Malaysia Company Focus

Sunway Construction Group

Bloomberg: SCGB MK | Reuters: SCOG.KL

Refer to important disclosures at the end of this report

DBS Group Research. Equity

28 Mar 2016

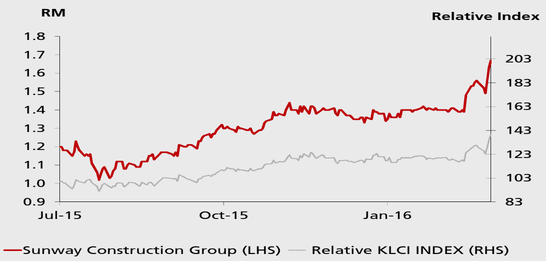
BUY

(Initiating Coverage)
Last Traded Price: RM1.67 (**KLCI :** 1,703.79)
Price Target: RM1.92 (15% upside)

Potential Catalyst: Good proxy for 11MP Infra projects, highly profitable precast segment

Analyst
Tjen-San, CHONG +603 2604 3972 tjensan@alliancedbs.com
Nor Nazirah MOHAMED +603 26043968 nnazirah@alliancedbs.com

Price Relative



Forecasts and Valuation

FY Dec (RMm)	2014A	2015A	2016F	2017F
Revenue	1,881	1,917	1,990	2,197
EBITDA	162	178	221	243
Pre-tax Profit	141	141	179	202
Net Profit	114	127	143	161
Net Pft (Pre Ex.)	125	127	143	161
EPS (sen)	8.83	9.84	11.1	12.5
EPS Pre Ex. (sen)	9.65	9.84	11.1	12.5
EPS Gth (%)	21	11	12	13
EPS Gth Pre Ex (%)	87	2	12	13
Diluted EPS (sen)	8.83	9.84	11.1	12.5
Net DPS (sen)	0.0	4.00	4.09	4.61
BV Per Share (sen)	24.4	34.9	41.8	49.7
PE (X)	18.9	17.0	15.1	13.4
PE Pre Ex. (X)	17.3	17.0	15.1	13.4
P/Cash Flow (X)	11.5	9.0	12.5	10.6
EV/EBITDA (X)	12.8	10.3	7.9	6.7
Net Div Yield (%)	0.0	2.4	2.4	2.8
P/Book Value (X)	6.8	4.8	4.0	3.4
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	24.6	33.2	28.8	27.2
Consensus EPS (sen):		10.0	10.7	11.9
Other Broker Recs:		B: 6	S: 0	H: 3

ICB Industry : Industrials
ICB Sector: Construction & Materials
Principal Business: Building and civil/infra works. It also involves in manufacturing and sales of precast concrete

Source of all data: Company, Bloomberg Finance L.P

Solid and dependable

- **Must-own proxy for MRT 2, LRT 3 and BRT, given its strong execution track record for initial phases**
- **ROE-enhancing precast business to be buoyed by HDB housing scheme**
- **Strong balance sheet, premium ROEs and immaculate execution track record to justify valuation re-rating**
- **Initiate with BUY and RM1.92 TP**

Malaysia's leading pure construction player. Sunway Construction Group (SCG) is the largest listed pure play construction player in Malaysia. Given its strong track record with MRT, LRT and BRT jobs previously, we are of the view that SCG is on a strong footing to bag several key infrastructure packages such as MRT2, LRT3 and BRT as well as other major highway projects like SUKE, DUKE and Pan-Borneo Highway. SCG has also established itself as the only construction specialist to be involved in all three Rapid Line infra projects (MRT, LRT and BRT). This makes the group one of the strongest contenders to win the pipeline of 11MP projects.

Riding on Singapore's public housing development. Its precast division is a strong proxy to the growing demand for HDB residences in Singapore where the government is targeting to build an additional 88,000 units of public housing in FY16-FY19. With premium EBIT margins recorded over the past few years, the business is ROE-enhancing and also synergistic to its construction business. The completion of its 3rd precast plant in Iskandar should give it ample capacity to cater for more orders and help to boost its earnings growth going forward.

Valuation. Our TP is based on sum-of-parts (SOP) valuation to reflect the growing contribution from its high-margin precast business. While our SOP value is RM2.77bn or RM2.14/share, we have ascribed a 10% discount to arrive at our target price of RM1.92. At our TP of RM1.92, SCG will trade at FY16F and FY17F PE of 17.3x and 15.4x respectively, which we believe is fair given its high ROEs of 27-29%, strong balance sheet which is in a net cash position, impeccable execution track record and synergistic precast business.

At A Glance

Issued Capital (m shrs)	1,293
Mkt. Cap (RMm/US$m)	2,159 / 536
Major Shareholders (%)	
Sunway Berhad	55.6
Tan Sri Jeffrey Cheah & Family	7.6
Free Float (%)	37.9
3m Avg. Daily Val (US$m)	0.89

INVESTMENT THESIS

Profile	Rationale
An established player with >30 years of heritage, Sunway Construction Group (SCG) is one of Malaysia's largest construction companies. It adopts an integrated business model that covers various phases of construction activities, from project design to completion. SCG also enjoys strong parentage with the support of holding company, Sunway Berhad, which has kept a 55.6% stake in SCG post-listing.	• SCGB is one of the largest pure play construction players in Malaysia with strong track record and execution. Given its notable brand name in the construction sector, it is likely to secure more jobs going forward and represents a good proxy for the 11MP. • Its precast business is primarily driven by the Singapore construction industry. With the completion of its 3rd precast plant in Iskandar, the group will continue to bid for precast tenders, riding on the growing demand for HDB residences in Singapore. It is a strong platform for future growth, with high margins being recorded over the past few years. • Its valuations are inexpensive considering its strong earnings visibility with RM3.7bn outstanding orderbook and potential to add more this year. SCGB is on a strong footing to participate in the upcoming work packages from 11MP mega projects such as MRT2, LRT3, BRT jobs and other highway projects.
Valuation	**Risks**
Fair value of RM 1.92. Our TP is based on sum-of-parts (SOP) valuation to reflect the growing contribution from its high-margin precast business. Our SOP value is RM2.77bn or RM2.14/share while we have ascribed a 10% discount to arrive at our target price that is based on a combination of DCF and PE. We have assumed a sustainable orderbook of RM3.5bn and pretax margins of 6% which we believe is fair given its current outstanding orderbook now stands at RM2.79bn, coupled with the strong prospects of chunky new wins from key transportation projects. We have assigned a PE of 14x to our DCF value, which translates into a 25% discount to the larger PEER of IJM and Gamuda that trade at CY16 PE of 18-19x. For the precast division, we have also valued it based on a combination of DCF and PE. We have assumed a sustainable orderbook of RM450m and margins of 21%. We think this is fair given the strong pipeline of HDB order flows, in which 25,000 units are targeted to be built each year in FY16-FY17F. Moreover, its 2-year historical margins have been 31-36%. We have assigned a PE of 16x to the precast division, a premium to its construction division which we believe is justified given the former's higher margins and less competitive nature. Our TP of RM1.92 translates into an FY16F PE of 17.3x and FY17F PE of 15.4x.	**Project risk.** This has always been a key risk for the construction industry given various factors such as changes in clients' requirements, problems on the site, and disputes with clients about job scopes. Unfavourable economic conditions may also lead to cancellations, postponement or scaling down of clients' projects. **Delays in construction.** There may be project cost overruns due to several factors such as design and engineering issues and soil conditions. Timely completion is critical to avoid paying liquidated ascertained damages to clients. **Fluctuations in prices of raw materials.** The construction business typically requires a wide range of raw materials including steel bars, ready mixed concrete, diesel, electrical cables and fittings, which are all subject to price fluctuations. This could result in fluctuating profit margins, although we noticed that SCG's profitability has been improving over the years, possibly because of bulk purchases from suppliers at favourable terms. **Dependence on subcontractors.** Given the scale of projects undertaken by SCG, it relies on the services of subcontractors to provide certain services and labour-intensive work. There is no assurance that the subcontractors will always deliver quality work in a timely manner.

