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Sunway Construction back on investors' radar screen

Group has surpassed its 2017 order book replenishment target with a whopping RM6.7bil

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TO many investors, construction companies can be difficult plays.

Many listed contractors have over the years secured loads of contracts but often times, the good news fades away because earnings do not live up to expectations.

Then, there are other contractors who, after building up their expertise, suffer from not having sufficient contracts to keep them busy.

Others who have ventured internationally have done well initially only to later hit roadblocks with their overseas projects and orders.

In the case of Sunway Construction Group Bhd (SunCon), though, it seems to be avoiding these pitfalls, possibly through trial and error.

While only having listed two years ago, SunCon can trace its beginnings to the early 1980s. That was when the group's founder, Tan Sri Jeffrey Cheah, was beginning his entrepreneurial journey with both property development and construction activities, among others.

Recall that SunCon was first listed in 1997 and grew to become one of the country's largest construction players, largely catering to the group's own vast property development projects.

However, in 2004, the group made a decision to privatise SunCon on the premise that the stock was trading at a value far below its peers.

Since then, the construction group has focused on building its capabilities.

"We restructured to build capabilities and capacity, and subsequently we relisted SunCon in July 2015," explains SunCon's managing director Chung Soo Kiong.

Since then, shares in the company have steadily grown in value by some 90% from its initial public offering price of RM1.20 to RM2.34 as at Friday.

SunCon had listed at a historical price earnings (PE) multiple of around 14 times. The stock now trades at a historical PE of 22.4 times.

In terms of earnings, the group's pre-tax profit achieved a compounded annual growth rate (CAGR) of 17.06% from 2012 to 2016, while normalised profit after tax and minority interests had a CAGR of 22.54% during the same period.

More recently, SunCon announced new contracts that put it on investors' radar again.

These include a RM74.8mil subcontract from Ahmad Zaki Sdn Bhd to undertake, among others, earthworks, piling and reinforced concrete works at the Bukit Bintang City Centre (BBCC).

The other is a letter of intent it received from Chin Teng Construction Co to supply precast components for the Clementi Neighbourhood 2 in Singapore comprising 1,179 dwelling units for RM65.2mil (S$20.9mil).

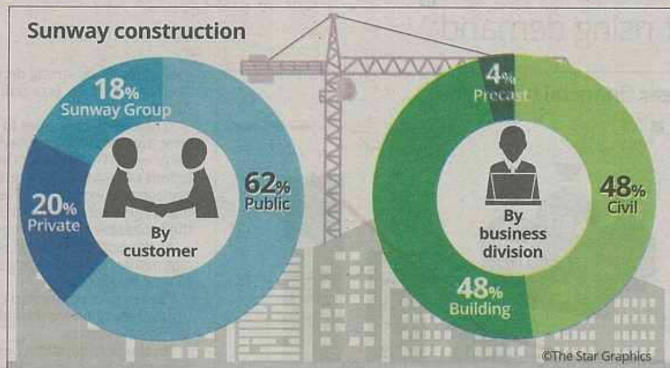
But the most prominent job win that has enabled it to surpass its 2017 order book replenishment target to a whopping RM6.7bil now is the RM2.18bil light rail transit line 3 (LRT 3) for Package GS07-08 from Prasarana Malaysia Bhd in early October.

Having stepped in as MD in November 2015, Chung concedes that it will be a challenging task for SunCon, especially since the company has secured a total of RM3.9bil in new orders this year alone.

SunCon had initially set an order book target of about RM2bil this year.

"Yes, it will be challenging, but we are all geared up for it.

"We intend to step up the game with the aim of taking on a project delivery partner (PDP) role for a major infrastructure job in future," says the affable 51-year-old, who joined the company in 1997 when it was known as Sunway Construction Sdn Bhd.



Chung: We intend to step up the game with the aim of taking on a project delivery partner role for a major infrastructure job in future.

While some analysts reckon that project execution remains a risk for SunCon (as it does for many other contractors winning large deals), Chung is unperturbed.

He explains that the group is supported by a "solid" business structure and has a proven track record both domestically and abroad.

SunCon's capabilities are wide, says Chung, adding that its diverse divisions range from the core construction division to areas such as geotechnical engineering to mechanical, electrical and plumbing services and down to the manufacturing of precast concrete.

"Because of this unique business structure, we do not have to rely on many third parties in our projects," says Chung.

