

# Malaysia Company Guide

# Sunway Construction Group

Version 6 | Bloomberg: SCGB MK | Reuters: SCOG.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

16 Jan 2017

## BUY

Last Traded Price ( 13 Jan 2017): RM1.69 (KLCI : 1,672.50)

Price Target 12-mth: RM1.92 (14% upside) (Prev RM1.92)

**Potential Catalyst:** Better earnings delivery and stronger contract wins

**Where we differ:** We are broadly in line for FY17F as we expect higher earnings recognition from its peak orderbook

### Analyst

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### What's New

- Starting 2017 with sizeable win
- Lower new wins projected y-o-y but margins should improve
- Exploring new markets
- BUY, discount to larger cap peers should narrow

### Price Relative



### Forecasts and Valuation

FY Dec (RM m)	2015A	2016F	2017F	2018F
Revenue	1,917	1,841	2,321	2,739
EBITDA	178	207	235	263
Pre-tax Profit	141	164	194	222
Net Profit	127	131	155	178
Net Pft (Pre Ex.)	127	131	155	178
Net Pft Gth (Pre-ex) (%)	1.9	3.1	18.3	14.7
EPS (sen)	9.84	10.1	12.0	13.8
EPS Pre Ex. (sen)	9.84	10.1	12.0	13.8
EPS Gth Pre Ex (%)	2	3	18	15
Diluted EPS (sen)	9.84	10.1	12.0	13.8
Net DPS (sen)	4.00	4.56	5.40	6.19
BV Per Share (sen)	34.9	40.5	47.1	54.6
PE (X)	17.2	16.7	14.1	12.3
PE Pre Ex. (X)	17.2	16.7	14.1	12.3
P/Cash Flow (X)	9.3	13.8	10.2	9.4
EV/EBITDA (X)	10.4	8.7	7.1	5.9
Net Div Yield (%)	2.4	2.7	3.2	3.7
P/Book Value (X)	4.8	4.2	3.6	3.1
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	33.2	26.9	27.4	27.1
Earnings Rev (%):		0	0	0
Consensus EPS (sen):		9.90	12.3	12.9
Other Broker Recs:		B: 10	S: 0	H: 3

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P

## Strong and steady

**Malaysia's leading pure construction player.** Sunway Construction Group (SCG) is the largest listed pure play construction company 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 LRT3 and BRT as well as other infrastructure-related and building projects. 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. We estimate that for every incremental RM200m new wins will raise our FY17F forecast by 6% vs 1% for construction wins.

**More modest RM2bn order win guidance for FY17F.** Not one to rest on its laurels, SCG will be bidding for LRT 3 (already prequalified), private and public sector building jobs and the internal projects from the property arm of its holding company. 2016 wins reached RM2.6bn (including precast) which exceeded its RM2.5bn guidance. For FY17F, it is guiding for RM2bn worth of new wins which should come from a combination of LRT3, internal jobs, precast projects and some other private sector building jobs.

### Valuation:

**BUY, TP set at RM 1.92.** 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.

### Key Risks to Our View:

The timely execution of its peak orderbook of RM5bn is crucial to minimise the risk of any earnings cuts. With its strong execution track record and experience, we believe the group is able to execute the projects in a timely manner.

### At A Glance

Issued Capital (m shrs)	1,293
Mkt. Cap (RMm/US\$m)	2,185 / 490
Major Shareholders (%)	
Sunway Berhad	55.6
Tan Sri Jeffrey Cheah & Family	7.6
Free Float (%)	37.9
3m Avg. Daily Val (US\$m)	0.51

ICB Industry : Industrials / Construction & Materials

**WHAT'S NEW****Post Conference Update**

**RM2bn new order target still decent:** SCG has already achieved 23% of this target.

**Margins should trend upwards:** This is due to the 'S' Curve effect and completion of provisions for other projects.

**Strong execution track record and balance sheet:** No change in our BUY rating and TP. Both these key attributes and better earnings delivery should ensure valuation expansion.

