

20 July 2020

Sarawak Consolidated

Early Stages of Growth

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INVESTMENT MERIT

Following the emergence of Dato' Karim as its largest shareholder, SCIB is now set to aggressively expand its construction arm, spurring explosive earnings growth. It plans to do so by expanding into new international markets, such as the Middle East, as well as strengthening positioning within the local space. Being a Sarawak-based company as well as the largest IBS manufacturer in East Malaysia, SCIB could be a potential dark horse amidst an opportune Sarawak construction thematic play. TRADING BUY with Fair Value of RM3.90.

New shareholder and management. Sarawak Consolidated Industries Berhad (SCIB) was founded in 1975, specialising in manufacturing of precast concrete products. However, last year, Dato' Mohd Abdul Karim, founder and largest shareholder of Serba Dinamik (currently holding 25.8% stake), emerged as the company's largest shareholder, with his holdings of SCIB currently at 38.3%. Following his emergence as largest shareholder, he was appointed as non-independent non-executive chairman of SCIB, and along with him, the new group CEO, Encik Rosland, and new finance director, Encik Mohd Ariff – both of whom are also from Serba Dinamik.

Ambitious growth targets. Concurrent with the emergence of a new major shareholder and management, the company is now strengthening its construction business, and setting highly ambitious growth targets, aiming to hit >RM1.5b order-book by end-FY20. Historically a purely Sarawak-based company, under the new leadership, SCIB now aims to penetrate new overseas markets, such as the Middle East (e.g. Qatar, Oman) and Indonesia, as well as locally in Malaysia, especially in its home soil of Sarawak. Our explosive earnings growth forecasts for FY20-21E (implying 3-year CAGR of >300%) are also broadly based on these targets. In order to achieve these targets, SCIB will be leveraging on management's and Dato' Karim's established experiences and connections from Serba Dinamik to land contracts and establish an early track record. All the aforementioned regions are also considered Serba Dinamik's stronghold markets, especially the Middle East where it is the largest earnings contributor to the group. Additionally, we also do not discount the possibility of Serba Dinamik subcontracting works to SCIB in the near future, after having secured mandates for related party transactions from both sets of shareholders.

Sarawak play. With the upcoming Sarawak state elections in 2021 and a potential record state budget (refer overleaf), SCIB could be a dark horse within the state's construction sector, competing against more established names such as CMS, Naim and HSL. SCIB is said to have submitted tenders for various Sarawak infrastructure projects, such as coastal roads, water supply grid programs, as well as building of schools, roads, and bridges. Being the largest IBS and precast concrete manufacturer in East Malaysia also provides SCIB an added competitive advantage against other local players.

TRADING BUY, with Fair Value of RM3.90, pegged to 8x FY21 PER – which is at the lower end of our small-mid cap construction targets of 7-12x PER and in-line with peers' average. Peers include: (i) KIMLUN - exposure to construction and IBS manufacturing, (ii) KERJAYA - involvement in private projects, and (iii) HSL - Sarawak play.

Risks to our call include: (i) failure to secure new contracts to hit order-book targets, (ii) job execution risks, given their newcomer status in the industry, (iii) costs overruns, (iv) high net gearing.

	Rating	Fair Value
Last Price	-	RM2.57
Kenanga Consensus	Trading Buy	RM3.90
	-	-

Stock Information

Shariah Status	Yes
Stock Name	Sarawak Consolidated Industries Berhad
CAT Code	9237
Industry	Building Materials
Industry Sub-sector	Bldg Prod-Cement/Aggreg
YTD stock price chg	35.26%
Market Cap (RM m)	315.17
Issued shares (m)	122.63
52-week range (Hi)	3.49
52-week range (Low)	0.9
3-mth avg daily vol:	1,373,467
Free Float	35.5%
Beta	2.07
Altman's Z-score	1.88

Major Shareholders

Abdullah Mohd Abdul	38.3%
Othman Encik Rosland	8.0%
Gaya Belian Sdn Bhd	5.6%

Financials

FY Jun (RM'm)	FY19A	FY20E	FY21E
Revenue	85.8	255.3	693.8
EBIT	4.9	44.0	112.4
PBT	3.1	27.2	74.0
Net profit	3.0	20.4	55.5
EPS (sen)	2.7	18.1	49.3
BV/Share (RM)	0.5	2.4	2.9
PER (x)	95.8	14.2	5.2
PBV (x)	5.6	1.1	0.9
Net gearing (x)	0.6	0.7	1.1
DPS (sen)	0.0	0.0	0.0

Quarterly Financial Data (RM'm)

