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15 July 2015 Wednesday

Sunway Construction Group Berhad



“Sweet Smell of the Growth”

We initiate coverage on Sunway Construction Group Berhad (SCG) with **BUY** call and target price of RM1.40. We value our target price by pegging to 14.2x PER to FY16 EPS of 10sen, derived based on 1+ SD above average mid-cap construction players’ PER of 11.3x given their bright outlook, solid fundamentals and diversified construction competencies. Our target price offers 17% upside potential in addition to 3% dividend yield in FY15, based on 35% dividend payout ratio assumption.

Snapshot

Fully integrated construction company. SCG emerges as the largest pure-play construction company offering full range of construction services including building, civil, infrastructure, geotechnics, mechanical, electrical and plumbing and precast services. The group has completed more than 85 major projects locally and internationally, having served reputable clients namely Putrajaya Holdings, Syarikat Prasarana Negara and MMC-Gamuda KVMRT (PDP).

Solid orderbook to fuel the growth. SCG’s latest orderbook remains solid at RM2.8 billion (1.5x of FY14 revenue) as at March 2015 which is expected to last the group at least until FY17. The group is expected to secure some goodies from the upcoming KVMRT2 and LRT3 awards in 2016 based on its solid track record in developing work package from the current KVMRT1 and LRT Kelana Jaya Line Extension.

Support from parent company, Sunway. SCG is able to leverage on the parent company, Sunway, one of the major property companies in Malaysia. Historically, Sunway has appointed SCG for selected strategic projects such as the construction of shopping malls, hospitals, education campuses and theme parks. Note that , 22% of its RM2.8

BUY (TP: RM1.40)

IPO Retail Price (RM)	RM1.20
Target Price (RM)	RM1.40
Previous Value (RM)	NA
Previous Recomm.	NA
Upside/(Downside) To Target	17%
Dividend Yield (FY15)	3%

Listing Details

Listing Sought	Main Market
Listing Date	28 th July 2015

Stock Information

Shariah Status	Yes
Sector	Construction
Offer for Sale Shares (mn)	398.7
Over-allotment Option (mn)	59.8
Share Capital (mn)	1,292.9
Market Cap (RM mn)	1,551.5

Major Shareholder

Sunway	51%
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billion orderbook as at March 2015 is comprise of internal jobs from Sunway's property development.

Investment Highlights:

One of the largest construction companies in Malaysia

Upon SCG's listing, it will emerge as one of the largest pure-play construction company in Malaysia based on the group's revenue of RM1.9 billion as at FY14 where all the contribution derived from construction related activities. Note that, a pure play construction player is determined based on 90% or more of its revenue contribution from construction related activities. SGC is set to become the fourth largest construction company with market capitalization of RM1.5 billion (based on final retail price of RM1.20), behind WCT (RM1.6 billion), Gamuda (RM11.3 billion) and IJM Corp (RM12.1 billion). Among the notable pure play construction companies in Malaysia other than SCG are Eversendai Corporation, Ahmad Zaki Resources, Hock Seng Lee, Econpile Holdings and Zelan.

Established track record and strong brand recognition

The group has completed various well-known projects locally and internationally over the last 30 years including major infrastructure and building projects, townships and mixed development projects as well as specialist engineering projects. Among the iconic projects that lifted the group strong track record in construction scenes include Sunway Pyramid Shopping Mall, Kuala Lumpur Convention Centre, SILK Highway and Legoland Malaysia Theme Park (Package 4). SCG will continue to leverage on the brand name "Sunway", a recognized construction player and synonymous with Malaysia's construction industry. The group has been rewarded with several awards and accolades at the Malaysian Construction Industry Excellent Award (MCIEA) including; i) Builder of the Year (2003, 2005, 2013), ii) Prominent Player Award (2013), iii) CEO of the year (2006, 2013) and iv) International Achievement Awards (2010, 2012).

Strong synergies with its holding company, Sunway

SCG will be powered by the strong synergies with its holding company, Sunway, one of the major property companies in Malaysia. Encouragingly,, Sunway has appointed SCG for selected strategic projects such as the construction of shopping malls, hospitals, education campuses, theme parks, office towers and hotels/resorts. The main purpose of the internal collaboration is to keep such technical knowledge and expertise within the ambit of Sunway Group in order to maintain competitive business advantage. Historically, SCG has constructed most of Sunway's key development projects in Bandar Sunway including Sunway Resort Hotel, Sunway Medical Centre, Sunway University and Sunway Pinnacle.

Solid orderbook of diversified project

SCG's current orderbook remains solid at RM2.8 billion (1.5x of FY14 revenue) as at March 2015 which is expected to last the group at least until FY17. Segmental wise, the orderbook breakdown is comprise of 56% (RM1.5 billion) from building projects, 31% (RM858 million) from civil and infrastructure project and 13% (RM359 million) from precast activities. The group's selected major on-going projects are comprise of MRT Package V4 (Section 17 to Semantan) worth RM1.2 billion, LRT Kelana Jaya Line Extension (Package B) worth RM569 million and BRT Sunway Line valued at RM453

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million. Moreover, the group is targeting to add RM2.0 billion worth of new jobs wins by the end of FY15 and we expect the group to emerge as one of the potential beneficiaries to grab some goodies from the upcoming KVMRT2 and LRT3 awards in 2016 based on its existing experience and solid track record in developing work package from the current KVMRT1 and LRT Kelana Jaya Line Extension.

