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Malaysia Infrastructure

Reuters SCOG.KL
Bloomberg SCGB MK

Priced on 5 October 2017

KLSE Comp @ 1,759.1

12M hi/lo RM2.36/1.59

12M price target RM2.80
±% potential +22%

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

Market cap US\$703m

3M average daily volume
RM3.7m (US\$0.9m)

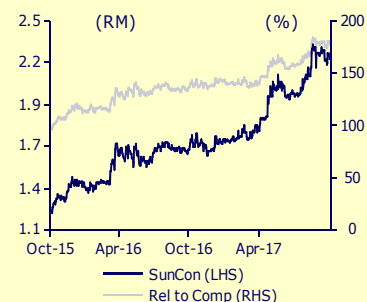
Foreign s'holding 9.0%

Major shareholders

Sunway Berhad 54.4%
Sungei Way Corp Sdn Bhd 10.1%

Stock performance (%)

	1M	3M	12M
Absolute	0.4	15.0	37.7
Relative	1.0	15.6	30.2
Abs (US\$)	1.5	16.9	34.4



Source: Bloomberg

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The rail deal

Largest-ever project of RM2.2 billion; guidance exceeded

SunCon has won a large RM2.2 billion award for Light Rail Transit Line 3 (LRT3), and the sheer magnitude that its RM2 billion job win guidance for 2017 has now been surpassed (YTD win of RM3.8 billion) should be convincingly positive. Propelling its order book to a lofty RM6.5 billion, this win not only enhances visibility as some projects complete in 2018, but also cements credentials for future prospects, namely the East Coast Rail Line (ECRL) and the High Speed Rail (HSR) where it may participate. This larger-than-expected award forms 17%/22% of EPS for 18CL/19CL and we slightly raise our TP to RM2.80 (from RM2.75) and stay Buyers.

Smashes SunCon's own job win guidance; extends visibility

A 3rd award by Prasarana in recent years, this package clinched by SunCon is its largest award ever, bringing the YTD job win tally to RM3.75 billion - ahead of its peers, and far exceeding SunCon's guidance and our expectation of RM2 billion and RM2.2 billion, respectively. Crucially, it extends visibility as several key projects, namely Putrajaya parcel F, Sunway Medical Center 4, KLCC and International School of Kuala Lumpur (combined estimated 38% of its order book previous to this win) would be completing by 2018.

Its 4th elevated rail job since 2011 lowers risk; slight margin trim

Credentials in rail projects, namely the LRT, mass and bus rapid transit (MRT & BRT) lines mitigate execution risk. Nevertheless, we bake in pretax margins of a slimmer 6% (8% expected previously) given the timeline (36 months), a well-populated area for construction and a cable-stayed bridge over a river (not SunCon's forte). On balance, the rise of steel prices (about 30% over the past 3 months) is manageable as it forms only a small portion of costs.

Likely to throw hat in the ring for ECRL and HSR

Guidance for 2018 has not been revealed but the ECRL and HSR could feed into the pipeline of rail-related jobs for SunCon over the next 18 months. In-house jobs to date sum up to RM453 million (12%), and we should be able to count on hospital jobs from its parent for padding up orders.

Maintain BUY. Mild nudge up of TP to RM2.80

Amid the better-than-expected job win, the ramp-up in earnings in 18CL shows its PE multiples will compress to 13.8x (peer average: 14.7x). Factoring in incremental profits from this award compared to our expectation raises our TP to RM2.80, which translates to a TSR of 25%.

Financials

Year to 31 December	15A	16A	17CL	18CL	19CL
Revenue (RMm)	1,917	1,789	2,380	3,304	3,488
Rev forecast change (%)	-	-	2.5	16.4	20.4
Net profit (RMm)	127	124	154	216	229
NP forecast change (%)	-	-	(1.9)	2.7	3.1
EPS (sen)	9.8	9.6	11.9	16.7	17.7
CL/consensus (12) (EPS%)	-	-	103	129	127
EPS growth (% YoY)	39.4	(2.9)	24.6	40.4	6.1
PE (x)	23.4	24.1	19.3	13.8	13.0
Dividend yield (%)	1.7	2.2	3.3	3.7	3.9
ROE (%)	30.6	26.2	29.5	35.8	32.2
Net debt/equity (%)	(56.2)	(66.7)	(65.0)	(72.9)	(70.4)

Source: CLSA

Largest ever job win; order book boosted to new heights

This award, package GS07-08 for LRT3, is SunCon's 4th rail-related award since 2011, following the clinching of parcels for MRT Line 1 (RM1.17 billion) in 2012, bus rapid transit (RM0.45 billion) in 2013, and more recently the MRT Line 2 for RM1.21 billion. Representing its largest job win ever, its outstanding order book is propelled to RM6.5 billion from RM4.7 billion previously. By source, external jobs dominated 88% of total wins to date. YTD, total job awards far exceeded its own guidance of RM2 billion and also beats ours of RM2.2 billion.