Source: AllianceDBS Research

SWOT Analysis

Strengths	Weaknesses
• **Strong parent support.** Sunway Berhad continues to maintain its interest in the business direction and financial performance of SCG. By retaining at least 51% stake in SCG, it is in a position to provide a ready pipeline of orders. • **Solid orderbook.** Promising earnings prospects over the next few years, on the back of strong orderbook balance and exposure to the Singapore market. • **Strong proxy to rapid line infrastructure projects.** SCG is the only specialist contractor to be involved in all three Rapid line systems (MRT, LRT and BRT).	• **Over–reliance on Malaysia construction industry.** Malaysia's construction industry is a cyclical industry which is heavily impacted by Malaysia's macroeconomic developments. This might pose downside risks to its ability to replenish its orderbook. • **Susceptible to a slowdown in Singapore's residential industry.** Its precast business contributes a large share to the group's earnings. Its order sales depend on the supply of HDB residential units in Singapore. • **Dependency on foreign labour.** Singapore has tightened its foreign worker policies. As a result, the foreign workers' population growth has slowed down.
Opportunities	**Threats**
• **Well positioned to ride on increasing project flows.** SCG is poised to ride on the anticipated awards of key 11MP projects which are expected to come onstream in 2016. • **Exposure to both the public and private sectors.** SCG is looking to capitalise on more public sector project awards this year from the 11MP. But it also has a strong niche in the private sector, particularly in building jobs, while also being able to leverage on Sunway's property business. • **Stable demand for HDB flats in Singapore.** Demand for HDB flats will drive the adoption of precast concrete. This will eventually boost its precast business.	• **Delays in the award of contract.** Any delay of government projects under the 11MP possibly would have an adverse impact on the construction industry. • **Higher material prices.** A surge in raw material prices like cement and steel will potentially lead to margin erosion. • **2016 budget cut**. Although the government is committed to the key high-multiplier projects, there is no guarantee that such projects will be rolled out – as there could still be cut backs in development expenditure going forward.

Source: AllianceDBS Research

Company Background

Exhibit : Integrated construction business model

Building Construction Services

- Design and construction service provider in the residential, commercial, institutional and specialty projects
- International portfolio includes several large building construction services projects in Singapore, UAE and Trinidad and Tobago
- Special Purpose Building Projects include Kuala Lumpur Convention Centre, Pinewood Studio, Sunway Medical Centre, Monash University Campus Malaysia; Sunway Shopping Mall

Civil/Infrastructure Construction Services

- Major provider of civil/infrastructure construction services and have participated in various roads, highways, airports, bridges and rail transportation infrastructure projects over the last 30 years
- Local Projects include Ipoh Airport, SILK, Maju Expressway, SKVE and special rail transportation infrastructure like MRT, LRT and BRT
- Overseas Projects include 7 highways and bridges in India

Foundation and Geotechnical Engineering Services

- Core services include piling solutions and earth retaining systems
- Services cover all types of buildings such as residential, commercial, institutional, purpose-built or specialty buildings, and civil/infrastructure construction projects.

Mechanical, Electrical and Plumbing Services

- Main services are categorised into mechanical, electrical, plumbing and specialised engineering solutions
- Services offered to both internal and external clients as part of integrated services and on stand alone basis

Manufacturing and Sale of Precast Concrete Products

- Develops, designs, manufactures and supplies precast concrete products with manufacturing plants located in Senai, Johor, Malaysia and Tampines, Singapore, respectively *(3rd plant in Iskandar will be operational 1st quarter of 2016)*
- Precast concrete products manufactured, include Industrialised Building System ("IBS") components, for residential, commercial and infrastructure development projects.

Source: Company

Established construction service provider. Sunway Construction Group (SCG) is the construction arm of Sunway. It is an integrated construction services company, with the capabilities to provide integrated services and products across different phases of construction, from project design to completion.

SCG is mainly involved in providing the following:

i. Building construction services
ii. Civil/infrastructure construction services
iii. Foundation and geotechnical engineering services
iv. Mechanical, electrical and plumbing services
v. Manufacturing and sale of precast concrete products

Operational efficiency through Virtual Design and Construction (VDC). The group's construction services business is further strengthened by the use of design technology, VDC. The utilisation of VDC technology enables the group to help clients save time and cost by identifying design flaws prior to construction. We believe this can be one of its competitive edges when tendering for jobs. In addition, the group has successfully delivered the 3D facet of VDC in its operations of design and build projects such as Sunway Pinnacle, Sunway Pyramid Phase 3 and Sunway Velocity Phase 2 using 3D VDC.

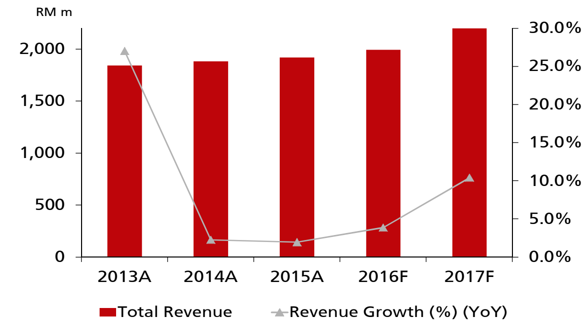
Exhibit : List of regular clients

Clients	Length of Relationships (Years)	Value of Projects (RMbn)
Putrajaya Holdings	> 10 years	7 major projects worth > RM2.9
Sunway	> 10 years	> 8 major projects worth > RM1.7
KLCC Group of Companies	> 10 years	5 major projects worth > RM1.3
IDR Asset	> 4 years	> 2 major projects worth > RM0.3
Syarikat Prasarana Negara	> 3 years	3 major projects worth > RM1.0
Iskandar Malaysia Studios	> 3 years	1 major project worth > RM0.3

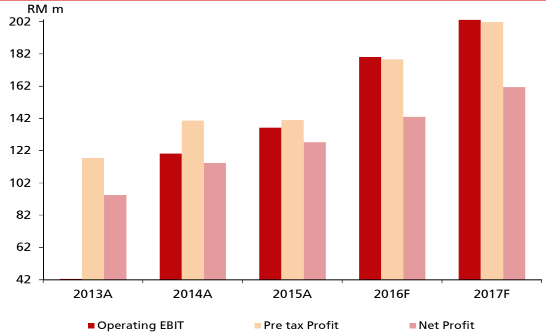
Source: Company

Strong flow of repeat customers. Some of the key clients include KLCC Corporation, Putrajaya Holdings and Khazanah Nasional. SCG also benefits from Sunway Group's strong presence in Iskandar Malaysia, which has resulted in several contract wins, including jobs at Legoland Malaysia Theme Park, Pinewood Iskandar Malaysia Studios and Coastal Highway Southern Link. We expect more recurring orders to come from its existing clientele to meet its yearly replenishment target of between RM2bn and RM2.5bn.

Revenue Trend

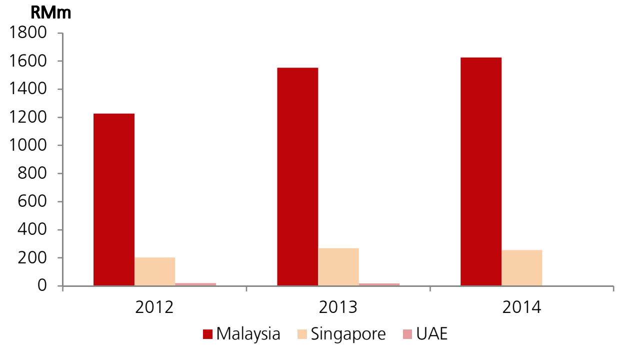


Profitability Trend [operating EBIT for 2013?]



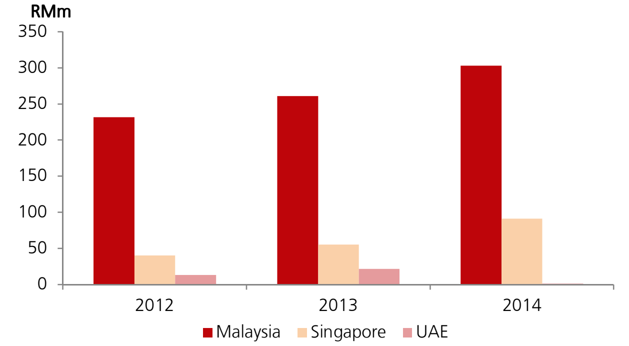
Source: Company, AllianceDBS Research

Exhibit : Revenue by geography



Source: Company, AllianceDBS

Exhibit : Gross profit by geography



Source: Company, AllianceDBS

International exposure. SCG has undertaken construction jobs locally and overseas. The group began its international foray in 1999 when it completed the provision of construction management services for a 960 MW combined-cycle power plant project in Haifu, Taiwan. The group subsequently expanded its geographical presence into several countries namely India, the Caribbean region (Trinidad and Tobago), UAE and Singapore. The largest international project to-date was the construction of Phase 1 A, Plot H of the Rihan Heights Project, an upmarket residential development in Abu Dhabi, UAE.