Table 1: Outstanding Orderbook as at March 2015

Project	Value (RM mil)	Outstanding Orderbook (RM mil)
LRT Package B (Kelana Jaya Line Extension)	569	129
KVMRT Package V4 (Section 17, PJ to Semantan)	1,173	502
BRT - Sunway Line	453	62
Sunway Velocity Shopping Mall	350	223
KLCC North East Car Park	304	215
KLCC Package II	222	113
Sunway Pyramid Phase 3	193	106
Afiniti Medini mixed development project, Iskandar Malaysia	283	113
Sunway Medical Centre Phase 3A & 3B	167	157
Coastal Highway Southern Link	170	165
Sunway University New Academic Block	204	8
Sunway Putra Place	258	-
Others	1,030	608
Precast	598	359
Total		2,760

Source: SCG

Expanding precast concrete capacity to cater the sturdy demand in Singapore

Precast concrete business contributed 14%-24% to the group's revenue between FY12-FY14. SCG currently manufactures and supplies precast concrete product to various client in Singapore, benefitting from the creditable growth in residential property development by Housing and Development Board's (HDB) in Singapore. Therefore, SCG has expanded its precast concrete manufacturing capacity in Senai, Johor, which is expected to raise the maximum average annual capacity to 76,000 m³ by the end of FY15 (FY13: 62,000 m³, FY14: 65,000 m³). Furthermore, the group is planning to develop a new precast concrete plant in Sunway Iskandar Johor in FY15 with total annual capacity of 93,150 m³ which is to be carried out in two phases and estimated to be completed in FY16.

Highly experienced senior management

SCG is backed by experience senior management and key management personnel with a wide knowledge and exposure in the construction industry. The group is headed by Senior Managing Director, Mr Kwan Foh Kwai who has over 37 years of experience in the industry. He began his career with the group since 1996, appointed as Executive Director of Sungei Way Construction Berhad. In 2001, He was promoted as Managing Director of Sunway Construction Berhad in 2001 and appointed as Senior Managing Director in 2014. Mr Kwan Foh Kwai is the Immediate past President of Master Builders Association of Malaysia (2012-2016) and a Member of The Institution of Engineers, Malaysia.

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Listing of Sunway Construction Group Bhd

Sunway has proposed to list its construction division, Sunway Construction Sdn Bhd (SunCon) on the Main Market of Bursa Malaysia. A new company, Sunway Construction Group Bhd (SCG) has been incorporated by Sunway Holdings Sdn Bhd (SunHoldings), a wholly-owned subsidiary of Sunway, to be the listing vehicle to acquire the entire shareholdings in SunCon for RM258.6 million via the issuance of 1,292.9 million shares. The group will be going for listing on the Main Market of Bursa Malaysia on 28th July 2015. The issue price for the retail offering is set at RM1.20 and the offer for sale is expected to raise RM478.4 million in proceeds. All the proceeds would be returned to Sunway Bhd's shareholders as special dividends. The total IPO shares is up to 398.7 million shares comprising 327.6 million shares that will be offered to institutional investors and the remaining 71.1 million shares for retail investors.

Table 2: Details of SCG's Listing

Categories	Distribution		Offer for Sales		Total	
	No. of Shares (mil)	%	No. of Shares (mil)	%	No. of Shares (mil)	%
Distribution:						
Entitled Shareholders of Sunway	175.01	13.5	-	-	175.01	13.5
Retail Offering:						
Malaysian Public (via balloting)						
∞ Bumiputera			25.9	2.0	25.9	2.0
∞ Non-Bumiputera			25.9	2.0	25.9	2.0
Eligible Persons			19.4	1.5	19.4	1.5
Sub-total			71.1	5.5	71.1	5.5
Institutional Offering:						
Bumiputera Investors Approved by MITI			135.8	10.5	135.8	10.5
Other Malaysian and Foreign Institutions and Selected Investors			191.8	14.8	191.8	14.8
Sub-total			327.6	25.3	327.6	25.3
Total	175.0	13.5	398.7	30.8	573.7	44.3

