

2Q18 results announced on 16 Aug are below expectations

17 August 2018

Construction & Engineering | Construction

Sunway Construction

Buy (Maintained)
No Rail Projects, No Problem; BUY

Target Price:	MYR2.30
Price:	MYR2.02
Market Cap:	USD636m
Bloomberg Ticker:	SCGB MK

We maintain our BUY call on Sunway Construction, with a new MYR2.30 TP from MYR2.42, 14% upside. 1H18 core earnings missed expectations, coming in at 42% of its FY18F net profit. We trim our FY18F-20F earnings by 10-14%, anticipating delays for its LRT3 contract. However, we continue to favour the stock, as it has won the second highest value of new jobs in 2018 at MYR854m. In addition, the company has outstanding tenders in excess of MYR4bn, comprising mainly of external building jobs.

Sunway Construction's earnings missed estimates. The company reported 2Q core PAT of MYR35.2m (-4.3% YoY, +5.3% QoQ) as a marginal MYR1.2m annual increase in construction EBIT was insufficient to negate a MYR4m decrease in precast EBIT. For 1H18, earnings were down 3.8% YoY to MYR68.7m, missing estimates, representing only 42% of our and 41% of consensus FY18 forecasts. An MYR0.035 dividend was announced, within estimates.

LRT3 the main culprit. The earnings miss can be attributed to slower-than-expected progress for the company's MYR2.2bn Light Rail Transit 3 (LRT3) contract, which only advanced 2ppts QoQ to 5%. This was coupled with fewer orders secured for its precast segment. Other external projects such as its Mass Rapid Transit 2 (MRT2) packages worth close to MYR1bn are progressing well, advancing 18ppts to 52% completion – a welcome relief.

We reduce our FY18F-20F earnings by 10-14% as we cut our billing assumptions for Sunway Construction's LRT3 project further. We understand that the project delivery partner (PDP), along with the project owner, Prasarana Malaysia, would be engaging work package contractors within the next couple of months (if not already) in order to implement cost reduction measures to lessen the overall project cost to MYR16.6bn (from MYR31.6bn). While the company will not see a reduction of the number of stations under its package, it would likely see a reduction in scale of some of its stations, in our view. Besides that, the target completion date for the project has been stretched to 2024 from 2021 – slowing progress billings.

Sitting second on the leaderboards. Sunway Construction's outstanding orderbook of MYR5.8bn as at June remains significantly higher (+35% YoY) vis-à-vis June 2017's MYR4.3bn. In terms of booking new jobs, it has not disappointed, raking in MYR854m worth of new orders in 2018 – second only to IJM Corp's MYR1.1bn (IJM MK, NEUTRAL, TP: MYR1.96) among Bursa Malaysia listed companies. To be conservative, the firm has reduced its new contract replenishment target to MYR1.5bn (from MYR1.5-2bn) despite upward of MYR4bn worth of tenders – which we matched in our forecast (reduced from MYR2.2bn).

Maintain BUY. Post our earnings revision, we have a reduced MYR2.30 TP, based on an unchanged ex-cash FY18F P/E of 16x. We rate the stock a BUY as one of the prime beneficiaries should mega projects (High Speed Rail, MRT3, Penang LRT) return – having displayed a stellar track record in open tenders. 1H18 net cash: MYR457m.

Share Data

Avg Daily Turnover (MYR/USD)	2.50m/0.61m
52-wk Price low/high (MYR)	1.74 - 2.62
Free Float (%)	35
Shares outstanding (m)	1,293
Estimated Return	14%

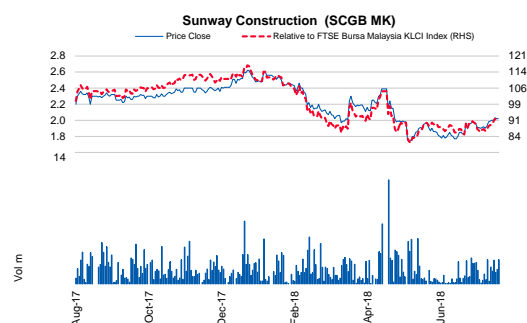
Shareholders (%)

Sunway	55.4
Sungei Way Corp	10.1
Employees Provident Fund	7.3

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(19.5)	9.2	(6.1)	(17.9)	(8.2)
Relative	(18.9)	5.8	(2.2)	(15.0)	(8.9)

