ALLIANCE RESEARCH

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Results Review

Sunway REIT — Neutral

REIT — *Bloomberg Ticker: SREIT MK | Bursa Code: 5176*

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12-month upside potential

Previous target price	1.56
Revised target price	1.40
Current price (as at 6 Aug)	1.33
Capital upside (%)	5.3
Net distribution (%)	6.2
Total return (%)	11.5

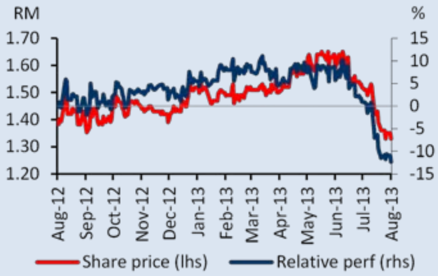
Key stock information

Syariah-compliant?	No
Market Cap (RM m)	3,882.8
Units outstanding (m)	2,919.4
Free float (%)	42.5
52-week high / low (RM)	1.65 / 1.33
3-mth avg volume ('000)	2,876.7
3-mth avg turnover (RM m)	4.4

Unit price performance

	1M	3M	6M
Absolute (%)	-12.5	-18.4	-10.6
Relative (%)	-13.1	-19.2	-19.2

Unit price chart



Source: Bloomberg

4QFY13: Spot on

Sunway REIT's FY13 results came within expectations, with realised net income making up 99.6% and 101.9% of ours and consensus full year forecasts. As results came within expectation, we keep our forward estimates unchanged. Nonetheless, we lower our TP by 10.3% to RM1.40, as we adjust our risk-free rate (4.0%), market risk premium (5.6%) and stock beta (0.83) assumptions in our DDM valuation model, to take into account changes in yield-curve and market risk. With no positive catalysts insight, we maintain our NEUTRAL call on Sunway REIT. Our revised TP now implies a yield of 5.9% for FY14.

FY13 ended with no surprises

- Sunway REIT's FY13 realised net income (RNI) came within expectation, making up 99.6% and 101.9% of ours and consensus full year forecasts.
- 4QFY13 revenue grew by 1.3% y-o-y, mainly driven by: - (1) Solid performance from Sunway Pyramid Shopping Mall (+3.9% y-o-y), and (2) New income contribution from Sunway Medical Centre (SMC) which was acquired on 31 Dec 2012.
- The key asset, Sunway Pyramid Shopping Mall recorded a marginally lower occupancy rate of 98.3% in FY13 (FY12- 98.6%). The mall manager managed to renew 24% (94% of its expiry profile) of its total NLA at an average positive rental reversion rate of 18.1% over a 3-year term. In terms of q-o-q comparison, 4QFY13 revenue contracted by 2.4% q-o-q, mainly due to (1) weaker performance from its hotel and office segment, and (2) loss of income from Sunway Putra Mall as it was closed down for major refurbishment in April 2013.
- In terms of net property income (NPI), Sunway REIT achieved 3.5% y-o-y growth and a 1.4% q-o-q contraction, indicating good cost control by management. The cost savings stemmed from lower utilities expenses at Sunway Pyramid as a result of energy saving upon the completion of the chiller retrofit exercise.
- 4QFY13 financing cost was significantly lower (-18.4% y-o-y and -10.3% q-o-q), mainly due to:- (1) One-off charge out of amortisation of loan transaction costs in 4QFY12, and (2) Lower effective interest rate as management converted RM400m floating-rate commercial papers to fixed-rate medium-term-notes during the quarter. This reduced its exposure on floating-rate borrowings from 44% in 3QFY13 to 19% in 4QFY13, allaying the fear of financing cost pressure as interest rate normalises.
- All in, 4QFY13 core EPU grew by 3.3% y-o-y but contracted by 9.9% q-o-q.
- Sunway REIT declared its final interim DPU of 2.02 sen, of which 0.68 sen per unit is taxable and 1.34 sen per unit is non-taxable. This brings its total distributions for FY13 to 100% of our full year estimate of 8.3 sen per unit, implying a payout ratio of 105.4%.
- On foreign shareholdings level, it has dropped from 21.8% in March 2013 to 20.5% in June 2013.

No change to our forecasts and introduce our FY16 estimates

- As results came within expectation, we keep our forecasts unchanged. Apart from that, we take this opportunity to introduce our FY16 estimates.

Maintain NEUTRAL with lower TP of RM1.40 (-10.3%)

- With no positive catalysts in sight, we maintain our NEUTRAL call on Sunway REIT with a lower TP of RM1.40 (-10.3%), as we adjust our risk-free rate (4.0%), stock's beta (0.83), and market risk premium (5.6%) assumptions in our DDM-valuation model, to take into account changing yield-curve and market risk. Our revised TP implies a net yield of 5.9% for FY14.
- Key risks include:- (1) Rising interest rate which could result to higher cost of equity that undermines our DDM valuation model, and (2) A sharp economic slowdown which will affect domestic consumptions and investment activities.

