

Malaysia Company Guide

Sunway Construction Group

Version 18 | Bloomberg: SCGB MK | Reuters: SCOG.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

4 Aug 2020

BUY

Last Traded Price (3 Aug 2020): RM1.89 (KLCI : 1,572.61)

Price Target 12-mth: RM2.30 (22% upside) (Prev RM2.30)

Analyst Tjen-San, CHONG, CFA +603 2604 3333
tjensan@alliancedbs.com

What's New

- Expect a weak 2Q20 but this will be the trough; cutting FY20-22F earnings but dividend payouts remain intact
- RM2bn new order guidance intact, with some upside
- Banking on LSS 4 tenders, awards in early FY21
- Maintain BUY with TP of RM2.30

Price Relative



Forecasts and Valuation

FY Dec (RMm)	2019A	2020F	2021F	2022F
Revenue	1,769	1,760	2,238	2,431
EBITDA	181	157	207	214
Pre-tax Profit	157	122	169	185
Net Profit	129	97.6	135	148
Net Pft (Pre Ex.)	129	97.6	135	148
Net Pft Gth (Pre-ex) (%)	(11.3)	(24.6)	38.3	10.0
EPS (sen)	10.0	7.55	10.4	11.5
EPS Pre Ex. (sen)	10.0	7.55	10.4	11.5
EPS Gth Pre Ex (%)	(11)	(25)	38	10
Diluted EPS (sen)	10.0	7.55	10.4	11.5
Net DPS (sen)	6.99	4.90	6.78	7.46
BV Per Share (sen)	48.2	50.8	54.5	58.5
PE (X)	18.9	25.0	18.1	16.5
PE Pre Ex. (X)	18.9	25.0	18.1	16.5
P/Cash Flow (X)	13.0	11.7	24.3	14.3
EV/EBITDA (X)	11.8	13.0	10.0	9.6
Net Div Yield (%)	3.7	2.6	3.6	3.9
P/Book Value (X)	3.9	3.7	3.5	3.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	21.3	15.2	19.8	20.3
Earnings Rev (%)		(17)	(7)	(3)
Consensus EPS (sen)		7.40	11.5	11.6
Other Broker Recs:		B: 7	S: 3	H: 4

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P

Position for a 2H recovery

2Q20 results to mark the trough before rebounding in 2H. We expect a weak 2Q20 performance before seeing a more meaningful pick-up in 2H20 earnings. While all of its Malaysian projects are already running at full steam and back at pre-Covid-19 levels, only three out of 16 of its Singapore precast projects have recommenced. SCGB is also making a stronger bid for LSS 4 tenders after gleaning experience with LSS 3, and is already doing internal solar jobs for its parent company.

Where we differ: Despite seemingly higher valuations for SCGB, we expect this premium to widen given its impeccable execution, net cash balance sheet with sustainable dividend payouts and improving visibility of project flows. We anticipate the new purer play contractors like SCGB to trade at a premium to the more diversified players once government pump priming is certain.

Key catalysts. SCGB will likely hit its RM2bn new order target for FY20F. A flawless execution track record post-Movement Control Order (MCO), a faster recovery in its precast division leading to a potential uplift in earnings and sustained dividend payouts could act as the next catalysts for the stock.

Valuation:

TP of RM2.30. Our target price (TP) is based on sum-of-parts (SOP) valuation to reflect the growing contribution from its high-margin precast business.

Key Risks to Our View:

The timely execution of its orderbook post-MCO is crucial to minimising the risk of any further earnings cuts. With its strong execution track record and experience, we believe the group is able to execute the projects in a timely manner.

At A Glance

Issued Capital (m shrs)	1,289
Mkt. Cap (RMm/US\$m)	2,437 / 575
Major Shareholders (%)	
Sunway Berhad	55.6
Tan Sri Jeffrey Cheah & Family	7.6
Free Float (%)	
3m Avg. Daily Val (US\$m)	0.28
GIC Industry : Industrials / Capital Goods	



Live more, Bank less

WHAT'S NEW

Positioning for a 2H recovery

2Q20 results could be worse than expected. While all of its Malaysian construction projects have resumed at close to full capacity since 1 June 2020, we believe 2Q20 results will be poorer than expected due to i) poor precast earnings in Singapore, and ii) still two months full impact from the MCO in Malaysia. We understand out of the 16 active projects in Singapore, only three have resumed and there is no real clarity when the balance will resume work. The major issue has been the still active and high cases among the foreign worker community in Singapore. The precast business has a high degree of operating leverage and we expect to slip into the red in 2Q20. For 1Q20, it made RM35m in revenue and RM0.8m in pretax profit – translating into a pretax margin of 2.1%.