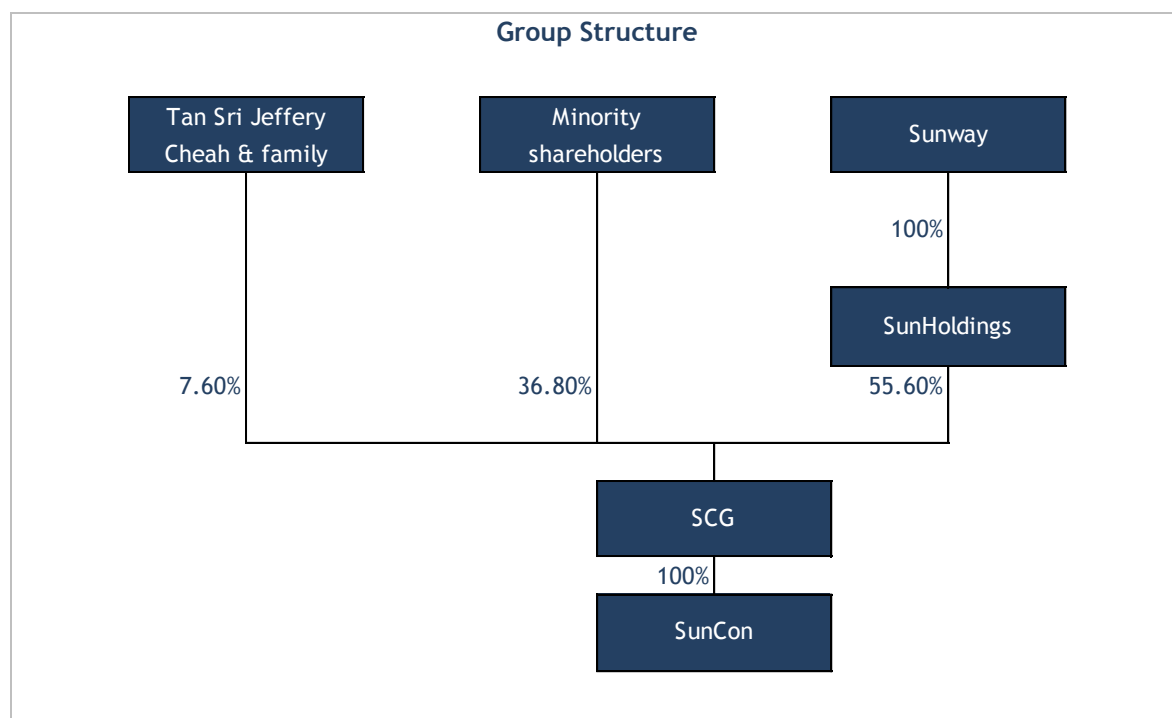
Source: Prospectus

Table 3: IPO Timetable

Activity	Date
Prospectus launch	29 June 2015
Institutional offering	29 June-7 July 2015
Retail offering	29 June-6 July 2015
Listing	28 July 2015

Source: Prospectus

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Source: Prospectus

Company Background

SCG was incorporated under the Companies Act 1965 as public company limited by shares on 10 September 2014. SGC has been incorporated by Sunway Holdings Sdn Bhd (SunHoldings), a wholly-owned subsidiary of Sunway, to be the listing vehicle to acquire the entire shareholdings in Sunway Construction Sdn Bhd (SunCon) for RM258.6 million via issuance of 1,292.9 million shares.

SunCon was listed on the Kuala Lumpur Stock Exchange (KLSE) on 12 June 1997 as Sungei Way Construction Berhad and changed his name to Sunway Construction Berhad on 13 December 1999. SunCon was delisted from KLSE on 16 December 2004 after SunHoldings undertook a voluntary general offer for all the shares it did not own and became a wholly-owned subsidiary of SunHoldings upon the completion of the corporate exercise. SunCon has more than 30 years of experience in the construction business with strong track record in completing some well-known projects including Kuala Lumpur Convention Centre, SILK Highway, Sunway Pyramid Shopping Mall and Legoland Theme Park. SCG is principally involved in the provision of construction services comprising; i) building and civil/infrastructure construction services, ii) foundation and geotechnical engineering services, and iii) mechanical, electrical and plumbing services. The group is also involved in manufacturing and sale of precast concrete products.

Business Overview

Building and civil/infrastructure construction services

The group offers integrated services from project design to construction completion for residential, commercial and institutional building projects. SCG is also involved in civil/infrastructure construction services and participated in many roads, highways and rail transportation infrastructure projects over the last 30 years. The group has also widened its construction services to foreign customer especially in UAE, India and Singapore.

Table 4: On-going Project of Building and Civil/Infrastructure Construction Services

Project	Client	Start	End	Value (RM mil)
LRT Package B (Kelana Jaya Line Extension)	Syarikat Prasarana Negara	Oct-11	Jun-15	569
KVMRT Package V4 (Section 17, PJ to Semantan)	MMC-Gamuda (PDP)	Jun-12	Jan-16	1173
BRT - Sunway Line	Syarikat Prasarana Negara	Mar-13	Jun-15	453
Sunway Velocity Shopping Mall	Sunway Velocity Mall	Mar-13	Dec-15	350
KLCC North East Car Park	Cititower	Jul-13	Dec-16	304
KLCC Package II*	Cititower	Jul-13	Feb-15	222
Sunway Pyramid Phase 3	Sunway Pyramid Hotel	Apr-13	Sep-15	193
Afiniti Medini mixed development project, Iskandar Malaysia	Pulau Indah Ventures	Sep-13	Oct-15	283
Citrine mixed development	Sunway Iskandar	Jan-14	Mar-17	213
Sunway Medical Centre Phase 3A & 3B	Sunway Medical Centre	Mar-14	Mar-17	167
Sunway Geo Retail and Flexi Suites	Sunway South Quay	Jun-14	Jun-16	153
Coastal Highway Southern Link	SJIC Bina	Jan-15	Jan-17	170

* Pending supplementary agreement from the client due to extension of project scope
Source: Prospectus

Foundation and geotechnical engineering services

The group's principal foundation geotechnical engineering services covers all types of building including residential, commercial, institutional, purpose-built/specialty buildings and civil/infrastructure projects which comprise the services of bored piles and earth retaining system.