Leveraging on parent support. SCG is normally the appointed contractor for selected strategic assets owned by Sunway Berhad. In the past, SCG has built the Sunway Pyramid Shopping Mall, Sunway Medical Centre, Sunway University Campus, Monash University Campus and Sunway Resort Hotel. These projects are constructed as part of Sunway's township developments. By retaining at least 51% stake in SCG, Sunway will be committed to continue providing a sustainable pipeline of orders to SCG.

Large asset base to maximise economies of scale. SCG's integrated construction services are supported by a large fleet of construction machinery and equipment that is not matched by most of its peers. Currently, the group operates two manufacturing plants (Senai and Tampines) with an average annual capacity of 200,000 m³. The group has also completed the expansion of its 3rd precast plant in Iskandar with an estimated annual production capacity of 51,000 m³. Other key assets include 23 boring rigs, 20 hydraulic excavators, 16 tower cranes, 13 crawler cranes, five launching girders and 25,000 m³ of system formworks.

Exhibit : Major completed jobs (>RM200m contract)

Project	Client	Contract period	Value (RMm)
Malaysia			
Sunway Pyramid	Sunway	Mar95-Nov96	209
Office block, Plaza Pantai	Atlas Corporation Sdn Bhd	Mar97-Dec98	239
National Registration Department and Ministry of Entrepreneur and Cooperative Development Buildings	Putrajaya Holdings Sdn Bhd	Apr01-Sep03	319
SILK Highway	Sistem Lingkaran Lebuhraya Kajang Sdn Bhd	Aug01-Apr04	1,045
KL Convention Centre	Kuala Lumpur Convention Centre	Sep02-Mar05	549
Sunway Pyramid Phase 2	Sunway	Feb05-Apr07	299
Ministry of Housing and Local Government and	Putrajaya Holdings Sdn Bhd	Sep07-Jan10	520
Sunway Velocity Phase 1A	Sunway	Feb11-Dec13	210
Legoland Malaysia Theme Park Package 4	IDR Assets Sdn Bhd	Mar11-Jun12	258
Pinewood Iskandar Malaysia Studios	Iskandar Malaysia Studios Sdn Bhd	Oct11-May13	309
Sunway University new academic block	Sunway	Sep12-Sep14	204
Sunway Putra Mall	Sunway REIT	May13-Mar15	258
Overseas			
Phase 1, Zone C of Al-Reem Island, Abu Dhabi	Tamouh Investments LLC	Oct06-Apr09	1,323
Phase 1A, Rihan Heights project, Abu Dhabi	Mubadala Capitaland Real Estate LCC	Nov08-Nov10	1,865
Grand trunk road, India	National Highways Authority of India	Apr02-Apr05	228
East-West Corridor roadworks, India	National Highways Authority of India	Jul05-Jan08	239
Ministry of Legal Affairs Tower, Trinidad & Tobago	The Urban Development Corporation of Trinidad and Tobago	May05-Aug07	213

Source: Company

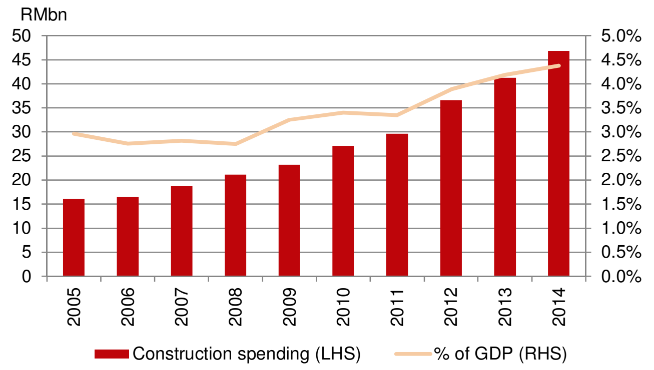
Exhibit: Key Management Team

Name and Designation	Industry Experience	Profile
Chung Soo Kiong Managing Director	20	• Mr Chung has held the position of Deputy Managing Director of SunCon since 2013 and was appointed as Managing Director in November 2015. • Notable projects completed under his supervision include the Kuala Lumpur Convention Centre; Ministry of Finance, National Registration Department and Ministry of Entrepreneur and Cooperative Development buildings in Putrajaya; and Rihan Heights and Al-Reem projects in Abu Dhabi.
Thomas Samuel A/L C T Samuel Executive Director - Foundation and Geotechnical Engineering Division	32	• Joined Sunway Geotechnics (M) as an executive director. • His principal job responsibilities include the development and supervision of foundation solutions for complex ground conditions for building and infrastructure projects undertaken by the SunCon group as a main contractor.
Liew Kok Wing Senior General Manager - Civil Division	20	• From 1996 to March 1998, he served as a Senior Geotechnical Engineer in SunCon, where he was involved in geotechnical works for various projects undertaken by SunCon in Malaysia. • Presently, he is heading the Civil Engineering Business Unit, a position he has held since 2013.
Wong Kwan Song, Richard Senior General Manager - Building Division	27	• He held various positions in the SunCon Group, during his 15-year tenure with the SunCon Group, and he is currently the Senior General Manager (a position that he has held since 2012). • His role includes overseeing the overall planning and coordination of construction projects, from conceptualising, design, construction through to completion within established budgets, schedules and quality standards.
Eric Tan Chee Hin Senior General Manager - MEP Division	18	• Joined Sunway Engineering Sdn Bhd and has held various positions in the company during his tenure of almost 14 years with SunCon Group. • Oversees the design management and mechanical, electrical and plumbing engineering (MEP) operations of the SunCon Group.
Kwong Tzyy En Senior General Manager - Precast Division	20	• Joined Sunway Sunway Concrete Products (S) in 2001 and has held various positions, based primarily in Singapore, during his tenure of almost 14 years with SunCon Group. • Oversees the design management and mechanical, electrical and plumbing engineering (MEP) operations of the SunCon Group.
Ng Bee Lien Senior General Manager - Finance	16	• In 2005, she joined SunCon as Senior Manager. Subsequently she was promoted to Assistant General Manager and General Manager, a position that she has held since 2011. • She takes charge of the finance department functions of the SunCon Group

Source: Company

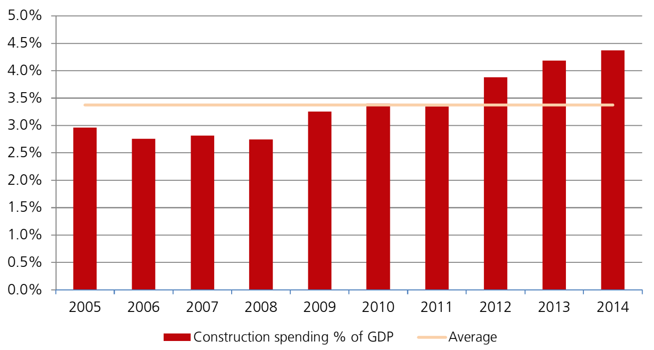
Construction segment – expect strong earnings in 2016 as 11MP mega projects come onstream

Exhibit : Construction spending as a percentage of GDP



Source: CEIC, AllianceDBS

Exhibit : Average of construction spending



Source: CEIC, AllianceDBS

Positive growth trajectory. Malaysia's construction industry has been growing steadily over the past 10 years. We believe the construction spending uptrend is primarily driven by major fiscal initiatives, specifically on the construction of several large infrastructure projects. An overall allocation of RM50bn for development expenditure in 2016 (vs RM47.4bn in 2015) translates into an industry growth rate of 5.4% y-o-y and GDP growth of 4%. In view of this, we think the construction sector will continue to grow, supported by government incentives to implement the infrastructure projects announced in Budget 2016.

