

COMPANY UPDATE

Sunway Construction (SCGB MK)

In Recovery Mode In 2H20

While the COVID-19 pandemic has probably put on hold some of the project rollouts, SunCon is upbeat about meeting its orderbook replenishment target of RM2b in 2020. SunCon expects its activities to normalise from mid-3Q20 and earnings to improve. The company has recently formed a JV with ENGIA SEA to further strengthen its position as the leading pure contractor play to provide green energy services to clients. Maintain HOLD. Target price: RM1.70. Entry price: RM1.55.

WHAT'S NEW

- Recovery in sight from 2H20.** Following 1Q20 earnings disappointment on lower billings from its construction orderbook and margin contraction due to the Movement Control Order (MCO) from mid-Mar 20, we expect Sunway Construction (SunCon) to see minimal losses or a breakeven in 2Q20. From our checks, almost all of SunCon's construction sites have resumed works beginning Jun 20 and they are expected to achieve pre-MCO levels from mid-3Q20. The 2H20 earnings recovery would be driven by accelerated billings from its key projects like the LRT3, TNB Campus and Petronas Learning Centre (PLC).
- Strengthening its position in the market.** Besides the normal "brick and mortar" construction services, SunCon has further strengthened its position and has integrated the green energy business as part of its offerings to clients. On 9 Jun 20, the company formed a JV with ENGIA SEA (ENGIA offers green energy services and solutions) The new JV will undertake district cooling system (DSC) projects in the future, including Sunway Bhd's property assets such as buildings, retail malls, educational institutions, medical centres, hotels, resorts, theme parks and factories.. We understand SunCon's mixed development project in Bandar Sunway will require expertise and services from this JV as Sunway plans to include green energy concepts in its future property developments.
- Maintaining orderbook target of RM2b.** While noting some of the project awardings might be delayed to late-20, SunCon is keeping its 2020 orderbook replenishment target at RM2b. We understand the internal projects that are highly likely to be dished out this year include the mixed development contract in Bandar Sunway that is worth RM500m. On the external front, SunCon is eyeing at least one building contract from KLCC Property (it tendered for three contracts, each worth RM500m) and a large solar package from a shortlisted independent power producer (RM300m, acting as EPCC with a potential local technological partner), which is expected to be announced in 2H20. For overseas contracts, SunCon is still upbeat of winning another India Highway contract worth RM500m (two active tenders) and contracts for precast products worth RM200m in Singapore.

KEY FINANCIALS

Year to 31 Dec (RMm)	2018	2019	2020F	2021F	2022F
Net turnover	2,257	1,769	1,311	2,064	2,213
EBITDA	196	161	129	212	216
Operating profit	155	121	92	171	172
Net profit (rep./act.)	144	129	83	149	152
Net profit (adj.)	142	133	83	149	152
EPS (sen)	11.0	10.3	6.4	11.5	11.7
PE (x)	17.1	18.3	29.2	16.3	16.0
P/B (x)	4.1	3.9	3.7	3.4	3.0
EV/EBITDA (x)	10.7	13.0	16.3	9.9	9.7
Dividend yield (%)	2.1	1.9	2.1	3.4	3.1
Net margin (%)	6.4	7.3	6.4	7.2	6.9
Net debt/(cash) to equity (%)	(46.6)	(49.9)	(49.7)	(52.4)	(55.5)
ROE (%)	25.5	21.3	13.0	21.6	19.9
Consensus net profit	-	-	93	150	152
UOBKH/Consensus (x)	-	-	0.89	0.99	1.00

Source: SunCon, Bloomberg, UOB Kay Hian

HOLD

(Maintained)

Share Price	RM1.88
Target Price	RM1.70
Upside	-9.6%

COMPANY DESCRIPTION

A leading construction company in Malaysia

STOCK DATA

GICS sector	Industrials
Bloomberg ticker:	SCGB MK
Shares issued (m):	1,289.4
Market cap (RMm):	2,424.0
Market cap (US\$m):	566.6
3-mth avg daily t'over (US\$m):	0.3

Price Performance (%)

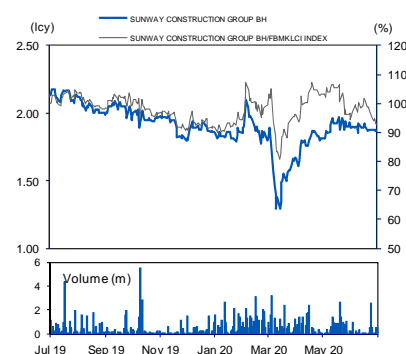
52-week high/low	RM2.18/RM1.29			
1mth	3mth	6mth	1yr	YTD
(1.1)	16.0	1.1	(11.3)	(1.6)

