

26 May 2022

Construction & Engineering | Construction

Sunway Construction (SCGB MK)

Buy (Maintained)

Margins Still Decent Despite Cost Pressures; BUY

Target Price (Return):	MYR1.93 (+22%)
Price (Market Cap):	MYR1.58 (USD463m)
ESG score:	3.20 (out of 4)
Avg Daily Turnover (MYR/USD)	0.60m/0.14m

- **Maintain BUY and MYR1.93 TP, 22% upside with c.4% yield.** Sunway Construction's 1Q22 core net profit met our and Street expectations – accounting for 25% and 26% of full-year forecasts. Looking ahead, we expect it to be a frontrunner for the job involving the elevated works portion of Mass Rapid Transit 3 (MRT3), as its lean balance sheet still allows it to take on large projects. Aside from that, its listed parent should continue to support earnings visibility – 48% of its orderbook comes from internal building contracts from its parent company.

- **Results review.** SunCon reported stronger 1Q22 core earnings of MYR34.9m (+83.5% YoY), underpinned by the 37.2% YoY growth in revenue to MYR624.7m (1Q21: MYR455.2m). This was achieved despite the 35% YoY rise in the cost of sales. Its construction segment's PBT surged by 95% YoY, amid the impact of the MCO in 1Q21, in addition to the finalisation of accounts for completed projects. Meanwhile, its precast segment booked a 71.4% YoY decline in PBT during the quarter, despite a 8.9% YoY revenue growth due to the impact of higher steel bar prices.

- **Update on orderbook.** SunCon's outstanding construction orderbook stood at MYR4.4bn as at end-1Q22 (end-4Q21: MYR4.8bn) – which should support earnings visibility well into FY24. YTD new job wins stand at MYR266m, which involves electrical fit-out works for Menara Merdeka 118 and piling works for the Light Rapid Transit 3 (LRT3) project, among others. Although this is behind our job replenishment target of MYR1.5bn for FY22, we believe that the group stands a high chance of winning jobs from the MRT3 project – given its previous track record under MRT2, with a cumulative contract value of MYR1.4bn.

- **We make no change to our earnings forecasts, as results are within expectations.** While rising building material costs remains an issue, we think SunCon will be able to weather the impact as it negotiates with its suppliers. We only expect its EBIT margin to reach 7.6% in FY22 (FY21: 8.2%), which is within management's guidance of 5-8%. Our target P/E of 15.5x, pegged to our FY23F EPS, remains unchanged. The valuation target is fair, in our view, as it has imputed SunCon's high likelihood of securing MRT3 jobs. The target P/E is above the KLCON's index forward P/E of 12.8x, considering SunCon's sturdy orderbook/revenue cover of c.2.8x, backed by a robust balance sheet with a manageable net debt-to-equity ratio 0.17x as of end-1Q22. All in, our TP of MYR1.93 remains unchanged, after imputing a 4% premium to our intrinsic valuation, based on our proprietary ESG scoring methodology.

- **Key downside risks** include project delays and prolonged high material costs.

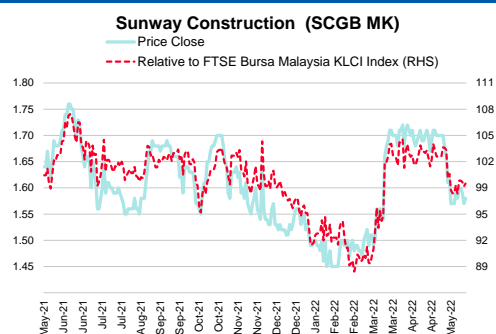
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	1.3	(5.4)	5.3	1.3	(3.7)
Relative	3.6	(1.7)	9.1	0.4	(0.7)
52-wk Price low/high (MYR)	1.45 – 1.76				



Source: Bloomberg

Overall ESG Score: 3.20 (out of 4)

E: EXCELLENT

SunCon implemented rooftop solar panels at its Sunway Precast Industries plant at Senai, Johor, to reduce the carbon emissions of site operations. With this, 98.6MWh of energy can be consumed via solar generation at this Senai plant, avoiding 57.7 tonnes of carbon emissions. In FY21, the group guided that its carbon emission intensity per unit revenue has declined from 98 tonnes carbon dioxide/MYRm.