Sweet spot ahead. We think SCG's construction segment is entering a 'sweet spot' on the back of the expected upturn in Malaysia's construction industry. Given its notable brand name and strong execution track record, we believe the group is one of the strongest contenders to bag several key projects under the Eleventh Malaysia Plan (11MP). We are of the view that SCG is on a strong footing to bag several key infrastructure packages such as MRT2, LRT3 and BRT as well as other major highway projects like SUKE, DUKE and Pan-Borneo Highway.

SCG is optimistic about the potential job pipeline in 2016. Besides MRT Line 2 and Pan Borneo highway, it has been prequalified for DASH and SUKE, and is also the only local contender competing for basement works for the IKEA project in Tebrau, Johor. We understand from management that the contract award is expected to be announced in 1H16 and it believes SCG stands a good chance in winning the job award. Apart from that, it is also tendering for piling works for a private sector piling job in Damansara Heights.

SCG is also awaiting the results for the BRT job in KL worth about RM1.5bn. Its proven track record with the first BRT job will put it in good stead to secure the contract. Given that SCG is the only specialist contractor to be involved in all three Rapid line infra projects, we remain upbeat that the group is likely to be able to capitalise on 2016 job flows, especially for mass rapid transit and highway-related projects. These include:

1. MRT 2 project from Sungai Buloh-Serdang-Putrajaya spanning 52 kilometres, with an estimated cost of RM28bn. The group has learnt from its experience with MRT1 and believes that it is in a better position to manage costs for MRT2. So far it has put in tenders for a main contractor role for one non-Bumi package as well as piling works for one Bumi package. The group has been automatically pre-qualified (given it won a viaduct package for MRT Line 1) and remains confident of clinching sizeable packages given its notable track record with MRT1 previously. We expect the jobs to be awarded in 1H16.

2. LRT3 project from Bandar Utama, Damansara-Johan Setia, Klang spanning 36 kilometres, with an estimated cost of RM10bn. We think the group is well positioned to bid competitively.

3. Bus Rapid Transit (BRT) project at a cost of approximately RM1.5bn. We think the group is the most preferred contractor and among the front runners to win this job.

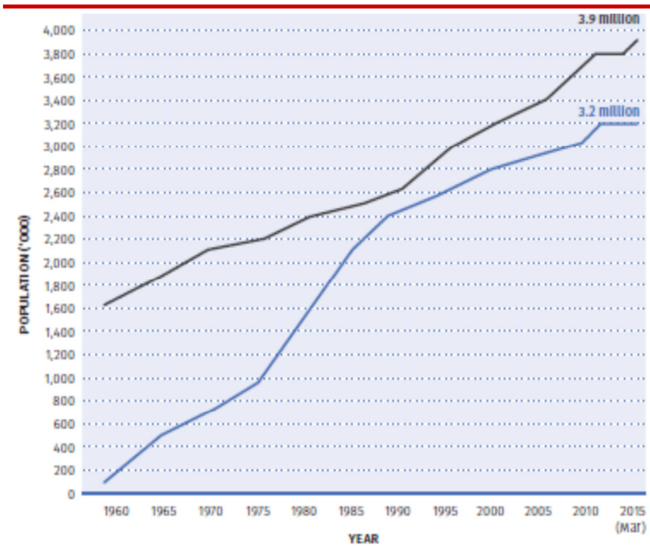
4. Pan-Borneo Highway – It has partnered with a local private company in Sarawak, KTS Holdings Sdn Bhd. For this project, it is understood that the share of the JV must be 70:30 with the local Sarawak contractor holding the majority stake.

Precast segment – margins should hold up, backed by ongoing government plans for HDB housing scheme

Exhibit : Targeted housing constructions in Singapore as at end-Jan 2016

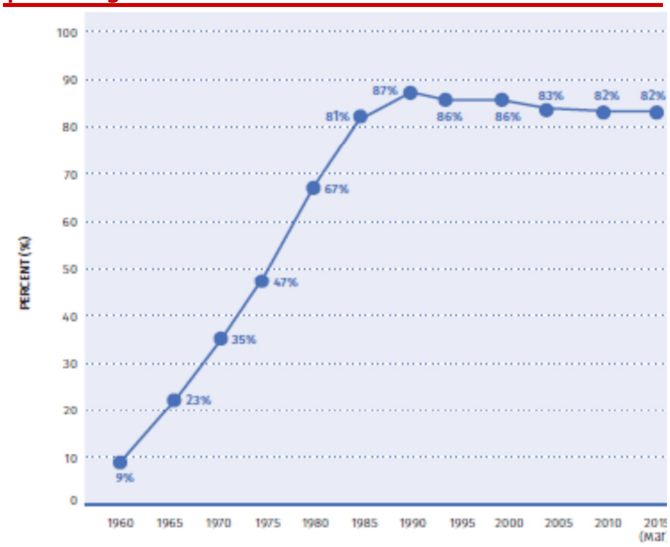
Sources: MND, Singapore

Exhibit : Population in Singapore and in HDB Flats as at end-March 2015



Sources: HDB, Singapore

Exhibit : Population in Singapore and in HDB Flats by percentage as at end-March 2015

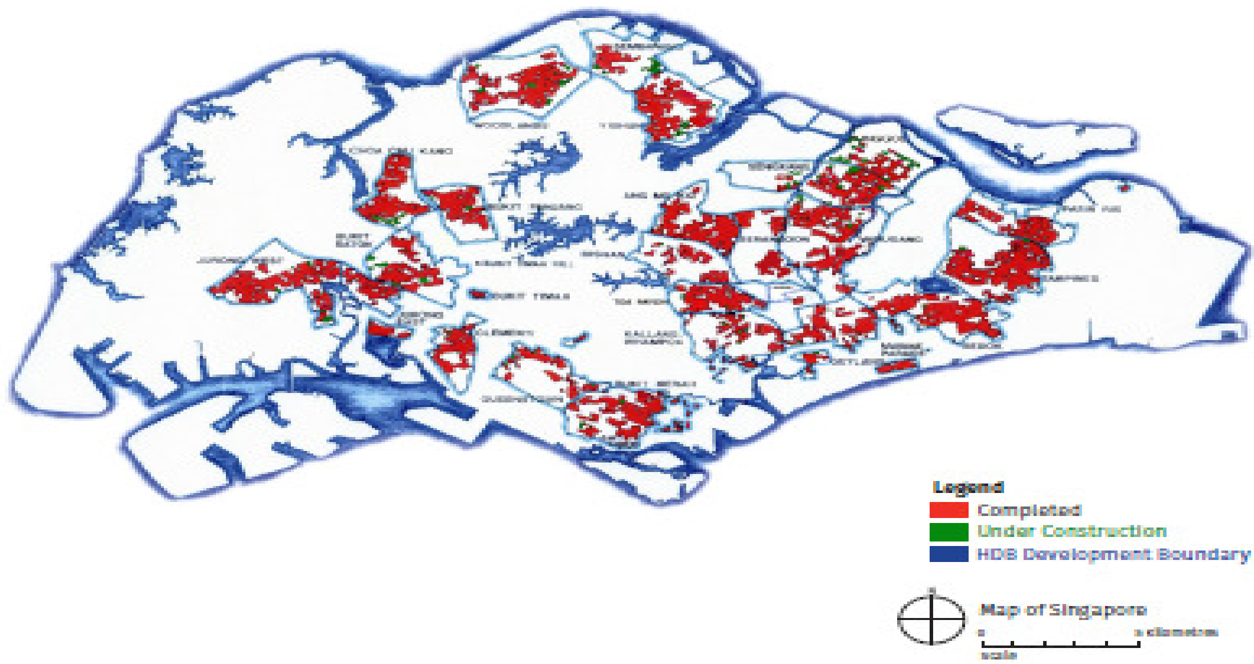


Sources: HDB, Singapore

Government initiative. SCG's precast business will continue to be sturdy in contributing a larger share of earnings to the group. This is spearheaded by the positive growth of Singapore's construction industry, which was largely spurred by the HDB's public residential development. Despite the completion of 48,300 residential units in 2015, with 50% being public housing units, the Singapore Government remains committed to providing affordable homes to its citizens.