Major Shareholders

Sunway Berhad	54.4
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FY20 NAV/Share (RM)	0.51
FY20 Net Cash/Share (RM)	0.25

PRICE CHART



Source: Bloomberg

ANALYST(S)

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STOCK IMPACT

- Strong and diversified outstanding orderbook.** SunCon's outstanding orderbook backlog of RM5.5b provides earnings visibility for its construction arm for the next 3-4 years. Ytd, SunCon has secured new contracts worth RM688m, including India Highway (RM508m, secured in 1Q20) via 60%-owned JV with a local Indian company, Sunway International School (RM121m) and MRT2 M&E works (RM54m).
- Not limiting to "bread and butter" contracts.** Traditionally, construction contracts won by SunCon in the past were financed projects from clients (ie SunCon to bill revenue based on progress billings and to be paid by the clients accordingly). Realising the shrinking pool of new contracts locally, the company has expanded into the Asean region and India to win new contracts - both ready financed projects and private finance initiative (PFI) projects. For instance, the highway contract won through its JV in India is a PFI project. The JV acts as the contractor (and do not bear any traffic risks) for the highway project and the project's progress payment will be paid by the National Highways Authority of India (NHAI). NHAI will pay the first 40% of the project during the duration of the construction (24 months, with construction works to commence in Oct 20) and the balance of 60% will be paid in annuity form during the 15-year concession period. The interest on the deferred payment is based on Reserve Bank of India's cash reserve ratio plus 3%. As such, we believe SunCon will carefully look into all aspects including the profitability of the projects as well as its ability to manage its cash flow.
- MCO dragged 1H20 performance.** Due to the MCO, SunCon's construction activities were halted for more than two months beginning mid-Mar 20. While SunCon has received approval to restart its construction works from May 20, the costs of adhering to the SOP, such as social distancing (ie less manpower on site) and other costs like thermal screenings might erode its margins. However, we understand that most of SunCon's workers have been tested for Covid-19, while the subcontractors are currently undergoing screening. As such, we expect construction activities would reach pre-MCO levels by mid-3Q20 as most of its workers would have been tested by then.
- LRT3 progress to-date.** The MRCB-GKENT JV (LRT3's turnkey contractor) has concluded the design and specification negotiations for the six stations and the bridge design under the SunCon package. Post design and specification revision (less facade works, lower number of escalators, removal of subcontractor fees), SunCon expects the JV to be able to reduce station construction costs by at least 30% to below RM40m per station. Conservatively, we had already revised down SunCon's LRT3 contract by 35% in our previous note (to RM1.1b, from RM1.7b), factoring in the revised scheme but margins remaining unchanged. SunCon is hopeful of finalising the formal review by 1H20, but has already commenced construction works in 1Q20 and should complete the project before the deadline of 2024.
- ICPH to commence operations by mid-21.** The ICPH in Singapore has an annual capacity of 100,000 cubic metre (cum) and is expected to begin operations by mid-21. It will supply precast products like prefabricated bathroom units and prefabricated volumetric construction products, primarily for Housing Development Board (HDB) flats in Singapore. The 51:49 JV (HL Building Materials Pte Ltd:SunCon) is expected to contribute from mid-21 with an estimated bottom line of >S\$5m annually (at JV level based on 50% utilisation rate). In addition, ICPH's precast products yield better margins (>10%) than Johor's precast products (annual capacity of 150,000cum).

EARNINGS REVISION/RISK

- No change to our earnings forecasts while we conservatively maintain our construction orderbook replenishment of RM1.7b for 2020-22.

VALUATION/RECOMMENDATION

- Maintain HOLD and target price of RM1.70**, based on 13x 2021F PE and net cash position as of Mar 19, implying 14.7x PE (trading at 5-year average). We ascribe a higher-than-peers' PE multiple in view of SunCon's solid fundamentals and earnings visibility, underpinned by new contracts secured, its ability to clinch a balanced mix of external and internal construction projects and a strong balance sheet (net cash). Should SunCon hit its orderbook replenishment target of RM2b in 2020, our target price will be RM1.74, based on 13x 2021F PE. Entry price is RM1.55.