Figure 1

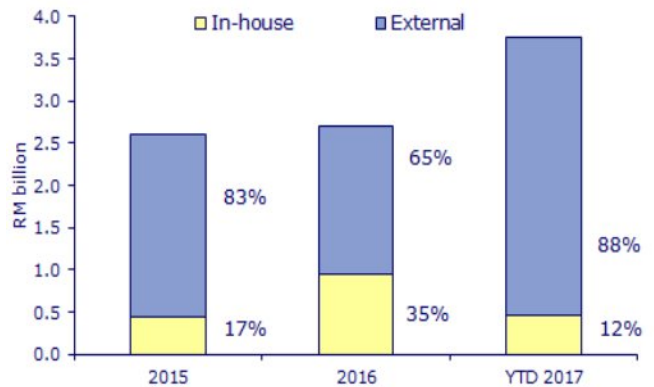
Outstanding order book and annual new jobs



Source: CLSA, SunCon

Figure 2

Split between in-house and external jobs wins



Source: CLSA, SunCon

Cable-stayed bridge a unique feature compared to previous undertakings;

SunCon is charged to complete 9.2 kilometers of viaducts in Klang (from Kawasan 17 to Sri Andalas) and 6 stations, among others (refer figure 3 & 4). Aside the longer viaduct (compared to SunCon's 4.9 kilometers entrusted under MRT Line 2), a key difference compared to previous undertakings take the form of a cable-stayed bridge that would run across the Klang River. While this is a design and build component – which normally fetches better margin – we note that bridges are beyond SunCon's usual forte.

Figure 3

Scope of SunCon's undertaking for package GS07-08

- 9.2 km of viaduct works
- 6 station works
- 1 cable-stayed bridge over Klang River (design & build)
- 2 Park & Ride at Pasar Besar Klang and Sri Andalas
- 1 centralised labour quarters at Johan Setia

Source: CLSA

Figure 4

LRT3 alignment – red section shows SunCon’s stretch



Red Line above denotes our proposed 9.2km alignment

Source: SunCon

Timeliness risk but has experience coordinating multiple large projects

To be completed in 36 months, SunCon is set to pencil in RM2.2 billion of top line over that time frame. While the short timeline to complete the task may pose a challenge, we think that execution risk is mitigated by the fact that SunCon had in the past proven that it was able to concurrently handle the Light Rail Transit, BRT and MRT Line 1 projects.

Factor in more-modest margins for the risk of this larger undertaking

SunCon’s strategy for LRT3 was to submit a few bids and it has done well to bag the biggest package announced to-date under LRT3 for viaduct awards. Considering the tight timeline, the need to build through a more-populated area, and some additional capital expenditure, we nevertheless capture the risk by estimating a pre-tax profit margin of a more modest 6%; this compares against the 8.1% and 9.4% construction margins seen in 1Q17 and 2Q17 respectively.

Steel price jump not seen to be an issue

On balance, although the jump in construction steel over the past 3 months up to end-September 2017 have been steep (estimated to be circa 30%), and that the LRT3 project award does not contain a pass-through clause for steel price (such as seen in the MRT projects), the percentage contribution of steel into overall project cost is understood to be small (in the single digits).

Figure 3

Comparison of viaduct packages awarded under LRT3

Company	Package	Job size (RM billion)	Length (Kilometers)	Value per kilometer (RM billion)	Remarks
SunCon	GS07-08	2.18	9.2	0.24	6 stations. From Kawasan 17 to Sri Andalas
Gabungan AQRS (Not rated)	GS04	1.14	4.5	0.25	-
WCT Holdings Berhad (Not rated)	GS02	0.64	2.9	0.22	Merchant Square to Suria Damansara
WCT	GS03	0.84	2.8	0.30	Suria Damansara to Temasya Glenmarie

Source: CLSA

Amounts to RM240 million per KM; this is comparable to its MRT line 2 award

While the value of the package clinched by SunCon towers over the rest of the packages so far awarded to other contractors, the value per kilometer basis is fairly comparable (refer figure 4). In addition, it also stacks up with SunCon’s package V201 under MRT Line 2, at a value of RM1.21 billion for a length of 4.9 kilometers (equivalent to c.RM250 million per kilometer).

