

20 November 2020

Construction & Engineering | Construction

Sunway Construction (SCGB MK)

Buy (Maintained)

Earnings Recovery Kicking In, Keep BUY

Target Price (Return): MYR2.09 (+14%)
Price: MYR1.83
Market Cap: USD577m
Avg Daily Turnover (MYR/USD) 0.49m/0.12m

- Maintain BUY on our Sector Top Pick and MYR2.09 TP, 14% upside and c.2% yield.** Sunway Construction's recovery post 10-week work restriction is showing results (within expectations) and expected to improve further as progress picks up momentum. Earnings visibility remains extensive with MYR5.4bn orders already in hand, and should potentially extend with more local transportation projects in the midst of being restored. We believe valuation remains attractive as the stock is trading at just 16x FY21F EPS (5-year mean).
- Normalcy kicks in.** 3Q20 revenue was MYR419.4m. Billings recognition came in nicely for the group, shown by the 4.2% YoY and >100% QoQ increase. Progressive impact is seen on its 9M20 core net earnings, which rose to MYR54.2m Cumulatively, earnings are within our and Street expectations at 79% and 71%. Despite the 44% YoY lower core earnings reported from the same period last year, we deem the 3Q20 results as commendable. This shows its agility to recover fast from 10 weeks of non-activity in the whole sector.
- Ramping up progress on big projects.** This includes the TNB Bangsar project which brings outstanding income opportunity of MYR614m. Note that 3Q20 construction revenue was largely driven by this project's progress, which represents c.60% of external building jobs. We posit billings from this project to remain strong in the near term, owing to its completion target slated by next year. At the group level, we do not discount further improvement in margins as we expect more billings to be recognised from the building jobs. YTD losses in the precast wing were partially reversed, thanks to a reversal of 2019 bonus not utilised and recognition of higher margin orders. We understand its working contribution will only turn meaningful when it resumes normal operations, starting 4Q20.
- Well positioned for cyclical recovery.** The company is supported by MYR5.4bn of total outstanding orderbook, offering positive earnings yield into FY23F. In our view, earnings visibility is robust (in comparison to KLCON construction peers), giving it more capacity to weather the sector's downside risks. Having exceeded its internal replenishment target this year, it continues to stand out as a strong contender for local infrastructure projects. As the Government reaffirms its commitment to improve local transportation links in Budget 2021, a pipeline of jobs is shaping up to be more extensive for sector key players like Sunway Construction. At this point, we make no changes to our earnings estimates.
- Downside risks** include a failure to secure new contracts, prolonged downturn in the retail and property markets, and longer-than-expected delay in the rollout of mega infrastructure projects. Sudden restrictions on activities – possibly due to lockdown measures, if implemented – may present another downside risk.

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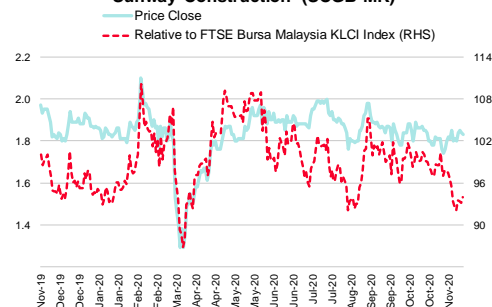
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(4.2)	(1.1)	1.7	(4.2)	(7.6)
Relative	(3.9)	(5.4)	1.2	(15.4)	(6.2)
52-wk Price low/high (MYR)	1.29 – 2.10				

Sunway Construction (SCGB MK)



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (MYRm)	2,257	1,769	1,273	2,005	2,051
Recurring net profit (MYRm)	147	116	69	150	150
Recurring net profit growth (%)	11.6	(20.9)	(40.2)	116.4	(0.2)
Recurring P/E (x)	16.11	20.38	34.10	15.76	15.79
P/B (x)	4.0	3.8	3.6	3.2	2.9
P/CF (x)	12.28	10.00	na	24.05	11.65
Dividend Yield (%)	3.8	3.4	1.5	3.2	3.2
EV/EBITDA (x)	9.09	11.31	15.94	9.02	8.39
Return on average equity (%)	25.5	19.7	10.8	21.6	19.5
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD1bn.