TARGET PRICE

			Value (RMm)	Remarks
2021F net profit	A		149	
Net interest (income)/expense after tax	B		-11	
Net profit less net interest income	C=A-B		138	1,792 13x PE
Net cash (as of Mar 19)	D		405	405
Total SOTP value	E=C+D		2,197	
Share base (m)	F		1,292	
				Implied PE (x)
TP (RM)	E/F		1.70	14.7
TP (RM) (ex-cash)	C/F		1.49	13.0

Source: UOB Kay Hian

OUTSTANDING ORDERBOOK AS OF MAR 20

	(RMm)
LRT3**	1,622
Tenaga HQ Campus	677
Petronas Learning Centre	287
India Highway*	508
Others	463
Total External (A)	3,557
Sunway Medical Centre - Phase 4	363
Sunway Serene	243
Sunway Velocity 2	286
Others	620
Total Internal (B)	1,5112
Precast (C)	286
Total (A+B+C)	5,359

*New contracts secured in 2020

**Subject to revision. However, based on our estimates, we revised the outstanding contract down by 35% to RM1.1b

Source: Sunway Construction, UOB Kay Hian

ORDERBOOK REPLENISHMENT ASSUMPTIONS

(RMm)	2020F	2021F	2022F
Construction	1,700	1,700	1,700
Precast	100	100	100

Source: UOB Kay Hian

ORDERBOOK REPLENISHMENT FOR YEAR 2020

	RMm
Internal (A)	1,000
Mixed Development	500
Residential	300
Medical Centre	200
External (B)	1,200
Building Works (to secure at least one of the three contracts. Each contract worth RM500m each)	500
Renewable Energy (EPCC) - 60 MW	200
Piling	300
Precast	200
Annual target replenishment for 2020	-2,200
Building works (2 contracts valued RM500m/each)	1,000
Mixed development - Myanmar	250
Toll Highways (RM500m/package), tendered 2 packages	1,000
Other potential job wins	-2,250

Source: Sunway Construction, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (RMm)	2019	2020F	2021F	2022F
Net turnover	1,769	1,311	2,064	2,213
EBITDA	161	132	212	216
Deprec. & amort.	40	40	40	44
EBIT	121	92	171	172
Total other non-operating income	20	0	0	0
Associate contributions	4	1	1	1
Net interest income/(expense)	12	11	14	17
Pre-tax profit	157	104	186	190
Tax	(27)	(21)	(37)	(38)
Minorities	(1)	0	0	0
Net profit	129	83	149	152
Net profit (adj.)	133	83	149	152

CASH FLOW

Year to 31 Dec (RMm)	2019	2020F	2021F	2022F
Operating	188	128	192	197
Pre-tax profit	157	104	186	190
Tax	(45)	(21)	(37)	(38)
Deprec. & amort.	40	40	40	44
Working capital changes	28	17	10	6
Other operating cashflows	7	(12)	(7)	(4)
Investing	(51)	(55)	(55)	(55)
Capex (growth)	(8)	(55)	(55)	(55)
Investments	(47)	0	0	0
Proceeds from sale of assets	0	0	0	0
Others	4	0	0	0
Financing	72	(55)	(85)	(78)
Dividend payments	(90)	(50)	(82)	(76)
Issue of shares	0	0	0	0
Proceeds from borrowings	168	0	0	0
Loan repayment	0	0	0	0
Others/interest paid	(6)	(5)	(3)	(2)
Net cash inflow (outflow)	208	18	52	64
Beginning cash & cash equivalent	485	692	710	763
Changes due to forex impact	0	0	0	0
Ending cash & cash equivalent	693	710	763	827

BALANCE SHEET

Year to 31 Dec (RMm)	2019	2020F	2021F	2022F
Other LT assets	195	211	225	237
Cash/ST investment	693	710	763	827
Other current assets	1,017	1,017	1,017	1,017
Total assets	1,905	1,938	2,005	2,081
ST debt	233	233	233	233
Other current liabilities	887	887	887	887
LT debt	148	148	148	148
Other LT liabilities	11	11	11	11
Shareholders' equity	623	656	723	799
Minority interest	2	2	2	2
Total liabilities & equity	1,905	1,938	2,005	2,081

KEY METRICS

Year to 31 Dec (%)	2019	2020F	2021F	2022F
Profitability				
EBITDA margin	9.1	10.0	10.3	9.7
Pre-tax margin	8.9	7.9	9.0	8.6
Net margin	7.3	6.4	7.2	6.9
ROA	7.0	4.3	7.6	7.4
ROE	21.3	13.0	21.6	19.9
Growth				
Turnover	(21.6)	(25.9)	57.4	7.2
EBITDA	(17.6)	(18.3)	60.8	1.9
Pre-tax profit	(13.9)	(33.8)	79.0	1.8
Net profit	(10.5)	(35.6)	79.0	1.8
Net profit (adj.)	(6.3)	(37.4)	79.0	1.8
EPS	(6.3)	(37.4)	78.8	1.8
Leverage				
Debt to total capital	37.9	36.7	34.5	32.3
Debt to equity	61.3	58.2	52.8	47.8
Net debt/(cash) to equity	(49.9)	(50.1)	(52.7)	(55.7)