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (MYRm)	1,789	2,076	2,145	2,340	2,416
Reported net profit (MYRm)	124	138	147	169	176
Recurring net profit (MYRm)	124	138	147	169	176
Recurring net profit growth (%)	(2.9)	11.7	6.7	14.5	4.5
Recurring EPS (MYR)	0.10	0.11	0.11	0.13	0.14
DPS (MYR)	0.05	0.07	0.08	0.09	0.09
Recurring P/E (x)	21.1	18.9	17.7	15.5	14.8
P/B (x)	5.30	5.08	4.55	4.08	3.68
P/CF (x)	na	17.4	9.3	11.8	11.7
Dividend Yield (%)	2.5	3.5	4.0	4.2	4.5
EV/EBITDA (x)	12.2	11.2	8.9	7.7	7.0
Return on average equity (%)	26.2	27.4	27.1	27.8	26.1
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			(13.1)		

Source: Company data, RHB

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Financial Exhibits

Financial model updated on : 2018-08-16.

Asia	Financial summary	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Malaysia	Recurring EPS (MYR)	0.10	0.11	0.11	0.13	0.14
Construction & Engineering	EPS (MYR)	0.10	0.11	0.11	0.13	0.14
Sunway Construction	DPS (MYR)	0.05	0.07	0.08	0.09	0.09
Bloomberg SCGB MK	BVPS (MYR)	0.38	0.40	0.44	0.50	0.55
Buy	Weighted avg adjusted shares (m)	1,293	1,293	1,293	1,293	1,293
Valuation basis	Valuation metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
We value the company based on 16x FY18F EPS, the higher end of our benchmark upcycle 1-year forward target P/E for mid-cap construction stocks. Sunway Construction's net cash position allows the company to gear up for more jobs moving forward.	Recurring P/E (x)	21.1	18.9	17.7	15.5	14.8
	P/E (x)	21.1	18.9	17.7	15.5	14.8
	P/B (x)	5.30	5.08	4.55	4.08	3.68
	FCF Yield (%)	(7.5)	3.6	9.5	7.7	7.8
	Dividend Yield (%)	2.5	3.5	4.0	4.2	4.5
	EV/EBITDA (x)	12.2	11.2	8.9	7.7	7.0
	EV/EBIT (x)	15.4	13.7	11.3	9.5	8.7
Key drivers	Income statement (MYRm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Sunway Construction's earnings are strongly backed by:	Total turnover	1,789	2,076	2,145	2,340	2,416
i. An outstanding order backlog of MYR5.8bn, of which >90% is from construction that may keep the firm busy for the next three years;	Gross profit	401	435	500	551	571
ii. Recurring orders from its parent company and key GLC clients;	EBITDA	188	202	234	256	267
iii. A highly profitable precast operation in Singapore.	Depreciation and amortisation	(39)	(38)	(49)	(48)	(50)
	Operating profit	149	165	184	208	217
	Net interest	4	7	1	2	2
	Income from associates & JVs	1	2	0	0	0
	Pre-tax profit	154	174	185	211	220
	Taxation	(30)	(36)	(38)	(43)	(45)
	Minority interests	(0)	0	0	1	1
	Recurring net profit	124	138	147	169	176
Key risks	Cash flow (MYRm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Upside risks include better-than-expected margins at the construction segment and new job wins coming in ahead of our estimates. Downside risks include possible cost overruns and higher material costs.	Change in working capital	(72)	(25)	84	7	(0)
	Cash flow from operations	(177)	150	279	221	223
	Capex	(19)	(55)	(30)	(20)	(20)
	Cash flow from investing activities	79	35	(30)	(20)	(20)
	Proceeds from issue of shares	0	0	0	0	0
	Dividends paid	(84)	(71)	(88)	(100)	(105)
	Cash flow from financing activities	(84)	(74)	(108)	(117)	(121)
	Cash at beginning of period	390	466	487	645	726
	Net change in cash	(183)	110	142	83	82
	Ending balance cash	208	575	629	728	808
Company Profile	Balance sheet (MYRm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Sunway Construction is one of the largest construction companies in Malaysia. Apart from civil & infrastructure construction services, the company also provides the more specialised foundation & geotechnical engineering services, and mechanical, electrical & plumbing (MEP) services. In addition, it runs a highly profitable precast concrete products manufacturing operation in Malaysia and Singapore. Aside from fulfilling local requirements, hose concrete products are supplied largely to Housing & Development Board (HDB) projects in the island republic.	Total cash and equivalents	466	487	645	726	806
	Tangible fixed assets	134	97	77	49	19
	Intangible assets	4	4	4	4	4
	Total investments	0	0	0	0	0
	Total other assets	12	2	2	2	2
	Total assets	1,567	1,831	1,794	1,942	2,028
	Short-term debt	137	135	115	95	75
	Other liabilities	0	(16)	0	0	0
	Total liabilities	1,073	1,316	1,219	1,301	1,317
	Shareholders' equity	493	515	573	640	710
	Minority interests	1	1	1	1	1
	Total equity	494	516	575	641	711
	Net debt	(329)	(353)	(530)	(631)	(731)
	Total liabilities & equity	1,567	1,831	1,794	1,942	2,028
	Key metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Revenue growth (%)	(6.7)	16.1	3.3	9.1	3.2
	Recurrent EPS growth (%)	(2.9)	11.7	6.7	14.5	4.5
	Gross margin (%)	22.4	21.0	23.3	23.6	23.6
	Operating EBITDA margin (%)	10.5	9.7	10.9	10.9	11.0
	Net profit margin (%)	6.9	6.6	6.9	7.2	7.3
	Dividend payout ratio (%)	52.3	65.6	60.0	59.3	59.3
	Capex/sales (%)	1.1	2.6	1.4	0.9	0.8
	Interest cover (x)	24.5	27.1	49.3	66.2	85.4