	3Q19	4Q19	1Q20
Revenue	21.9	28.6	51.8
Revenue growth (QoQ)	22%	31%	81%
Operating Profit	1.1	1.3	4.7
PBT	0.8	0.8	4.3
Net profit	0.8	0.8	4.3
EPS (sen)	0.7	0.7	3.8
EPS Growth (QoQ)	-777%	5%	442%
Net profit margin	3%	3%	8%

Peers Comparisons	FY20E PER (x)	FY21E PER (x)	Mkt Cap (RM'm)
HSL	20.9	9.9	610.0
KERJAYA	12.7	8.8	1,325.6
KIMLUN	9.5	5.2	251.2
Average	14.4	8.0	



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Other Salient Points

Expect strong 2HFY20. Currently, SCIB's order-book stands at ~RM1b, with the company targeting to reach >RM1.5b by end-FY20. With most of its jobs being short-term in nature (i.e. <2 years), we are anticipating a strong 2HFY20 as earnings recognitions kick in via the progression of jobs at hand.

Breakdown of Jobs Awarded

Project	Client	Location	Duration
1 Project temporary facility PKG05 HEC office building	PT. Samudera Nusantara Energi	Indonesia	Oct 2019 – Jun 2020
2 Construction, completion & maintenance of 6 villas (ground + 1st floor + penthouse, including external majlis, ancillary block and external block works) at Al-qutaifiya, Qatar	Pavilion Qatar Engineering Co. W.L.L.	Qatar	Oct 2019 – Oct 2020
3 Complete construction of 9 residential villas at Street 47, Block 327, Al Hayl, Muscat, Oman	Revenue International L.L.C.	Oman	Oct 2019 – Oct 2020
4 Main building works Phase 1 Package C: Independent Utility Facility	Edaran Kencana Sdn. Bhd	Malaysia	Nov 2019 – Jan 2021
5 Main building works Phase 1 Package C: Maintenance, Repair & Overhaul	Edaran Kencana Sdn. Bhd	Malaysia	Nov 2019 – Mar 2021
6 Complete construction of 20 villas at Street 14, Block 112, Ruwi, Muscat Sultanate of Oman	Revenue International L.L.C.	Oman	Apr 2020 – Apr 2021
7 Construction and completion of 2 units of service centres at Al Khor, State of Qatar	Sky View Trading and Contracting W.L.L.	Qatar	Apr 2020 – Apr 2021
8 Buildings, proposed new boundary wall, guard house and car parking at Doha, Qatar	Interceptor Trading and Contracting W.L.L.	Qatar	Mar 2020 – Mar 2021

Source: Company

Dissecting the contracts award above, we noticed that the jobs are mostly civil or property development-related, with fairly low complexity in terms of job scope. Nonetheless, we believe these jobs could provide SCIB the opportunity to establishing a track record in the target markets, before gradually transitioning to more complex jobs in the future after having successfully established its early track record in key markets.

Vertical integration adds to competitive edge. Construction aside, SCIB is the largest precast concrete and IBS manufacturer in East Malaysia, operating three integrated factories based in Sarawak with a total annual capacity of 500k tonnes. Owning a manufacturing arm for the prefabrication materials, the vertical integration gives SCIB an added advantage when tendering for jobs. This also protects project margins for SCIB, as they can source prefabrication materials in-house rather than externally - enhancing their competitiveness for projects tenders.

Piggybacking on Serba Dinamik and Dato' Mohd Abdul Karim. To recap, Serba Dinamik's key markets are the Middle East as well as Malaysia – also the two key markets that SCIB is eyeing to establish itself in as well. Serba Dinamik has managed to established itself a strong presence in the Middle East given Dato' Mohd Abdul Karim's strong connections in the region, having laid down the ground works needed throughout the years at the helm of Serba Dinamik. Seeing that SCIB shares the same major shareholder with Serba Dinamik in Dato' Mohd Abdul Karim, we believe SCIB could also be a beneficiary of his strong connections, leveraging on his business relations to help SCIB landing contracts necessary to meeting its high order-book target. Additionally, given this relationship, SCIB could also stand a chance to win sub-contract jobs from Serba Dinamik, having already secured shareholders' approvals from both of the listed entities to allow related party transactions. From Serba Dinamik's point of view, they can now tender for EPCC and construction projects on a lump-sum turnkey basis, with Serba Dinamik focusing on the plant EPCC while sub-contracting the necessary surrounding civil works (e.g. roads and infrastructure) to SCIB. The added ability to tender for jobs in a lump-sum turnkey basis would also, in theory, elevate Serba Dinamik's bidding competitiveness, as compared to a purely plant EPCC-only bid, as they are now able to offer a one-stop end-to-end value-chain solution to their clients.

