

Sunway Construction Group Bhd

SCOG.KL SCGB MK

EQUITY: ENGINEERING & CONSTRUCTION

Parentco supports orderbook replenishment

3Q18 results weaker due to precast segment

Action: Reduce TP to MYR2.00; reiterate Buy

Amid the uncertainty around project awards in Malaysia, Suncon's orderbook has been well supported by internal projects from parentco, with total YTD awards of MYR1.35bn of which ~MYR1.1bn are internal. As a result, we reiterate our Buy rating on Sunway Construction (SunCon) as a defensive exposure to the sector. SunCon's 3Q18 earnings were weak due to lower contribution from pre-cast business on higher steel prices and competitive pricing, therefore we reduce our FY18F/19F earnings by 7%/13% to build this, leading to a new TP of MYR2.00 (implying 24% upside). We believe the negatives have already been captured in the stock price, which is down 36% YTD (vs KLCI -5%). We expect SunCon's precast business to grow again, as the company will be able to bid for tenders launched by the Housing & Development Board in the next award cycle, after SunCon won the tender for a precast plant in Singapore in July. It has a strong balance sheet and is sitting on net cash of MYR324mn. We also build in SGD65mn (~MYR200mn) capex over three years (starting Aug 2018) for the precast plant in Singapore.

Valuation: TP based on 15x cash-adjusted FY19F P/E (EPS: MYR0.12)

We now value SunCon at a cash-adjusted P/E of 15x (vs 19x earlier) and roll forward our valuation to FY19F (EPS of MYR0.12), vs. the current cash adjusted FY19F P/E of 10x, to arrive at a lower TP of MYR2.00 (implying 24% upside potential). We lower our target P/E multiple in line with derating in the sector (see KLCON P/E in Fig. 4).

Catalysts: Earnings recovery from LRT3

We expect the stock to outperform when earnings recover, due to the LRT3 project recognition. Precast awards from Singapore and potential higher dividends are other catalysts. Downside risks include: 1) delays in construction project awards; 2) lower-than-expected margins; 3) Singapore housing units not growing as expected; 4) a lack of new projects.

Year-end 31 Dec	FY17		FY18F		FY19F		FY20F	
Currency (MYR)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	2,076	2,314	2,173	2,303	1,964	2,134	1,964	
Reported net profit (mn)	138	163	146	164	151	160	164	
Normalised net profit (mn)	130	163	146	164	151	160	164	
FD normalised EPS	10.08c	12.63c	11.28c	12.66c	11.69c	12.37c	12.70c	
FD norm. EPS growth (%)	22.5	25.4	12.0	0.2	3.6	-2.3	8.6	
FD normalised P/E (x)	16.0	N/A	14.3	N/A	13.8	N/A	12.7	
EV/EBITDA (x)	8.8	N/A	7.9	N/A	7.7	N/A	6.9	
Price/book (x)	3.8	N/A	3.5	N/A	3.2	N/A	2.9	
Dividend yield (%)	4.3	N/A	4.6	N/A	4.7	N/A	5.1	
ROE (%)	26.3	28.1	25.3	25.8	24.1	23.4	23.9	
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash	

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart.

Global Markets Research

21 November 2018

Rating	Buy
Remains	
Target Price	MYR 2.00
Reduced from 2.60	
Closing price	MYR 1.61
19 November 2018	
Potential upside	+24.2%

Anchor themes

We expect pure-play Malaysian contractors to continue to outperform diversified companies, which have property exposure. We like stocks where management is looking beyond short-term project awards and generating earnings growth and healthy cash flows, which in our view are the best indicators of long-term outperformance.

Nomura vs consensus

Our FY18F earnings are 7% below consensus.