SNAPSHOT OF FINANCIAL RESULTS

Figure 1 : Results commentaries

	4QFY13	4QFY12	% y-o-y change	% q-o-q change	FY13	FY12	% y-o-y change	Comments
Key financial highlights								
Gross rental income (RM m)	103.9	102.6	1.3	-2.4	415.9	406.4	1.3	4QFY13 revenue grew by 1.3% y-o-y but contracted by 2.4% q-o-q, mainly driven by: - (1) Solid performance from Sunway Pyramid Shopping Mall (+3.9% y-o-y), and (2) New income contribution from Sunway Medical Centre (SMC) which was acquired on 31 Dec 2012. The q-o-q contraction was mainly due to: - (1) Weaker performance from its hotel and office segment, and (2) Loss of income from Sunway Putra Mall as it was closed for major refurbishment in April 2013.
Operating costs (RM m)	-25.3	-26.7	-5.0	-5.3	-106.6	-107.2	-5.0	Operating costs were lowered by 5.0% y-o-y and 5.3% q-o-q from lower utilities expenses from Sunway Pyramid as a result of energy saving upon the completion of the chiller retrofit exercise.
Net rental income (RM m)	78.6	75.9	3.5	-1.4	309.3	299.3	3.5	
Others (RM m)	0.5	0.4			1.4	1.3		
Total trust income (RM m)	252.5	306.4	-17.6	215.3	484.2	530.7	-8.8	
Financing cost (RM m)	-15.7	-19.2	-18.4	-10.3	-63.6	-81.2	-21.7	4QFY13 financing cost is significantly lower (-18.4% y-o-y and -10.3% q-o-q), mainly due to :- (1) One-off charge out of amortisation of loan transaction costs in 4QFY12, and (2) Lower effective interest rate as management converted its floating-rate note to fixed-rate medium term notes.
Other trust expenditure (RM m)	-7.8	-8.9	-12.1	6.3	-28.3	-29.1	-2.6	
Net income (RM m)	229.0	278.3	-17.7	314.7	392.3	420.5	-6.7	
Core net income (RM m)	55.5	48.1	15.3	0.5	218.8	190.3	15.0	FY13 core net income came within expectations, making up 99.6% and 101.9% of ours and consensus full year forecasts.
Realised net income (RM m)	55.5	48.1	15.4	0.5	218.8	190.6	14.8	
Per share data								
EPS (sen)	8.07	10.32	-21.8	297.5	14.11	15.62	-9.7	
Core EPS (sen)	1.83	1.77	3.3	-9.9	7.87	7.07	11.3	
Net DPU (sen)	2.02	1.89			8.30	7.50		Declared 2.02 sen DPU, bringing YTD distribution to 100% of our full year forecast.
NAV/share (RM)	1.20	1.12			1.20	1.12		
Other key indicators								
Gearing (x)	0.31	0.33			0.31	0.33		
Net rental margin (%)	75.6	74.0			74.4	73.6		
Core net margin (%)	53.4	46.9			52.6	46.8		
Payout ratio (%)	110.4	106.8			105.4	106.1		
Revenue by segment (RM m)								
Retail	71.0	72.3	-1.8	-7.0	296.1	292.3	1.3	
Hotel	17.6	19.8	-11.4	16.4	69.0	71.6	-3.6	
Office	10.6	10.4	1.3	2.8	41.3	42.6	-3.2	Office segment revenue growth was mainly attributed to the completion of AEI at Menara Sunway, which leads to an NLA increase of 5%.
Hospital	4.8	0.0			9.6	0.0		

Source: Company, Alliance Research

Figure 2 : Key financial data

FYE 30 June	FY12	FY13	FY14F	FY15F	FY16F
Revenue (RM m)	406.4	415.9	427.0	453.5	485.7
EBITDA (RM m)	270.2	281.2	293.2	311.5	335.1
EBIT (RM m)	270.2	281.0	293.2	311.4	335.1
Pretax profit (RM m)	420.5	392.3	229.9	244.6	267.8
Reported net profit (RM m)	420.5	392.3	229.9	244.6	268.8
Core net profit (RM m)	190.3	218.8	229.9	244.6	267.8
EPU (sen)	15.6	14.0	7.9	8.3	9.1
Core EPU (sen)	7.1	7.8	7.9	8.3	9.1
Alliance / Consensus (%)			100.7	94.4	N/A
Core EPU growth (%)	12.8	10.6	0.5	6.1	9.1
P/E (x)	18.8	17.1	16.9	15.9	14.6
EV/EBITDA (x)	19.0	19.4	19.2	18.2	16.9
ROE (%)	6.3	6.6	6.9	7.3	7.9
Gearing (%)	33.4	32.0	33.8	34.3	33.9
Net DPU (sen)	7.5	8.3	8.3	8.8	9.6
Net distribution yield (%)	5.6	6.2	6.3	6.6	7.2
NAV/share (RM)	1.12	1.20	1.15	1.15	1.15
P/NAV (x)	1.2	1.1	1.2	1.2	1.2