SCG attended our Pulse of Asia Conference in Singapore recently. There was a mixture of investors who were new and those who were familiar with the company.

**Key highlight – new contract win.** There were no major updates since our last note in October 2016. But the key highlight from the conference is SCG is off to a great start to the year with a RM450m contract win from its parent company. This is to build a 52-storey residential building in Kelana Jaya. The contract is at Letter of Intent stage and will be converted to a firm Letter of Award once the design is firmed up.

With this win, SCG would have achieved 23% of its RM2bn new order win guidance this year. It is also optimistic of clinching a portion of LRT 3, more internal jobs from its parent and also traffic dispersal project in the city.

**To tender for less jobs in 2017.** 2017 will likely see lower new order wins vs 2016 where SCG achieved new wins of RM2.6bn. This was also because in 2016 it tendered for a total of RM55b worth of jobs. This comprised largely six packages for Pan Borneo Sarawak and three packages for MRT Line 1. It did not win any packages for Pan Borneo Sarawak and will likely not participate in Pan Borneo Sabah, citing the uncertain raw material environment and pricing as the key reasons.

**But construction margins to show gradual improvement.** In spite of lower order wins this year, it expects margins to be better given the S curve effect of its orderbook. Also, pricing for a key project in its outstanding RM4.8bn orderbook, MRT V201 worth RM1.27bn is 35% higher on a cost per km basis as compared to its MRT V4 package which should ensure gradual margin recovery. Its current orderbook of RM4.8bn will give it two and a half years of earnings visibility.

We are conservatively projecting construction margins of 6.5% and 6.8% in FY17F and FY18F vs 6.9% in FY16. 9M16 construction margins was 7.4%. Although the raw material cost environment is higher now compared to a year ago, this

is partly mitigated given its MRT V201 and its precast business in Singapore has cost pass through clauses.

**Watch out for high labour costs.** There may be higher labour costs going forward with the change in ruling where employers are to be fully accountable for their foreign workers' levy and can no longer deduct the amount from the workers' salaries. Nonetheless, this will only impact the 600 foreign workers it has directly under its payroll where it has been gradually training to be more skilful. As a comparison, we understand its MRT V201 package and Putrajaya Parcel F project will require 1,000 workers each.

For new projects, SCG will bid for where labour is outsourced, it will price this into the tender amount. Based on the incremental levy of RM1,850 per worker for its 600 workers, this constitutes less than 1% of its FY17F net profit.

**Exploring new markets.** SCG also sees 2017 as a year where it may potentially explore some overseas ventures in other ASEAN countries such as Indonesia and Myanmar. This is still at a preliminary stage. SCG is generally more cautious in nature and unlikely to take unnecessary risks. It cites its successful Abu Dhabi project where its clients were CapitalLand and Mudabala where it recognised 20% net margin for this project.

**Premium for execution and balance sheet strength.** Generally purer play contractors trade at a discount to the larger cap diversified players like IJM, Gamuda and WCT given the lack of recurring income base. While this theory may hold some truth, we think SCG's discount to its larger cap peers should not be too wide. Based on our estimates, SCG trades at 14.1x CY17 PE which is at a discount of 27-39% to IJM, Gamuda and WCT of 17.9x, 19.5x and 18.1x respectively. SCG's strong execution track record being the only contractor with a track record in MRT, LRT and BRT, its net cash balance sheet and ROE-enhancing precast division should still ensure PE expansion.

Our TP of RM1.92 values the stock at CY17 PE of 16x which assumes sustainable orderbooks of RM3.5bn and RM0.45bn for its construction and manufacturing division respectively.

