

## Sunley Holdings

### Construction bloom ahead

#### to summarize...

- Long-history HK foundation industry contractor with recent exposure in Macau with full range of services
- Management with as much as 40 years experience in construction industry
- Encouraging visible short-term orders with priced-in increase of worker cost
- HK\$1,956m outstanding projects on hand by Sep 2012
- Delivery assumption of projects signals strong performance in 6-12 months
- HK\$3.00 represents 24% upside; current 9.8x projected P/E for year Mar 2014

**Long-history HK foundation industry contractor with recent exposure in Macau with full range of services.** Sunley Holdings (SH) is a contractor in HK foundation industry with operating subsidiaries named Sunley and Sunnic. Sunley was incorporated in 1982, which was acquired entirely by NED Leung Chee Hon and Chairman Ho Kar Chung. Since then, Sunley engaged in foundation business in HK covering bored piling, pile cap, site formation and drilling works with particular specialization in bored piling. For main differences between bored piles and classic percussive piles, illustration can be found at the last section. Sunley was first approved to be a specialist contractor in foundation works and site formation works in 1999. On the other hand, Sunnic was incorporated in 1993 and was acquired by SH in 2010. It focused on socketed H piling, percussive piling, mini-piling, pile cap, site formation, site investigation, drilling works and building works with particular specialization in piling design. The two subsidiaries are complementary to each other that enabled SH to provide full range of foundation services to both private and public sector in HK.

**Management with as much as 40 years experience in construction industry.** Key management of SH has extensive network and experience in construction industry in HK. Single-largest shareholder Leung Chee Hon has over 40 years experience in the industry. In 1991 upon listing of Chee Shing Holdings (0687 HK) (now Tysan Holdings), Mr Leung was the Chairman and ED of the said company. As for Dr Ho Kar Chung, he had over 30 years experience that he served Gammon as a contract manager and Chee Shing Holdings as managing director. Chief Executive Cheng Wing On Michael also had 30 years experience in the industry and he founded Sunnic in 1993. Surviving through cycles in construction industry, we believe the key managements have solid industry background as well as operation expertise to capture recent property boom in HK and Macau.

**Encouraging visible short-term orders with priced-in increase of worker cost.** While it is expected to see an increase in construction work in HK, the management indicated that staff cost is largely absorbed. General foundation contract usually has a term of 6 to 12 months, where increase in staff cost during the period is usually estimated and priced in upon entering into particular contract, according to the management. As such, staff cost-to-sales ratio was relatively stable. Table 1 on the next page shows major cost items breakdown. Staff cost, including directors emoluments, was 15% to 20% compared to sales during the track record period. Taking into account the fact that in mid 2010 SH acquired Sunnic of more direct workers that partly distorted the ratio, latest cost-to-sales of 16.8% as in 1H FY03/13A was relatively stable compared to previous years. The management hinted that profit margin could be encouraging at least in short-term. Further combining HK\$1,956m outstanding contracts on hand and our delivery assumption, we expect SH to recognize strong income and profit at least in the coming 6 to 12 months.

Ticker	1240 HK
Rating	Not Rated
Price (HK\$)	2.41
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	0.88 - 2.43
Market cap. (US\$m)	92.7
Daily t/o (US\$m)	0.15
Free float (%)	25.0

#### Financial summary

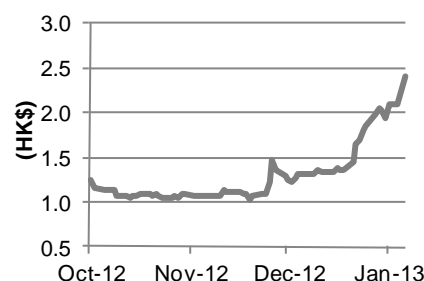
Year to Mar	10A	11A	12A
Turnover (HK\$m)	51.3	257.5	313.1
Net Profit (HK\$m)	10.7	35.4	25.8
EPS (HK\$)	n.a.	n.a.	n.a.
P/E (x)	67.9	20.4	28.1
P/B (x) pre-money	13.2	4.9	4.4
EV/EBITDA (x)	34.0	11.9	12.6
Yield (%)	n.a.	n.a.	n.a.
ROE (%)	n.a.	34.7	16.4
ROCE (%)	14.8	15.8	10.6
N. Gear. (%)	30.1	31.7	37.5