Figure 4

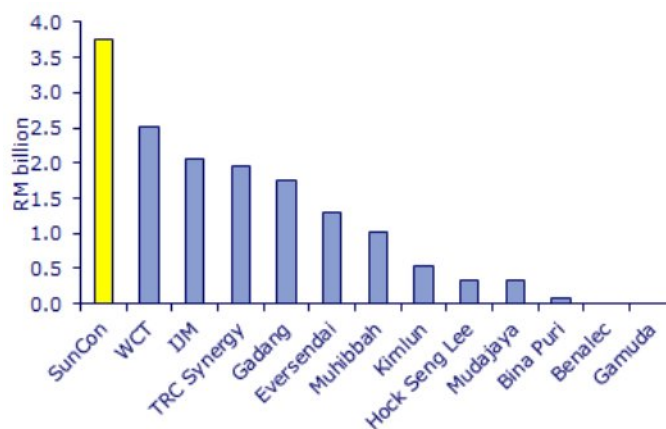
SunCon’s job wins this year –RM3.8 billion

Contract	Duration	Contract Sum (RM mil)
LRT3: package GS07-08	Q4 2020	2,178
PPA1M project in Kota Bharu	1Q 2020	582
Sunway Serene	4Q 2020	449
MRT 201	4Q 2020	212
Gas District Cooling (GDC) 1	3Q 2018	152
Precast	-	98
SUKE and DASH highway	1H 2018	34
Bukit Bintang City Center (piling)	1Q 2018	34
Mega Capital (piling)	4Q 2017	9
CP3 walkway	3Q 2017	4
Total		3,752

Source: CLSA, SunCon

Figure 5

YTD job wins for selected construction peers



Source: CLSA, companies

SunCon is in pole position for YTD job wins when juxtaposed against selection of listed peers

Trading above sector average but PE multiple will compress in 18CL

Smashing expectations on job wins this year, we remain **BUYERS** of SunCon. Having cemented further its credentials in rail-related jobs with this win,

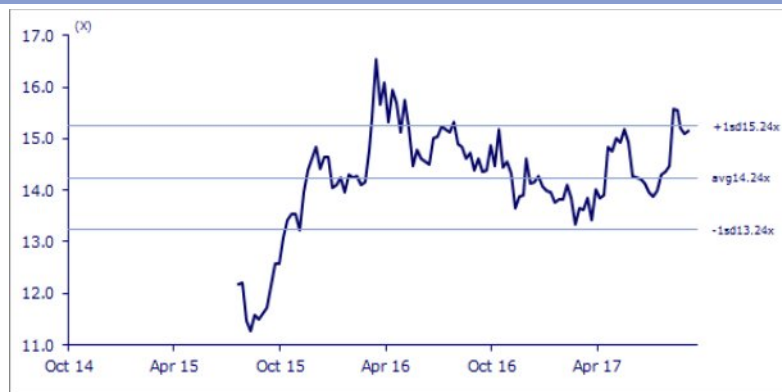
Trading at 0.9 sd above mean PE since listing, but justified by a surge in order book

SunCon stands in good stead to participate in future projects such as the ECRL and the HSR, in addition to in-house job prospects from its parent.

This larger-than-predicted award is envisaged to make up 2/3 cents for EPS of 18CL/19CL. Trading at 19.3x PE for 17CL, the earnings growth in 18CL will compress the multiples quickly. We continue to price SunCon at 16.7x PE for 18CL, deriving a slightly raised target price of RM2.80 (from RM2.75).

Figure 6

SunCon: forward PE



Source: CLSA

Figure 7

Summary of changes to PATMI

RM mil	Previous	Revised	Variance	Remark
17CL	157	154	(3)	Later than expected LRT3 award; lowered margin expectation
18CL	210	216	6	Increment from larger-than-expected award
19CL	222	229	7	

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 reflect 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.