On the positive side, its local construction projects are progressing very well and have not been impacted by supply chain issues. Additionally, all of its building projects like TNB HQ Campus have already locked in all RMC costs throughout the tenure of the project at lower costs.

RM2bn new orders still intact. While most contractors have struggled to replenish its orderbook over the past two years, SCGB has met this with ease. YTD wins have already amounted to RM688m and is well on track to hit its RM2bn target for FY20F. SCGB expects another RM1bn of new orders from its parent company in FY20F coming from three projects. This leaves just another RM200-300m from external projects where potential upside will come from the revival of government mega projects.

Bullish on LSS 4. SCGB has learned from its past mistakes when bidding for LSS 3 and is already bidding for 4 EPCC tenders for LSS 4 where it is working with the project owners. We understand collectively these tenders which close in September 2020 and awards amounting to RM800m could take place in January 2021. To be sure, it is also already doing small-scale renewable energy projects for its parent company.

Tender delays due to Covid-19. Due to the heightened spread of Covid-19 in Bangalore India, SCGB's Indian HAM project is only expected to achieve financial close in 4Q20 and kick off in mid-FY21F. It remains committed to bid for projects in India and it is still expecting one more project in India but this is likely to be awarded in FY21F.

In terms of some of the local building jobs it is bidding for, there have also been delays due to Covid-19. We think this is likely because the pandemic may have caused some design changes and given rise to the new normal for working and doing business. Some of these projects were:

- i) Putrajaya 7MD& building job estimated at RM500m where SCG is already the piling contractor. Additionally, SCG appears to be the go-to contractor for Putrajaya jobs where it has completed RM2.8bn worth of works since 2001. The more recent one being the Putrajaya Parcel F project.
- ii) KLCC podium project estimated at RM300m which may be bundled together with the superstructure (value not known).

Dividends. As at 31 March 2020, the company is in a net cash position of RM359m or RM0.28/share. It has a fixed dividend policy of paying 35% of net profit but has been paying c.70% since FY17. We think it is likely to continue paying both its interim and final dividends for FY20F and the payout will remain high but the absolute amount of dividends will be lower given the lower projected profit. We are projecting 4.9 sen, 6.8 sen and 7.5 sen dividend per share for FY20-22F, respectively, based on a payout ratio of 65%.

Cutting earnings. In light of the anticipated poor 2Q numbers because of the precast business in Singapore, we cut our FY20-22F earnings by 3-17%. We have staggered the recognition of its local orderbook to be recognised more in FY21F and beyond, while we assume its precast business to be loss making in FY20F before turning around in FY21F. We think 2Q20 will mark the bottom for earnings and there should be a more meaningful pick-up in 4Q20.

BUY, TP set at RM2.30. In spite of the cut in earnings, we leave our TP unchanged at RM2.30 as it is based on SOP. SCGB remains a strong proxy to the anticipated revival in infrastructure spending given its experience and solid track record in rail-based projects such as MRT and LRT. Its internal pipeline of projects from its parent company also gives it a comfortable base of orders every year. We expect its balance sheet to remain solid and dividend payout ratios to be maintained. Our BUY rating is maintained.

Sunway Construction Group

CRITICAL DATA POINTS TO WATCH

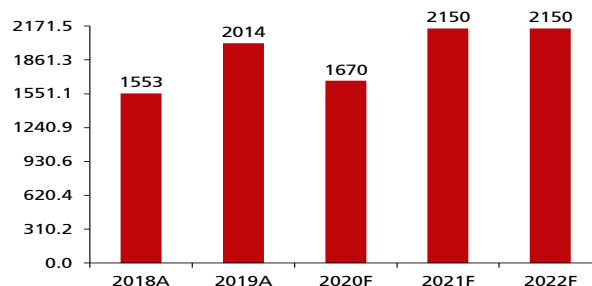
Reliable track record. SCGB's construction division stands strong given its reliable execution track record, despite the current soft and less visible project flows. Given its well-established brand name and strong execution track record, we believe the group will still be relevant for both private and public sector projects. SCGB has solidified its position in MRT Line 2 and LRT 3 projects.