Source: SBI/Bloomberg

	12F	13F	14F
Consensus EPS (HK\$)	n.a.	n.a.	n.a.
Previous earnings (HK\$m)	n.a.	n.a.	n.a.
Previous EPS (HK\$)	n.a.	n.a.	n.a.

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	75.2	94.1	n.a.
Actual price changes (%)	84.0	111.4	n.a.



Source: Bloomberg

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**Major cost items during track record period.** Management entered into contracts as main contractors or subcontractors for both private and public projects during track record period. Further, SH focused on core-foundation works and subcontracted non-core construction works to third parties. Subcontracting works include welding, steel bar fixing, concrete coring and excavation. Since completion of acquiring Sunnic, subcontracting costs to sales was around 20% since FY03/11A. Beside subcontracting costs, other major items include construction material costs, staff costs and depreciation, which made up around 35-45%, 15-20% and 5-10% in the past 2.5 years. Operating margin was stabilizing at around 10% as of 1H FY03/13A.

**Table 1. Major cost items breakdown**

HK\$m	FY03/10A	FY03/11A	FY03/12A	1H FY03/13A
Revenue of the year	51.3	257.5	313.1	182.3
- Revenue associated with provision reversal	0	6.4	0	0
Major operating costs	38.7	218.2	279.3	164.4
- Construction material costs	16.7	91.9	115.4	78.8
- Subcontracting non-core works	2.1	57.9	56.6	33.2
- Staff costs, including directors emoluments	8.0	38.7	63.8	30.7
- Depreciation of owned assets	7.2	10.9	10.2	6.1
- Depreciation of assets under financial leases	1.0	9.2	16.9	9.8
- One-off gain on provision reversal	0.0	(11.2)	0.0	0.0
- Other operating costs	3.8	20.8	16.3	5.9

Source: SBI E2-Capital

**Projects completed by SH between Apr 2009 and Sep 2012.** At IPO, SH disclosed projects it completed during the track record period since Apr 2009 up to then latest applicable date in Sep 2012. Table 2 and Table 3 show major selected projects SH completed during said track record period. In the recent 3.5 years, near 80% of SH project sizes were HK\$20m+, the majority of which were private projects. As a subcontractor, the largest project during the period was Fung Yuen. According to our channel checks, Fung Yuen is situated about 2km from Tai Po Town Centre, a famous site for appreciating butterflies in HK and Asia. Fung Yuen is supported by Tai Po Environmental Association, which is an NGO founded in 2006. Scope of work for Fung Yuen included a comprehensive solution of bored piles, socketed-H pile and jacked piles. Over 16 months, SH delivered foundation works for a contract sum of HK\$142m. In addition to projects like Fung Yuen, the company completed projects for private property developers and government. Total sum during the period was HK\$776m. The number included non-foundation works such as welding, steel bar fixing, concrete coring and excavation, which was usually subcontracted to third parties such that SH can concentrate on high-margin core foundation works, according to the management.

**Table 2. Major selected projects completed from Apr 2009 to Sep 2012 (as main contractor)**

Location of project	Category	Contractor	Construction period	Contract sum
12 Mount Kellett Road	Private	Main contractor	Feb 2009 – Nov 2010	HK\$68m
72 Mount Kellett Road	Private	Main contractor	Mar 2011 – Jun 2012	HK\$49m
Kwai Shing Circuit	Public	Main contractor	Nov 2010 – Aug 2011	HK\$39m
59 Mount Kellett Road	Private	Main contractor	Aug 2010 – Mar 2012	HK\$34m
Bonham Strand	Private	Main contractor	Mar 2011 – Mar 2012	HK\$33m
Warren Street	Private	Main contractor	Apr 2011 – May 2012	HK\$28m
Chung Hom Kok Road	Private	Main contractor	Feb 2009 – May 2010	HK\$22m
Des Voeux Road West	Private	Main contractor	Jan 2010 – Oct 2010	HK\$22m
Others				HK\$58m
Total as main contractor				HK\$353m