Higher adoption of precast components. In fact, the government has reiterated its target as at Jan 2016, to build an additional 88,000 public residential units in FY16-FY19. Approximately 82% of the nation's population lives in HDB flats. Hence, we remain optimistic about the potential order flows for its precast business in the next 2-4 years. As such, we believe SCG will keep its presence in Singapore, riding on the steady demand for public housing, where 70% of the building components are precast concrete products.

Exhibit : Location of HDB developments



Sources: HDB Singapore

Exhibit : Precast manufacturing facilities

Financial Year	Annual Capacity (m³)	Actual Production (m³)	Utilisation rate (%)
Senai, Johor, Malaysia (own)			
Dec-12	62,000	2,411	3.9
Dec-13	62,000	16,983	27.4
Dec-14	65,500	25,993	39.6
Aug-15	**76,000**	**21,706**	**42.5**
Tampines, Singapore (rented)			
Dec-12	145,000	105,515	72.8
Dec-13	145,000	92,878	64.1
Dec-14	124,000	90,673	73.1
Aug-15	**124,000**	**58,336**	**70.5**
Current Capacity	**200,000**		
Iskandar Plant (rented)			
Aug-15	**51,000**	**To commence in 1Q16**	
Estimated Total Capacity	**251,000**		

Source: Company

Capacity expansion. The group has expanded its manufacturing capacity in Senai, Johor through the installation of additional three lines to replace the Tampines Plant for the production of selected products. The expansion managed to increase its average annual capacity to 76,000 m³ from 65,500 m³ in 2014. Presently, it has completed the expansion of phase 1 Iskandar plant with the installation of five lines and will continue with the 2nd phase by gradually raising the production capacity.

The expansion of both Senai and Iskandar plants is intended to fully replace the Tampines plant (which is rented). The continuous expansion of its plants enables the group to have ample capacity to cater for more orders from the Singapore market, as the group plans to return the Tampines plant by year 2017.

The recent expansion of its 3rd plant is estimated to add another 51,000 m³ annual capacity to the manufacturing line. Assuming that the group is retaining the Tampines plant till 2016, this will increase the overall annual capacity of its precast plants to 251,000m³. Thus, we expect the group to operate at higher economies of scale, which could lead to stronger earnings growth going forward.

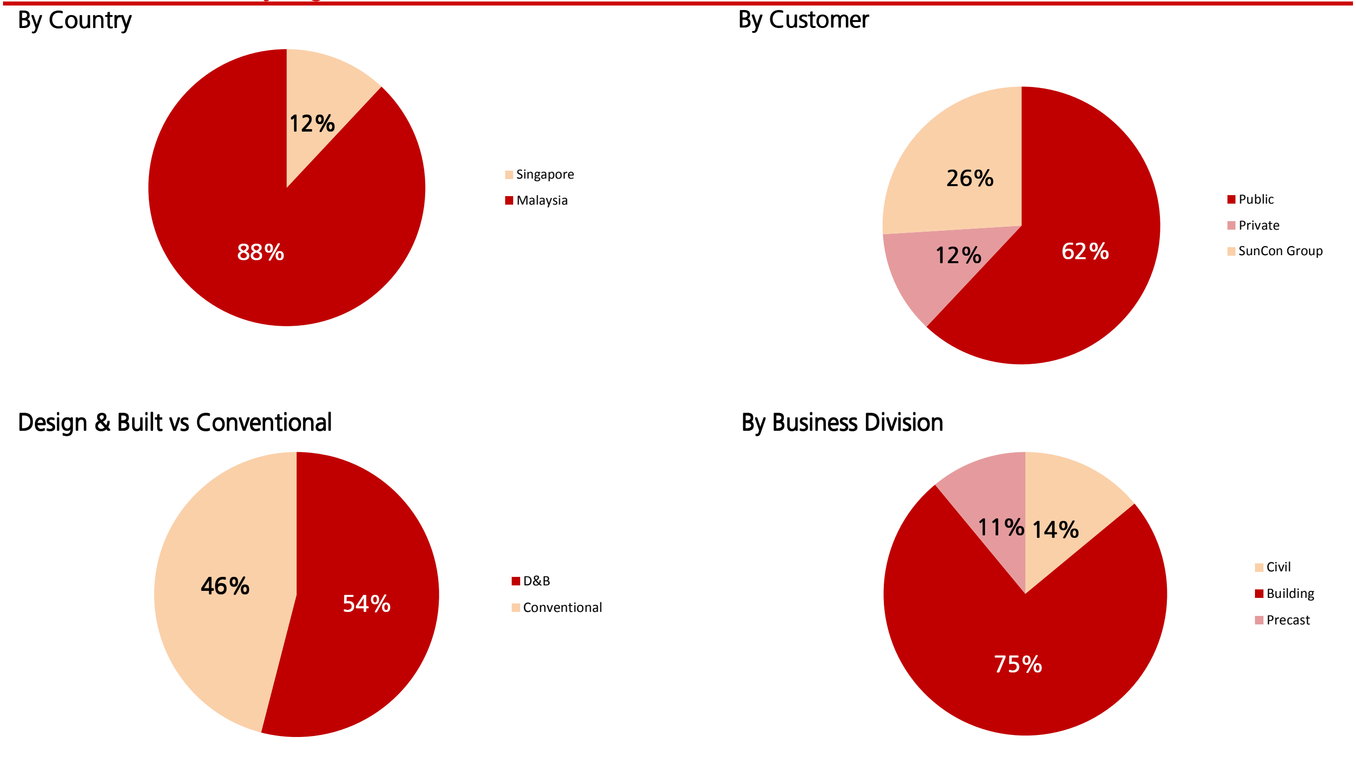
Orderbook– its sizeable orderbook may grow further with more potential project wins ahead

Exhibit: Outstanding orderbook

Civil & infrastructure	Contract sum (RMm)	Sep-15	Dec-15
MRT Package V4 (Sec 17 to Semantan)	1,173	373	320
LRT Kelana Jaya Line Extension (Package B)	569	66	41
Coastal Highway Southern Link	170	133	99
Subtotal	**1,912**	**572**	**460**
Building/ Piling/ Substructure			
Putrajaya Parcel F	1,610	1,610	1,382
KLCC NEC	304	206	199
KLCC package 2 (piling & substructure)	222	134	129
KLCC package 2a	120	120	111
Sunway Velocity Mall (Substructure)	350	136	102
Sunway Geo Retail & Flexi Suites	153	112	93
Sunway Iskandar- Citrine Swc Apt (Sub & Superstructure)	213	146	128
Affinity Medini mixed development project	283	39	15
Sunway Medical Centre phase 3	167	134	118
Sunway Lenang Phase 1A	96	68	53
Sunway Iskandar- Emerald Residences	175	141	137
Sunway Geo Retail & Flexi Suites Phase 2	244	244	222
Others	698	128	100
Subtotal	**4,635**	**3,218**	**2,789**
Precast	**848**		**416**
Total	**7,395**	**3,790**	**3,665**

Source: Company

Exhibit : Orderbook by Segmentation as at end-Jan 2016



Source: Company

Exhibit : New orderbook secured in 2015 and YTD 2016

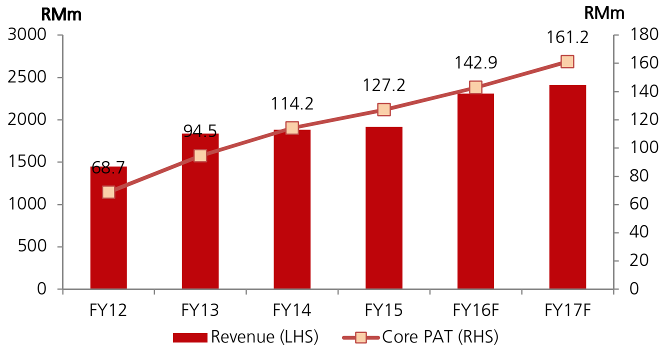
Projects	Contract Sum (RMm)
Civil, Infrastructure & Building	
CP3	244
Bukit Lenang Phase 1A	95.7
Sunway Iskandar International School	27.1
Parcel F, Precint 1	1609.6
Sunway Iskandar Emerald Residence	174.5
KLCC Package 2a	120
Others	22.7
Subtotal	2293.6
Singapore Projects	
Precast	316.8
Grand Total	2610.4

Source: Company

Solid orderbook balance. Its current outstanding orderbook stands at RM3.7bn (2x FY15 revenue) of which RM1.6bn comes from the Putrajaya Parcel F building jobs won last year. We understand that for February 2016, its new order book wins amounted to RM142m (RM60m for precast in Singapore; RM62m for Sunway Geotechnics; and RM20m for Velocity Link Bridge).

