

21 May 2024

Construction & Engineering | Construction

Sunway Construction (SCGB MK)

Buy (Maintained)

Catalysts Intact Despite a Muted 1Q24; BUY

Target Price (Return): MYR3.81 (14%)
 Price (Market Cap): MYR3.35 (USD922m)
 ESG score: 3.3 (out of 4)
 Avg Daily Turnover (MYR/USD) 10.9m/2.30m

- **Still BUY, new MYR3.81 TP (from MYR3.34), 14% upside, c.2% yield.** 1Q24 core net profit of MYR27m (+4% YoY) missed our and Street's estimates at 14% and 15% of full-year projections, mainly due to lower-than-expected progress billings of ongoing projects. While we expect Sunway Construction to see 5% YoY core earnings growth in FY24, we think FY25 will be a supercharged year underpinned by stronger recognition from a mix of data centre (DC) jobs and steady internal contracts (from its listed parent), which make up 34% of its outstanding orderbook.
- **The construction arm's PBT** only grew 5% YoY in 1Q24 vs 16% YoY revenue growth in 1Q24, leading to a lower PBT margin of 7% (1Q23: 7.7%). This was mainly due to internal residential projects with thinner margins. The precast segment saw 1Q24 PBT of MYR3.7m vs MYR1.3m in 1Q23 supported by better activity at the group's Integrated Construction & Prefabrication Hub amid better precast demand.
- **Prospects.** SCGB's construction orderbook stood at MYR6.3bn at end-1Q24 (end-1Q23: MYR6bn), with MYR1.7bn orders secured YTD (FY24 target: MYR3bn). Looking ahead, SCGB has MYR9.4bn worth of active tenders comprising DC, warehousing, and semiconductor facilities. Additional job replenishment could come from the reinstatement of five Light Rail Transit (LRT) 3 stations and the Penang LRT Mutiara Line via Segment 2.
- **We cut FY24F earnings by 10%** but revise FY25-26F earnings upwards by 2-4% each as we backlog revenue recognition for some jobs, particularly the DC job in Sedenak Tech Park (completion rate relatively unchanged in 1Q24 vs 4Q23 at c.14%). We do not discount the possibility of the DC job extending into 1Q25 (from 3Q24 initially).
- **Valuation.** We revise our target P/E to 20.5x (from 18.5x), pegged to our FY25F EPS to reflect SCGB's position to secure more DC jobs in Johor and Selangor, after securing MYR2.8bn worth of DC contracts (which were absent during the CY17 construction upcycle, when it traded at 18.5x P/E). Long-term catalysts are Sunway's (SWB MK, BUY, TP: MYR3.53) hospital expansion plans across Penang, Kelantan, and Iskandar Puteri. The net effect of such adjustments is our new MYR3.81 TP (includes a 6% ESG premium).
- **The stock is trading at 19x FY25 P/E**, at a premium to the Bursa Malaysia Construction Index's 5-year mean of 13x. We think this is justified, as SCGB's ROE is significantly higher than peers', and it will potentially benefit from the Johor-Singapore Special Economic Zone via Sunway City Iskandar Puteri. Our estimates have yet to impute the Song Hau 2 power plant project which may boost its orderbook by c.MYR6bn and raise FY24-26F earnings by 8-17% if the project commences from 1H24, and financial close is obtained.
- **Key risks:** Project delays and a prolonged period of high material costs.

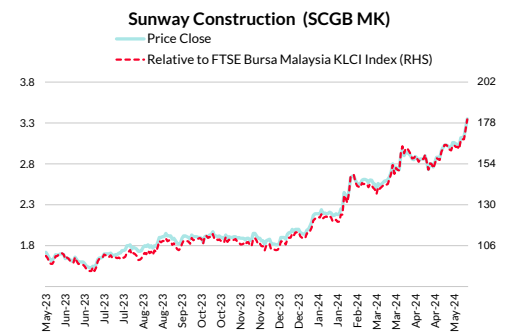
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	72.7	21.4	28.4	74.5	94.8
Relative	60.8	16.2	23.8	62.8	80.9
52-wk Price low/high (MYR)				1.53	-3.35



Source: Bloomberg

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (MYRm)	2,155	2,671	2,843	3,463	4,100
Recurring net profit (MYRm)	144	170	176	226	259
Recurring net profit growth (%)	(0.3)	18.2	3.2	28.7	14.6
Recurring P/E (x)	30.00	25.38	24.60	19.11	16.68
P/B (x)	5.9	5.3	4.9	4.4	4.0
P/CF (x)	na	na	9.44	30.30	13.90
Dividend Yield (%)	1.6	1.8	2.4	3.1	3.6
EV/EBITDA (x)	19.44	16.04	18.04	13.53	12.73
Return on average equity (%)	18.8	18.6	20.5	24.2	25.1
Net debt to equity (%)	net cash	38.7	26.8	28.4	33.8

Source: Company data, RHB

Overall ESG Score: 3.3 (out of 4)

E: EXCELLENT

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/RM million.