**Table 3. Major selected projects completed from Apr 2009 to Sep 2012 (as subcontractor)**

Location of project	Category	Contractor	Construction period	Contract sum
Fung Yuen	Private	Subcontractor	Aug 2010 – Nov 2011	HK\$142m
Lan Kwai Fong	Private	Subcontractor	Aug 2011 – May 2012	HK\$39m
Tin Shui Wai	Public	Subcontractor	Feb 2010 – Sep 2010	HK\$37m
Wo Hop Shek, Fanling	Public	Subcontractor	Mar 2010 – Nov 2010	HK\$29m
Bonham Road	Private	Subcontractor	May 2009 – Oct 2009	HK\$27m
Lam Tin	Public	Subcontractor	Jan 2010 – Aug 2010	HK\$23m
West Drainage Tunnel	Public	Subcontractor	Dec 2009 – Jan 2011	HK\$20m
Others				HK\$106m
Total as subcontractor				HK\$423m

Source: SBI E2-Capital

**Delivery assumption of HK\$1,956m outstanding projects signals strong performance in 6-12 months.** Table 4 shows SH projects in progress and projects to be commenced as of Sep 2012. While there are certain projects such as Kai Tak River and Yue Long Town Lot with relatively long construction period, general contract visibility is usually 6 months to 12 months. Based on Prospectus data, there was a total of HK\$1,956m outstanding value of HK\$2,131m contract sum as of Sep 2012. In accordance with industry dynamics, we assume 50% contract value to be realized at the month of completion, while the other 50% value is to be realized in linear fashion on monthly basis. The table also shows our delivery projections for various projects. Subject to minor construction and payment period adjustment in Kai Tak River project, Yuen Long Town Lot project and Tung Chau Street, near-term delivery is substantial. As for 2H FY03/13F, existing contract should be able to contribute a total of HK\$290m sales. While there is potential of new contracts for 1H FY03/14F, existing contracts for the period was already as much as HK\$337m according to our projections. SH is expected to record very strong income and core profit in near term, in our view.

**Table 4. Projects in progress as of Sep 2012 and delivery projection**

	Outstanding	Booking (F)	2H FY03/13F	1H FY03/14F	2H FY03/14F
Yuen Long Town Lot	HK\$661.0m	Oct 2012 – Sep 2014	HK\$82.6m	HK\$82.6m	HK\$82.6m
Tung Chau Street	HK\$139.0m	Oct 2012 – Jun 2013	HK\$46.3m	HK\$92.7m	0
Bonham Strand West & Wing Lok Street	HK\$35.1m	Oct 2012 – Nov 2012	HK\$35.1m	0	0
Tan Kwai Tsuen Road	HK\$105.1m	Oct 2012 – Aug 2013	HK\$28.2m	HK\$76.9m	0
Lee Kung Street	HK\$16.4m	Oct 2012	HK\$16.4m	0	0
59 Mount Kellett Road	HK\$48.0m	Oct 2012 – Aug 2013	HK\$13.1m	HK\$34.9m	0
Connaught Road Central	HK\$12.2m	Oct 2012	HK\$12.2m	0	0
Catchick Street	HK\$12.1m	Oct 2012	HK\$12.1m	0	0
Goldsmith Road	HK\$10.6m	Oct 2012 – Nov 2012	HK\$10.6m	0	0
Lin Fa Kung Street	HK\$24.2m	Oct 2012 – Apr 2013	HK\$10.4m	HK\$13.8m	0
Shan Kwong Road	HK\$43.3m	Oct 2012 – Sep 2013	HK\$9.2m	HK\$34.1m	0
Fui Yiu Kok Street	HK\$5.2m	Oct 2012 – Jan 2013	HK\$5.2m	0	0
Gordon Road	HK\$4.4m	Oct 2012 – Nov 2012	HK\$4.4m	0	0
Electric Road	HK\$8.9m	Oct 2012 – Oct 2012	HK\$1.9m	HK\$1.9m	HK\$5.2m
Tsun Yip Street	HK\$1.9m	Completed	HK\$1.9m	0	0
Kai Tak River	HK\$728.0m	Oct 2012 – Nov 2016	0	0	0
Projects awarded but not commenced	HK\$100.5m	To be confirmed			
<b>Total</b>	<b>HK\$1,956m</b>		<b>HK\$290m</b>	<b>HK\$337m</b>	<b>HK\$88m</b>