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3Q18 results recap

- SunCon reported 3Q18 net income of MYR36mn and cumulatively 9M18 net income of MYR108mn (+2% y-y) forms 74%/69% of our new/consensus estimates for FY18F. High steel prices and competitive pricing remain the profitability dampeners.
- On a q-q basis, 3Q18 performance was similar to 2Q, with revenue and net income both up marginally by 2% q-q.
- SCGB is in a net cash position of MYR325mn, which could potentially be used for higher dividend or new investments, supporting our bullish thesis. Note that SCGB also won the tender for a pre-cast plant in Singapore in July, which will put its Singapore precast segment on the growth path again, as the company will be able to bid for tenders in the HDB market in the next award cycle.
- In YTD 2018, SunCon has won MYR1.35bn worth of new contracts with management's full year target of MYR1.5b intact. As at end-Sep 2018, the outstanding orderbook stands at MYR5.2bn, which does not include ~MYR400mn of contracts awarded in 4Q18.
- **Construction:** Construction revenue for 3Q18 was MYR524mn, up 11% y-y, driven by higher contribution from civil division. PBT of MYR47mn increased by 16% y-y, with 1pp increase in PBT margin. Similarly, YTD revenue of MYR1.5bn was up 26% y-y and PBT of MYR126mn was up 23% y-y. On a q-q basis, revenue and PBT were up 2% and 17% respectively.
- **Precast:** Precast revenue for 3Q18 was MYR33mn, up 70% y-y due to better progress from existing sales orders. However, the division reported a pre-tax loss of MYR2mn in the quarter due to higher steel prices and competitive product pricing.

Fig. 1: SunCon: 3Q18 result snapshot

MYR mn	9M18	NMR FY18F new	as % of NMR	Cons FY18F	as % of cons
Revenue	1,631	2,173	75%	2,401	68%
Adj PBT	136	184	74%	201	68%
Adj NPATAMI	108	146	74%	157	69%
Reported NPATAMI	108	146	74%	157	69%

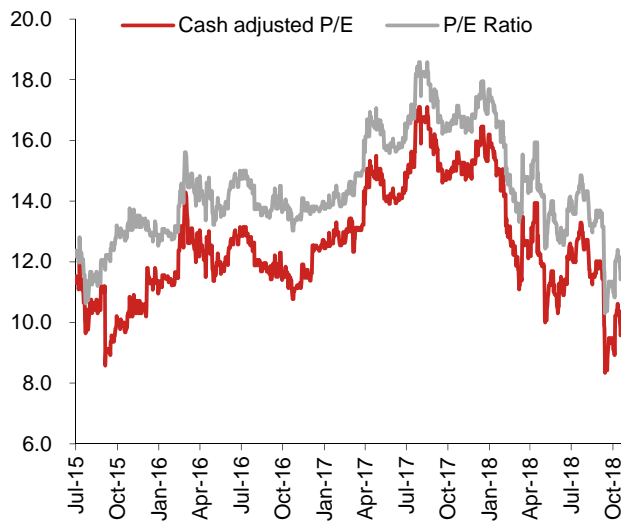
Source: Company data, Bloomberg, Nomura estimates

Fig. 2: SunCon: 3Q18 results review

MYR mn	3Q18	3Q17	% chg y-y	2Q18	% chg q-q	9M18	9M17	% chg y-y	FY18F (new)	as % of FY18F
Revenues	557	491	13%	544	2%	1,631	1,328	23%	2,173	75%
Construction	524	472	11%	512	2%	1,528	1,210	26%	2,001	76%
Precast concrete	33	20	70%	33	2%	103	118	(13%)	172	60%
Operating profit	45	42	6%	42	7%	130	126	3%	174	74%
Construction	47	40	16%	40	17%	126	102	23%		
Precast concrete	(2)	2	(182%)	2	(184%)	4	24	(84%)		
Adjusted Pretax profit	47	43	9%	45	4%	136	130	4%	184	74%
Construction	49	41	20%	43	14%	132	106	25%	177	74%
Precast concrete	(2)	2	(182%)	2	(186%)	4	24	(84%)	7	57%
Core PAT	37	34	6%	36	2%	108	106	2%	146	74%
Core PAT - equityholders	36	35	5%	36	2%	108	106	2%	146	74%
Other one-off charges	0	0	NM	0	NM	0	0	NM	0	NM
Headline NPAT - equityholders	36	35	5%	36	2%	108	106	2%	146	74%
Adj Pretax margins	8%	9%	0 ppt	8%	0 ppt	8%	10%		8%	
Construction	9%	9%	1 ppt	8%	1 ppt	9%	9%		9%	
Precast concrete	(6%)	12%	-18 ppt	7%	-13 ppt	4%	21%		4%	