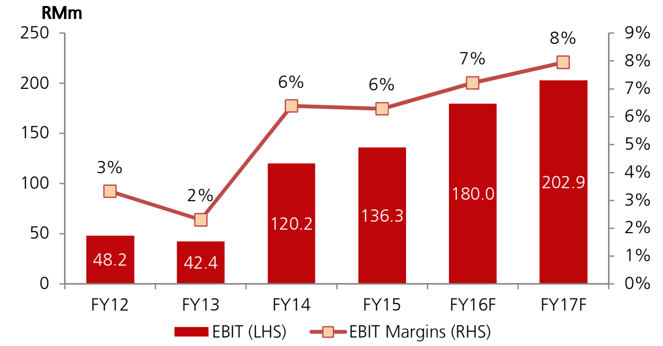
Financial Highlights

Exhibit : Revenue and Core PAT



Source: Company, AllianceDBS

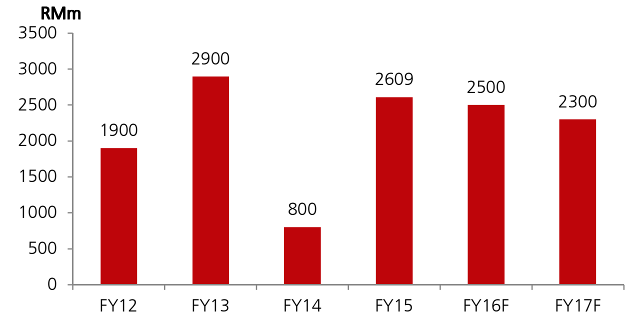
Exhibit : EBIT and EBIT margins



Source: Company, AllianceDBS

Record profits. SCG achieved a record-high core PAT of RM127m (+11% y-o-y) in FY15. This was mainly due to higher margins contributed by the precast concrete segment and additional profits recognised from ongoing local construction projects.

Exhibit : Orderbook replenishment



Source: Company, AllianceDBS

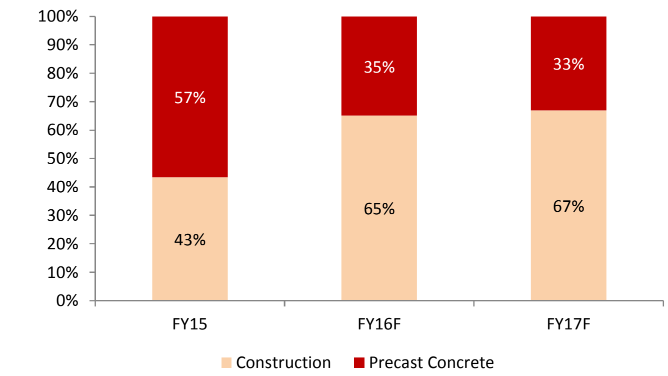
Exhibit : New wins assumptions (FY15-FY17F)

(RMm)	2015A	2016F	2017F
Construction	2,292	2,200	2,000
Precast	317	300	300
New wins assumptions	2,609	2,500	2,300

Source: Company, AllianceDBS

We are projecting RM2.5bn and RM2.3bn orderbook replenishment for FY16Fand FY17F, respectively, which is in line with management's target range of RM2-2.5bn each year. This is largely premised on the assumptions of stronger order flows in 2016, buoyed by upcoming major infrastructure projects.

Exhibit : Segmental EBIT by percentage (FY15-FY17F)



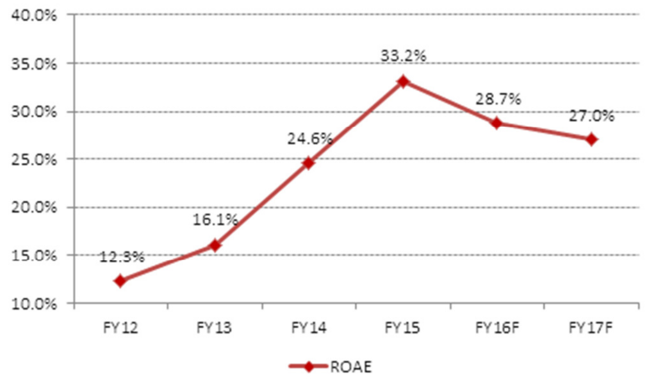
Source: Company, AllianceDBS

Precast margins to normalise towards 20% range. SCG's precast division made up 13-16% of revenue in FY12-FY15. It was the largest earnings contributor in FY15, accounting for 57% of the group's overall EBIT. The group believes the normalised margin lies in the 20% range. Hence, we forecast a precast margin of 21% for FY16-FY17F. This is supported by sustainable orders from the Singapore market. We have built in an annual order replenishment of c.RM300m, in line with management guidance. Our assumptions are also backed by the completion of its 3rd precast plant in Iskandar which is scheduled to commence operations in 1Q16. Assuming that it will retain the 3rd precast plant this year, its total annual production capacity in 2016 is estimated to rise to 251,000 m³.

We reckon that the expansion of its precast capacity is one of the catalysts that will bring about more promising margin growth in the future.

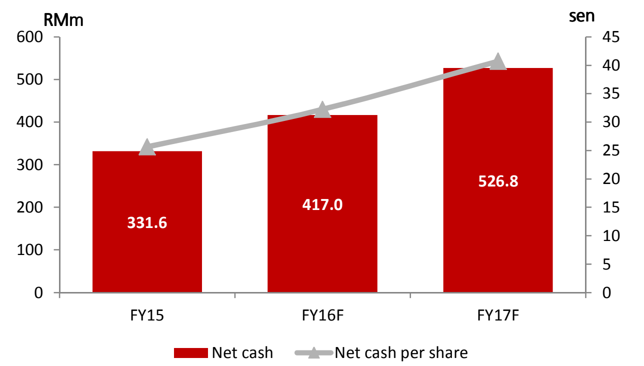
Moderate construction margins for FY16-FY17F. We project its construction segment to register a turnover of c. RM2bn in FY16F and RM2.2bn in FY17F, with stronger EBIT margins of 7% to be recognised each year (vs 3.6% in FY15). Our assumptions have built in the impact of the finalisation of several accounts such as LRT2 which will be completed in 2Q16. This is also backed by management guidance that civil/Infrastructure projects tend to record higher margins.

Exhibit : ROAE (2013-2017)



Source: Company, AllianceDBS

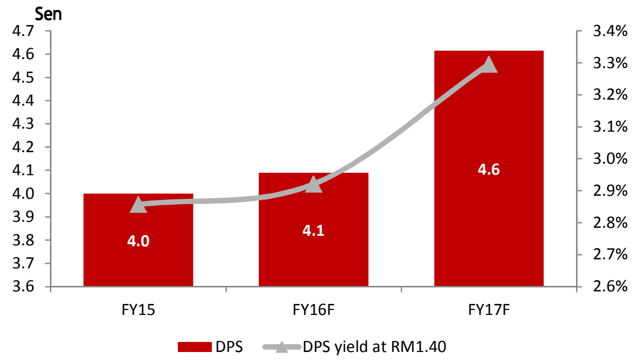
Exhibit : Net cash forecasts



Source: Company, AllianceDBS

Strong balance sheet and cash generation ability. With a net cash position of RM332m in FY15 with no long-term borrowings and minimal working capital requirements going forward, we estimate the group will retain its strong balance sheet with a net cash position for FY16-FY17F. Meanwhile, its ROAE is expected to hover around the 27-29% range.

Exhibit : Dividend forecasts



Source: Company, AllianceDBS

Dividend payout policy of >35%. SCG is committed to distribute >35% of its core profit to shareholders, which is rare among construction players. This could be attributable to its sizeable operations with a large asset base that requires little capex spending going forward. We have imputed a 37% dividend payout ratio, based on our strong net cash forecasts. This translates into decent dividend yields of c.3%.