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.

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Malaysia	Recurring EPS	0.11	0.13	0.14	0.18	0.20
Construction & Engineering	DPS	0.05	0.06	0.08	0.11	0.12
Sunway Construction	BVPS	0.57	0.64	0.69	0.76	0.84
SCGB MK	Return on average equity (%)	18.8	18.6	20.5	24.2	25.1
Buy						
	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Valuation basis	Recurring P/E (x)	30.00	25.38	24.60	19.11	16.68
We value the company based on FY25F P/E of 20.5x.	P/B (x)	5.9	5.3	4.9	4.4	4.0
Sunway Construction's minimal net debt position allows it to gear up for more jobs moving forward.	FCF Yield (%)	(5.6)	(7.0)	9.3	2.0	5.9
	Dividend Yield (%)	1.6	1.8	2.4	3.1	3.6
	EV/EBITDA (x)	19.44	16.04	18.04	13.53	12.73
	EV/EBIT (x)	21.92	19.99	21.75	15.73	14.83
Key drivers	Income statement (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Sunway Construction's earnings are backed by:	Total turnover	2,155	2,671	2,843	3,463	4,100
i. An outstanding order backlog of MYR6.3bn, of which >90% is from construction, which would keep the firm busy for the next three years;	Gross profit	366	198	454	753	787
ii. Recurring orders from its parent company.	EBITDA	210	279	244	329	357
	Depreciation and amortisation	(24)	(55)	(42)	(46)	(50)
	Operating profit	187	224	203	283	307
	Net interest	(4)	(21)	(5)	(1)	(1)
	Pre-tax profit	184	189	207	277	316
	Taxation	(45)	(43)	(40)	(54)	(62)
	Reported net profit	135	145	176	226	259
	Recurring net profit	144	170	176	226	259
Key risks	Cash flow (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
i. Project delays;	Change in working capital	(382)	(498)	250	(126)	6
ii. A prolonged period of high material costs.	Cash flow from operations	(215)	(286)	458	143	311
	Capex	(27)	(18)	(55)	(55)	(56)
	Cash flow from investing activities	424	(88)	(54)	(53)	(256)
	Dividends paid	(90)	(72)	(105)	(136)	(155)
	Cash flow from financing activities	143	349	259	155	129
	Cash at beginning of period	99	492	470	593	611
	Net change in cash	351	(25)	662	245	183
	Ending balance cash	446	467	1,133	839	797
Company Profile	Balance sheet (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Sunway Construction is one of the largest construction companies in Malaysia. Apart from civil & infrastructure construction services, the company also provides the more specialised: i. Foundation & geotechnical engineering services; ii. Mechanical, electrical & plumbing (MEP) 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 hose concrete products for Housing & Development Board (HDB) projects in the island republic.	Total cash and equivalents	576	582	705	723	688
	Tangible fixed assets	108	99	183	191	196
	Total investments	223	253	253	253	253
	Total assets	2,236	3,083	2,936	3,248	3,709
	Short-term debt	172	438	488	538	588
	Total long-term debt	312	489	477	487	497
	Total liabilities	1,415	2,191	1,965	2,184	2,536
	Total equity	821	892	971	1,065	1,173
	Total liabilities & equity	2,236	3,083	2,936	3,248	3,709
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	24.6	23.9	6.4	21.8	18.4
	Recurrent EPS growth (%)	(0.3)	18.2	3.2	28.7	14.6
	Gross margin (%)	17.0	7.4	16.0	21.7	19.2
	Operating EBITDA margin (%)	9.8	10.5	8.6	9.5	8.7
	Net profit margin (%)	6.3	5.4	6.2	6.5	6.3
	Dividend payout ratio (%)	52.5	53.3	60.0	60.0	60.0
	Capex/sales (%)	1.3	0.7	1.9	1.6	1.4
	Interest cover (x)	10.3	4.7	3.3	5.8	6.8