## CRITICAL DATA POINTS TO WATCH

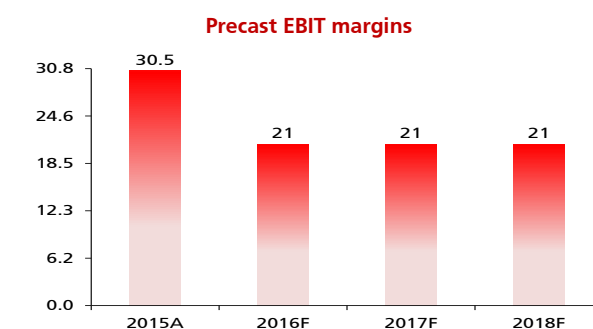
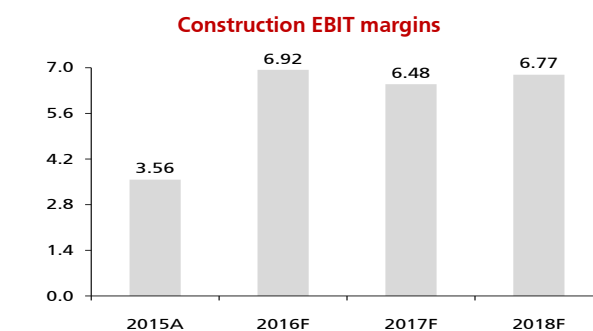
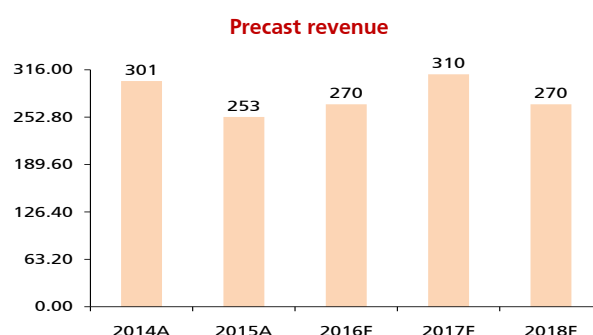
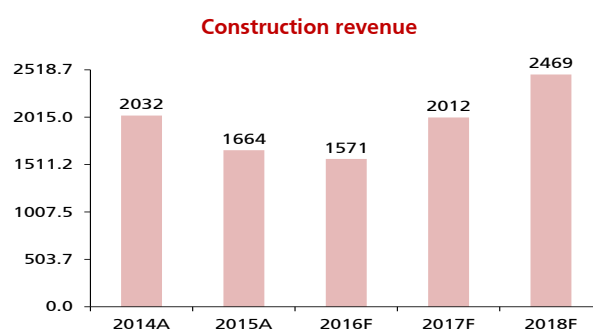
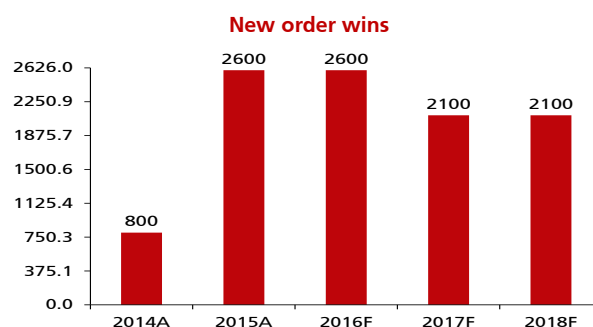
### Earnings Drivers:

**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 LRT3, BRT and other private sector building jobs.

**Stronger infrastructure orderbook.** With MRT2 viaduct package (V201) being the major infra win in 2016, its construction orderbook now stands at RM4.5bn (RM4.8bn including precast). For 2016, the company's new contract wins of RM2.6bn exceeded its initial guidance of RM2.5bn. The quality of its orderbook is also strong and we think margins should also be relatively intact. About half of its outstanding orderbook comes from two key projects – MRT Line 2 V201 and Putrajaya Parcel F where the raw material requirements for MRT aboveground works are borne by the government while it has also locked in half of the steel requirements for the Putrajaya job at lower prices.

**Highly profitable precast segment.** SCG's precast segment should be sturdy in contributing a larger share of earnings to the group. 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 20-25% range. This is supported by sustainable orders from the Singapore market. Its Tampines plant will be returned in April 2017 but will be compensated by an additional four lines for its Iskandar plant by 2Q17 and better capacity for its Senai plant. This will increase the capacity of both its Johor plants to c.170,000 m<sup>3</sup>/year.