- **Bored piling** is piling work to carry heavy loads from structures which involves boring and simultaneous removal of soil from the ground to a circular hole through the use of an excavating tool consisting of mechanical rotary rig or hydraulic drilling rig.
- **Earth retaining system** is structure retaining walls that restrains soil to unnatural slopes and constructed to resist the lateral pressure of soil when there is a desired change in ground elevation that exceeds the angle of repose of the soil.

Table 5: On-going Project of Foundation and geotechnical engineering services

Project	Client	Start	End	Value (RM mil)
Sunway Velocity Phase 3*	Sunway Integrated Properties	Dec-11	Jul-14	291
Mengkuang Dam Expansion (Penang)	Gerbang Kesuma	Aug-12	Jul-16	47
Sunway South Quay Commercial Precinct 4*	Sunway South Quay	Nov-12	Jun-14	82
Sunway Velocity Tunneling	Sunway City	Jan-13	Jul-15	78
Sunway South Quay Commercial Precinct 3*	Sunway South Quay	Aug-13	Apr-15	99

* Pending extension of time from changes in project design by client and difficult soil condition
Source: Prospectus

Mechanical, Electrical and Plumbing services

- **Mechanical:** Air-Conditioning and Mechanical Ventilation (ACMV), lift and escalator system, fire systems, gas piping systems and building and control system
- **Electrical:** high tension and low voltage electrical systems including transformers, main distribution boards and lighting systems, extra low voltage electrical systems, smart home systems, closed-circuit televisions and security systems.
- **Plumbing:** Water plumbing, sanitary plumbing, and irrigation systems.
- **Specialised engineering:** Purpose-built CUF such as biomass and chilled water plants.

Table 6: On-going Project of Mechanical, Electrical and Plumbing services

Project	Client	Start	End	Value (RM mil)
Pasar Seni MRT Station	MMC-Gamuda KVMRT (UGW)	Oct-14	Dec-16	23
Gas District Cooling Plant II, Putrajaya	Gas District Cooling (Putrajaya)	Mar-15	Sep-15	7

Source: Prospectus

Manufacturing and sale of precast concrete products

SCG develops, designs, manufactures and supplies precast concrete products through its subsidiaries, Sunway Precast Industries and Sunway Concrete Products (S) with manufacturing plants located in Senai, Johor and Tampines, Singapore. In Malaysia, Sunway Precast Industries manufactures and supplies precast concrete products including architectural façade panels, flooring systems, household shelters, prefabricated toilet, roof fascia, precast walls and columns and precast beams. The group's subsidiaries in Singapore, Sunway Concrete Products (S) manufactures and supplies precast concrete products for the building sector in Singapore including for Housing and Development Board's (HDB) public housing projects as well as private sector projects.

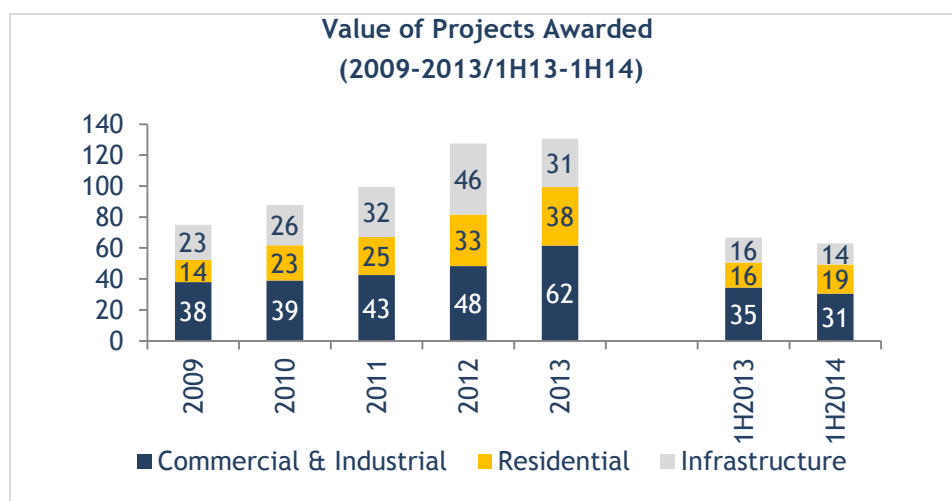
Industry Overview**I. Malaysia**

According to Smith Zander, GDP for the construction industry in Malaysia has increased from RM19.3 billion to RM29.6 billion between 2009 to 2013, representing compounded annual growth rate (CAGR) of 11.3%. Its contribution to Malaysia's total GDP grew from 3.1% in 2009 to 3.8% in 2013. The significant upsurge in the contribution of construction industry to overall Malaysia's GDP was driven by continuous increase in demand for residential, commercial, industrial and infrastructure development to achieve a high income nations status by 2020. From 2009-2013, the value of project awarded rose from RM74.9 billion to RM130.7 billion, translating into a CAGR of 14.9%. Of note, the construction industry in Malaysia experienced a slowdown in 2009 impacted by the global financial crisis and rebounded in 2010 as the government and private sector resumed spending on construction activities.

