysia	Recurring EPS (MYR)	0.10	0.11	0.10	0.12	0.14
Construction	DPS (MYR)	0.07	0.07	0.06	0.08	0.08
<b>Sunway Construction</b>	BVPS (MYR)	0.42	0.46	0.50	0.54	0.59
SCGB MK	ROE (%)	25.54	25.76	20.90	23.65	24.05

Valuation basis	Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
We value the company based on FY20F ex-cash P/E of 14x, in line with larger-cap construction stocks. Sunway Construction's net cash position allows it to gear up for more jobs moving forward.	Recurring P/E (x)	19.2	17.3	19.6	15.9	14.3
	P/B (x)	4.72	4.33	4.00	3.66	3.34
	FCF Yield (%)	0.32	5.20	(3.87)	(0.97)	4.80
	Dividend yield (%)	3.6	3.6	3.2	3.9	4.3
	EV/EBITDA (x)	14.8	13.6	14.2	10.7	9.4
	EV/EBIT (x)	18.4	16.7	18.0	13.5	12.1

Key drivers	Income statement (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Sunway Construction's earnings are backed by:	Total turnover	2076	2257	1830	2388	2655
i. An outstanding order backlog of MYR5.8bn, of which >90% is from construction, which may keep the firm busy for the next three years;	Gross profit	428	446	417	548	613
ii. Recurring orders from its parent company.	EBITDA (adj.)	196	216	195	249	284
	Depreciation & amortisation	(38)	(40)	(41)	(52)	(63)
	Operating profit	158	176	154	196	221
	Net interest	7	8	7	2	1
	Pre-tax profit	169	183	162	199	222
	Taxation	(36)	(38)	(33)	(41)	(46)
	Net profit	132	145	129	158	177
	Recurring net profit	132	146	129	158	177

Key risks	Cash flow (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
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.	Change in working capital	(112)	(10)	(162)	(73)	(36)
	Cash flow from operations	63	189	1	135	203
	Capex	(48)	(55)	(100)	(160)	(80)
	Cash flow from investing activities	35	(74)	(100)	(160)	(80)
	Dividends paid	(71)	(97)	(80)	(98)	(109)
	Cash flow from financing activities	(74)	(118)	(50)	(78)	(119)
	Cash at beginning of period	466	487	485	336	233
	Net change in cash	24	(3)	(149)	(103)	4
	Ending balance cash	487	485	336	233	237

Company Profile	Balance sheet (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Sunway Construction is one of the largest construction companies in Malaysia. Apart from civil & infrastructure construction services, the company also provides the more specialised:	Total cash and equivalents	487	485	360	260	264
i. Foundation & geotechnical engineering services;	Tangible fixed assets	150	163	226	334	351
ii. Mechanical, electrical & plumbing (MEP) services.	Total investments	0	45	45	45	45
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 hose concrete products for Housing & Development Board (HDB) projects in the island republic.	Total assets	1,810	1,754	1,579	1,865	2,020
	Short-term debt	135	114	144	164	154
	Total long-term debt	-	-	-	-	-
	Total liabilities	1,266	1,162	938	1,164	1,251
	Total equity	543	591	640	700	767
	Total liabilities & equity	1,810	1,754	1,579	1,865	2,020

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 (%)	7.1	9.4	(11.1)	23.2	11.4
Gross margin (%)	20.6	19.8	22.8	23.0	23.1
Operating EBITDA margin (%)	7.6	7.8	8.4	8.2	8.3
Net profit margin (%)	6.3	6.5	7.0	6.6	6.6
Capex/sales (%)	2.3	2.4	5.5	6.7	3.0
Interest cover (x)	26.0	21.2	26.6	28.4	30.9

Source: Company data, RHB

Figure 1: Suncon's results review

FYE Dec (MYRm)	3Q18	2Q19	3Q19	QoQ (%)	YoY (%)	9M18	9M19	YoY (%)	Comments
<b>Revenue</b>	<b>557.3</b>	<b>440.2</b>	<b>402.6</b>	<b>(8.5)</b>	<b>(27.8)</b>	<b>1,630.8</b>	<b>1,282.8</b>	<b>(21.3)</b>	Lower progress billings.
<b>EBIT</b>	<b>44.5</b>	<b>38.0</b>	<b>35.4</b>	<b>(6.7)</b>	<b>(20.4)</b>	<b>129.5</b>	<b>109.2</b>	<b>(15.7)</b>	
<i>EBIT margin (%)</i>	8.0	8.6	8.8			7.9	8.5		Improved construction margins.
Interest expense	(1.3)	(3.6)	(3.9)	9.7	209.8	(6.3)	(9.8)	56.7	
Interest income	3.9	7.2	5.1	(28.6)	31.8	12.5	16.5	31.7	
El/others	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	Impairments, FX, and write-offs.
<b>Pretax profit</b>	<b>47.1</b>	<b>41.2</b>	<b>35.6</b>	<b>(13.7)</b>	<b>(24.5)</b>	<b>135.8</b>	<b>116.9</b>	<b>(13.9)</b>	
<i>Pretax margin (%)</i>	8.5	9.4	8.8			8.3	9.1		
Tax	(10.4)	(8.2)	(2.5)	(69.2)	(75.7)	(27.6)	(19.3)	(30.2)	
<i>Effective tax rate (%)</i>	(22.1)	(20.0)	(7.1)			(20.3)	(16.5)		
Minority interest	0.1	0.2	0.3	0.0	0.0	0.0	0.0	0.0	
<b>Net profit</b>	<b>36.8</b>	<b>33.2</b>	<b>33.4</b>	<b>0.6</b>	<b>(9.2)</b>	<b>108.3</b>	<b>97.6</b>	<b>(9.9)</b>	
<b>Core profit</b>	<b>36.8</b>	<b>33.5</b>	<b>34.4</b>	<b>2.7</b>	<b>(6.4)</b>	<b>108.3</b>	<b>96.5</b>	<b>(10.9)</b>	Below estimate, at 71% of FY19F.
<i>Core net margin (%)</i>	6.6	7.6	8.5			6.6	7.5		

Source: Company data, RHB

Figure 2: Suncon's segmental results

FYE Dec (MYRm)	3Q18	2Q19	3Q19	QoQ (%)	YoY (%)	9M18	9M19	YoY (%)	Comments
<b>Revenue:</b>									
Construction	524.1	406.3	365.1	(10.1)	(30.3)	1,527.8	1,178.4	(22.9)	Majority of existing projects are at initial stages, and delay in LRT3 project.
Precast Concrete	33.3	33.9	37.5	10.7	12.7	103.1	104.4	1.3	Larger orderbook compared to previous quarter.
<b>EBIT:</b>									
Construction	46.5	36.9	33.6	(8.9)	(27.8)	125.6	108.3	(13.8)	
Precast Concrete	(2.0)	0.8	0.8	5.1	(140.5)	3.9	1.9	(51.4)	
<b>EBIT Margin %:</b>									
Construction	8.9%	9.1%	9.2%			8.2%	9.2%		9M19 margin improved 1ppt.
Precast Concrete	-6.0%	2.3%	2.2%			3.8%	1.8%		

Source: Company data, RHB

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