Summary financials

Year to 31 December	2015A	2016A	2017CL	2018CL	2019CL
Summary P&L forecast (RMm)					
Revenue	1,917	1,789	2,380	3,304	3,488
Op Ebitda	178	188	245	329	349
Op Ebit	136	149	186	263	277
Interest income	8	10	12	12	15
Interest expense	(4)	(6)	(5)	(5)	(5)
Other items	-	0	-	-	-
Profit before tax	141	154	193	270	287
Taxation	(13)	(30)	(39)	(54)	(57)
Minorities/Pref divs	(1)	0	0	0	0
Net profit	127	124	154	216	229
Summary cashflow forecast (RMm)					
Operating profit	136	149	186	263	277
Operating adjustments	(3)	(22)	0	0	0
Depreciation/amortisation	42	39	59	66	72
Working capital changes	65	(59)	(42)	(6)	(77)
Net interest/taxes/other	(8)	(33)	(39)	(54)	(57)
Net operating cashflow	232	75	165	269	215
Capital expenditure	(39)	(19)	(45)	(45)	(45)
Free cashflow	193	56	120	224	170
Acq/inv/disposals	40	13	-	-	-
Int, invt & associate div	(57)	89	12	12	15
Net investing cashflow	(56)	83	(33)	(33)	(30)
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	35	126	69
Exch rate movements	5	2	(5)	(6)	(5)
Opening cash	278	390	465	495	616
Closing cash	390	465	495	615	679
Summary balance sheet forecast (RMm)					
Cash & equivalents	390	466	495	616	679
Debtors	579	732	796	1,104	1,166
Inventories	17	24	0	0	0
Other current assets	230	220	233	233	233
Fixed assets	162	138	125	104	77
Intangible assets	4	6	6	6	6
Other term assets	14	11	11	11	11
Total assets	1,397	1,597	1,665	2,074	2,171
Short-term debt	137	137	137	137	137
Creditors	796	955	977	1,280	1,264
Other current liabs	9	11	-	-	-
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	550	656	770
Total liabs & equity	1,397	1,597	1,665	2,074	2,172
Ratio analysis					
Revenue growth (% YoY)	1.9	(6.7)	33.1	38.8	5.6
Ebitda growth (% YoY)	10.2	5.7	30.0	34.3	6.1
Ebitda margin (%)	9.3	10.5	10.3	10.0	10.0
Net profit margin (%)	6.6	6.9	6.5	6.5	6.6
Dividend payout (%)	40.6	52.3	62.9	50.8	50.7
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)	(65.0)	(72.9)	(70.4)
ROE (%)	30.6	26.2	29.5	35.8	32.2
ROIC (%)	59.1	65.5	83.2	113.4	108.9
EVA@/IC (%)	48.2	54.6	72.3	102.5	98.0

Source: CLSA



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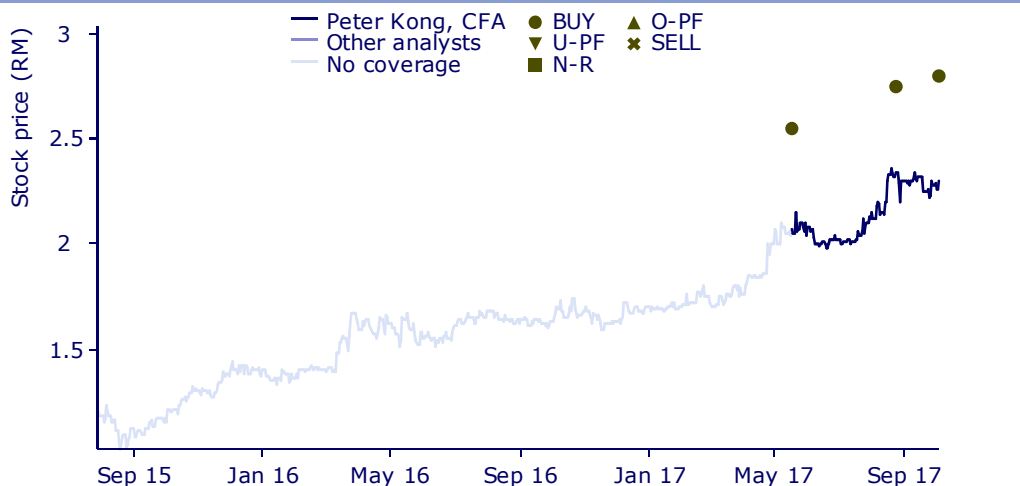
- SunCon (SCGB MK - RM2.30 - BUY)
- Gamuda (GAM MK - RM5.25 - U-PF)
- Hock Seng Lee (N-R)
- IJM (IJM MK - RM3.24 - O-PF)
- Mudajaya (N-R)
- TRC Synergy (N-R)
- WCT (N-R)

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Recommendation history of Sunway Construction Group Bhd SCGB MK



Date	Rec	Target	Date	Rec	Target
LATEST	BUY	2.80	18 May 2017	BUY	2.55
25 Aug 2017	BUY	2.75			

Source: CLSA

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