Stronger infrastructure orderbook. After a strong 2017 with RM4bn new wins, 2018 and 2019 new wins moderated to RM1.55bn and RM1.77bn while its outstanding orderbook is currently at RM5.4bn. 2018 new wins have largely been driven by job flows from its parent company. The largest job win for 2019 was Tenaga HQ Campus Phase 2 worth RM780m. We have already taken the cost reduction in contract value of LRT 3 into account.

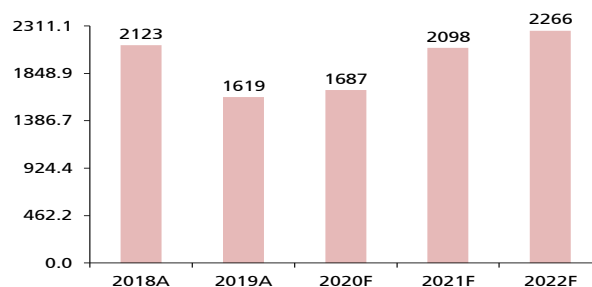
Precast turn around facing setbacks due to Covid-19. For 1Q20, its precast division was slightly profitable at RM0.8m but we expect it to swing into the red in 2Q20 due to circuit breaker in Singapore. We understand only a fraction of its 16 on-going jobs in Singapore have recommenced. The group believes normalised margins are within the 10-15% range. We now expect meaningful improvement in its precast business in FY21F. The total capacity for both its Senai and Iskandar plants is 156,000m³ per annum. This will double post the completion of its Industrial Concrete Precast Hub in Singapore in the next three years.

What is in store for FY20F? The guidance for FY20F new order wins is set at RM2bn. This could be surpassed given that out of the RM2bn, half or RM1bn will come from its more assured pipeline of internal jobs. SCGB is banking on two main overseas markets – Myanmar and India. In Myanmar, progress has been slow. It will continue to bid for highway projects in India under HAM and has won one so far in FY20F and expects another in early FY21F. It is also actively bidding for tenders for LSS 4

