

Results Note **Outthink. Outperform.****3Q18: Precast concrete loss**

Sunway Construction (Suncon) reported 3Q18 results that were below market and our expectations. Core net profit grew only 12% yoy to RM107m in 9M18, lagging our forecast. Hence, we cut our core EPS by 7-16% for FY18-20E. Note that Suncon also secured RM1.35bn worth of new contracts YTD (target RM1.5bn in FY18) to replenish its order book to RM5.2bn, providing earnings visibility. Suncon remains our top sector mid-cap BUY with a reduced TP of RM2.00, based on a 10% discount to RNAV.

Below expectations

Suncon's net profit of RM108m (+5% yoy) in 9M18 comprised only 67-69% of the consensus full-year forecast of RM157m and our estimate of RM161m respectively. We were surprised by the results at its precast concrete business, which incurred a loss before tax of RM1.9m in 3Q18, and slow progress billings for its construction arm. The review of the Klang Valley LRT Line 3 (LRT3) project led to delays in progress billings. The stations are being re-designed by the main contractor, MRCB-George Kent Joint Venture, to reduce costs. The current review of Suncon's RM2.18bn LRT3 Package GS07-08 contract, with the potential for cuts in the scope of works and value, is expected to complete in 4Q18.

Construction remains key earnings driver

Revenue jumped 23% yoy to RM1.63bn in 9M18, driven by Suncon's construction (+26% yoy) division, and partly offset by the 13% yoy decline in precast concrete revenue. Suncon's PBT increased by a slower 7% yoy to RM136m as construction PBT rose 25% yoy, partly held back by the 82% yoy decline in precast concrete PBT. High production costs and stiff price competition in Singapore contributed to the lower precast concrete PBT of RM4m in 9M18.

Cutting EPS forecasts and TP

The slow progress billings for construction and weaker precast concrete earnings lead us to cut our core EPS estimates by 7-16% in FY18-20E. We maintain our RM1.5bn new contract assumption but cut our assumptions to RM1.5bn (-25%) in FY19E and RM2bn (-20%) in FY20E in view of the challenging construction-sector prospects.

Lower RNAV/share but still a BUY

We cut our RNAV/share estimate to RM2.22 from RM2.72 to reflect our lower valuations for the construction and precast concrete divisions. Based on the same 10% discount to RNAV, we cut our TP to RM2.00 from RM2.45. Maintain BUY.

Earnings & Valuation Summary

FYE 31 Dec	2016	2017	2018E	2019E	2020E
Revenue (RMm)	1,788.8	2,076.3	2,283.0	2,404.6	2,318.4
EBITDA (RMm)	184.1	200.0	223.4	231.1	240.4
Pretax profit (RMm)	153.7	174.2	196.8	205.8	215.5
Net profit (RMm)	123.5	137.8	149.5	156.3	163.7
EPS (sen)	9.6	10.7	11.6	12.1	12.7
PER (x)	16.9	15.1	13.9	13.3	12.7
Core net profit (RMm)	119.0	135.4	149.5	156.3	163.7
Core EPS (sen)	9.2	10.5	11.6	12.1	12.7
Core EPS growth (%)	(12.7)	13.9	10.3	4.6	4.7
Core PER (x)	17.5	15.4	13.9	13.3	12.7
Net DPS (sen)	5.0	7.0	7.0	7.0	8.0
Dividend Yield (%)	3.1	4.3	4.3	4.3	5.0
EV/EBITDA (x)	9.5	8.6	7.1	6.5	5.9
Chg in EPS (%)			(7.2)	(16.4)	(15.2)
Affin/Consensus (x)			1.0	0.9	0.9

Source: Company, Affin Hwang forecasts, Bloomberg

Affin Hwang Investment Bank Bhd (14389-U)