Source: Company data, RHB

Figure 1: Sunway Construction – 2Q18 results review

FYE Dec (MYRm)	2Q17	1Q18	2Q18	QoQ (%)	YoY (%)	1H17	1H18	YoY (%)	Comments
Revenue	417.2	529.2	544.3	2.8	30.4	836.8	1,073.5	28.3	
EBIT	41.7	40.3	41.4	2.6	(0.8)	83.8	81.7	(2.4)	
<i>EBIT Margin (%)</i>	<i>10.0</i>	<i>7.6</i>	<i>7.6</i>			<i>10.0</i>	<i>7.6</i>		
Interest expense	(1.3)	(2.8)	(1.7)	(40.1)	33.7	(2.3)	(4.5)	93.0	
Interest income	2.3	3.8	4.9	27.8	109.9	5.5	8.6	57.2	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI/Others	0.0	2.4	0.6	(74.1)	nm	0.0	3.0	nm	
Pretax profit	42.8	43.7	45.2	3.3	5.6	86.9	88.9	2.2	
<i>Pretax Margin (%)</i>	<i>10.3</i>	<i>8.3</i>	<i>8.3</i>			<i>10.4</i>	<i>8.3</i>		
Tax	(6.1)	(7.9)	(9.3)	17.9	53.0	(15.6)	(17.2)	10.2	
<i>Effective tax rate (%)</i>	<i>(14.2)</i>	<i>(18.0)</i>	<i>(20.6)</i>			<i>(17.9)</i>	<i>(19.3)</i>		
Minority Interest	0.1	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0	
Net Profit	36.8	35.9	35.8	(0.0)	(2.6)	71.4	71.7	0.4	
Core Profit	36.8	33.5	35.2	5.3	(4.3)	71.4	68.7	(3.8)	
<i>Core Net Margin (%)</i>	<i>8.8</i>	<i>6.3</i>	<i>6.5</i>			<i>8.5</i>	<i>6.4</i>		

Source: Company data, RHB

Figure 2: 2Q18 segmental breakdown

FYE Dec (MYRm)	2Q17	1Q18	2Q18	QoQ (%)	YoY (%)	1H17	1H18	YoY (%)	Comments
Revenue:									
Construction	387.2	492.1	511.6	4.0	32.2	737.9	1,003.7	36.0	
Precast Concrete	30.1	37.1	32.6	(12.1)	8.4	98.9	69.8	(29.4)	
EBIT:									
Construction	38.5	39.2	39.7	1.5	3.1	64.8	78.9	21.8	
Precast Concrete	6.3	3.6	2.3	(36.5)	(64.1)	22.1	5.8	(73.6)	
EBIT Margin %:									
Construction	10.0%	8.0%	7.8%			8.8%	7.9%		
Precast Concrete	21.0%	9.6%	6.9%			22.3%	8.4%		