Furthermore, the sector continued to recover in 2011 and 2012 due to the implementation of 10th Malaysian Plan (10MP) and the Economic Transformation Programme (ETP). 10MP classified 52 high impact projects worth RM63.0 billion including Light Rail Transit (LRT) extension from Kelana Jaya to Putra Heights worth RM7.0 billion and new Low Cost Carrier Terminal (LCCT) worth RM2.0 billion. Moreover, the government introduced ETP in January 2011 to further develop our country including the construction of Klang Valley MRT System (KVMRT) which is to cost RM55 billion and Pengerang Independent Deepwater Petroleum Terminal (PIDPT) and Refinery and Petrochemical Integrated Development (RAPID) in Johor, worth RM60 billion.

Budget 2015 marks significant plans to support the growth of the construction industry in Malaysia with several infrastructure projects to be implemented which will result in higher demand for construction services. Although a slight revision to Budget 2015 has been made in January 2015 due to the decline in oil prices, the government is committed to maintain the allocation for the construction industry especially on projects involving public housing, flood mitigation, water supply, electricity and public transport infrastructure. Furthermore, Prime Minister, Datuk Seri Najib Tun Abdul Razak has successfully revealed 11th Malaysian Plan (11 MP) on 21st May 2015. The 5-year plan (2016-2020) is an important landmark for Malaysia to become an advanced nation by 2020 and hence, contains a lot of high impact projects. As expected, construction sector is one of the major beneficiaries for 11MP, with the sector estimated to expand by 10.3% per annum during the 5-year plan.

Some well-known projects in Budget 2015 which will be implemented during 11MP period include KVMRT2, LRT3, Pan-Borneo Highway, West Coast Expressway, KL-Singapore HSR, Electrified Double Track (Gemas-JB), Pengerang Integrated Petroleum Complex (PIPC), Central Spine Road and several government housing initiatives including Project Perumahan Rakyat 1Malaysia (PR1MA). In addition, the government also announced several new projects to be developed under 11MP including i) Malaysia Vision Valley (development of west part of Negeri Sembilan), ii) new sewerage treatment plant and pipe network in Perak, and iii) new airport in Mukah, Sarawak.



Source: Prospectus

Table 7: Construction Industry in Malaysia (2009-2014p)

Year	National GDP (RM mil)	Construction GDP(RM mil)	Contribution to National GDP
2009	629,885	19,270	3.1%
2010	676,653	21,459	3.2%
2011	711,351	22,464	3.2%
2012	751,471	26,531	3.5%
2013	787,611	29,554	3.8%
2014p	835,040	32,984	3.9%
CAGR 2009-2013	5.7%	11.3%	

P: preliminary

Source: Prospectus, Market Research by Smith Zander

Table 8: Budget 2015 Major Project Announcement

	RM (bil)
Railway	
KVMRT2 (56km)	23.0
LRT3	9.0
Upgrading East Coast Railway	0.2
Highway	
Sungai Besi-Ulu Klang Expressway (59km)	5.3
Damansara-Shah Alam Highway (47km)	4.2
Eastern Klang Valley Highway (36km)	1.6
West Coast Expressway (276km)	5.0
Pan Borneo Highway (1,663km)	27.0

Source: 2015 Budget Speech

II. Singapore

According to Smith Zander, GDP for the construction industry in Singapore surged from SGD15.0 billion in 2009 to SGD17.2 billion in 2013, representing a CAGR of 3.5%. The value of contract awarded in Singapore increased from SGD22.5 billion in 2009 to SGD35.8 billion in 2013, translating into a CAGR of 12.3% mainly spurred by residential development which has formed the largest proportion of construction activities in Singapore at 45%. Public residential development in Singapore is headed by HDB that plans and develops public housing township. The total number of completed public housing units grew from 1,769 units to 12,744 units at a CAGR of 63.8% due to strong demand for new flats. In January 2014, Singapore's Minister for National Development announced the planned construction of additional 80,000 units of public housing over the next 3 years. The government allocated SGD484.0 million for upgrading purpose of HDB's public housing precincts under Budget 2014.

The Urban Redevelopment Authority of Singapore has unveiled the Concept Plan 2011 and the Master Plan 2014 with intentions to promote the social well-being and increase the standard of living in Singapore. Among the identified projects including Garden in a City project and upgrading and construction of bus stops. Moreover, the Healthcare 2020 Masterplan will involve the development of several hospitals which are in the midst of construction and expected to commence operations within the next 5 years including Ng Teng Fong General Hospital, Jurong Community Hospital and Sengkang General and Community Hospitals. The government of Singapore also plans to invest heavily on land transportation to upgrade and enhance the transportation infrastructure. The Land and Transport

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Authority aims to increase the country's MRT network to 360 km by 2030, consisting projects such as the Jurong Region line and Cross Island line and Thomson line. Based on Smith Zander forecasts, the construction industry in Singapore is expected to increase in terms of awarded contract value from SGD35.8 billion in 2013 to SGD53.0 billion in 2017 representing a CAGR of 10.3%.

