

Sunway Bhd (SWB MK)

1Q16: Steady operating performance & pre-sales forecast achievable

Neutral

Price: M\$3.03

27 May 2016

Price Target: M\$3.30

PT End Date: 30 Dec 2016

SWB's 1Q16 core net profit (-20% Y/Y) came in at 23%/19% of JPM/consensus FY16E forecast. Profits were dragged down by lower income from construction arm (due to its listing in Jul-15 which saw a reduction in the group's stake to 54%), though contributions from property investment and property development were stronger. First quarter is traditionally weaker and strong replenishment in construction order-book YTD will help improve earnings from the division going forward. Hence, we maintain our forecast. 1Q16 pre-sales rose 17% Y/Y coming in at 26% of our FY16E forecast which looks achievable helped also by the group's recently introduced easy payment schemes. SWB trades at 37% RNAV discount (versus the sector historical mean of 30%). **We prefer its peers, SP Setia (OW) and Eco World (OW)** which are trading at steeper RNAV discounts of 47% and 58% respectively and with strong mid-to-long term fundamentals. **SWB remains a Neutral.**

- **On a core basis for 1Q16, net income down 20% Y/Y against stable performance in revenue and operating profit (+2% Y/Y).** The fall in profits at the net level largely due to reduction in contribution from construction arm to 54% following its listing in Jul-15.
- **Steady core operating profit (+2% Y/Y) for 1Q16** as higher profits from property development (+39% Y/Y) and property investment (+69% Y/Y) compensated for lower construction contributions (-33% Y/Y). Property development segment benefited from sales and profit recognition from its Singapore project (Avant Parc), while property investments saw higher occupancy, rental and contributions from new assets, i.e. Sunway Pinnacle office tower, Sunway Putra Hotel and Sunway University New Academic Block. Construction profits fell with completion of civil and building projects in 2015 (i.e. includes the BRT)
- **1Q16 pre-sales up 7% Y/Y, strong construction order-book.** 1Q16 pre-sales rose 7% Y/Y to M\$263MM, of which 35% came from Iskandar and 16% from Singapore. This accounts for 26% of our FY16E pre-sales forecast of M\$1B and 19% of management's target of M\$1.4B. We believe our pre-sales forecast is achievable to be driven also by SWB's recent easy payment schemes (i.e. guaranteed loans of up to 88% for 15 years and deferred deposit payment). While this raises the risk premium for the stock due to transfer of funding risk of the purchaser from banks to developer in this case, SWB's net gearing estimated at 37% by end-FY16E we believe is comfortable. Construction order-book is strong at M\$5B (4x historical revenue) which includes M\$2B replenishment YTD, which will help improve income from the division going forward

Table 1: Sunway 1Q16 results summary

| M\$ mn; year-end Mar | 1Q16 | 1Q15 | Y/Y | 4Q15 | Q/Q |
|------------------------------|------------|------------|-------------|------------|-------------|
| Revenue | 1,069 | 1,060 | 1% | 1,399 | -24% |
| Core Operating profit | 150 | 147 | 2% | 204 | -27% |
| Operating margin | 14.0% | 13.9% | | 14.6% | |
| Net finance costs | -16 | -11 | 42% | -22 | -26% |
| Associates & JVs | 43 | 38 | 12% | 50 | -14% |
| Core PBT | 178 | 178 | 0% | 244 | -27% |
| Net income | 102 | 147 | -30% | 215 | -52% |
| Core net income | 105 | 131 | -20% | 180 | -42% |
| Core margin | 9.8% | 12.3% | | 12.9% | |
| Core EPS (sen) | 5.59 | 7.10 | -21% | 9.63 | -42% |

Source: Company.

Table 2: Sunway 1Q16 core operating profit breakdown

| M\$mn | 1Q16 | 1Q15 | Y/Y | 4Q15 | Q/Q |
|------------------------------|------------|------------|-----------|------------|-------------|
| Prop development | 56 | 40 | 39% | 96 | -42% |
| Prop investment | 36 | 21 | 69% | 45 | -20% |
| Construction | 36 | 53 | -33% | 27 | 33% |
| Trading & Manufacturing | 9 | 14 | -40% | 12 | -27% |
| Quarry | 6 | 8 | -16% | 6 | 9% |
| Others | 7 | 11 | -35% | 18 | -60% |
| Core operating profit | 150 | 147 | 2% | 204 | -27% |

Source: Company.