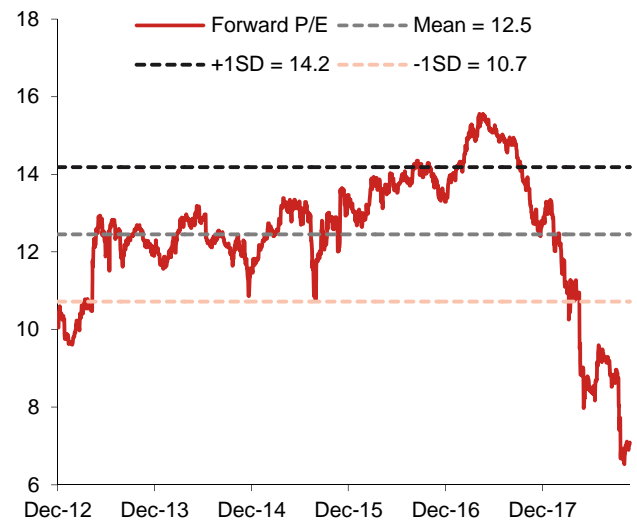
Source: Company data, Nomura estimates

Fig. 3: SunCon: Forward P/E vs forward cash adjusted P/E



Source: Company data, Bloomberg, Nomura estimates

Fig. 4: KLCON forward P/E



Source: Bloomberg, Nomura research

Fig. 5: SunCon's outstanding orderbook

As at Sep 2018

MYR mn	Contract Sum	Outstanding order book
Infrastructure/Piling		
MRT V201 + S201 (Sg Buloh-Persiaran Dagang)	1,213	527
LRT3: Package GS07-08	2,178	2,021
BBCC - Bore piling	88	12
Others	87	14
Piling Works	75	64
Building		
Putrajaya Parcel F	1,610	287
KLCC NEC	304	
KLCC Package 2 (Piling & Substructure)	222	82
KLCC package 2a	120	
PPA1M project in Kota Bharu	582	208
Nippon Express	70	68
GDC (Plant 2)	14	14
Others	487	39
Internal		
Sunway Velocity Medical Centre	185	67
Sunway Medical Centre Phase 4	512	449
Sunway Iskandar - Emerald Residences	175	6
Big Box Iskandar	170	114
Sunway Serene - Serviced Residences	449	351
Sunway GEOLake	223	190
Carnival Mall Ext	286	261
SMC Seberang Jaya	180	176
Velocity Ecodeck	11	11
M&E works	30	20
Singapore		
Precast	330	98
Precast - New order 2018	130	128
Total	9,729	5,205
Orderbook burn rate (FY17, including internal)		2,076
Implied earnings visibility (years)		2.5

Source: Company data, Nomura research

Fig. 6: SunCon: Orderbook replenishment

Includes ~MYR400mn awards in 4Q18

2017	
MYR mn	Contract sum
Kelana Jaya Condo	449
CP3 walkway	4
Precast	158
GDC Plant 1	152
SUKE and DASH	34
MRT S201: 3 Elevated Stations	212
BBCC (piling work)	34
Mega Capital (piling work)	9
PPA1M project in Kota Bharu	582
LRT3: Package GS07-08	2,178
BBCC (piling work) - P4 & P5	75
Warehouse in Shah Alam	70
Total	3,957
YTD 2018	
MYR mn	Contract sum
Sunway Carnival 2 Extension	286
SunGeo Lake 44 storey residential tower	223
Sunway Medical Centre	180
Piling works	75
Precast	129
Others - Inhouse	56
SUKE CA1 - piling works	53
Sunway Velocity TWO	352
Total	1,354

Source: Company data, Nomura research

Fig. 7: SunCon: Changes in estimates

MYR mn	Old			New			% change		
	FY18F	FY19F	FY20F	FY18F	FY19F	FY20F	FY18F	FY19F	FY20F
Orderbook replenishment	1,550	1,800	1,800	1,550	1,800	1,800	0%	0%	0%
External	1,000	1,000	1,000	200	1,000	1,000	(80%)	0%	0%
Internal	500	500	500	1,200	500	500	140%	0%	0%
Precast	50	300	300	150	300	300	200%	0%	0%
Revenue	2,314	2,303	2,134	2,173	1,964	1,964	(6%)	(15%)	(8%)
Adj PBT	206	207	202	184	191	208	(11%)	(8%)	3%
PBT margins	8.9%	9.0%	9.5%	8.5%	9.7%	10.6%	(0.4 ppt)	0.7 ppt	1.1 ppt
Adj NPAT	163	164	160	146	151	164	(11%)	(8%)	3%