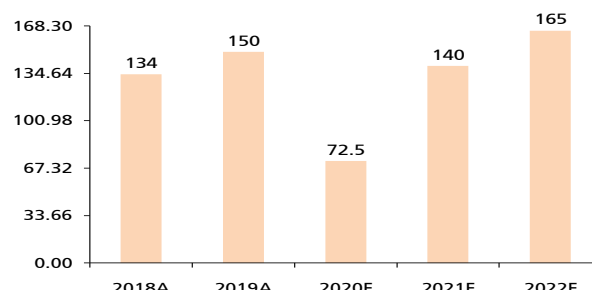
New order wins



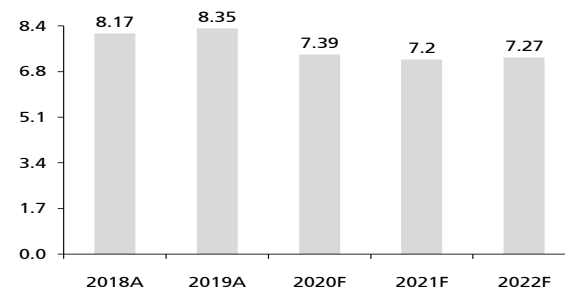
Construction revenue



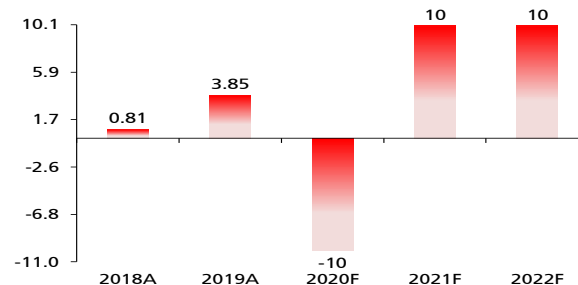
Precast revenue



Construction EBIT margins

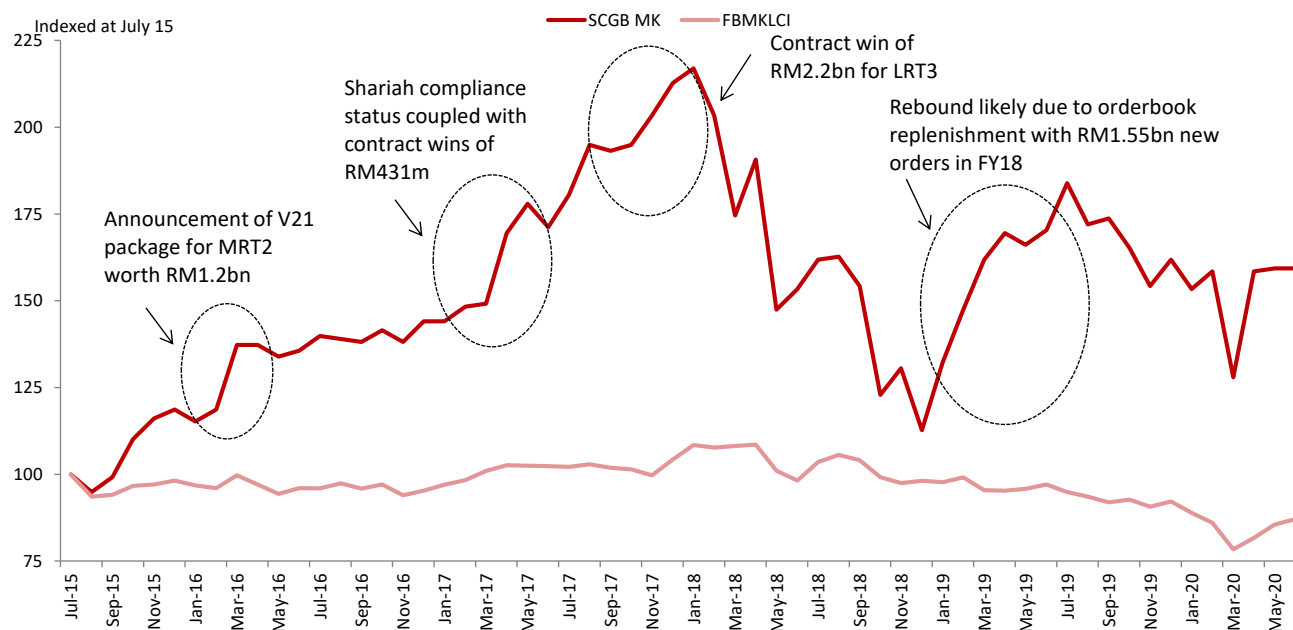


Precast EBIT margins



Source: Company, AllianceDBS

Appendix 1: A look at Company's listed history – what drives its share price?



SCGB had its initial public offering (IPO) on July 2015. So far, it appears that contract wins have been the main share driver given that it is a pure play construction stock. From January to March 2016, SCGB's share price rose due to the announcement of its RM1.2bn V201 package for MRT Line 2. On a cost per km basis, the contract was also c.30% higher than its MRT Line 1 package.

In January to April 2017, SCGB's share price also performed well likely due to expectations of being classified as a Shariah-compliant stock again, coupled with some other contract wins worth a total of RM431m. In October 2017, SCGB announced sizeable contract wins, the largest being a RM2.2bn contract for LRT 3.

The company's share price has remained relatively unchanged, despite its outstanding orderbook hitting an all-time high of RM6.7bn. This leads us to believe that improved earnings delivery arising from smooth execution will be more an important re-rating catalyst now. After the 14th General Elections (GE14) in May 2018, the stock has underperformed the KLCI in line with most construction stocks. However, it has since rebounded as it replenished its orderbook with RM1.55bn new orders in FY18.



Sunway Construction Group

Balance Sheet:

Strong balance sheet and cash generation ability. As at 31 March 2020, the group had a net cash position of RM359m and minimal working capital requirements going forward. We estimate the group will retain its strong balance sheet position. Its return on average equity ROAE is expected to hover around the 20% level.

Share Price Drivers:

Executing orderbook and LRT 3. SCGB's outstanding orderbook now stands at RM5.4bn. This gives it about two years of revenue visibility. The execution of LRT 3 and payment collection for this project are quite vital for SCGB. It is guiding for RM2bn new wins for FY20F.

Recovery in precast margins only in FY21F. Its precast business has been severely impacted by the circuit breaker in Singapore due to Covid-19. We only expect more significant improvements in SCGB's precast business in FY21F.