Key Assumptions

FY Dec	2012A	2013A	2014A	2015A	2016F	2017F
Construction revenue	1,576	1,955	2,032	1,664	1,691	1,877
Precast revenue	204	252	301	253	300	320
Construction margins	0.0	0.0	0.0	3.56	6.92	7.23
Precast margins	0.0	0.0	0.0	30.5	21.0	21.0

Sensitivity Analysis

	2016
250m new wins	Net Profit+1%

Segmental Breakdown

FY Dec	2012A	2013A	2014A	2015A	2016F	2017F
Revenues (RMm)						
Construction	1,576	1,955	2,032	1,664	1,691	1,877
Precast Concrete	204	252	301	253	300	320
Consolidated Adjustments	(331)	(368)	(452)	0.0	0.0	0.0
Total	**1,448**	**1,840**	**1,881**	**1,917**	**1,990**	**2,197**
EBIT (RMm)						
Construction	0.0	0.0	0.0	59.2	117	136
Precast Concrete	0.0	0.0	0.0	77.1	62.9	67.2
Total	**48.2**	**42.4**	**120**	**136**	**180**	**203**
EBIT Margins (%)						
Construction	0.0	0.0	0.0	3.6	6.9	7.2
Precast Concrete	0.0	0.0	0.0	30.5	21.0	21.0
Total	3.3	2.3	6.4	7.1	9.0	9.2

Source: Company, AllianceDBS Research

RM2bn new wins in 2017

More jobs for construction segment with better margins in 2016 and 2017

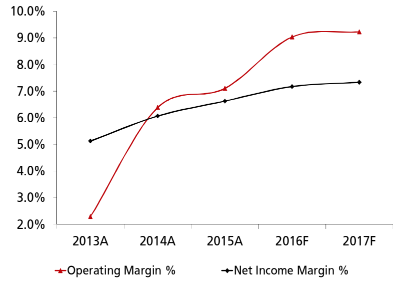
Precast margins to normalise towards 20% range

Income Statement (RMm)

FY Dec	2012A	2013A	2014A	2015A	2016F	2017F
Revenue	1,448	1,840	1,881	1,917	1,990	2,197
Cost of Goods Sold	(1,167)	(1,502)	(1,485)	(1,514)	(1,530)	(1,713)
Gross Profit	**282**	**338**	**395**	**403**	**460**	**484**
Other Opng (Exp)/Inc	(234)	(296)	(275)	(267)	(280)	(281)
Operating Profit	**48.2**	**42.4**	**120**	**136**	**180**	**203**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	29.2	45.4	30.4	(0.1)	0.0	0.0
Net Interest (Exp)/Inc	4.49	2.07	0.72	4.54	(1.3)	(1.3)
Exceptional Gain/(Loss)	13.9	27.6	(10.6)	0.0	0.0	0.0
Pre-tax Profit	**95.8**	**117**	**141**	**141**	**179**	**202**
Tax	(18.4)	(23.7)	(26.5)	(13.0)	(35.7)	(40.3)
Minority Interest	(8.8)	0.85	0.05	(0.6)	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0	0.0
Net Profit	**68.7**	**94.5**	**114**	**127**	**143**	**161**
Net Profit before Except.	54.8	66.9	125	127	143	161
EBITDA	75.8	85.2	162	178	221	243
Growth						
Revenue Gth (%)	nm	27.0	2.2	1.9	3.8	10.4
EBITDA Gth (%)	nm	12.4	90.0	10.1	24.3	9.7
Opg Profit Gth (%)	nm	(12.1)	183.7	13.4	32.0	12.7
Net Profit Gth (Pre-ex) (%)	nm	22.2	86.5	1.9	12.4	12.8
Margins & Ratio						
Gross Margins (%)	19.5	18.4	21.0	21.0	23.1	22.0
Opg Profit Margin (%)	3.3	2.3	6.4	7.1	9.0	9.2
Net Profit Margin (%)	4.7	5.1	6.1	6.6	7.2	7.3
ROAE (%)	12.3	16.1	24.6	33.2	28.8	27.2
ROA (%)	4.7	6.5	8.5	9.2	9.1	9.3
ROCE (%)	9.0	10.2	21.8	25.3	22.2	21.8
Div Payout Ratio (%)	0.0	0.0	0.0	40.7	37.0	37.0
Net Interest Cover (x)	NM	NM	NM	NM	134.2	151.3

Source: Company, AllianceDBS Research

Margins Trend

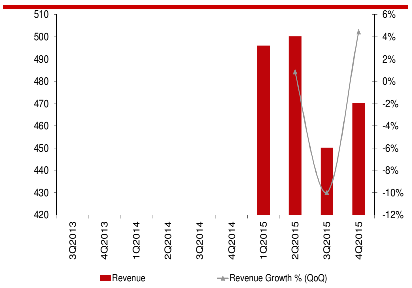


Quarterly / Interim Income Statement (RMm)

FY Dec	2Q2015	3Q2015	4Q2015
Revenue	500	450	470
Other Oper. (Exp)/Inc	(459)	(422)	(443)
Operating Profit	**41.3**	**28.2**	**27.6**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0
Net Interest (Exp)/Inc	0.37	1.90	1.84
Exceptional Gain/(Loss)	0.0	0.0	0.0
Pre-tax Profit	**41.7**	**30.1**	**29.4**
Tax	(3.8)	(5.0)	0.97
Minority Interest	0.0	0.46	(1.0)
Net Profit	**37.8**	**25.7**	**29.4**
Net profit bef Except.	37.8	25.7	29.4
EBITDA	41.3	28.2	27.6
Growth			
Revenue Gth (%)	0.8	(10.0)	4.4
EBITDA Gth (%)	5.4	(31.6)	(2.4)
Opg Profit Gth (%)	5.4	(31.6)	(2.4)
Net Profit Gth (Pre-ex) (%)	10.0	(32.1)	14.4
Margins			
Opg Profit Margins (%)	8.3	6.3	5.9
Net Profit Margins (%)	7.6	5.7	6.2

Source: Company, AllianceDBS Research

Revenue Trend



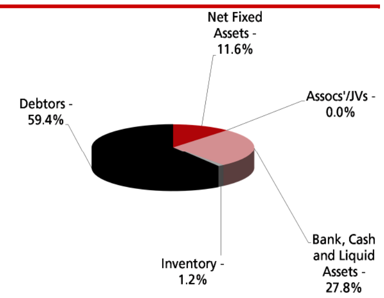
Mainly due to higher margins contributed by precast segment

Balance Sheet (RMm)

FY Dec	2012A	2013A	2014A	2015A	2016F	2017F
Net Fixed Assets	176	206	179	163	156	151
Invts in Associates & JVs	26.2	22.1	24.2	0.0	0.0	0.0
Other LT Assets	5.73	5.77	10.8	17.4	17.4	17.4
Cash & ST Invts	154	156	222	468	554	664
Inventory	21.9	25.5	20.2	17.3	19.8	21.9
Debtors	1,070	1,020	790	835	873	963
Other Current Assets	1.52	5.44	8.52	14.4	14.4	14.4
Total Assets	**1,456**	**1,442**	**1,254**	**1,515**	**1,634**	**1,832**
ST Debt	45.2	75.1	135	137	137	137
Creditor	796	731	791	913	942	1,038
Other Current Liab	2.64	9.42	13.2	9.26	9.26	9.26
LT Debt	18.0	15.4	0.07	0.0	0.0	0.0
Other LT Liabilities	1.05	1.57	4.29	4.10	4.10	4.10
Shareholder's Equity	560	614	315	451	541	643
Minority Interests	32.6	(4.5)	(5.2)	0.63	0.63	0.63
Total Cap. & Liab.	**1,456**	**1,442**	**1,254**	**1,515**	**1,634**	**1,832**
Non-Cash Wkg. Capital	295	311	14.1	(56.1)	(45.0)	(48.0)
Net Cash/(Debt)	91.2	65.6	86.4	332	417	527
Debtors Turn (avg days)	269.6	207.4	175.7	154.7	156.5	152.5
Creditors Turn (avg days)	255.1	191.0	192.4	211.3	227.5	216.1
Inventory Turn (avg days)	7.0	5.9	5.8	4.6	4.6	4.5
Asset Turnover (x)	2.0	1.3	1.4	1.4	1.3	1.3
Current Ratio (x)	1.5	1.5	1.1	1.3	1.3	1.4
Quick Ratio (x)	1.5	1.4	1.1	1.2	1.3	1.4
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	89.9	0.0	29.2	18.8	25.6	25.6