Source: SBI E2-Capital

**HK\$3.00 represents 24% upside; current 9.8x projected P/E for year Mar 2014.** SH was listed in Oct last year at HK\$0.88. Revenue came in at HK\$313.1m with 19.1% gross margin and 8.2% net margin for FY03/12A due to relative sharp and less-expected increase in staff cost in FY03/12A. If SH is to record HK\$290m top-line and same level of profit margin for 2H FY03/13F, core net profit will be HK\$23.8m, which is 44.2% YoY higher than 2H a year ago. On a full year basis, revenue and core net profit will be HK\$472m and HK\$37.2m respectively for FY03/13F, up from HK\$313.1m and HK\$25.8m respectively for FY03/12A. Nevertheless, as one-off expenses associated with listing are expected to impact on profit and loss in 2H, reported net profit for FY03/13F is potentially lower than that of FY03/12A. On core net profit basis, current price at HK\$2.41 represents 19.4x FY03/13F P/E. Base on HK\$159m equity as of Sep 2012, HK\$66m IPO gross proceeds and latest estimated listing fees of HK\$18m, post-money historical equity will be HK\$209m, where current valuation represents 3.5x P/B. On the other hand, if SH is to recognize HK\$337m in 1H FY03/14F plus another potential HK\$337m in 2H, at average margin of FY03/11A and FY03/12A at 11.0%, net profit for FY03/14F could be HK\$74.1m. At HK\$3.00 per share of HK\$900m market cap, valuation would be 12.1x for the financial year ended Mar 2014.

**Table 5. Profit and loss forecast (Full-year)**

HK\$m	FY03/10A	FY03/11A	FY03/12A	1H FY03/13A
Revenue	51.31	257.51	313.12	182.32
Cost of sales	(32.52)	(186.66)	(253.45)	(151.20)
Gross profit	18.79	70.85	59.67	31.11
Other income and gains	0.65	4.09	0.12	0.12
Administrative expenses	(6.21)	(31.49)	(25.81)	(13.20)
EBIT	13.23	43.45	33.98	18.04
Finance Costs	(0.05)	(0.43)	(2.10)	(1.79)
EBT	13.18	43.02	31.88	16.25
Income tax expenses	(2.53)	(7.66)	(6.13)	(2.87)
Profit for the year	10.65	35.36	25.76	13.38

Source: SBI E2-Capital

Table 6. Balance sheet items

HK\$m	FY03/10A	FY03/11A	FY03/12A	1H FY03/13A
Non-current assets	84	171	186	206
Property, plant and equipment	84	158	172	192
Goodwill	0	13	13	13
Other non-current assets	0	0	0	0
Current assets	24	126	137	129
Trade and other receivables	24	126	137	104
Cash and cash equivalents	2	45	47	7
Other current assets	4	4	3	0
Non-current liability	18	78	98	102
Borrowings	8	62	80	84
Other non-current liability	9	16	18	19
Current liabilities	36	70	60	74
Trade and other payables	15	34	29	22
Borrowings	10	29	29	0
Tax payable	10	6	2	48
Total Equity	55	149	165	159
Shareholders' equity	55	149	165	159