Dividend payout policy of at least 35%. SCGB is committed to distributing a minimum 35% of its core profit to shareholders, which is uncommon among construction players. But it has been paying 70% over the past three years. This could be attributable to its sizeable operations, with a large asset base that requires little capital expenditure (capex) ahead. We have imputed a 65% dividend payout ratio, based on our strong net cash forecasts.

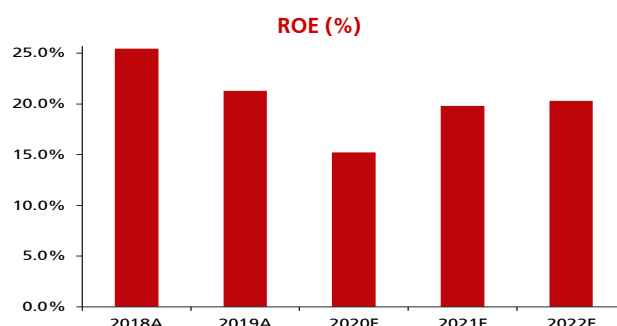
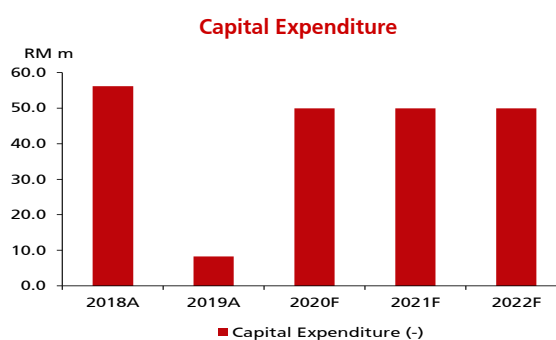
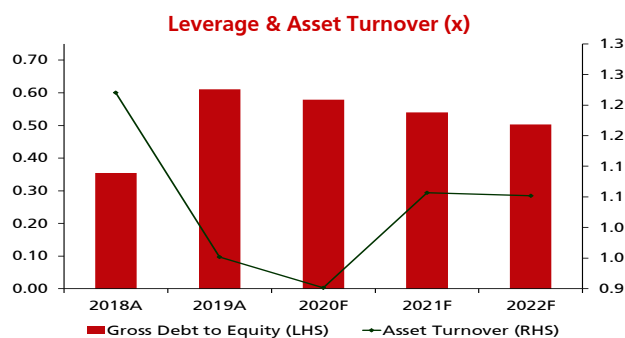
Key Risks:

Delays in construction. There may be project cost overruns due to several factors such as design and engineering issues and soil conditions.

Fluctuating prices of raw materials. The construction business typically requires a wide range of raw materials including steel bars, ready-mixed concrete, diesel, electrical cables and fittings, which are all subject to price fluctuations.

Company Background

An established player with 30 years of heritage, Sunway Construction Group (SCGB) is one of Malaysia's largest construction companies. It adopts an integrated business model that covers various phases of construction activities, from project design to completion.



Source: Company, AllianceDBS

Sunway Construction Group

Key Assumptions

FY Dec	2018A	2019A	2020F	2021F	2022F
New order wins	1,553	2,014	1,670	2,150	2,150
Construction revenue	2,123	1,619	1,687	2,098	2,266
Precast revenue	134	150	72.5	140	165
Construction EBIT margins	8.17	8.35	7.39	7.20	7.27
Precast EBIT margins	0.81	3.85	(10.0)	10.0	10.0

Segmental Breakdown

FY Dec	2018A	2019A	2020F	2021F	2022F
Revenues (RMm)					
Construction	2,123	1,619	1,687	2,098	2,266
Precast Concrete	134	150	72.5	140	165
Total	2,257	1,769	1,760	2,238	2,431
EBIT (RMm)					
Construction	174	135	125	151	165
Precast Concrete	1.09	5.77	(7.3)	14.0	16.5
Total	175	141	118	165	181
EBIT Margins (%)					
Construction	8.2	8.4	7.4	7.2	7.3
Precast Concrete	0.8	3.8	(10.0)	10.0	10.0
Total	7.7	8.0	6.7	7.4	7.5

Income Statement (RMm)