Table 3: Sunway 1Q16 core operating margin breakdown

| M\$mn | 1Q16 | 1Q15 | Y/Y | 4Q15 | Q/Q |
|------------------------------|--------------|--------------|---------------|--------------|----------------|
| Prop development | 23.8% | 22.2% | 2 ppts | 23.0% | 1 ppts |
| Prop investment | 21.5% | 15.4% | 6 ppts | 24.5% | -3 ppts |
| Construction | 11.4% | 14.1% | -3 ppts | 6.6% | 5 ppts |
| Trading & Manufacturing | 4.4% | 7.4% | -3 ppts | 5.7% | -1 ppts |
| Quarry | 16.5% | 14.1% | 2 ppts | 10.2% | 6 ppts |
| Others | 5.8% | 9.2% | -3 ppts | 14.0% | -8 ppts |
| Core operating margin | 14.0% | 13.9% | 0 ppts | 14.6% | -1 ppts |

Source: Company.

Table 4: Developer sector peer comparison

| As at: 27 May-16 | FYE | Mkt cap (US\$m) | Price (M\$) | Rating | Target (M\$) | P/E | | EPS growth | | Net div yield | | P/B | ROE | RNAV (M\$) | Prem/disc to RNAV |
|-------------------------|-----|-----------------|-------------|--------|--------------|-------------|-------------|---------------|--------------|---------------|-------------|------------|------------|------------|-------------------|
| | | | | | | CY16E | CY17E | CY16E | CY17E | FY16E | FY17E | | | | |
| Eco World Develop | Oct | 736 | 1.27 | OW | 1.90 | 22.7 | 12.1 | 105.3% | 87.4% | 0.0% | 0.0% | 0.9 | 3.5 | 3.00 | -58% |
| IGB Corporation | Dec | 788 | 2.41 | UW | 2.30 | 13.3 | 12.1 | 18.3% | 9.6% | 3.6% | 3.6% | 0.7 | 5.5 | 5.40 | -55% |
| Mah Sing Group | Dec | 885 | 1.50 | N | 1.50 | 11.0 | 10.3 | -3.4% | 6.8% | 3.6% | 3.9% | 1.1 | 11.9 | 2.10 | -29% |
| SP Setia | Dec | 2,041 | 3.17 | OW | 3.80 | 13.1 | 10.5 | -30.9% | 25.3% | 4.4% | 5.5% | 1.1 | 8.4 | 6.00 | -47% |
| Sunway | Dec | 1,457 | 3.02 | N | 3.30 | 12.6 | 11.1 | -20.1% | 13.7% | 2.9% | 3.3% | 0.8 | 7.2 | 4.80 | -37% |
| UEM Sunrise | Dec | 1,156 | 1.04 | N | 1.10 | 16.4 | 16.6 | 12.1% | -1.5% | 1.9% | 2.9% | 0.7 | 4.2 | 2.80 | -63% |
| Weighted average | | 7,064 | | | | 14.3 | 11.9 | -17.6% | 18.8% | 3.0% | 3.6% | 0.9 | 7.1 | | -47% |

Source: Bloomberg, J.P. Morgan estimates.

Investment Thesis

Longer-term, we continue to like Sunway for its integrated business, with strong assets and branding (property development land-bank, commercial assets via 36%-owned Sunway REIT), as well as its asset-light model, with the next asset recycling and hence further prospects for value unlocking likely in the next two to three years, upon maturity of its large recent and soon-to-be-completed commercial properties (i.e., Velocity mall, Pinnacle office tower).

However, we see limited catalysts over the near to medium term given the weak property market outlook. Hence, we are Neutral on Sunway Bhd.

Valuation

Our Dec-16E PT of M\$3.30 is based on a 30% discount to RNAV, in line with sector historical mean. We believe this is fair versus at over -1SD to historical mean for its peers, given its more diversified/integrated business providing support in the current slow down (i.e. stable to higher income from property investment and construction) and proven past efforts to unlock value (i.e. special dividends following the construction listing in 2015).