Source: SBI E2-Capital

Table 7. Major shareholders

	Shareholding
NED Leung Chee Hon and other mgmt	75%
Public	25%
Total	100%

Source: HKEx

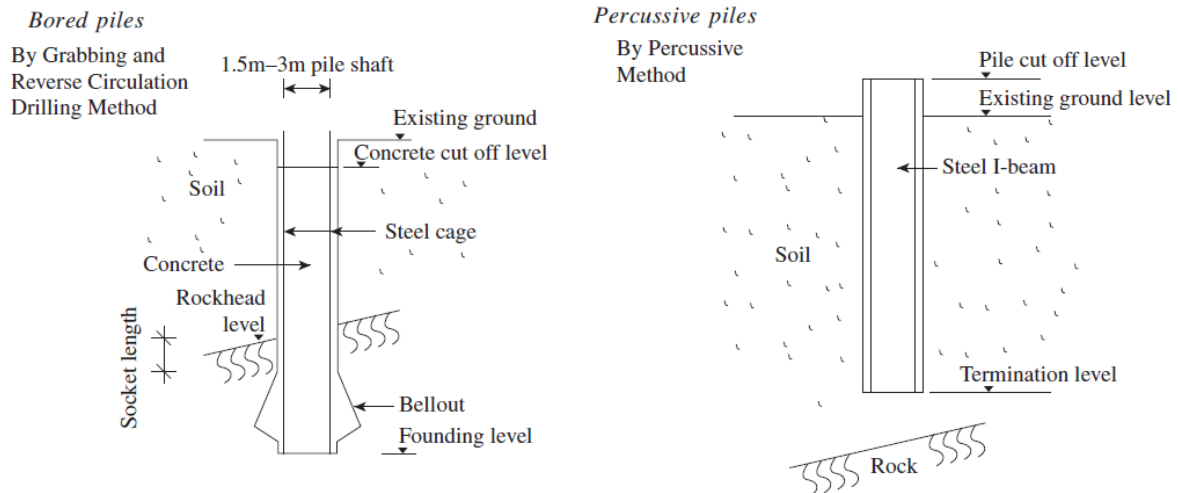
Table 8. Peers valuation statistics

Company name	Ticker	Fiscal year	Mkt cap (US\$m)	His P/E (x)	1-Yr P/E (x)	2-Yr P/E (x)	PB (x)	ROE (%)
SUNLEY HOLDINGS	1240 HK Equity	03/2012	81.3	24.5	n.a.	n.a.	n.a.	16.4
TYSAN HLDGS LTD	687 HK Equity	03/2012	158.8	4.9	n.a.	n.a.	0.6	5.0
CHINNEY ALLIANCE	385 HK Equity	12/2011	31.1	11.9	n.a.	n.a.	0.5	4.0
			avg:	13.8				
CHINA STATE CONS	3311 HK Equity	12/2011	5,256.8	21.6	18.5	14.8	3.7	18.5
HSIN CHONG CONST	404 HK Equity	12/2011	174.4	6.4	5.6	2.6	0.7	13.0
YAU LEE HLDG LTD	406 HK Equity	03/2012	96.1	13.3	n.a.	n.a.	0.5	3.9
HANISON CONSTRUC	896 HK Equity	03/2012	88.7	3.4	n.a.	n.a.	0.7	12.9
CHUN WO DEV	711 HK Equity	03/2012	85.9	11.6	n.a.	n.a.	0.4	3.9
PAUL Y. ENGINEER	577 HK Equity	03/2012	83.8	17.5	n.a.	n.a.	1.0	5.7
VISION FAME INTE	1315 HK Equity	03/2012	61.2	12.4	n.a.	n.a.	2.7	24.9
DESON DEV HLD	262 HK Equity	03/2012	38.9	6.2	n.a.	n.a.	0.4	10.0
BUILD KING HOLDI	240 HK Equity	12/2011	28.8	9.0	n.a.	n.a.	0.8	9.8
			avg:	11.3				