Financial Exhibits

Asia	Financial summary (MYR)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Malaysia	Recurring EPS	0.11	0.09	0.05	0.12	0.12
Construction & Engineering	DPS	0.07	0.06	0.03	0.06	0.06
Sunway Construction	BV/PS	0.46	0.48	0.51	0.57	0.62
SCGB MK	Return on average equity (%)	25.5	19.7	10.8	21.6	19.5
Buy						
	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Valuation basis	Recurring P/E (x)	16.11	20.38	34.10	15.76	15.79
18x FY21F P/E	P/B (x)	4.0	3.8	3.6	3.2	2.9
	FCF Yield (%)	5.8	9.7	(1.4)	0.6	6.3
Key drivers	Dividend Yield (%)	3.8	3.4	1.5	3.2	3.2
Sunway Construction's earnings are backed by:	EV/EBITDA (x)	9.09	11.31	15.94	9.02	8.39
i. An outstanding order backlog of MYR5.4bn, which may keep the firm busy for the next three years;	EV/EBIT (x)	11.04	15.04	24.31	11.41	10.96
ii. Recurring orders from its parent company.						
	Income statement (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Key risks	Total turnover	2,257	1,769	1,273	2,005	2,051
i. Possible cost overruns;	Gross profit	447	121	222	399	397
ii. Higher material costs;	EBITDA	215	170	122	221	227
iii. Failure to secure any large-scale contracts.	Depreciation and amortisation	(38)	(42)	(42)	(46)	(53)
	Operating profit	177	128	80	175	174
Company Profile	Net interest	8	12	7	6	6
Sunway Construction is one of the largest construction companies in Malaysia. Apart from civil & infrastructure construction services, it also provides the more specialised:	Pre-tax profit	183	148	87	189	189
i. Foundation & geotechnical engineering services;	Taxation	(38)	(27)	(18)	(39)	(39)
ii. Mechanical, electrical & plumbing (MEP) services.	Reported net profit	145	120	69	150	150
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.	Recurring net profit	147	116	69	150	150
	Cash flow (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Change in working capital	(10)	86	(144)	(98)	(0)
	Cash flow from operations	193	237	(33)	98	203
	Capex	(56)	(8)	(1)	(85)	(55)
	Cash flow from investing activities	(74)	(51)	(1)	(85)	(55)
	Dividends paid	(97)	(91)	(35)	(75)	(75)
	Cash flow from financing activities	(118)	72	3	(67)	(67)
	Cash at beginning of period	487	485	693	662	608
	Net change in cash	0	257	(31)	(54)	81
	Ending balance cash	489	742	662	608	689
	Balance sheet (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	485	693	682	629	709
	Tangible fixed assets	163	139	98	136	138
	Total investments	45	49	49	49	49
	Total assets	1,754	1,905	1,620	1,971	2,076
	Short-term debt	114	233	253	243	233
	Total long-term debt	0	62	62	62	62
	Total liabilities	1,162	1,280	960	1,236	1,266
	Total equity	593	625	660	735	810
	Total liabilities & equity	1,754	1,905	1,620	1,971	2,076
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	8.7	(21.6)	(28.0)	57.5	2.3
	Recurrent EPS growth (%)	11.6	(20.9)	(40.2)	116.4	(0.2)
	Gross margin (%)	19.8	6.8	17.5	19.9	19.4
	Operating EBITDA margin (%)	9.5	9.6	9.6	11.0	11.1
	Net profit margin (%)	6.4	6.8	5.5	7.5	7.3
	Capex/sales (%)	2.5	0.5	0.1	4.2	2.7
	Interest cover (x)	21.3	9.7	6.0	12.9	13.3