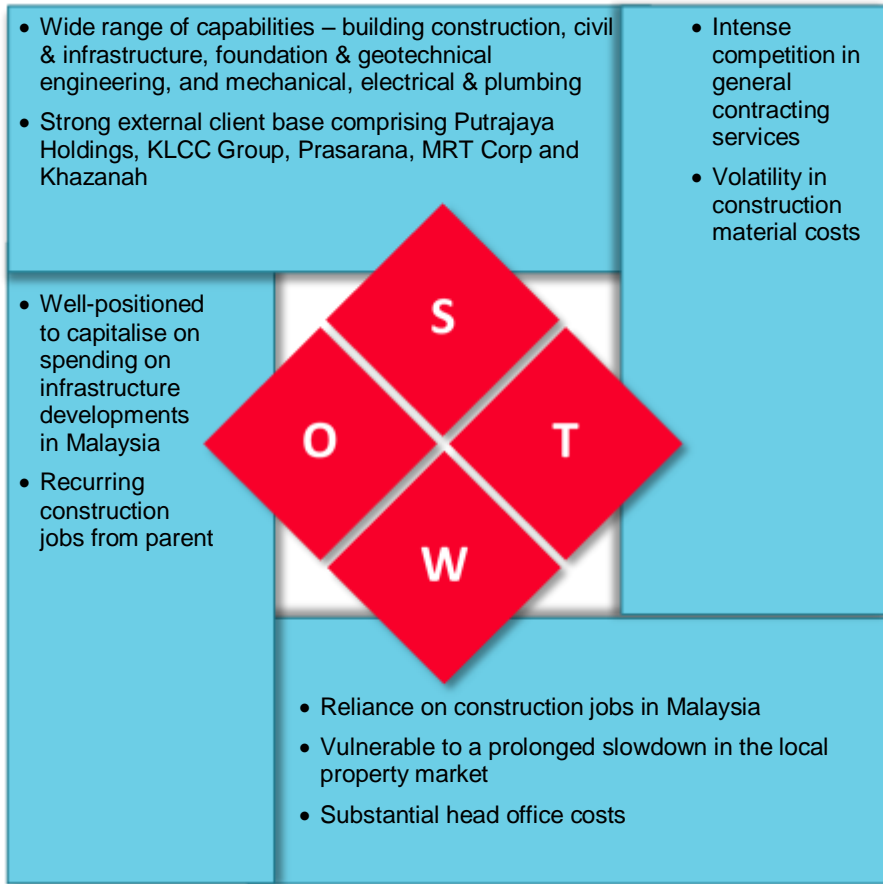
Source: Company data, RHB

Figure 3: New jobs secured in 2018

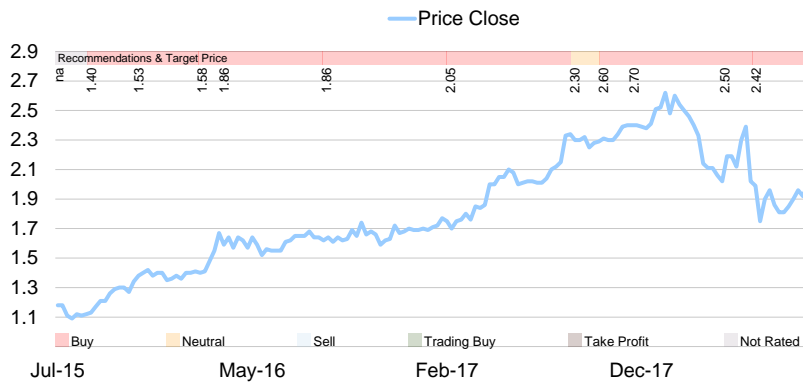
Contracts secured in 2018	Award date	Duration (months)	Contract sum (MYRm)
Sunway GEOLake	26/2/2018	36	223.0
Sunway Carnival Ext	27/2/2018	32	286.0
Sunway Medical Seberang Jaya	14/5/2018	31	180.0
BBC piling	23/5/2018	15	46.3
TNB Bangsar piling	23/5/2018	7	23.1
Others – in house & piling	16/8/2018	12	40.6
Precast	16/8/2018	N/A	55.0
Total			854.0

Source: Company data, RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-05-18	Buy	2.42	2.02
2018-04-02	Buy	2.50	2.06
2018-02-27	Buy	2.70	2.40
2017-12-29	Buy	2.70	2.51
2017-11-20	Buy	2.70	2.40
2017-10-06	Buy	2.60	2.29
2017-08-25	Neutral	2.30	2.34
2017-02-24	Buy	2.05	1.75
2016-08-26	Buy	1.86	1.62
2016-07-24	Buy	1.86	1.65

Source: RHB, Bloomberg

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