S: GOOD

The group ensures the safety and health of all its employees, and public areas surrounding the construction sites, via various training and safety programmes. Apart from up-to-standard health & safety policies, we see active community engagement and efforts to uplift employee relations.

G: EXCELLENT

57% of its board members are independent, with full disclosure on director remuneration, including salaries and bonuses. The group has an in-house investor relations team. Accessibility to investor relations is excellent, and the team mostly helps to deal with investor queries.

Note:

Small cap stocks are defined as companies with a market capitalization of less than USD0.5bn.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (MYRm)	1,553	1,729	2,354	2,737	2,687
Recurring net profit (MYRm)	92	110	141	151	154
Recurring net profit growth (%)	(31.6)	19.9	27.7	7.4	1.8
Recurring P/E (x)	22.20	18.52	14.51	13.51	13.27
P/B (x)	3.2	2.9	2.7	2.5	2.3
P/CF (x)	9.70	17.14	24.64	10.00	10.82
Dividend Yield (%)	2.5	3.3	4.1	4.4	4.5
EV/EBITDA (x)	13.40	8.92	6.68	5.88	6.03
Return on average equity (%)	11.6	17.2	19.4	19.3	18.2
Net debt to equity (%)	16.7	21.1	32.4	20.2	11.8

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Malaysia	Recurring EPS	0.07	0.09	0.11	0.12	0.12
Construction & Engineering	DPS	0.04	0.05	0.07	0.07	0.07
Sunway Construction	BVPS	0.49	0.54	0.58	0.63	0.68
SCGB MK	Return on average equity (%)	11.6	17.2	19.4	19.3	18.2
Buy						
	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Valuation basis	Recurring P/E (x)	22.20	18.52	14.51	13.51	13.27
We value the company based on FY22F P/E of 15.5x.	P/B (x)	3.2	2.9	2.7	2.5	2.3
Sunway Construction's minimal net debt position allows it to gear up for more jobs moving forward.	FCF Yield (%)	10.1	4.1	1.4	7.3	6.5
	Dividend Yield (%)	2.5	3.3	4.1	4.4	4.5
	EV/EBITDA (x)	13.40	8.92	6.68	5.88	6.03
	EV/EBIT (x)	18.36	10.67	8.73	7.74	7.58
Key drivers	Income statement (MYRm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Sunway Construction's earnings are backed by:	Total turnover	1,553	1,729	2,354	2,737	2,687
i. An outstanding order backlog of MYR4.7bn, of which >90% is from construction, which should keep the firm busy for the next three years;	Gross profit	270	358	416	463	491
ii. Recurring orders from its parent company.	EBITDA	124	167	234	254	238
	Depreciation and amortisation	(33)	(27)	(55)	(61)	(49)
	Operating profit	91	139	179	193	189
	Net interest	1	(0)	(8)	(8)	(7)
	Pre-tax profit	102	155	177	190	191
	Taxation	(28)	(41)	(36)	(39)	(37)
	Reported net profit	73	115	141	151	154
	Recurring net profit	92	110	141	151	154
	Cash flow (MYRm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Change in working capital	104	(36)	(113)	(8)	(14)
	Cash flow from operations	211	119	83	204	189
	Capex	(3)	(35)	(55)	(55)	(55)
	Cash flow from investing activities	(173)	(174)	(55)	(55)	(54)
	Dividends paid	(62)	(52)	(84)	(91)	(92)
	Cash flow from financing activities	(147)	(122)	(10)	(16)	(18)
	Cash at beginning of period	615	200	99	78	211
	Net change in cash	(110)	(177)	18	133	117
	Ending balance cash	505	23	117	211	328
	Balance sheet (MYRm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Total cash and equivalents	200	99	78	211	328
	Tangible fixed assets	107	130	130	124	130
	Total investments	489	724	724	724	724
	Total assets	1,906	1,869	1,997	2,251	2,335
	Short-term debt	234	93	143	193	243
	Total long-term debt	73	158	163	173	183
	Total liabilities	1,267	1,153	1,296	1,489	1,512
	Total equity	639	717	701	761	823
	Total liabilities & equity	1,906	1,869	1,997	2,251	2,335
	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Revenue growth (%)	(12.2)	11.4	36.1	16.3	(1.8)
	Recurrent EPS growth (%)	(31.6)	19.9	27.7	7.4	1.8
	Gross margin (%)	17.4	20.7	17.7	16.9	18.3
	Operating EBITDA margin (%)	8.0	9.6	9.9	9.3	8.9
	Net profit margin (%)	4.7	6.6	6.0	5.5	5.7
	Dividend payout ratio (%)	70.9	58.9	60.0	60.0	60.0
	Capex/sales (%)	0.2	2.0	2.3	2.0	2.0
	Interest cover (x)	13.0	30.4	16.7	14.7	12.2

