

1Q18 results announced on 17 May are below expectations

17 May 2018

Construction & Engineering | Engineering & Construction

Sunway Construction

Buy (Maintained)

Backed By Robust Unbilled Orderbook

 Target Price: MYR2.42
 Price: MYR2.15
 Market Cap: USD700m
 Bloomberg Ticker: SCGB MK

We maintain our BUY call on Sunway Construction, with a new MYR2.42 TP from MYR2.50, 13% upside. Its 1Q18 core earnings missed expectations, coming in at 19% of its FY18F net profit. Despite trimming our FY18F-20F earnings by 9-13%, we expect the coming quarters to perform better. This is underpinned by a significantly higher amount of unbilled contracts at MYR6.3bn vs MYR4.6bn a year ago. We remain positive on Sunway Construction's ability to secure new contracts from its parent, as well as external parties.

Sunway Construction reported earnings of MYR35.9m (+3.5% YoY, +12.2% QoQ). Excluding several one-off items – comprising gain on arbitration of MYR1.7m, gain on disposal of fixed assets of MYR1m and unrealised forex losses of MYR0.3m – we derive a core net profit of MYR33.5m. This represents 19% of our and consensus estimates, ie below expectations.

We reduce our FY18F-20F earnings by 9-13% after lowering our progress billing assumptions for certain key projects. Among them is the MYR2.2bn Light Rail Transit 3 (LRT3) project that was awarded in Oct 2017. In our estimate, the latest progress of the contract is only 3%, ie behind schedule due to delays in the site handover from the awardee. The company is likely to seek an extension of time (EOT) for the project, which – in our view – is expected to be approved.

We remain sanguine despite the setbacks – this positive view is premised on Sunway Construction's outstanding orderbook of MYR6.3bn as at March, which is significantly higher (+37% YoY) vis-à-vis Mar 2017's MYR4.6bn. So far in 2018, the company has secured three contracts from its parent totalling MYR0.64bn – making it on track to meet our FY18 MYR2.2bn new jobs target.

Maintain BUY. Post our earnings revision, we have a new MYR2.42 TP from MYR2.50. This is based on an unchanged ex-cash FY18F P/E of 16x. We remain optimistic on Sunway Construction's prospects in securing new jobs, both from its parent and external parties. Work package tenders for major infrastructure projects – eg Kuala Lumpur-Singapore high speed rail (HSR), Mass Rapid Transit 3 (MRT3) and Penang LRT – could still be on the cards after reviews are completed. Our BUY call is further justified, given its ability to maintain robust ROEs, which have averaged at 28% for the past three financial years. In addition, Sunway Construction has steadily grown its net cash pile to MYR457m from MYR280m a year ago – even after declaring MYR90m in dividends in FY17.

Figure 1: Sunway Construction's quarter results review

FYE Dec (MYRm)	1Q17	4Q17	1Q18	q-o-q (%)	y-o-y (%)	Comments
Revenue	419.5	748.2	529.2	(29.3)	26.1	Higher recognition of building projects – Parcel F and ISKL.
EBIT	42.1	39.9	40.3	1.1	(4.1)	
EBIT margin (%)	10.0	5.3	7.6			
Interest expense	(1.1)	(1.8)	(2.8)	59.1	163.0	
Interest income	3.2	5.4	3.8	(29.1)	19.0	
Associates	0.0	0.0	0.0	n.a.	n.a.	
El/others	0.0	0.7	2.4	242.0	n.a.	Arbitration gain, gains on disposal and forex losses.
Pretax profit	44.2	44.2	43.7	(1.1)	(1.0)	
Pretax margin (%)	10.5	5.9	8.3			
Tax	(9.5)	(12.0)	(7.9)	(34.6)	(17.2)	
Effective tax rate (%)	(21.6)	(27.3)	(18.0)			
Minority interest	(0.0)	(0.2)	0.0	(114.5)	(307.7)	
Net profit	34.6	31.9	35.9	12.2	3.5	
Core profit	34.6	31.2	33.5	7.1	(3.4)	
Core net margin (%)	8.3	4.2	6.3			Margins were brought down by the precast division, due to higher steel prices – a key raw material.

Source: Company data, RHB

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (MYRm)	1,789	2,076	2,383	2,731	2,791
Reported net profit (MYRm)	124	138	164	196	203
Recurring net profit (MYRm)	124	138	164	196	203
Recurring net profit growth (%)	(2.9)	11.7	18.7	19.5	3.5
Recurring EPS (MYR)	0.10	0.11	0.13	0.15	0.16
DPS (MYR)	0.05	0.07	0.08	0.09	0.09
Recurring P/E (x)	22.5	20.2	17.0	14.2	13.7
P/B (x)	5.64	5.40	4.79	4.23	3.77
P/CF (x)	na	18.6	9.1	11.0	11.2
Dividend Yield (%)	2.3	3.3	3.7	4.0	4.2
EV/EBITDA (x)	13.1	12.0	8.8	7.3	6.7
Return on average equity (%)	26.2	27.4	29.9	31.6	29.0
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			(3.3)		

Source: Company data, RHB

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