**What's in store for 2017?** SCG is guiding for a more modest RM2bn worth of new wins inclusive of precast in FY17F. Our current forecast is RM2.1bn. This would likely come from one package for LRT 3, in-house projects, private sector building jobs and a pick-up in orders for its precast division. At this point, it is unlikely to bid for the Pan Borneo Sabah highway project, citing its experience with Pan Borneo Sarawak as a key reason for its non-participation. It is exploring jobs overseas in two countries, Myanmar and Indonesia, but works are just in the preliminary stages.



Source: Company, AllianceDBS

**Sunway Construction Group**

**Balance Sheet:**

**Strong balance sheet and cash generation ability.** As at 30 September 2016, the company has a net cash position of RM331m, 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 of RM417m in for FY16F and RM527m in FY17F. Meanwhile, its ROAE is expected to hover around the 27-29% level.

**Share Price Drivers:**

**Executing on peak orderbook.** SCG's outstanding orderbook now stands at RM4.8bn which is at its peak. This will give it two and a half years' visibility. The largest projects are Putrajaya Parcel F and MRT Line 2, V201 package which form 53% of the orderbook. More importantly, we think pretax margins for these two key projects will also be at least 7-8%. Recall that 2015 pretax margin was low at 3.6% due to MRT Line 1 and KLCC project (NEC and Package 2 and 2A) where certain losses and provisions were fully provided for.

**Dividend payout policy of at least 35%.** SCG is committed to distribute a minimum 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 45% dividend payout ratio, based on our strong net cash forecasts. This translates into decent yields of c.3.3-3.8%.

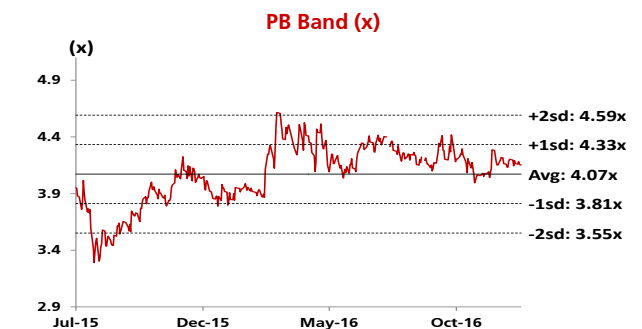
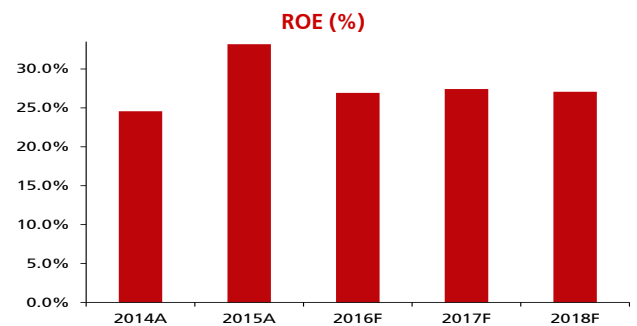
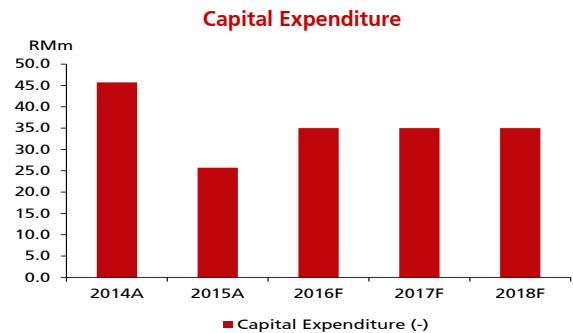
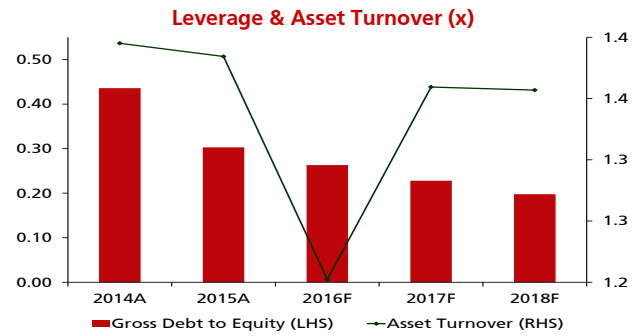
**Key Risks:**

**Delays in construction.** There may be project cost overruns due to several factors such as design and engineering issues and soil conditions.