Sunway RNAV

| Projects | % stake | Description | Undeveloped land (acres) | Remaining GDV (M\$ M) | Years to develop | Revaluation surplus (M\$ M) | Comments |
|---|---------|---------------------------------|--------------------------|-----------------------|------------------|-----------------------------|---------------------------|
| Klang Valley | | | | | | | |
| Sunway Damansara | 60% | Residential/commercial township | 15 | 1,691 | 5 | 103 | Discounted at WACC of 10% |
| Sunway South Quay | 60% | Lakeside mixed development | 40 | 3,087 | 7 | 271 | Discounted at WACC of 10% |
| Sunway Monterez | 60% | Residential | 4 | 38 | 3 | 2 | Discounted at WACC of 10% |
| Sunway Semenyih | 70% | Residential | 398 | 729 | 10 | 51 | Discounted at WACC of 10% |
| Sunway Cheras | 100% | Residential | 6 | 17 | 3 | 2 | Discounted at WACC of 10% |
| Sunway Duta | 60% | Residential | 3 | 120 | 3 | 12 | Discounted at WACC of 10% |
| Sunway Montana | 100% | Residential | 2 | 56 | 3 | 6 | Discounted at WACC of 10% |
| Sunway Resort City | 100% | Commercial | 15 | 660 | 6 | 66 | Discounted at WACC of 10% |
| Casa Kiara III | 80% | Residential | 3 | 210 | 3 | 18 | Discounted at WACC of 10% |
| Sunway Velocity | 85% | Mixed development | 10 | 1,984 | 6 | 264 | Discounted at WACC of 10% |
| Sunway Tower KL 1 | 100% | Office | 1 | 240 | 3 | 19 | Discounted at WACC of 10% |
| Bangi | 100% | Residential | 3 | 59 | 2 | 5 | Discounted at WACC of 10% |
| Melawati | 100% | Residential | 2 | 43 | 2 | 4 | Discounted at WACC of 10% |
| Sg Long | 80% | Residential | 111 | 277 | 4 | 22 | Discounted at WACC of 10% |
| Mont Putra, Rawang | 100% | Residential | 163 | 156 | 6 | 13 | Discounted at WACC of 10% |
| Kelana Jaya | 100% | Mixed development | 22 | 1,900 | 5 | 197 | Discounted at WACC of 10% |
| Kampung Subang | 80% | Industrial | 6 | 110 | 5 | 20 | Discounted at WACC of 10% |
| Sunway Alam Suria | 100% | Residential | 0 | 0 | 2 | 0 | Discounted at WACC of 10% |
| | | | 805 | 11,376 | | 1,075 | |
| Northern | | | | | | | |
| Sunway City Ipoh | 65% | Residential | 441 | 1,048 | 10 | 73 | Discounted at WACC of 10% |
| Sunway Tunas, Balik Pulau | 100% | Residential | 9 | 60 | 2 | 6 | Discounted at WACC of 10% |
| Sunway Betong, Balik Pulau | 100% | Residential | 20 | 110 | 2 | 10 | Discounted at WACC of 10% |
| Paya Terubong | 100% | Residential | 24 | 1,500 | 6 | 143 | Discounted at WACC of 10% |
| Sungai Ara | 100% | Residential | 81 | 849 | 8 | 81 | Discounted at WACC of 10% |
| Bukit Mertajam | 100% | Residential | 53 | 725 | 5 | 69 | Discounted at WACC of 10% |
| | | | 627 | 4,293 | | 382 | |
| Singapore | | | | | | | |
| Novena | 30% | Medical suites, retail, hotel | 0 | 0 | 3 | 10 | Discounted at WACC of 10% |
| Sembawang, Singapore | 100% | Residential | 0 | 0 | 2 | 0 | Discounted at WACC of 10% |
| | | | 0 | 0 | | 10 | |
| Johor | | | | | | | |
| Bukit Lenang | 80% | Residential | 65 | 698 | 5 | 60 | Discounted at WACC of 10% |
| Medini | 38% | Mixed development | 656 | 11,293 | 10 | 424 | Discounted at WACC of 10% |
| Pendas | 60% | Mixed development | 1,079 | 18,000 | 15 | 666 | Discounted at WACC of 10% |
| | | | 1,800 | 29,991 | | 1,150 | |
| China | | | | | | | |
| Sunway Guanghao | 65% | Mixed development | 4 | 67 | 2 | 4 | Discounted at WACC of 10% |
| Tianjin Eco City | 60% | Mixed development | 17 | 1,060 | 6 | 38 | Discounted at WACC of 10% |
| India | | | | | | | |
| Sunway OPUS Grand India | 50% | Condos | 24 | 702 | 5 | 26 | Discounted at WACC of 10% |
| Sunway MAK Signature Residence (JV with M.A.K Builders) | 60% | Residential | 14 | 181 | 5 | 10 | Discounted at WACC of 10% |
| Australia | | | | | | | |
| Wonderland Business Park (Sydney) | 45% | Industrial | 13 | 44 | 6 | 2 | Discounted at WACC of 10% |
| | | | 72 | 2,054 | | 80 | |
| Total | | | 3,304 | 47,714 | | 2,697 | |