Table 9: Construction Industry in Singapore (2009-2013)

Year	National GDP (SGD mil)	Construction GDP(SGD mil)	Contribution to National GDP
2009	279,858	14,997	5.4%
2010	322,361	14,221	4.4%
2011	344,712	14,827	4.3%
2012	358,543	16,028	4.5%
2013	372,814	17,228	4.6%
CAGR 2009-2013	7.4%	3.5%	

Source: Prospectus, Market Research by Smith Zander

Table 10: Selected Major Property Development in Singapore

Location	Project	Type of Development	Estimated Value (SGD mil)
Changi	Project Jewel	Mixed-used	1,470.0
Punggol	Watertown	Residential	1,600.0
Woodlands	HDB building works	Residential	204.5
Sembawang	HDB building works	Residential	188.0
Yishun	HDB building works	Residential	149.8
Punggol West	HDB building works	Residential	94.8
Pasir Panjang	Pasir panjang Terminal Phase 3 and 4	Industrial	3,500.0
Loyang	Loyang bus depot	Industrial	61.2
Jurong Island	Storage tank for LNG terminal	Industrial	638.0
Kallang	Singapore Sports Hub	Social Amenities	1,330.0
Islandwide	Upgrading and cosntruction of bus stops	Transportation	23.4
Sengkang	Sengkang General & Community Hospital	Social Amenities	1,911.5
Jurong	Ng Teng Fong General & Jurong Community Hospital	Social Amenities	700.0
Islandwide	Gas transmission pipelines from Jalan Bahar to Old Choa Chu kang Road	Utilities	13.7
Islandwide	Cycling Masterplan	Transportation	43.2
Islandwide	Downtown MRT Line	Transportation	1,400.0
Islandwide	Thomson MRT Line	Transportation	18,000.0
Islandwide	Marina Coastal Expressway	Transportation	4,300.0
Jurong Island	Jurong Rock Caverns	Infrastructure	200.0
Changi	Changi Airport Terminal 4	Transportation	985.0

Source: Prospectus, Market Research by Smith Zander

Selected risks

Uncertainty in securing new contracts to replenish orderbook

Construction sector's outlook remains optimistic supported by several upcoming infrastructure projects stated in Budget 2015 and 11MP. However, any failure to grab a new contract on timely basis will mark a major risk in orderbook replenishment and hence, may negatively impact earnings. Moreover, the synergies with Sunway Bhd in term of internal works orders from property development activities may pose risks arising from property sector's cooling measures by central bank which may slow down internal contract awards. Of note, 22% of its RM2.8 billion orderbook as at March 2015 is comprise of internal jobs from its own property development.

Fluctuation in raw material prices

The construction company usually required to purchase wide range of raw materials including steel bars, ready mixed concrete, diesel electrical cables and fittings. The group achieved higher EBIT margin of 6% as at FY14 (FY13: 2%, FY12: 3%) due to the weakening in steel prices coupled with the decline in oil prices since 2H2014. Therefore, the recovery in raw material prices would adversely impact the group's profitability margin.

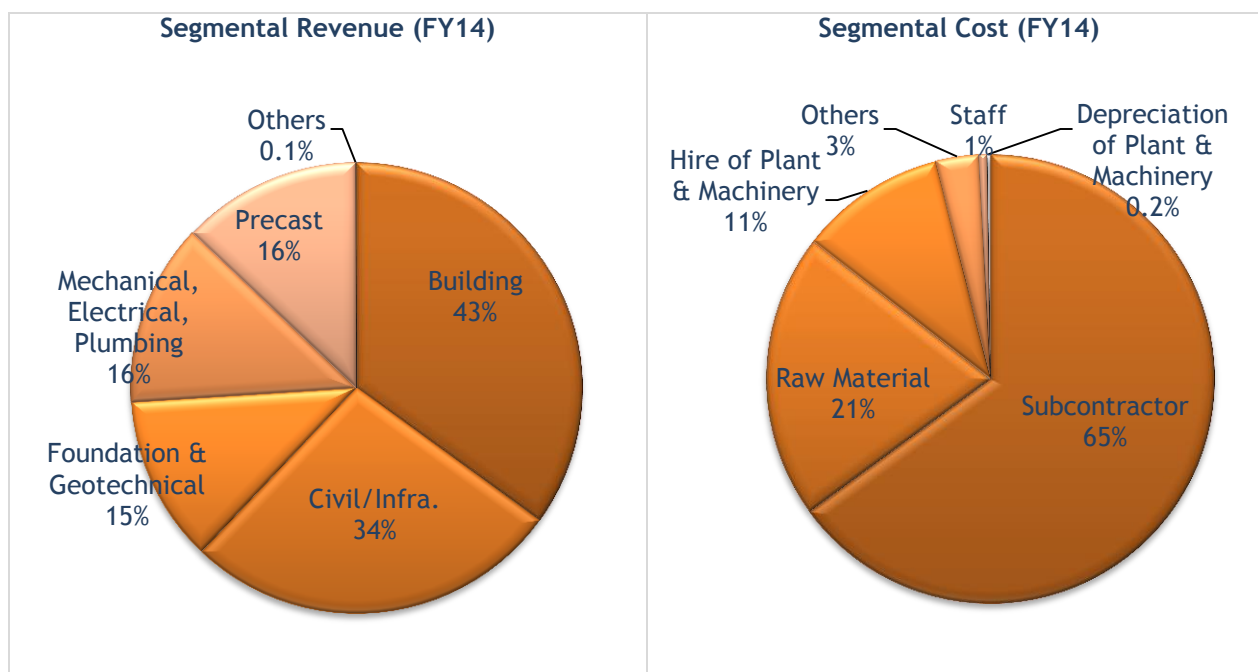
Securing premises for our Singapore manufacturing and sale of precast concrete products business

SCG operates its Singapore's manufacturing and sale of precast products business in two parcel of land leased from HDB in Tampines which due to expire in 2017. Nevertheless, HDB may no longer renew the lease upon the expiry term due to the changes in Singapore government policy but may invest in Integrated Construction and Precast Hubs (ICPH) with estimated cost ranging from SGD60-80 million. If the group decides not to proceed with the investment in ICPH and relying to the Senai precast plant, the group will incur higher logistics cost for transportation to Singapore's client.