Prospects of SCIB's overseas markets. As previously mentioned, one key target market for SCIB is the Middle East, having already secured some contracts in Qatar and Oman. Outside the Middle East, SCIB is also targeting Indonesia.

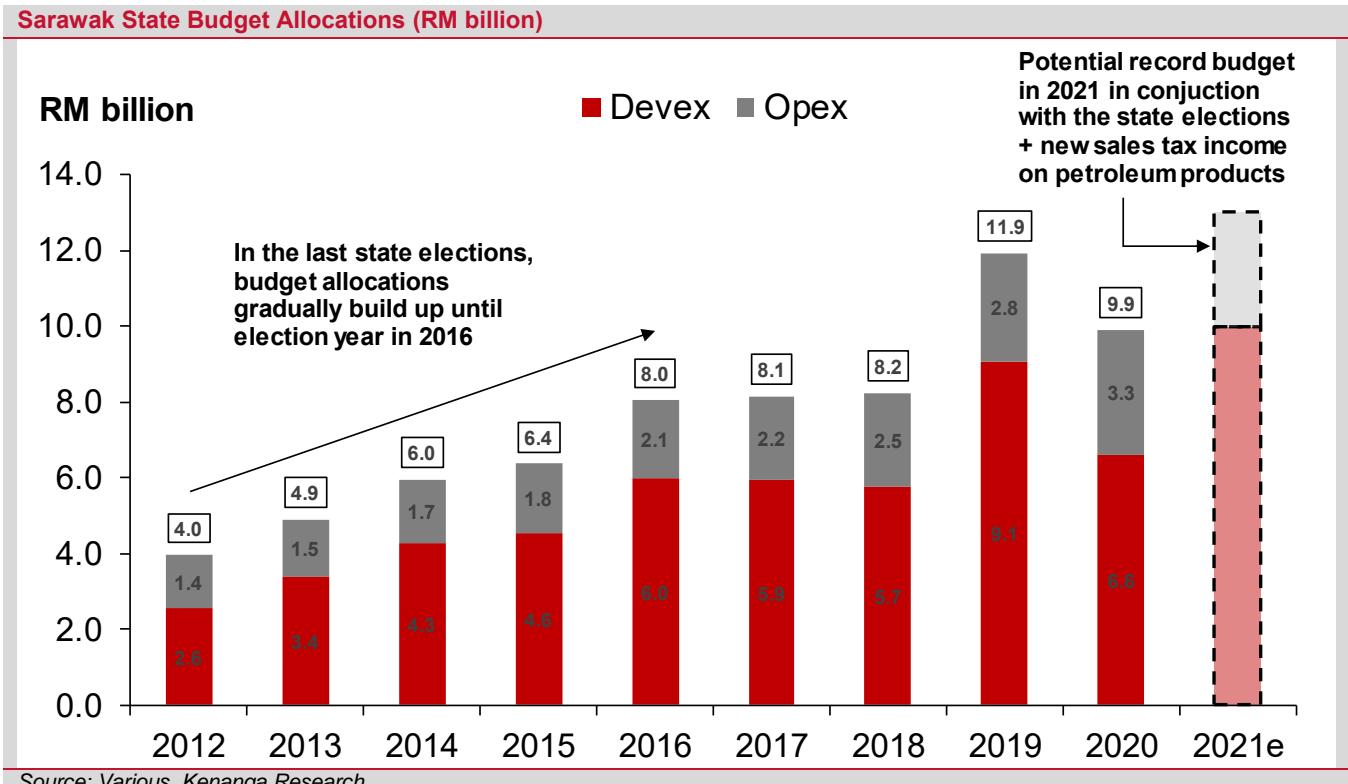
In Qatar, one biggest catalyst would be the World Cup 2022, where the state has been reportedly spending USD500m per week on capital projects. In total, the state is expected to spend USD200b in preparation for 2022. This is on top of other surrounding infrastructures, such as residential and commercial areas, roads, airports and hospitals to accommodate the global sporting event. While most of the direct tenders related to the World Cup event have already been awarded out, SCIB could still participate in sub-bids and other private-sector developments that are being pushed in tandem of 2022.

Meanwhile for Oman, the sleepy port town of Duqm has been gazetted as a special economic zone. The state has the ambitions of making the town one of the largest economic projects in the Middle East and in the world, with a generous land space of 2,000 square kilometres. Currently, a slew of Chinese firms have already poured in billions worth of investments into the region, seeing this as a greater extension of the Belt and Road initiative.