Source: Company data, RHB

Results At a Glance

Figure 1: SunCon's results review

FYE Dec (MYRm)	1Q21	4Q21	1Q22	QoQ (%)	YoY (%)	Comments
Revenue	455.2	626.6	624.7	(0.3)	37.2	Higher revenue was due to normalisation as the corresponding quarter of the preceding financial year was affected by MCO 2.0 from 13 Jan 2021 to 4 Mar 2021
EBIT	26.1	84.0	42.9	(48.9)	64.5	
<i>EBIT margin (%)</i>	<i>5.7</i>	<i>13.4</i>	<i>6.9</i>			
Interest expense	(1.6)	(1.1)	(1.2)	6.5	(27.3)	
Interest income	0.8	1.0	2.2	112.4	194.3	
JV/Associates	2.0	6.2	3.2	(48.7)	60.1	
EI/Others	1.2	0.9	(0.4)	(147.1)	(133.7)	Net disposal gains from PPE, which are non-recurring in nature.
Pre-tax profit	27.2	91.0	47.2	(48.2)	73.1	
<i>Pre-tax margin (%)</i>	<i>6.0</i>	<i>14.5</i>	<i>7.6</i>			
Tax	(6.9)	(26.0)	(11.5)	(55.7)	66.3	
<i>Effective tax rate (%)</i>	<i>(27.4)</i>	<i>(30.7)</i>	<i>(26.2)</i>			
Minority interest	(0.1)	(0.3)	(1.1)	326.2	1,435.6	
Net profit	20.2	64.7	34.5	(46.7)	70.5	
Core profit	19.0	63.9	34.9	(45.3)	83.5	In line with our and Street expectations.
<i>Core net margin (%)</i>	<i>4.2</i>	<i>10.2</i>	<i>5.6</i>			

Source: Company data, RHB

Recommendation Chart

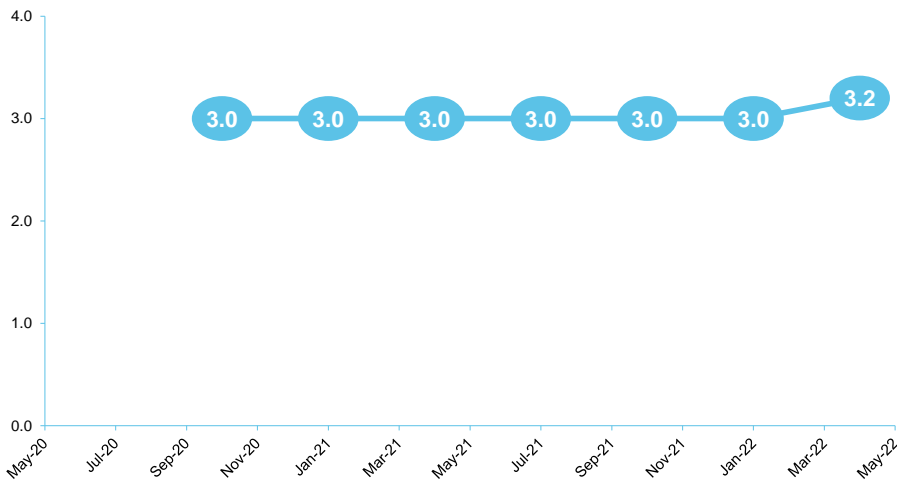


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-04-26	Buy	1.93	1.69
2022-02-24	Buy	1.74	1.47
2021-08-11	Buy	1.81	1.58
2021-06-29	Buy	1.94	1.64
2021-05-21	Buy	2.03	1.63
2021-02-24	Buy	2.18	1.66
2020-08-20	Buy	2.09	1.80
2020-08-19	Buy	2.14	1.80

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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