Source: Nomura estimates

Fig. 8: Target price valuation methodology

	Dec-19
	FY19F
Normalised net profit (MYR mn)	151
Less: Interest income (MYR mn)	15
Net profit ex interest income (MYR mn)	136
Target FY19F cash adjusted P/E	15.0 x
Equity value ex cash holdings (MYR mn)	2,039
Add: Cash and Cash Equivalents (MYR mn)	510
Equity value (MYR mn)	2,550
FD number of shares outstanding (mn)	1,293
Price target (MYR/ sh)	2.00

Source: Nomura estimates

Appendix A-1

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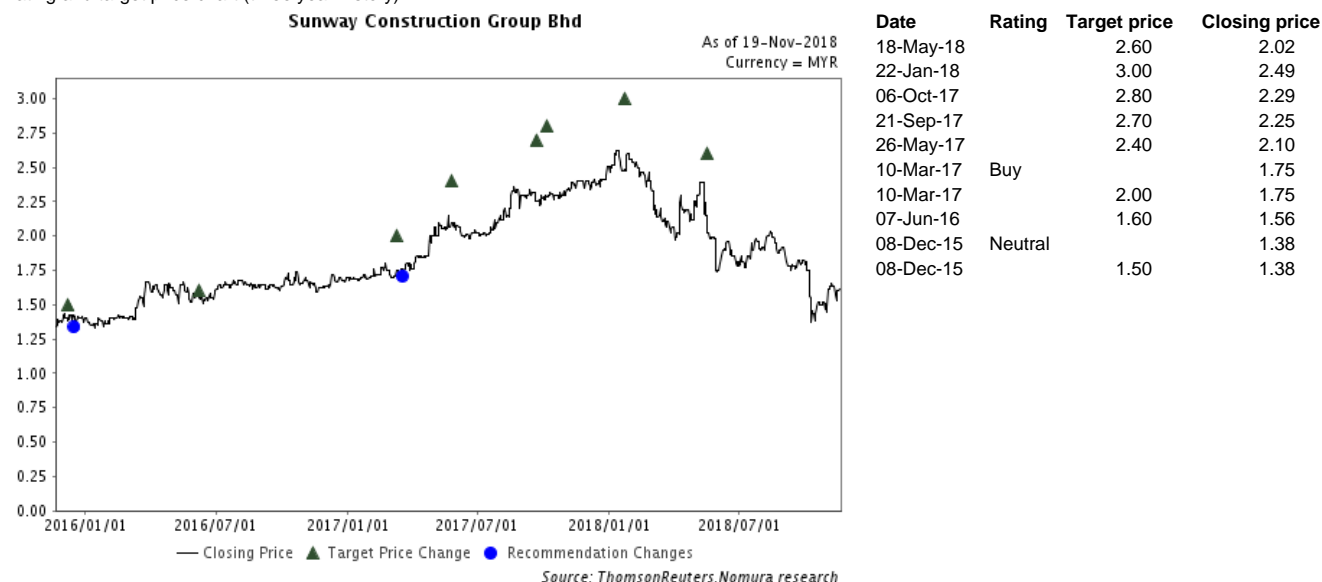
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Sunway Construction Group Bhd	SCGB MK	MYR 1.61	19-Nov-2018	Buy	N/A	

Sunway Construction Group Bhd (SCGB MK) MYR 1.61 (19-Nov-2018) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value SunCon at a cash-adjusted P/E of 15x on FY19F earnings and value the cash on its balance sheet separately. Using net income less interest income of MYR136mn for FY19F and a cash-adjusted P/E of 15x, we arrive at an equity value, ex-cash holdings, of MYR2bn. To this we add the estimated cash balance at end-FY19F to arrive at our TP of MYR2.00. The benchmark index for the stock is the MSCI Malaysia.

Risks that may impede the achievement of the target price Downside risks: 1) delay or cancellation of construction project awards; 2) lower-than-expected margins; 3) Singapore housing units not growing as expected; and 4) lower-than-expected orderbook inflows.

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