Financial Review (FY12-FY14)

SCG's revenue gained at solid FY12-FY14 CAGR of 14% lifted by continuous growth in its two main business segment comprising construction services and civil/infrastructure construction services which contributed 43% and 34% respectively to the group's topline in FY14. Recall that FY13 revenue surged by 27% y-o-y to RM1.84 billion lifted by higher contribution from building construction services (+19% y-o-y) and civil/infrastructure construction services (+143% y-o-y) due to higher billings from projects including Pinewood Iskandar Malaysia Studios, Sunway Pinnacle, LRT Package B and KVMRT package V4 as well as the commencement of BRT Sunway Line project in FY13. In FY14, the flat revenue growth of 2% y-o-y to RM1.88 billion was impacted by weaker contribution from foundation and geotechnical engineering services (-31% y-o-y) due to the lower progress billings from projects such as Tropicana Avenue, Sunway Pyramid 3, Sunway Velocity (phase 2 & phase 3) and Tropicana Garden. Nonetheless, civil/infrastructure construction services continued to register a strong FY14 growth of 43% y-o-y thanks to the acceleration in KVMRT package 4, BRT Sunway Line and LRT package A projects. The group's core PAT soared at impressive FY12-FY14 CAGR of 21% in tandem with the strong orderbook replenishment after successfully adding RM2.6 billion and RM1.1 billion worth of new contracts in FY13 and FY14 respectively.

Cost of sales. The cost analysis by component shows that subcontractor costs was the largest contributor to the group's cost of sales, contributing 51%-56% of cost in FY12-FY14 respectively. Raw material cost was the second largest, contributing 16%-17% share in cost in FY12-FY14 respectively. To recap, SCG's cost of sales rose 29% y-o-y in FY13 lifted by the increase in subcontractor costs (+26% y-o-y), raw material costs (+30% y-o-y) and hire of plant and machinery costs (+100% y-o-y) in tandem with additional new project awards in FY13 including Sunway Putra Mall, Sunway University new academic block, Legoland Water Park and BRT Sunway Line. In FY14, the group's cost of sales declined slightly by 1% y-o-y mainly due to the decrease in subcontractor costs (-6% y-o-y) as the group still relied on its own workers instead of hiring subcontractors for building construction services and civil/infrastructure services.



Source: Prospectus, M&A Securities

Earnings Outlook (FY15-FY17)

We expect SCG to post a sustainable growth in FY15 PAT of 10% y-o-y to be anchored by the acceleration in KVMRT1 package V4 working progress. However, we estimate the group to register a drop in FY16 PAT (-5% y-o-y) as most of the projects are nearing the tail-end progress and also weaker-than-expected new contract awards as at 1H2015 which would translate into lower earnings recognition in FY16. Nonetheless, we expect major projects awards including KVMRT2, LRT3 and BRT to be awarded by FY16 which will boost SCG's outstanding orderbook and hence, translating into higher earnings growth in FY17 (+8% y-o-y).

SCG introduces a dividend policy of minimum 35% of its annual net profit to be distributed to the shareholders. SCG dividend yield is set to reach 3.1% based on our FY15 EPS forecast of 10.7 sen and final retail price of RM1.20 which is attractive compared to peers (Gamuda: 2.6%, IJM Corp: 2.4%, Kimlun Corp.: 2.3%, Mudajaya: 2.2%, Hock Seng Lee: 1.5%)

Valuation and recommendation

We initiate coverage on SCG with a **BUY** call and a target price of RM1.40 based on PER multiple of 14.2x over its FY16 EPS estimate at 10sen. The valuation is pegged to 1+ SD above average mid-cap construction players' PER of 11.3x and justified by 1) strong track record in building and civil/infrastructure construction services; 2) largest pure play construction player with market cap of RM1.55 billion; 3) leverage on the support from its parent, Sunway Bhd; and 4) robust outlook on construction industry in Malaysia backed by 11MP and Budget 2015. Our target price of RM1.40 offers 17% upside potential in addition to 3% dividend yield in FY15, based on a 35% dividend payout assumption.

Table 11: Mid-Cap Average PER**

Year	Avg. 3 year PER	SD* Avg. 3 Years PER	1+ SD
WCT	11.30	3.68	14.98
Muhibbah	11.08	3.46	14.54
Hock Seng Lee	11.54	1.52	13.06
Average	11.31	2.88	14.19

**Market Cap. Between RM900 mil-RM2 billion

*SD: Standard Deviation

Source: Bloomberg, M&A Securities

Table 12: Peers comparison (Calenderised)