**Fluctuating 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.

**Company Background**

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.



Source: Company, AllianceDBS

**Key Assumptions**

FY Dec	2014A	2015A	2016F	2017F	2018F
New order wins	800	2,600	2,600	2,100	2,100
Construction revenue	2,032	1,664	1,571	2,012	2,469
Precast revenue	301	253	270	310	270
Construction EBIT margins		3.56	6.92	6.48	6.77
Precast EBIT margins		30.5	21.0	21.0	21.0

**Segmental Breakdown**

FY Dec	2014A	2015A	2016F	2017F	2018F
<b>Revenues (RMm)</b>					
Construction	2,032	1,664	1,571	2,012	2,469
Precast Concrete	301	253	270	310	270
Consolidated Adjustments	(452)	0.0	0.0	0.0	0.0
<b>Total</b>	<b>1,881</b>	<b>1,917</b>	<b>1,841</b>	<b>2,321</b>	<b>2,739</b>

**EBIT (RMm)**

Construction		59.2	109	130	167
Precast Concrete		77.1	56.6	65.1	56.7
<b>Total</b>	<b>120</b>	<b>136</b>	<b>165</b>	<b>195</b>	<b>224</b>

**EBIT Margins (%)**

Construction		3.6	6.9	6.5	6.8
Precast Concrete		30.5	21.0	21.0	21.0
<b>Total</b>	<b>6.4</b>	<b>7.1</b>	<b>9.0</b>	<b>8.4</b>	<b>8.2</b>

**Income Statement (RMm)**

FY Dec	2014A	2015A	2016F	2017F	2018F
Revenue	1,881	1,917	1,841	2,321	2,739
Cost of Goods Sold	(1,485)	(1,514)	(1,395)	(1,845)	(2,233)
<b>Gross Profit</b>	<b>395</b>	<b>403</b>	<b>446</b>	<b>477</b>	<b>507</b>
Other Opg (Exp)/Inc	(275)	(267)	(280)	(281)	(283)
<b>Operating Profit</b>	<b>120</b>	<b>136</b>	<b>165</b>	<b>195</b>	<b>224</b>
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	30.4	(0.1)	0.0	0.0	0.0
Net Interest (Exp)/Inc	0.72	4.54	(1.4)	(1.4)	(1.5)
Exceptional Gain/(Loss)	(10.6)	0.0	0.0	0.0	0.0
<b>Pre-tax Profit</b>	<b>141</b>	<b>141</b>	<b>164</b>	<b>194</b>	<b>222</b>
Tax	(26.5)	(13.0)	(32.8)	(38.8)	(44.5)
Minority Interest	0.05	(0.6)	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>114</b>	<b>127</b>	<b>131</b>	<b>155</b>	<b>178</b>
Net Profit before Except.	125	127	131	155	178
EBITDA	162	178	207	235	263
<b>Growth</b>					
Revenue Gth (%)	2.2	1.9	(4.0)	26.1	18.0
EBITDA Gth (%)	90.0	10.1	16.0	13.9	11.7
Opg Profit Gth (%)	183.7	13.4	21.3	18.2	14.6
Net Profit Gth (Pre-ex) (%)	86.5	1.9	3.1	18.3	14.7
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	21.0	21.0	24.2	20.5	18.5
Opg Profit Margin (%)	6.4	7.1	9.0	8.4	8.2
Net Profit Margin (%)	6.1	6.6	7.1	6.7	6.5
ROAE (%)	24.6	33.2	26.9	27.4	27.1
ROA (%)	8.5	9.2	8.6	9.1	8.8
ROCE (%)	21.8	25.3	20.6	21.7	22.0
Div Payout Ratio (%)	0.0	40.7	45.0	45.0	45.0
Net Interest Cover (x)	NM	NM	120.3	138.2	154.0

