

### COMPANY UPDATE

## Sunway Construction (SCGB MK)

En Route To A Better Year

SunCon has clinched its first external contract in 1Q20 and is on track to achieving its RM2b job win target in 2020. Meanwhile, the company expects to deliver stronger profits in 2020, driven by accelerated billings of its orderbook backlog. However, projects are yielding slightly lower-than-expected margins. SunCon's current share price offers an attractive dividend yield, having consistently paid DPS of 7 sen from 2017-19. Maintain HOLD with a lower target price of RM1.60. Entry price: RM1.45.

### WHAT'S NEW

- Weak 1H20, followed by a stronger 2H20.** Sunway Construction (SunCon) is expected to deliver stronger earnings yoy in 2020, thanks to accelerated billings of its key projects like LRT3, TNB Campus and Petronas Learning Centre (PLC). While 1H20 earnings is seasonally weaker (vs 2H20) due to festive seasons and with this compounded by the one-month MCO, SunCon believes earnings will pick up strongly in 2H20 as both TNB Campus and PLC will achieve greater milestone billings. Positively, the LRT3 project cost review is close to finalisation, where the overall contract is expected to be reduced by ~35%. Recall that the original contract size was RM2.1b. Also, billings for LRT3 will accelerate from 1Q20, and we expect revenue recognition to increase by more than 50% (from RM15m/month to RM25m/month).
- Continues to deliver.** Amid the economic uncertainties, Sunway Construction (SunCon) continues to replenish its orderbook. The company via its 60% JV has clinched a RM508m (effective value: RM305m) highway project in India for 24 months. Separately, during 1H20, we anticipate SunCon to secure new contracts from its parent – mixed development and international school projects worth RM200m and RM100m each respectively. On the external front, contracts that SunCon is upbeat on securing are: a) India Highway (RM500m), b) building works from KLCC Property (tendered for three different contracts, each worth RM500m), c) Large Scale Solar (RM300m, acting as EPCC) and precast contracts from Singapore worth RM200m.
- Steady dividend to shareholders.** SunCon's share price was not spared following the underperformance of the Malaysian bourse index. Ytd, share price has dropped by 16%. While valuation looks fair based on our estimates currently, SunCon's current share price offers an attractive dividend yield of 4.7%, assuming dividend per share (DPS) of 7 sen. In comparison with the mid-cap construction space, SunCon has rewarded its shareholders with an absolute annual DPS of 7 sen since year 2017 to 2019. We reckon the annual DPS of 7 sen is sustainable, underpinned: by a) net cash position of RM407m (RM0.32/share) as of Dec 19, b) the company is expected to deliver stronger profits in 2020, and c) modest capex for its Integrated Construction Prefabrication Hub (ICPH).

### KEY FINANCIALS

Year to 31 Dec (RMm)	2018	2019	2020F	2021F	2022F
Net turnover	2,257	1,769	1,945	2,156	2,026
EBITDA	196	161	196	216	201
Operating profit	155	121	159	175	156
Net profit (rep./act.)	144	129	138	153	140
Net profit (adj.)	142	133	138	153	140
EPS (sen)	11.0	10.3	10.6	11.8	10.8
PE (x)	13.6	14.6	14.1	12.7	13.9
P/B (x)	3.3	3.1	2.9	2.6	2.4
EV/EBITDA (x)	8.1	9.9	8.1	7.4	7.9
Dividend yield (%)	2.6	2.3	4.3	4.3	3.6
Net margin (%)	6.4	7.3	7.1	7.1	6.9
Net debt/(cash) to equity (%)	(46.6)	(49.9)	(51.3)	(53.9)	(56.5)
ROE (%)	25.5	21.3	21.2	21.4	17.9
Consensus net profit	-	-	154	161	155
UOBKH/Consensus (x)	-	-	0.89	0.95	0.91

Source: Sunway Construction, Bloomberg, UOB Kay Hian

n.m. : not meaningful; negative P/E, EV/EBITDA reflected as "n.m."