Company	FYE	Price (RM)	EPS (sen)		P/E (X)		P/B (X)		ROE (%)	DY (%)	TP (RM)	Call
			FY15	FY16	FY15	FY16	FY15	FY16				
IJM CORP	Mar	6.84	41	47	20.6	15.8	1.5	1.4	6	2	8.14	Buy
GAMUDA	Jul	4.81	32	32	16.0	16.0	2.0	1.9	13	2	5.87	Buy
WCT	Dec	1.39	13	14	14.6	12.9	0.9	0.9	5	1	1.54	Hold
SCG*	Dec	1.20	10	10	11.5	12.1	3.9	3.2	40	3	1.40	Buy
BENALEC	Jun	0.60	3	6	15.2	12.8	1.0	0.9	0	0	NR	NR
CREST BUILDER	Dec	1.07	11	8	10.9	14.2	0.4	0.0	6	3	NR	NR
EVERSENDAL	Dec	0.96	8	10	9.7	7.4	0.6	0.6	4	1	NR	NR
KIMLUN	Dec	1.32	15	16	8.5	7.8	0.9	0.8	13	2	NR	NR
MRCB	Dec	1.12	6	9	23.7	15.7	1.4	1.4	8	2	NR	NR
AZRB	Dec	0.67	5	7	14.1	10.1	0.0	0.0	5	NA	NR	NR
YTL CORP	Jun	1.57	14	13	13.3	12.8	1.2	1.1	9	6	NR	NR
Average					14.7	12.5	1.0	0.9	7	2		

*SCG: Sunway Construction Berhad

Source: Bloomberg, M&A Securities

Initiation Coverage - Sunway Construction Group Berhad

Table 13: SCG Profit and Loss (FY13-FY17F)

FYE DEC (RM million)	FY13	FY14	FY15F	FY16F	FY17F
Revenue	1,840	1,881	1,914	1,816	1,932
Gross profit	338	395	402	381	406
EBITDA	85	162	176	171	180
EBIT	42	120	134	127	135
Net Finance cost	7	7	15	17	22
Share of JV	45	30	34	33	35
PBT	90	151	173	164	177
Taxation	(24)	(26)	(38)	(36)	(39)
PAT	66	125	135	128	138
Minority interest	1	0	0	0	0
Net profit	67	125	135	128	138
EPS (sen)	5	10	10	10	11
EBITDA margin	5%	9%	9%	9%	9%
EBIT margin	2%	6%	7%	7%	7%
PBT margin	5%	8%	9%	9%	9%
Net profit margin	4%	7%	7%	7%	7%
PER (x)	NA	NA	11.5	12.1	11.2
P/BV (x)	NA	NA	3.9	3.2	2.7
Dividend (sen)	NA	NA	4	3	4
Dividend yield	NA	NA	3%	3%	3%

Source: M&A Securities, Prospectus

Table 14: SCG Balance Sheet (FY13-FY17F)

FYE DEC (RM million)	FY13	FY14	FY15F	FY16F	FY17F
Non-current assets					
PPE	181	179	187	195	201
Other investments	26	0	0	0	0
Investment in JV	22	24	25	23	25
Goodwill	4	4	4	4	4
Deferred tax assets	2	7	7	7	7
Total non-current Assets	234	214	223	229	237
Current assets					
Inventories	26	20	21	20	21
Receivables	1,020	790	804	763	811
Tax recoverable	5	9	9	8	9
Derivatives	0	0	0	0	0
Cash and bank balances	156	220	299	397	492
Total Current assets	1,208	1,039	1,132	1,187	1,333
Current liabilities					
Borrowings	75	135	135	140	145
Payables	731	791	806	764	813
Tax payable	9	13	13	13	14
Derivatives	0	0	0	0	0
Total current liabilities	815	940	954	917	972
Net current (liabilities)/assets	392	99	178	270	362
	627	313	401	499	599

Initiation Coverage - Sunway Construction Group Berhad

Equity					
Share capital	0	259	259	259	259
Reserves	0	56	143	227	316
Invested equity	614	0	0	0	0
Shareholders' equity	614	314	402	485	575
Non-controlling interest	-4	-5	-5	-5	-5
Total equity	610	309	397	480	570
Non-current liabilities					
Borrowings	15	0	0	15	25
Deferred tax liabilities	2	4	4	4	4
Total non-current liabilities	17	4	4	19	29
	627	313	401	499	599

Source: M&A Securities, Prospectus

Table 15: SCG Cash Flow (FY13-FY17F)

FYE DEC (RM million)	FY13	FY14	FY15F	FY16F	FY17F
PBT	90	151	173	164	177
Net cash from operating activities	83	184	84	165	172
Net cash from investing activities	(69)	349	345	346	346
Net cash used in financing activities	10	(382)	(409)	(414)	(423)
Changes in cash	24	151	21	97	95
Currency translation difference	8	1	1	1	1
Cash at beginning of year	94	126	277	299	397
Cash at end of year	126	277	299	397	492

Source: M&A Securities, Prospectus

M&A Securities

STOCK RECOMMENDATIONS

BUY Share price is expected to be $\geq +10\%$ over the next 12 months.
TRADING BUY Share price is expected to be $\geq +10\%$ within 3-months due to positive newsflow.
HOLD Share price is expected to be between -10% and $+10\%$ over the next 12 months.
SELL Share price is expected to be $\geq -10\%$ over the next 12 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT The sector is expected to outperform the FBM KLCI over the next 12 months.
NEUTRAL The sector is expected to perform in line with the FBM KLCI over the next 12 months.
UNDERWEIGHT The sector is expected to underperform the FBM KLCI over the next 12 months.

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