Sunway Construction

SCGB MK
Sector: Construction**RM1.61 @ 19 November 2018****BUY (maintain)**

Upside 24%

Price Target: RM2.00

Previous Target: RM2.45

**Price Performance**

	1M	3M	12M
Absolute	5.9%	-19.1%	-32.9%
Rel to KLCI	7.2%	-15.7%	-32.5%

Stock Data

Issued shares (m)	1,292.2
Mkt cap (RMm)/(US\$m)	2081/497
Avg daily vol - 6mth (m)	1.2
52-wk range (RM)	1.3-2.64
Est free float	23.1%
BV per share (RM)	0.44
P/BV (x)	3.7
Net cash/ (debt) (RMm) (3Q18)	325
ROE (2018E)	25.6%
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholder

Sunway Bhd	54.4%
Sungei Way Corp	10.1%
EPF	7.4%
ASB	2.2%

Source: Affin Hwang, Bloomberg

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Potential reduction in LRT3 and MRT2 contract values

The renegotiation of the LRT3 and MRT2 contracts could lead to reductions in the scope of works and contract values. Hence, we assume that Suncon's MRT2 and LRT3 contracts are reduced by 23% from RM1.21bn to RM0.93bn and 30% from RM2.18bn to RM1.53bn respectively in our revised earnings forecasts. These reduced contract amounts are based on the overall reduction percentages announced by the main contractors of MRT2 and LRT3.

Key risks

Key downside risks are: (i) delays in the implementation of public infrastructure projects due to the new government's plan to review major projects; and (ii) cost overruns due to high steel bar prices.

Fig 1: Results comparison

FYE 31 Dec (RMm)	3Q FY17	2Q FY18	3Q FY18	QoQ % chg	YoY % chg	9M FY17	9M FY18	YoY % chg	3Q18 Comment
Revenue	491.4	544.3	557.3	2.4	13.4	1,328.1	1,630.8	22.8	Higher construction revenue (+30% yoy) was partly offset by lower precast concrete revenue (-3% yoy) in 9M18. Higher steel costs.
Op costs	(438.4)	(492.7)	(500.5)	1.6	14.2	(1,184.4)	(1,472.4)	24.3	
EBITDA	53.0	51.6	56.8	10.1	7.2	143.7	158.5	10.3	Slower EBITDA growth due to higher cost increase compared to revenue growth.
<i>EBITDA margin (%)</i>	<i>10.8</i>	<i>9.5</i>	<i>10.2</i>	<i>0.7ppt</i>	<i>(0.6ppt)</i>	<i>10.8</i>	<i>9.7</i>	<i>(1.1ppt)</i>	
Depn and amort	(9.7)	(10.2)	(10.1)	(0.9)	4.9	(28.0)	(30.1)	7.7	
EBIT	43.3	41.4	46.7	12.8	7.7	115.7	128.4	10.9	
Interest income	2.6	4.9	3.9	(20.1)	48.1	8.1	12.5	54.3	Higher return on net cash.
Interest expense	(2.0)	(1.7)	(1.7)	2.1	(11.7)	(4.3)	(6.3)	45.3	
Associates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Forex gain (losses)	0.0	(0.1)	(0.1)	(19.5)	(311.1)	0.8	(0.5)	NA	
Exceptional items	(1.8)	0.8	(1.8)	(335.9)	(1.7)	7.0	1.7	(75.6)	Arbitration gain for the past completed project in Trinidad & Tobago and gain on sale of equipment.
Pretax profit	42.2	45.2	46.9	3.9	11.2	127.4	135.8	6.6	Below expectations. Contraction in precast concrete PBT (-82% yoy) was partly offset by higher construction PBT (+25% yoy).
Core pretax	44.0	44.5	48.8	9.6	11.0	119.5	134.6	12.6	
Tax	(8.6)	(9.3)	(10.4)	12.2	21.3	(24.2)	(27.6)	14.1	
<i>Tax rate (%)</i>	<i>20.4</i>	<i>20.6</i>	<i>22.2</i>	<i>1.6ppt</i>	<i>1.9ppt</i>	<i>19.0</i>	<i>20.3</i>	<i>1.3ppt</i>	
Minority interests	0.1	(0.0)	(0.1)	319.0	(181.5)	0.2	(0.1)	(144.1)	
Net profit	33.7	35.9	36.4	1.6	8.0	103.4	108.1	4.6	Below expectations.
Core net profit	35.5	35.2	38.3	8.7	7.9	95.6	107.0	11.9	Excluding one-off items.
EPS (sen)	2.7	2.8	2.8	0.0	3.7	8.0	8.4	4.6	