Source: Company, AllianceDBS Research

Asset Breakdown



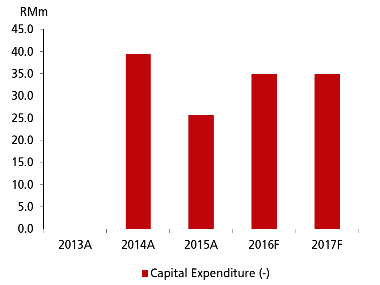
Strong balance sheet and net cash position

Cash Flow Statement (RMm)

FY Dec	2012A	2013A	2014A	2015A	2016F	2017F
Pre-Tax Profit	81.9	89.8	151	141	179	202
Dep. & Amort.	27.6	42.8	41.6	41.9	41.5	40.1
Tax Paid	(18.4)	(23.7)	(26.5)	(13.0)	(35.7)	(40.3)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(5.0)	(66.8)	297	79.9	(11.1)	3.04
Other Operating CF	(32.3)	43.3	(276)	(10.1)	0.0	0.0
Net Operating CF	**53.8**	**85.4**	**187**	**240**	**173**	**204**
Capital Exp.(net)	(56.8)	0.0	(39.5)	(25.7)	(35.0)	(35.0)
Other Invts.(net)	0.0	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0	0.0
Other Investing CF	23.2	(69.2)	389	(38.8)	0.0	0.0
Net Investing CF	**(33.6)**	**(69.2)**	**349**	**(64.5)**	**(35.0)**	**(35.0)**
Div Paid	(15.1)	(19.5)	(429)	(70.0)	(52.9)	(59.7)
Chg in Gross Debt	18.1	29.2	46.5	1.64	1.00	1.00
Capital Issues	0.0	0.0	0.0	0.0	0.0	0.0
Other Financing CF	0.0	0.0	0.0	0.0	0.0	0.0
Net Financing CF	**3.09**	**9.70**	**(382)**	**(68.4)**	**(51.9)**	**(58.7)**
Currency Adjustments	0.0	0.0	0.0	0.0	0.0	0.0
Chg in Cash	23.3	26.0	154	107	86.4	111
Opg CFPS (sen)	4.55	11.8	(8.5)	12.3	14.3	15.6
Free CFPS (sen)	(0.2)	6.60	11.4	16.5	10.7	13.1

Source: Company, AllianceDBS Research

Capital Expenditure



Capex capped at RM40m going forward

Valuation

Fair value of RM1.92. Within our construction universe, SCG stands out as a pure construction player. We are valuing SCG using sum-of-parts (SOP) methodology to reflect its growing contribution from its high-margin precast business. While our SOP value is RM2.77bn or RM2.14/share, we have ascribed a 10% discount to arrive at our target price of RM1.92.

For the construction division, we have valued it based on a combination of DCF and PE. We have assumed a sustainable orderbook of RM3.5bn and pretax margins of 6% which we believe is fair given its current outstanding orderbook of RM2.79bn, coupled with the strong prospects of chunky new wins from key transportation projects. We have assigned a PE of 14x to our DCF value, which translates into a 25% discount to the larger PEER of IJM and Gamuda that trade at CY16 PE of 18-19x.

For the precast division, we have also valued it based on a combination of DCF and PE. We have assumed a sustainable orderbook of RM450m and margins of 21%. We think this is fair given the strong pipeline of HDB order flows, in which 25,000 units are targeted to be built each year in FY16-FY17F. Moreover, the 2-year historical margins have been 31-36%. We have assigned a PE of 16x to the precast division, a premium to its construction division which we believe is justified given the former's higher margins and less competitive nature. At our TP of RM1.92, this translates into an FY16F PE of 17.3x and FY17F PE of 15.4x.

In our view, Suncon should trade at premium to WCT which is of similar size in market cap given it is a pure exposure to the sector. Moreover, we are at the start of an upswing for construction awards on the back of the onset of the 11MP. This is also further underpinned by company-specific positives such as being the largest listed pure play construction play as well as boasting an impeccable execution track record and a robust orderbook. Another reason for our valuation premium is SCG's stronger balance sheet and higher ROEs, compared to its peers within our construction coverage. As it delivers stronger earnings and clinches more sizeable projects over time, we believe there is potential for further re- rating to nudge the share price closer to our TP of RM1.92.

Exhibit : SOP valuation

SOP Method	DCF value	PE	Attributed Value	Per Share
Construction	130.44	14	1,826.1	1.412
Precast	58.70	16	939.1	0.726
SOP Value			**2,765.3**	**2.14**
TP based on 10% discount				1.92

Sources: AllianceDBS

Exhibit : Peers comparison

	Market Cap	Rec.	TP	Diluted PE (x)			P/NTA (x)			Net Div Yield (%)			ROE (%)		
	(USDm)		(Local currency)	CY15	CY16	CY17	CY15	CY16	CY17	CY15	CY16	CY17	CY15	CY16	CY17
Malaysia															
Gamuda	2,546.8	BUY	5.80	17.4	19.4	17.7	1.8	1.8	1.7	2.0	2.0	2.0	4.0	4.2	4.1
IJM	2,885.1	HOLD	3.30	20.2	18.4	17.5	1.4	1.4	1.4	3.3	3.3	3.3	8.2	3.3	3.3
WCT	453.0	HOLD	1.55	9.5	16.7	16.1	0.7	1.0	1.0	2.1	2.1	2.1	9.0	5.8	5.9
Muhibbah Eng	252.6	BUY	2.90	11.3	8.6	8.0	1.2	1.0	1.0	1.9	2.2	2.5	11.6	11.8	11.9
Kimlun	107.2	BUY	2.38	8.5	7.9	7.3	1.0	0.9	0.9	2.5	2.3	2.6	14.8	13.4	13.7
Average				**13.4**	**14.2**	**13.3**	**1.2**	**1.2**	**1.2**	**2.4**	**2.4**	**2.5**	**9.5**	**7.7**	**7.8**
SunCon	525.0	**BUY**	**1.92**	14.2	12.0	11.2	4.0	3.3	3.3	2.9	3.1	3.3	33.2	28.8	27.2

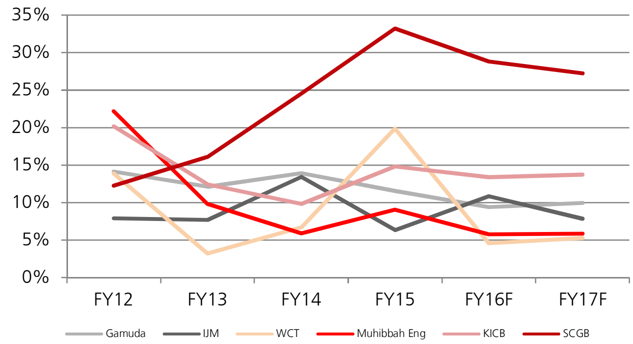
Sources: AllianceDBS, Bloomberg Finance L.P

Exhibit : TP sensitivity to orders and margins

			Sustainable Construction orders				
					Base Case		
			2500	3000	3500	4000	4500
		margins %	4	5	6	7	8
Precast orders	350	19	1.18	1.52	1.73	2.39	2.93
	400	20	1.29	1.46	1.82	2.50	3.04
	450	21	1.26	1.74	2.14	2.61	3.15
	500	20	1.37	1.85	2.26	2.73	3.27
	550	22	1.64	1.98	2.15	2.86	3.39

Sources: AllianceDBS

Exhibit : SCG's ROE vs peers



Sources: AllianceDBS

AllianceDBS Research recommendations are based an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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AllianceDBS Research Sdn Bhd
(128540 U)
19th Floor, Menara Multi-Purpose, Capital Square,
8 Jalan Munshi Abdullah 50100
Kuala Lumpur, Malaysia.
Tel.: +603 2604 3333 Fax: +603 2604 3921 email : general@alliancedbs.com