Source: Company data, RHB

Results At a Glance

Figure 1: SCGB's results review

FYE Dec (MYRm)	4Q22	3Q23	4Q23	QoQ (%)	YoY (%)	Comments
Revenue	522.1	871.5	604.8	(30.6)	15.8	Better progress billings due from newer projects
EBIT	41.7	81.8	53.1	(35.1)	27.4	
<i>EBIT margin (%)</i>	8.0	9.4	8.8			
Interest expense	(8.3)	(15.2)	(16.2)	6.7	95.7	
Interest income	4.1	8.6	4.7	(44.9)	15.4	
EI/Others	(1.9)	(24.7)	5.4	>-100	>-100	
Pretax profit	37.5	60.8	41.6	(31.5)	11.0	
<i>Pretax margin (%)</i>	7.2	7.0	6.9			
Tax	(8.9)	(12.3)	(8.9)	(27.6)	0.7	
<i>Effective tax rate (%)</i>	(1.7)	(16.4)	(21.5)			
Minority interest	(0.8)	0.8	(0.3)	>-100	(61.9)	
Net profit	27.8	49.3	32.4	(34.2)	16.4	
Core profit	25.9	74.0	27.0	(63.5)	4.1	Missed expectations
<i>Core net margin (%)</i>	5.0	8.5	4.5			Thinner margins from internal residential projects

Source: Company data, RHB

Emissions And ESG

Trend analysis

While total emissions have been increasing, the Scope 1 emissions have eased to 7,440 tonnes in FY23 from 9,713 in FY20.

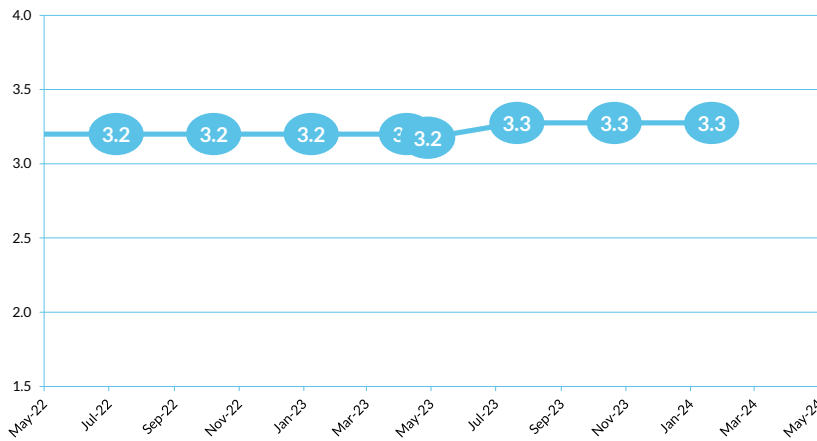
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	6,104	7,167	7,440
Scope 2	3,863	4,504	6,997
Scope 3	144,401	168,888	314,414
Total emissions	154,368	180,559	328,851

Source: Company data, RHB

Latest ESG-Related Developments

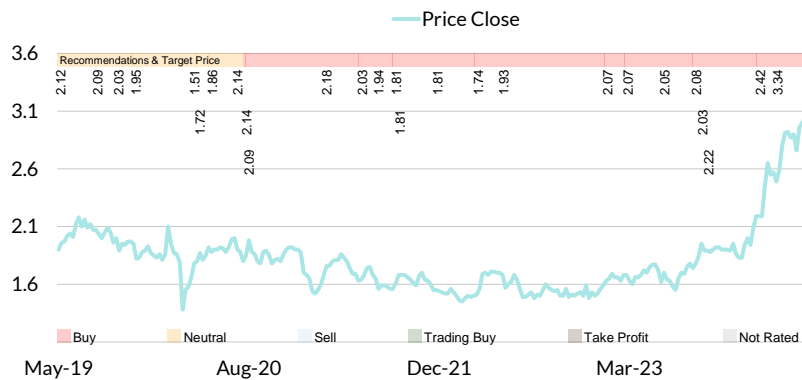
- Through its Sustainable Energy Services division, the group continues to be in the forefront of ongoing efforts to enable the transition towards a greener economy.
- In FY22, the division completed 18 rooftop solar panels installation projects with a cumulative clean energy generating capacity of 17,866 kWp.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-03-21	Buy	3.34	2.73
2024-02-22	Buy	3.34	2.60
2024-02-21	Buy	3.34	2.61
2024-01-12	Buy	2.42	2.19
2023-11-22	Buy	2.22	1.89
2023-10-06	Buy	2.22	1.92
2023-09-07	Buy	2.22	1.88
2023-08-24	Buy	2.03	1.79
2023-08-08	Buy	2.08	1.76
2023-07-12	Buy	2.05	1.70
2023-05-23	Buy	2.05	1.69
2023-05-16	Buy	2.07	1.72
2023-04-05	Buy	2.07	1.69
2023-03-02	Buy	2.07	1.69
2023-02-22	Buy	2.07	1.66

Source: RHB, Bloomberg

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Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
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Analyst	Company
-	-

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