Source: Alliance Research, Bloomberg

Figure 3 : Revised-DDM valuation model

DDM Valuation Model

Key Assumptions:

Market Risk Premium (MRP)	5.6%
Beta (*B*)	0.83
Risk free rate (Rf)	4.0%
Constant DPU growth rate (g)	2.0%
Cost of equity (r) = Rf + (*B* x MRP)	8.6%

Equity value per share (RM) = Present value of future dividend + Terminal value

$$= D0 + \frac{D1}{(1+r)^{n}} + \frac{D2}{(1+r)^{n+1}} + \frac{D3}{(1+r)^{n+1}} + \left[\frac{D3 \times (1+g)}{(r-g)} \times \frac{1}{(1+r)^{n+1}}\right]$$

$$= 0.020 + \frac{0.083}{(1.086)^{1}} + \frac{0.088}{(1.086)^{2}} + \frac{0.096}{(1.086)^{3}} + \left[\frac{0.096x\,(1.02)}{(0.086 - 0.02)} \times \frac{1}{(1.086)^{2}}\right]$$

$$= 0.020 + 0.077 + 0.075 + 0.075 + 1.154$$

$$= 1.40$$

* n = period

Source: Alliance Research, Bloomberg

Figure 4 : Previous-DDM valuation model

Key Assumptions:

Market Risk Premium (MRP)	7.1%
Beta (*B*)	0.50
Risk free rate (Rf)	3.5%
Constant DPU growth rate (g)	2.0%
Cost of equity (r) = Rf + (*B* x MRP)	7.1%

Equity value per share (RM) = Present value of future dividend + Terminal value

$$= D0 + \frac{D1}{(1+r)^{n}} + \frac{D2}{(1+r)^{n+1}} + \left[\frac{D3 \times (1+g)}{(r-g)} \times \frac{1}{(1+r)^{n+1}}\right]$$

$$= 0.031 + \frac{0.083}{(1.071)^{1}} + \frac{0.088}{(1.071)^{2}} + \left[\frac{0.088x\,(1.02)}{(0.071 - 0.02)} \times \frac{1}{(1.071)^{2}}\right]$$

$$= 0.031 + 0.078 + 0.077 + 1.551$$

$$= 1.74$$

Target Price = DDM-derived fair value - 10% discounting factor due to its flattish EPU growth for FY14

$$= 1.74 - 10\%$$

$$= 1.56$$

* n = period

Source: Alliance Research, Bloomberg

DISCLOSURE

Stock rating definitions

Strong buy	- High conviction buy with expected 12-month total return (including dividends) of 30% or more
Buy	- Expected 12-month total return of 15% or more
Neutral	- Expected 12-month total return between -15% and 15%
Sell	- Expected 12-month total return of -15% or less
Trading buy	- Expected 3-month total return of 15% or more arising from positive newsflow. However, upside may not be sustainable

Sector rating definitions

Overweight	- Industry expected to outperform the market over the next 12 months
Neutral	- Industry expected to perform in-line with the market over the next 12 months
Underweight	- Industry expected to underperform the market over the next 12 months

Commonly used abbreviations

Adex = advertising expenditure
bn = billion
BV = book value
CF = cash flow
CAGR = compounded annual growth rate
Capex = capital expenditure
CY = calendar year
Div yld = dividend yield
DCF = discounted cash flow
DDM = dividend discount model
DPS = dividend per share
EBIT = earnings before interest & tax
EBITDA = EBIT before depreciation and amortisation

EPS = earnings per share
EV = enterprise value
FCF = free cash flow
FV = fair value
FY = financial year
m = million
M-o-m = month-on-month
NAV = net assets value
NM = not meaningful
NTA = net tangible assets
NR = not rated
p.a. = per annum
PAT = profit after tax

PBT = profit before tax
P/B = price / book ratio
P/E = price / earnings ratio
PEG = P/E ratio to growth ratio
q-o-q = quarter-on-quarter
RM = Ringgit
ROA = return on assets
ROE = return on equity
TP = target price
trn = trillion
WACC = weighted average cost of capital
y-o-y = year-on-year
YTD = year-to-date

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