In Indonesia, the relocation of its capital from Jakarta to East Kalimantan is reported to cost a total of USD33b in new developments. With East Kalimantan being also in the Borneo islands and in close proximity of Sarawak, SCIB could also gain a somewhat geographical advantage in new opportunities there.

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Timely to double down in Sarawak. With a rich historical record of supplying IBS and precast products to key jobs in Sarawak i.e. Pan Borneo, SCIB's new strategy to establish themselves as a contractor in Sarawak is extremely timely – ahead of Sarawak 2021 state elections which would be held latest by Sept 2021. Drawing experience from the 2016 state elections, we note that the quantum of state budget allocations (from 2012 to 2016) gradually builds up to the highest in the election year itself. Coupled with Petronas recently agreeing to pay Sarawak 5% sales tax/annum for petroleum products (which works out to be c.RM2b referencing 2019 as a basis), we are convinced that 2021 state budget would likely be a record budget – higher than 2019's record of RM11.9b, providing huge contracting opportunities for SCIB. Amongst key mega projects within the state are the Coastal road, Second Trunk Road, Sabah-Sarawak Link Road and the Sarawak Water Grid programme.



Explosive earnings growth. Our FY20E/FY21E net profit forecasts of RM20m/RM56m (or earnings growth of 576%/172%) imply a 3-year CAGR of >300%. These numbers are broadly based on the following assumptions :- (i) construction order book of RM1.5b/RM2.5b by end-FY20E/FY21E, (ii) net margins of 8%, and (iii) 10% YoY growth for manufacturing segment.

Watch out for risk of net-gearing. In order to aggressively grow its order-book, the company will have to incur heavy borrowings to fund working capital requirements to execute the jobs. Hence, we believe net gearing levels will likely breach >1.0x by in FY22.

Sarawak Consolidated Industries Berhad

On Our Radar

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Daily Charting – Sarawak Consolidated Industries Berhad



Comment: Currently, SCIB is technically on a mini uptrend, breaking past the previous consolidation phase and lead key SMAs into a “golden crossover”. From here, a push backed by strong volumes could see the share breaks past overhead resistance at RM3.05 (R1) and retest its high at RM3.49 (R2). Otherwise, find immediate support at RM2.53 (S1) and RM1.96 (S2).

About the stock:

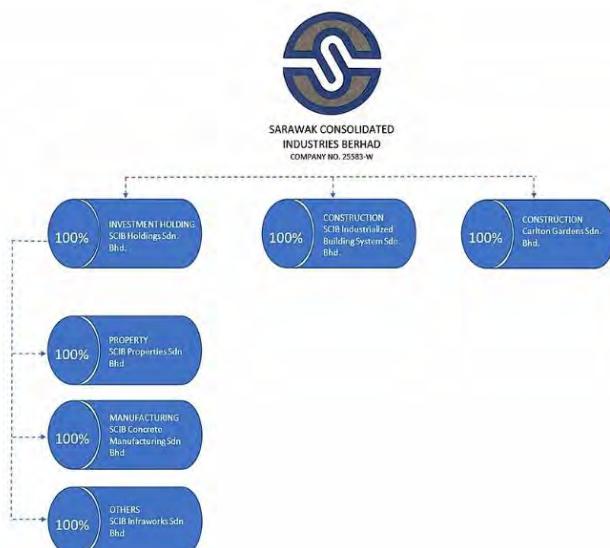
Name	:	Sarawak Consolidated Industries Berhad
Bursa Code	:	SCIB
CAT Code	:	9237

Key Support & Resistance level

Resistance	:	RM3.05 (R1)	RM3.49 (R2)
Support	:	RM2.53 (S1)	RM1.96 (S2)
Outlook	:	Bullish	

Source: Kenanga Research

CORPORATE STRUCTURE



BUSINESS OVERVIEW

Sarawak Consolidated Industries Berhad (SCIB) was founded in 1975. It now operates three factories producing precast concrete products in Kuching, Sarawak. Precast concrete products manufactured by SCIB include pre-stressed spun piles, reinforced concrete square piles, spun concrete pipes, reinforced concrete box culverts, pre-stressed beams, concrete roofing tiles and prefabricated concrete building components for its Industrialised Building System (IBS) such as Hollow Core Slabs, Wall Panels, Columns and Beams.

Following the introduction of Dato' Mohd Abdul Karim as its major shareholder, the company is now turning its focus into construction, both locally and internationally.

BUSINESS SEGMENTS

- (i) Manufacturing
- (ii) Property Trading
- (iii) Construction

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