Source: Company, Affin Hwang estimates

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Fig 2: Segmental PBT breakdown

Segment	3Q17	4Q17	1Q18	2Q18	3Q18	% qoq	% yoy	9M17	9M18	% chg
Construction	42.4	41.2	40.1	42.9	48.9	13.9	15.2	105.5	131.9	25.0
Precast concrete	(0.2)	5.6	3.6	2.3	(1.9)	(185.6)	738.4	21.9	3.9	(82.2)
Total	42.2	46.8	43.7	45.2	46.9	3.9	11.3	127.4	135.8	6.6

Source: Company, Affin Hwang estimates

Fig 3: Segmental PBT margin

FYE 31 Dec (%)	3Q17	4Q17	1Q18	2Q18	3Q18	ppt qoq	ppt yoy	9M17	9M18	ppt yoy
Construction	9.0	5.7	8.2	8.4	9.3	0.9	0.3	8.7	8.6	(0.1)
Precast concrete	(1.2)	21.2	9.6	7.0	(5.8)	(12.8)	(4.7)	18.5	3.8	(14.7)
Total	8.6	6.3	8.3	8.3	8.4	0.1	(0.2)	9.6	8.3	(1.3)

Source: Company, Affin Hwang estimates

Fig 4: RNAV and target price

Segments	Stake (%)	New RNAV (RMm)	Old RNAV (RMm)	Change (%)
Construction @ PE 14x avg earnings of RM140m	100	2,100	2,528	(17)
Pre-cast concrete @ PE 14x avg earnings of RM30m	100	420	640	(34)
Net cash/(debt)		353	353	0
RNAV		2,873	3,521	(18)
No. of shares (m shrs)		1,293	1,293	0
RNAV/share (RM)		2.22	2.72	(18)
Target price at 10% discount to RNAV/share		2.00	2.45	(18)

Source: Affin Hwang estimates

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Fig 5: Construction order book

Project	Completion	Contract value (RMm)	Outstanding value (RMm)
Infrastructure			
MRT V201 (Sg Buloh - Persiaran Dagang)	2Q21	1,213	527
BBCC Piling Works	4Q18	88	12
LRT3: Package GS07-08	2Q21	2,178	2,021
Others		87	14
Piling works	Various	75	64
		3,641	2,638
Building			
Putrajaya Parcel F	1Q19	1,610	287
KLCC (NEC + Package 2 & 2a)	2Q18	646	82
PPA1M project in Kota Bharu	1Q20	582	208
Nippon Express warehouse in Shah Alam	4Q19	70	68
Gas District Cooling (Plant 2)	3Q19	14	14
Others		487	39
		3,409	698
Internal			
Sunway Velocity Medical Centre	1Q19	185	67
Sunway Medical Centre 4 (2 towers)	4Q19	512	449
Sunway Iskandar - Emerald Residences	4Q18	175	6
Sunway Iskandar - Retail Complex/Big Box	4Q19	170	114
Sunway Serene - Serviced Residences	4Q20	449	351
Sunway GeoLake	1Q21	223	190
Carnival Mall Extension	4Q20	286	261
Sunway Medical Centre Seberang Jaya	4Q20	180	176
Velocity Ecodeck	4Q18	11	11
M&E works	4Q18	30	20
		2,221	1,645
Singapore			
Precast	Various	330	98
Precast – New orders in 2018	Various	130	128
Grand total		9,731	5,207

Source: Company

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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