Source: Bloomberg

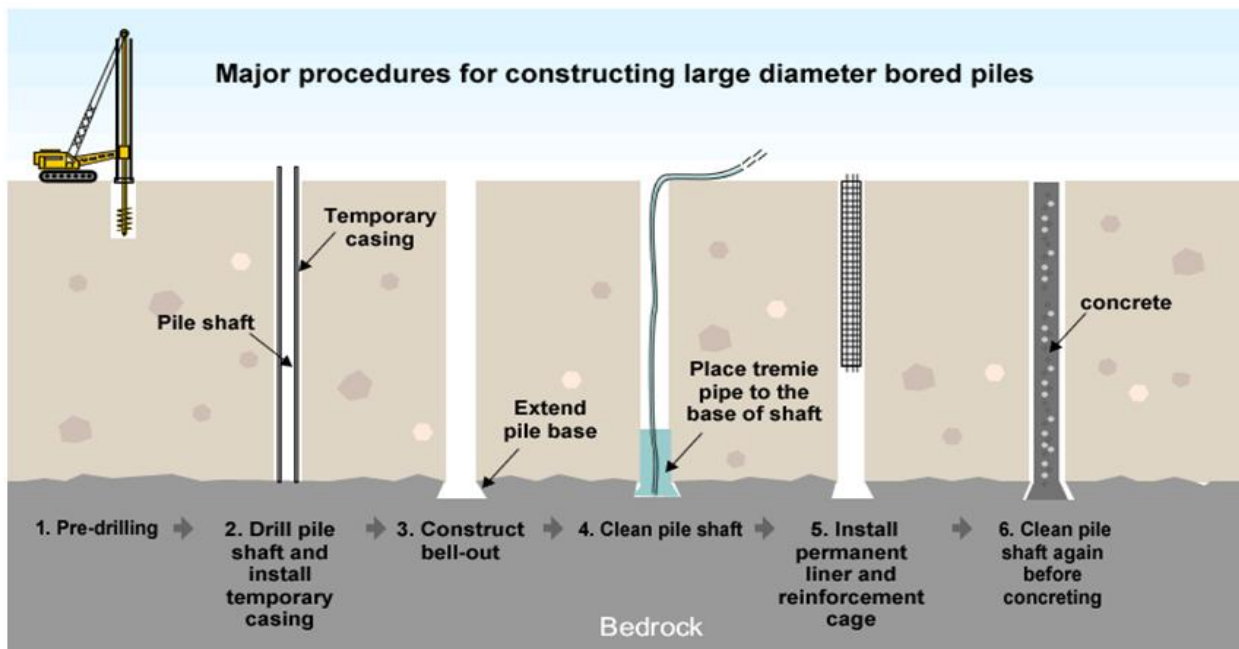
**Typical procedures for constructing large diameter bored piles as well as percussive piles.** Bored piles and percussive piles are most common piling method in HK especially for high-rise buildings in non-restrictive area. Illustration 1 shows basic format of the methods. As for bored piles, diameters are large. They are usually installed by machine boring and grapping to required level where the bored hole is subsequently filled with reinforced concrete. They usually provide high load bearing capacity with low noise and vibration. Illustration 2 shows its major construction procedure. They are usually used in large construction that could accommodate bored piling plant. As for percussive piles, the piles are driven to the required depth by direct or indirect hammering, which creates noises and vibration that disturbs neighborhood. Material cost is usually higher due to large proportion of steel structure.

**Illustration 1. Foundation works - typical bored piles (LHS) and percussive piles (RHS)**



Source: Sunley Holdings

**Illustration 2. Major procedures for constructing large diameter bored piles without percussive measures**



Source: HKSAR Gov (ICAC)

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Disclosure of interests: SBI E2-Capital Financial Services Limited acted as Joint Bookrunners and Joint Lead Managers for Sunley Holdings Limited (stock code: 1240 HK) during IPO in Oct 2012.

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