FY Dec	2018A	2019A	2020F	2021F	2022F
Revenue	2,257	1,769	1,760	2,238	2,431
Cost of Goods Sold	(1,782)	(1,397)	(1,404)	(1,831)	(2,013)
Gross Profit	474	372	356	408	417
Other Opng (Exp)/Inc	(299)	(231)	(238)	(243)	(236)
Operating Profit	176	141	118	165	181
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.73	4.42	0.0	0.0	0.0
Net Interest (Exp)/Inc	7.74	12.0	4.43	3.51	4.11
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	184	157	122	169	185
Tax	(38.0)	(27.1)	(24.4)	(33.7)	(37.1)
Minority Interest	(0.3)	(1.0)	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	146	129	97.6	135	148
Net Profit before Except.	146	129	97.6	135	148
EBITDA	218	181	157	207	214
Growth					
Revenue Gth (%)	8.7	(21.6)	(0.5)	27.2	8.6
EBITDA Gth (%)	6.5	(16.9)	(13.3)	31.7	3.6
Opg Profit Gth (%)	6.1	(19.7)	(16.7)	40.5	9.8
Net Profit Gth (Pre-ex) (%)	5.0	(11.3)	(24.6)	38.3	10.0
Margins & Ratio					
Gross Margins (%)	21.0	21.0	20.2	18.2	17.2
Opg Profit Margin (%)	7.8	8.0	6.7	7.4	7.5
Net Profit Margin (%)	6.5	7.3	5.5	6.0	6.1
ROAE (%)	25.5	21.3	15.2	19.8	20.3
ROA (%)	7.9	7.0	5.0	6.4	6.4
ROCE (%)	20.5	15.5	9.9	12.9	13.5
Div Payout Ratio (%)	66.5	69.9	65.0	65.0	65.0
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, AllianceDBS

Sunway Construction Group

Quarterly Income Statement (RMm)

FY Dec	1Q2019	2Q2019	3Q2019	4Q2019	1Q2020
Revenue	440	440	403	486	366
Other Oper. (Exp)/Inc	(402)	(403)	(368)	(455)	(347)
Operating Profit	38.2	37.6	34.4	30.8	18.7
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	4.42	0.0
Net Interest (Exp)/Inc	1.93	3.58	1.19	5.26	2.54
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	40.1	41.2	35.6	40.5	21.2
Tax	(8.5)	(8.2)	(2.5)	(7.8)	(4.3)
Minority Interest	(0.6)	0.21	0.46	(1.1)	(0.6)
Net Profit	31.0	33.2	33.5	31.6	16.4
Net profit bef Except.	31.0	33.2	33.5	31.6	16.4
EBITDA	38.2	37.6	34.4	35.3	18.7

Growth

Revenue Gth (%)	(29.7)	0.0	(8.5)	20.7	(24.7)
EBITDA Gth (%)	(16.6)	(1.5)	(8.6)	2.5	(47.0)
Opg Profit Gth (%)	(15.2)	(1.5)	(8.6)	(10.3)	(39.4)
Net Profit Gth (Pre-ex) (%)	(15.2)	7.0	0.9	(5.5)	(48.3)

Margins

Opg Profit Margins (%)	8.7	8.5	8.5	6.3	5.1
Net Profit Margins (%)	7.0	7.5	8.3	6.5	4.5

Balance Sheet (RMm)

FY Dec	2018A	2019A	2020F	2021F	2022F
Net Fixed Assets	164	139	149	158	175
Invts in Associates & JVs	44.7	48.4	48.4	48.4	48.4
Other LT Assets	6.58	7.81	7.81	7.81	7.81
Cash & ST Invts	485	693	788	751	775
Inventory	30.0	25.1	18.9	23.9	25.9
Debtors	1,059	970	964	1,227	1,332
Other Current Assets	22.9	21.7	21.7	21.7	21.7
Total Assets	1,812	1,905	1,999	2,237	2,386
ST Debt	114	233	233	233	233
Creditor	995	885	945	1,136	1,233
Other Current Liab	14.6	1.56	1.56	1.56	1.56
LT Debt	96.3	148	148	148	148
Other LT Liabilities	0.57	11.2	11.2	11.2	11.2
Shareholder's Equity	591	623	657	704	756
Minority Interests	1.44	2.22	2.22	2.22	2.22
Total Cap. & Liab.	1,812	1,905	1,999	2,237	2,386
Non-Cash Wkg. Capital	103	130	58.5	134	145
Net Cash/(Debt)	275	311	406	369	394
Debtors Turn (avg days)	182.3	209.4	200.6	178.6	192.1
Creditors Turn (avg days)	228.6	252.9	244.8	212.3	218.3
Inventory Turn (avg days)	5.7	7.4	5.9	4.4	4.6
Asset Turnover (x)	1.2	1.0	0.9	1.1	1.1
Current Ratio (x)	1.4	1.5	1.5	1.5	1.5
Quick Ratio (x)	1.4	1.5	1.5	1.4	1.4
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	26.8	2.2	13.1	13.1	13.1
Z-Score (X)	3.4	3.0	2.8	2.8	2.8