Source: Company, AllianceDBS

## Sunway Construction Group

## Quarterly / Interim Income Statement (RMm)

FY Dec	3Q2015	4Q2015	1Q2016	2Q2016	3Q2016
Revenue	450	470	424	430	381
Cost of Goods Sold	0.0	0.0	0.0	0.0	0.0
<b>Gross Profit</b>	<b>450</b>	<b>470</b>	<b>424</b>	<b>430</b>	<b>381</b>
Other Oper. (Exp)/Inc	(422)	(443)	(389)	(393)	(342)
<b>Operating Profit</b>	<b>28.2</b>	<b>27.6</b>	<b>35.4</b>	<b>37.6</b>	<b>39.6</b>
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	1.90	1.84	2.14	0.51	0.84
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
<b>Pre-tax Profit</b>	<b>30.1</b>	<b>29.4</b>	<b>37.5</b>	<b>38.1</b>	<b>40.4</b>
Tax	(5.0)	0.97	(8.5)	(6.8)	(9.1)
Minority Interest	0.46	(1.0)	0.0	0.0	(0.2)
<b>Net Profit</b>	<b>25.7</b>	<b>29.4</b>	<b>29.1</b>	<b>31.3</b>	<b>31.1</b>
Net profit bef Except.	25.7	29.4	29.1	31.3	31.1
EBITDA	28.2	27.6	35.4	37.6	39.6

## Growth

Revenue Gth (%)	(10.0)	4.4	(9.8)	1.4	(11.4)
EBITDA Gth (%)	(31.6)	(2.4)	28.4	6.3	5.2
Opg Profit Gth (%)	(31.6)	(2.4)	28.4	6.3	5.2
Net Profit Gth (Pre-ex) (%)	(32.1)	14.4	(1.0)	7.8	(0.6)

## Margins

Opg Profit Margins (%)	6.3	5.9	8.3	8.7	10.4
Net Profit Margins (%)	5.7	6.2	6.8	7.3	8.2

## Balance Sheet (RMm)

FY Dec	2014A	2015A	2016F	2017F	2018F
Net Fixed Assets	179	163	156	151	147
Invt in Associates & JVs	24.2	0.0	0.0	0.0	0.0
Other LT Assets	10.8	17.4	17.4	17.4	17.4
Cash & ST Invt	222	468	534	644	762
Inventory	20.2	17.3	18.4	23.3	27.6
Debtors	790	835	807	1,018	1,201
Other Current Assets	8.52	14.4	14.4	14.4	14.4
<b>Total Assets</b>	<b>1,254</b>	<b>1,515</b>	<b>1,547</b>	<b>1,868</b>	<b>2,170</b>
ST Debt	135	137	138	139	140
Creditor	791	913	872	1,107	1,309
Other Current Liab	13.2	9.26	9.26	9.26	9.26
LT Debt	0.07	0.0	0.0	0.0	0.0
Other LT Liabilities	4.29	4.10	4.10	4.10	4.10
Shareholder's Equity	315	451	523	608	706
Minority Interests	(5.2)	0.63	0.63	0.63	0.63
<b>Total Cap. &amp; Liab.</b>	<b>1,254</b>	<b>1,515</b>	<b>1,547</b>	<b>1,868</b>	<b>2,170</b>
Non-Cash Wkg. Capital	14.1	(56.1)	(41.8)	(60.7)	(75.9)
Net Cash/(Debt)	86.4	332	396	505	622
Debtors Turn (avg days)	175.7	154.7	162.8	143.4	147.8
Creditors Turn (avg days)	192.4	211.3	240.7	200.1	201.0
Inventory Turn (avg days)	5.8	4.6	4.8	4.2	4.2
Asset Turnover (x)	1.4	1.4	1.2	1.4	1.4
Current Ratio (x)	1.1	1.3	1.3	1.4	1.4
Quick Ratio (x)	1.1	1.2	1.3	1.3	1.3
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	33.8	18.8	25.4	25.2	25.0
Z-Score (X)	3.4	3.2	3.3	3.1	3.0