He boasts of SunCon being the only contractor in the country with vast experience in all the key rapid transit projects, namely the mass raid transit (MRT), bus rapid transit (BRT) and LRT.

Chung says SunCon's focus will be on infrastructure and building projects in 2018.

For the financial year 2018 (FY18), the group has set a rather conservative orderbook target of RM1.5bil.

With about 70% of the RM210bil value of projects under Budget 2018 focused on rail, including the high-speed rail (HSR) and the East Coast Rail Link (ECRL), Chung affirms that SunCon will be vying for these projects.

Where building projects are concerned, Chung says SunCon's competitive edge is its RM20mil IT platform called Virtual Design and Construction (VDC).

"The platform was created by one of the biggest construction firms in the Middle East.

"We have used VDC for some of our building projects. It enables us to view the building design virtually even before it is being built. It also saves cost and increases efficiency in the long run," adds Chung.

On the recent BBCC contract, the company has also been invited to participate in building the office space.

So, while SunCon is selective in the jobs that it bids for, Chung says the company typically looks at 5%-8% pre-tax margins for all its construction jobs.

And why not double-digit pre-tax margins?

To this, Chung says Sunway as a whole invests a lot in sustainability and safety, and it wants to be competitive in terms of pricing.

In the meantime, SunCon has a role in supporting Sunway Bhd's development plans in building medical centres. This includes the recent announcement of about RM1bil in capital expenditure to build five new medical centres – two Sunway Penang hospitals, one in Sunway Velocity, Cheras, and one each in Sunway Damansara and Sunway Ipoh.

The group's precast business division is also gaining traction, as plans are underway to build an integrated construction precast hub (yard in Pulau Punggol Barat in Singapore.

"We intend to build a fully automated robotic precast plant on the yard with an annual capacity of 300 metre cube," he notes. The group is awaiting the outcome of its tender, via a 50:50 joint venture with a Singaporean partner, which will be made known by mid-2018.

SunCon's precast hub in Iskandar and Senai, Johor, is said to have a capacity of 156.6 metre cube at present.

Having had the exposure in the Middle East, India and Singapore, the company plans to venture into Myanmar and Bandung, Indonesia, and could possibly go back to India. It had in the past built seven highways there.

"We have had multiple discussions and meetings in these countries to search for potential partners.

"In Myanmar, we will soon be signing a heads of agreement with a local conglomerate there to build a medical centre (not under the Sunway brand). In Bandung, the projects will entail rail and healthcare," explains Chung, adding that the company will make the appropriate announcements when it is finalised.

Overall, there are now 10 "buy" recommendations on SunCon against four "hold" ratings, according to a Bloomberg survey of 14 analysts.

Hong Leong Investment Bank's (HLIB) October report indicates that the slew of recent job wins has resulted in SunCon's orderbook surging 56% to an all-time high of RM6.7bil (compared with RM4.3bil as of the second quarter of FY17). This, it said, implies a strong cover of 3.7 times on FY16 revenue, providing strong earnings visibility over the next three years.

"However, with this all-time high orderbook, execution would be the key risk," the house notes.

Nevertheless, HLIB reckons that its premium valuation yardstick for SunCon is justified, given its superior return on equity of 27%, which is more than double its peer average, and healthy balance with a net cash position of RM364mil (28 sen per share), notes HLIB. The house has an unchanged target price of RM2.59 for the stock.

Meanwhile, Macquarie Research has revised upwards SunCon's target price by 12% from RM2.50 to RM2.80 on the back of the LRT3 job win.

The research house also adjusted its FY17-FY19 profit after tax forecast by -2.5%/+18.9%/+43.4%, respectively.

"We revised lower our estimates for FY17 forecast due to the weaker demand of precast recorded in its second-quarter results," it notes.

Macquarie explains that precast products give an earnings before interest and taxes (EBIT) margin of between 20% and 24%, while construction EBIT margins are between 7% and 10%.

As such, it believes SunCon will not register anymore order wins leading up to the end of FY17, as the company is unlikely to participate in the ECRL and Pan Borneo Highway Sabah projects.

Macquarie has maintained SunCon's target PE at 16 times to arrive at the new target price of RM2.80.

The revised target price brings an implied PE of 17 times to SunCon's FY18 forecast earnings per share (EPS). SunCon is currently trading at 14 times FY18 EPS, notes the research firm.

While analysts are positive on SunCon's contract wins, Chung concludes the interview by saying that there is still much to do as it raises the bar to achieve its goal to hold a PDP role in a major infrastructure project.