Source: Company data, RHB

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Results At a Glance

Figure 1: Sunway Construction's results review

FYE Dec (MYRm)	3Q19	2Q20	3Q20	QoQ (%)	YoY (%)	9M19	9M20	YoY (%)	Comments
Revenue	402.6	140.2	419.4	>100	4.2	1,282.8	925.4	(27.9)	Higher quarterly revenue was driven by the ramping up of construction progress for the TNB Bangsar project
EBIT	35.4	0.1	32.1	>100	(9.3)	109.2	52.7	(51.7)	
<i>EBIT Margin (%)</i>	<i>8.8</i>	<i>0.0</i>	<i>7.7</i>			<i>8.5</i>	<i>5.7</i>		
Interest expense	(3.9)	(2.3)	(1.6)	(31.8)	(59.9)	(9.8)	(6.6)	(32.8)	
Interest income	5.1	4.5	4.6	1.7	(10.3)	16.5	14.3	(13.0)	
JV/Associates	0.0	0.1	0.0	(100.0)	nm	0.0	0.1	nm	
El/Others	(1.0)	0.0	(1.2)	nm	16.1	1.0	(1.0)	>100	
Pretax profit	35.6	2.3	36.0	>100	1.1	116.9	59.5	(49.1)	
<i>Pretax Margin (%)</i>	<i>8.8</i>	<i>1.7</i>	<i>8.6</i>			<i>9.1</i>	<i>6.4</i>		Margin was better supported by higher margin orders from the precast segment
Tax	(2.5)	(0.2)	(11.7)	>100	>100	(19.3)	(16.3)	(15.6)	
<i>Effective tax rate (%)</i>	<i>(7.1)</i>	<i>(9.4)</i>	<i>(32.6)</i>			<i>(16.5)</i>	<i>(27.3)</i>		
Minority Interest	0.3	0.1	(0.2)	0.0	0.0	(0.1)	(0.7)	>100	
Net Profit	33.4	2.2	24.0	>100	(28.0)	97.6	42.6	(56.4)	Deviation from core net profit due to MFRS 9 provision
Core Profit	36.5	4.7	31.9	>100	(12.6)	96.7	54.2	(44.0)	Within expectations
<i>Core Net Margin (%)</i>	<i>9.1</i>	<i>3.4</i>	<i>7.6</i>			<i>7.5</i>	<i>5.9</i>		

Source: Company data, RHB

Figure 2: Suncon's segmental results

FYE Dec (MYRm)	3Q19	2Q20	3Q20	QoQ (%)	YoY (%)	9M19	9M20	YoY (%)	Comments
Revenue:									
Construction	365.1	137.2	403.4	>100	10.5	1,178.4	870.2	(26.2)	YTD revenue was lower due to 2.5 months of non-activity
Precast Concrete	37.5	3.1	16.0	>100	(57.4)	104.4	55.2	(47.1)	
EBIT:									
Construction	33.6	3.4	31.7	>100	(5.7)	108.3	52.4	(51.7)	
Precast Concrete	0.8	(3.3)	1.3	(138.5)	59.2	1.9	(0.7)	>-100	
EBIT Margin %:									
Construction	9.2%	2.5%	7.8%			9.2%	6.0%		Margin increased QoQ as work progress improved to pre-pandemic level
Precast Concrete	2.2%	>-100	8.1%			1.8%	-1.2%		

Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-08-20	Buy	2.09	1.80
2020-08-13	Buy	2.14	1.81
2020-07-23	Neutral	2.14	1.99
2020-05-22	Neutral	1.86	1.92
2020-04-23	Neutral	1.72	1.76
2020-04-09	Neutral	1.51	1.67
2019-11-20	Neutral	1.95	1.97
2019-10-09	Neutral	2.03	1.95

Source: RHB, Bloomberg

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