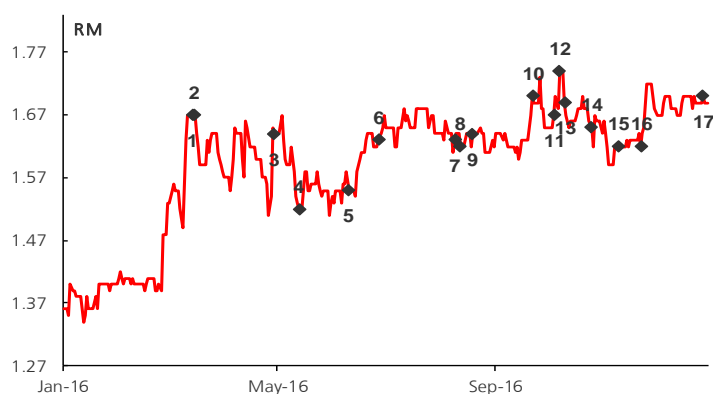
Source: Company, AllianceDBS

## Cash Flow Statement (RMm)

FY Dec	2014A	2015A	2016F	2017F	2018F
Pre-Tax Profit	151	141	164	194	222
Dep. & Amort.	41.6	41.9	41.5	40.1	39.0
Tax Paid	(26.5)	(13.0)	(32.8)	(38.8)	(44.5)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	297	79.9	(14.3)	18.9	15.2
Other Operating CF	(279)	(13.6)	0.0	0.0	0.0
<b>Net Operating CF</b>	<b>184</b>	<b>236</b>	<b>158</b>	<b>214</b>	<b>232</b>
Capital Exp.(net)	(45.7)	(25.7)	(35.0)	(35.0)	(35.0)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	395	(38.8)	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>349</b>	<b>(64.5)</b>	<b>(35.0)</b>	<b>(35.0)</b>	<b>(35.0)</b>
Div Paid	(429)	(70.0)	(59.0)	(69.8)	(80.1)
Chg in Gross Debt	46.5	1.64	1.00	1.00	1.00
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(85.5)	65.7	0.0	0.0	0.0
<b>Net Financing CF</b>	<b>(468)</b>	<b>(2.6)</b>	<b>(58.0)</b>	<b>(68.8)</b>	<b>(79.1)</b>
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	65.5	169	65.3	110	118
Opg CFPS (sen)	(8.7)	12.1	13.4	15.1	16.8
Free CFPS (sen)	10.7	16.3	9.54	13.9	15.3

Source: Company, AllianceDBS

## Target Price &amp; Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	28 Mar 16	1.67	1.92	BUY
2:	29 Mar 16	1.67	1.92	BUY
3:	13 May 16	1.64	1.92	BUY
4:	27 May 16	1.52	1.92	BUY
5:	24 Jun 16	1.55	1.92	BUY
6:	11 Jul 16	1.63	1.92	BUY
7:	23 Aug 16	1.63	1.92	BUY
8:	26 Aug 16	1.62	1.92	BUY
9:	02 Sep 16	1.64	1.92	BUY
10:	06 Oct 16	1.70	1.92	BUY
11:	18 Oct 16	1.67	1.92	BUY
12:	21 Oct 16	1.74	1.92	BUY
13:	24 Oct 16	1.69	1.92	BUY
14:	08 Nov 16	1.65	1.92	BUY
15:	23 Nov 16	1.62	1.92	BUY
16:	06 Dec 16	1.62	1.92	BUY
17:	10 Jan 17	1.70	1.92	BUY

Source: AllianceDBS

Analyst: Chong Tjen San



AllianceDBS recommendations are based on 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*

Completed Date: 16 Jan 2017 08:04:57 (MYT)

Dissemination Date: 16 Jan 2017 08:15:41 (MYT)

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