### HOLD

(Maintained)

Share Price	RM1.58
Target Price	RM1.60
Upside	+1.5%
(Previous TP)	RM1.64

### 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):	2,037.2
Market cap (US\$m):	467.4
3-mth avg daily t'over (US\$m):	0.4

### Price Performance (%)

52-week high/low	RM2.18/RM1.29			
<b>1mth</b>	<b>3mth</b>	<b>6mth</b>	<b>1yr</b>	<b>YTD</b>
(10.7)	(15.5)	(22.9)	(18.6)	(17.3)

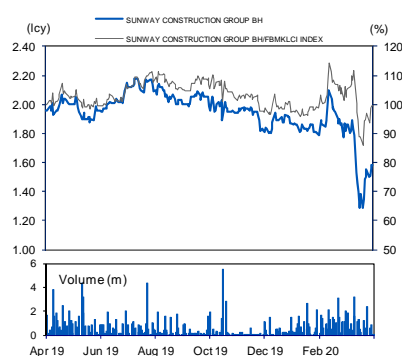
### Major Shareholders

	%
Sunway Berhad	54.4
-	-
-	-

FY20 NAV/Share (RM) 0.52

FY20 Net Cash/Share (RM) 0.27

### 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. The first contract won in 2020 via was the RM508m highway job in India via its 60% JV. The JV will not bear any traffic risk from this construction as it only acts as the contractor for the projects, and project progress payment will be paid by National Highways Authority of India (NHAI). NHAI will pay the first 40% of the project during construction duration (24 months, with construction works to commence in Oct 20) and the 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 + 3%.
- MCO to impede SunCon's activities.** The extension of MCO till middle of April 20 has adversely impacted SunCon's bottom-line. The ongoing construction works have been halted temporarily, while its precast delivery to Singapore for construction of HDB's will be suspended till mid Apr 20. Compounded, SunCon is expected to face storage constraints for its precast products as it needs to house the final precast products scheduled for delivery during MCO. As a result, its operation efficiency will be affected and limit the ability of SunCon to further produce new precast orders.
- 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, margins remain 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.
- Precast segment to gradually improve.** Following the sluggish precast performance from 2018 to mid-19 arising from negative cost push effect, we understand precast performance would gradually improve from early-1Q20, underpinned by: a) better ASP, b) stable margins on easing steel prices, and c) stronger demand for precast products for its public housing projects in Singapore. SunCon recognises precast revenue only upon delivery of projects to customers while incurring costs during the precast process.
- Cement price hike.** Despite the recent gradual cement price hike to RM255/tonne in Feb 20, we reckon SunCon will be able to continue to sustain its margins as the company has factored in some buffer to cushion the rise in building materials prices. Also, the gradual hikes in the coming quarters would allow SunCon to factor in some buffer for its future contract tenders in order to minimise impact on its construction margins. Positively, SunCon has "locked in" its cement prices for 80% of its outstanding orderbook, which further minimises the downside risk should cement prices spike in the near term.
- 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 positively from mid-21 with an estimated bottom-line of >\$5m annually (on JV level based on 50% utilisation rate). In addition, ICPH's precast products yield better margins (>10%) than Johor precast products (annual capacity of 150,000cum).

### EARNINGS REVISION/RISK

- We tweak our earnings by 1-2% for housekeeping adjustment. Our current forecasted earnings have factored the cut in LRT3 contract value by 35% as well as factored in the effect from MCO ie lower billings for 2Q20 and delivery of precast products.

### VALUATION/RECOMMENDATION

- Maintain HOLD with a lower target price of RM1.60** (post earnings adjustment), based on 13x 2020F PE and net cash position as of Mar 19. 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 RM1.63, based on 13x 2020F PE. Entry price is RM1.45.

### TARGET PRICE

		(RMm)	Value (RMm)	Remarks
2020F net profit	A	138		
Net interest (income)/expense after tax	B	-9		
Net profit less net interest income	C=A-B	128	1,667	13x PE
Net cash (as of Mar 19)	D	405	405	
Total SOTP value	E=C+D		2,073	
Share base (m)	F		1,292	
				Implied PE (x)
TP (RM)	E/F		1.60	15.0
TP (RM) (ex-cash)	C/F		1.39	14.0

Source: UOB Kay Hian

### OUTSTANDING ORDERBOOK AS OF MAR 20

	(RMm)
LRT3**	1,718
Tenaga HQ Campus	704
Petronas Learning Centre	299
India Highway*	305
Others	390
<b>Total External (A)</b>	<b>3,579</b>
Sunway Medical Centre – Phase 4	379
Sunway Serene	261
Sunway Velocity 2	300
Others	714
<b>Total Internal (B)</b>	<b>1,654</b>
<b>Precast (C)</b>	<b>304</b>
<b>Total (A+B+C)</b>	<b>5,536*</b>

\*New contracts secured in 2020

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

\*Based on UOB Kay Hian estimates

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
<b>Internal (A)</b>	<b>1,100</b>
Medical Centre	200
International school	100
Residential	500
Mixed development	300
<b>External (B)</b>	<b>1,200</b>
Piling	300
Building Works (to secure at least one of the three contracts. Each contract worth RM500m each)	500
Renewable Energy (EPCC) – 60 MW	200
Precast	200
<b>Annual target replenishment for 2020</b>	<b>-2,300</b>
Building works (2 contracts valued RM500m/each)	1,000
Mixed development - Myanmar	250
Toll Highways (RM500m/package), tendered 2 packages	1,000
<b>Other potential job wins</b>	<b>-2,250</b>

Source: Sunway Construction, UOB Kay Hian

\*SunCon will potentially to achieve its target from item (A) and (B).