Source: Company, AllianceDBS

Sunway Construction Group

Cash Flow Statement (RMm)

FY Dec	2018A	2019A	2020F	2021F	2022F
Pre-Tax Profit	184	157	122	169	185
Dep. & Amort.	42.5	40.3	39.6	41.8	33.0
Tax Paid	(38.0)	(27.1)	(24.4)	(33.7)	(37.1)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(59.3)	(15.6)	72.0	(76.0)	(10.9)
Other Operating CF	59.7	33.1	0.0	0.0	0.0
Net Operating CF	189	188	209	101	170
Capital Exp.(net)	(56.2)	(8.3)	(50.0)	(50.0)	(50.0)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	(17.7)	(43.1)	0.0	0.0	0.0
Net Investing CF	(73.8)	(51.4)	(50.0)	(50.0)	(50.0)
Div Paid	(96.9)	(90.4)	(63.4)	(87.7)	(96.4)
Chg in Gross Debt	75.3	172	0.0	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(95.9)	(10.5)	0.0	0.0	0.0
Net Financing CF	(118)	71.1	(63.4)	(87.7)	(96.4)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	(2.4)	208	95.7	(37.0)	24.0
Opg CFPS (sen)	19.2	15.8	10.6	13.7	14.0
Free CFPS (sen)	10.3	13.9	12.3	3.92	9.32

Source: Company, AllianceDBS

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	20 Aug 19	2.05	2.70	BUY
2:	15 Nov 19	1.97	2.70	BUY
3:	20 Nov 19	1.97	2.70	BUY
4:	21 Feb 20	1.95	2.60	BUY
5:	27 Mar 20	1.55	2.60	BUY
6:	01 Apr 20	1.56	2.30	BUY
7:	22 May 20	1.92	2.30	BUY

Note: Share price and Target price are adjusted for corporate actions.

Source: AllianceDBS

Analyst: Chong Tjen-San

AllianceDBS recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are AllianceDBS unless otherwise specified.

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DBS Regional Research Offices

HONG KONG

DBS (Hong Kong) Ltd

Contact: Carol Wu
13th Floor One Island East,
18 Westlands Road,
Quarry Bay, Hong Kong
Tel: 852 3668 4181
Fax: 852 2521 1812
e-mail: dbsvhk@dbs.com

MALAYSIA

AllianceDBS Research Sdn Bhd

Contact: Wong Ming Tek (128540 U)
19th Floor, Menara Multi-Purpose,
Capital Square,
8 Jalan Munshi Abdullah 50100
Kuala Lumpur, Malaysia.
Tel.: 603 2604 3333
Fax: 603 2604 3921
e-mail: general@alliancedbs.com

SINGAPORE

DBS Bank Ltd

Contact: Janice Chua
12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982
Tel: 65 6878 8888
Fax: 65 65353 418
e-mail: equityresearch@dbs.com
Company Regn. No. 196800306E

THAILAND

DBS Vickers Securities (Thailand) Co Ltd

Contact: Chanpen Sirithanarattanakul
989 Siam Piwat Tower Building,
9th, 14th-15th Floor
Rama 1 Road, Pathumwan,
Bangkok Thailand 10330
Tel. 66 2 857 7831
Fax: 66 2 658 1269
e-mail: research@th.dbs.com
Company Regn. No 0105539127012
Securities and Exchange Commission, Thailand

INDONESIA

PT DBS Vickers Sekuritas (Indonesia)

Contact: Maynard Priajaya Arif
DBS Bank Tower
Ciputra World 1, 32/F
Jl. Prof. Dr. Satrio Kav. 3-5
Jakarta 12940, Indonesia
Tel: 62 21 3003 4900
Fax: 6221 3003 4943
e-mail: indonesiaresearch@dbs.com