Source: Company, J.P. Morgan estimates.

Sunway RNAV

| | Value (M\$ M) | Comments |
|---|---------------|--|
| Revaluation surplus | 2,697 | |
| Book value as at Dec-15 | 6,230 | |
| Revaluation gain from investment properties | 231 | Valuing 36%-owned Sunway REIT at PT of M\$1.70 |
| Revaluation gain from construction division | 549 | Valued at market price |
| Outstanding cash obligation for land | (422) | Discounted value for Iskandar land purchase |
| Total RNAV | 9,285 | |
| Number of shares (M) | 1,761 | |
| RNAV per share (M\$) | 5.27 | |
| FD RNAV | | |
| Warrants & ESOS | | |
| Add proceeds from warrants & ESOS | 931 | 258.5M outstanding warrants at M\$2.50/share and 133.6M ESOS |
| Adjusted RNAV | 10,215 | |
| Fully diluted number of shares (M) | 2,148 | With warrants and ESOS |
| RNAV/share (M\$) | 4.80 | |
| PT (M\$) | 3.30 | 30% discount to RNAV |

Source: J.P. Morgan estimates.

Risks to Rating and Price Target

Key downside risks include: (1) slower-than-expected property sales, (2) rising competition in Iskandar, with supply expansion affecting the high-rise, high-density segment in particular – for Sunway, its low-density Medini project in Iskandar accounts for 20% of our base-case RNAV, and (3) funding/balance sheet risk from its new property incentives (i.e. guaranteed loans and deferred payment schemes). Key upside risks include attractive, accretive land acquisitions, especially in the Klang Valley.

Real Estate

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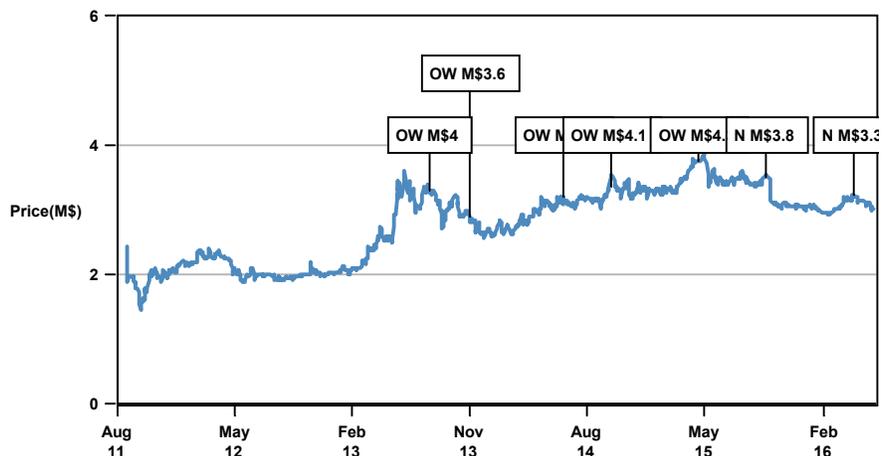
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Sunway Bhd (SWAY.KL, SWB MK) Price Chart



| Date | Rating | Share Price (M\$) | Price Target (M\$) |
|-----------|--------|-------------------|--------------------|
| 26-Jul-13 | OW | 3.30 | 4.00 |
| 28-Oct-13 | OW | 2.88 | 3.60 |
| 05-Jun-14 | OW | 3.19 | 3.80 |
| 22-Sep-14 | OW | 3.36 | 4.10 |
| 17-Apr-15 | OW | 3.75 | 4.30 |
| 19-Sep-15 | N | 3.50 | 3.80 |
| 08-Apr-16 | N | 3.24 | 3.30 |

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jul 26, 2013.

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