### PROFIT & LOSS

Year to 31 Dec (RMm)	2019	2020F	2021F	2022F
<b>Net turnover</b>	<b>1,769</b>	<b>1,945</b>	<b>2,156</b>	<b>2,026</b>
EBITDA	161	196	216	201
Deprec. & amort.	40	37	41	44
EBIT	121	159	175	156
Total other non-operating income	20	0	0	0
Associate contributions	4	1	1	1
Net interest income/(expense)	12	12	15	17
<b>Pre-tax profit</b>	<b>157</b>	<b>172</b>	<b>191</b>	<b>175</b>
Tax	(27)	(34)	(38)	(35)
Minorities	(1)	0	0	0
<b>Net profit</b>	<b>129</b>	<b>138</b>	<b>153</b>	<b>140</b>
Net profit (adj.)	133	138	153	140

### CASH FLOW

Year to 31 Dec (RMm)	2019	2020F	2021F	2022F
<b>Operating</b>	<b>188</b>	<b>175</b>	<b>194</b>	<b>184</b>
Pre-tax profit	157	172	191	175
Tax	(45)	(34)	(38)	(35)
Deprec. & amort.	40	37	41	44
Working capital changes	0	0	0	0
Other operating cashflows	35	0	0	0
<b>Investing</b>	<b>(51)</b>	<b>(55)</b>	<b>(55)</b>	<b>(55)</b>
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
<b>Financing</b>	<b>72</b>	<b>(83)</b>	<b>(84)</b>	<b>(70)</b>
Dividend payments	(90)	(83)	(84)	(70)
Issue of shares	0	0	0	0
Proceeds from borrowings	168	0	0	0
Loan repayment	0	0	0	0
Others/interest paid	(6)	0	0	0
<b>Net cash inflow (outflow)</b>	<b>208</b>	<b>37</b>	<b>55</b>	<b>59</b>
<b>Beginning cash &amp; cash equivalent</b>	<b>485</b>	<b>692</b>	<b>729</b>	<b>784</b>
Changes due to forex impact	0	0	0	0
<b>Ending cash &amp; cash equivalent</b>	<b>693</b>	<b>730</b>	<b>784</b>	<b>843</b>

### BALANCE SHEET

Year to 31 Dec (RMm)	2019	2020F	2021F	2022F
Other LT assets	195	213	227	238
Cash/ST investment	693	730	784	843
Other current assets	1,017	1,017	1,017	1,017
<b>Total assets</b>	<b>1,905</b>	<b>1,960</b>	<b>2,029</b>	<b>2,099</b>
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	678	747	817
Minority interest	2	2	2	2
<b>Total liabilities &amp; equity</b>	<b>1,905</b>	<b>1,960</b>	<b>2,029</b>	<b>2,099</b>

### KEY METRICS

Year to 31 Dec (%)	2019	2020F	2021F	2022F
<b>Profitability</b>				
EBITDA margin	9.1	10.1	10.0	9.9
Pre-tax margin	8.9	8.8	8.8	8.6
Net margin	7.3	7.1	7.1	6.9
ROA	7.0	7.1	7.7	6.8
ROE	21.3	21.2	21.4	17.9
<b>Growth</b>				
Turnover	(21.6)	9.9	10.8	(6.0)
EBITDA	(17.6)	21.8	10.0	(7.1)
Pre-tax profit	(13.9)	9.3	10.9	(8.4)
Net profit	(10.5)	6.4	10.9	(8.4)
Net profit (adj.)	(6.3)	3.3	10.9	(8.4)
EPS	(6.3)	3.3	10.8	(8.4)
<b>Leverage</b>				
Debt to total capital	37.9	36.0	33.8	31.8
Debt to equity	61.3	56.3	51.1	46.8
Net debt/(cash) to equity	(49.9)	(51.3)	(53.9)	(56.5)