Sunway REIT (SREIT MK) : BUY

Mkt. Cap: US$1,001m I **3m Avg. Daily Val:** US$0.54m

Last Traded Price : RM1.48

Price Target : RM1.70 (15% upside)

Shariah Compliant: No

Analyst

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Sustainable growth

- **2QFY16 earnings in line, boosted by contribution from Sunway Putra Mall and improvement in the hotel segment**
- **Retaining our positive outlook on rising Sunway Putra contributions, asset enhancement work and asset injection opportunities**
- **Declares DPU of 2.57 sen, ex-date 11 Feb**
- **Maintain BUY with TP of RM1.70**

Highlights

Sustainable growth

- 1HFY16 net distributable income of RM139m came largely in line at 50% of our/consensus forecasts, taking into account contribution from Sunway Putra Mall (SPM) and improvement in NPI for all hotels, with exception of Sunway Hotel Seberang Jaya.
- 2QFY16 registered net distributable income of RM76m (+14 y-o-y) and NPI of RM97m (+12%) supported by the inclusion of new assets, but NPI margin was dragged down to 73.6% (2QFY15: 76.1%) due to costs for the refurbishment works of SPM.
- DPU of 2.57 sen was declared, which brings 1HFY16 DPU to 4.69 sen implying full payout.

Resilient performance from retail segment

- The highest contributing retail segment recorded 2QFY16 NPI of RM67m (+15% y-o-y), as Sunway Pyramid's occupancy was steady at c.98.2% in 2QFY16 (2QFY15: 97.9%). Decent renewals were also secured, as remaining lease expiries are about 7% from 15% previously, at reversion rates averaging in the high single digit.
- It was disclosed that SPM's occupancy reached 84.9% (from 82.4%), and tenants such as TGV Cinema and H&M have opened to help draw footfall. We look forward to higher contributions as we expect occupancy to reach c.90% by end-2016.

Hotel segment improving, plans for asset enhancement

- The hospitality segment surprised on the upside, with 2QFY16 revenue and NPI y-o-y growth of 25% and 24% respectively, due to strong performances from Sunway Resort Hotel & Spa and Sunway Putra Hotel. This was due to strong tourist visits amid the weak Ringgit. Moreover, NPI was also boosted by new contribution from Sunway Hotel Georgetown.
- In view of the intensifying competitive business landscape, management plans to embark on a refurbishment project for Pyramid Tower East which saw its occupancy rate dropping to 80% in 2QFY16 (2QFY15: 92%). The drop is mainly due to lower demand from corporates. The project is expected to commence progressively in 3QFY16 with full closure of the hotel by 4QFY16 for approximately 12 months with budgeted capex of c.RM100m. The NPI foregone (FY15: RM18m) will be offset by the recent inclusion of assets.

Office segment struggling

- The office segment was a major drag due to significant vacancies at Sunway Tower and Sunway Putra Tower, leading to 2QFY16 revenue and NPI falling 27% and 43% y-o-y respectively.
- We foresee the office segment facing challenges in filling up occupancies in the current oversupply and weak market environment. Additionally, little headway was made in replenishing occupancies at Sunway Tower and Sunway Putra Tower after the departure of anchor tenants.

Outlook

We remain positive on prospects. We remain positive on SunREIT. DPU remains attractive in the near-to-mid-term, following the completion of refurbishment works of the Sunway Putra assets (mall, office and hotel) and full-year income contribution from Sunway Hotel Georgetown. Furthermore, we expect further earnings accretion from the asset enhancement work done in Pyramid Tower East slated to be completed by 3QFY17.

Visible sponsor asset pipeline. Sunway REIT's sponsor and shareholder (33% stake) Sunway Bhd has a large pipeline of potential assets for injection under its "build-own-operate" model. Future injections could include Sunway University and Monash University campuses, The Pinnacle office tower, Sunway Giza mall, Sunway VeloCity mall and Sunway Pyramid Phase 3. These underpin an attractive growth pipeline for the REIT. We are optimistic of potential injections by its sponsor Sunway Bhd to meet the REIT's RM7bn asset target by 2017.

Valuation:

Our DDM-derived TP is maintained at RM1.70 (8% cost of equity, 1.5% terminal growth). This stock provides yield of c.6.3%. Reiterate BUY on SunREIT, premised on its strong DPU and asset growth potential.

Key risks:

Pace of acquisitions. SunREIT's yields are on par with its larger M-REIT peers, so the draw is the potential to secure steady acquisitions. On this note, any significant delay in acquisitions could cap share price appreciation, especially as its peers are also looking at asset growth.

Weak general sentiment. Dampened consumer sentiment may have a negative impact on the retail and hospitality sectors, in the form of lowered retail spending, rental reversions and local tourist visits.

Office space oversupply. As the supply overhang of office spaces persist, vacancies will be challenging to fill and rental rates may see negative growth.

Quarterly / Interim Income Statement (RMm)

FY Jun	2Q2015	1Q2016	2Q2016	% chg yoy	% chg qoq
Gross revenue	114	121	132	15.7	8.8
Property expenses	(27.3)	(31.3)	(34.8)	27.7	11.3
Net Property Income	86.7	89.9	97.1	11.9	7.9
Other Operating expenses	(6.7)	(3.9)	(3.9)	(41.2)	(0.7)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	N/A	N/A
Net Interest (Exp)/Inc	(16.8)	(21.5)	(21.6)	28.6	0.6
Exceptional Gain/(Loss)	0.0	(4.0)	2.06	N/A	N/A
Net Income	**63.3**	**60.6**	**73.6**	**16.3**	**21.5**
Tax	0.0	0.0	0.0	N/A	N/A
Minority Interest	0.0	0.0	0.0	N/A	N/A
Net Income after Tax	**63.0**	**60.6**	**73.6**	**16.8**	**21.5**
Total Return	63.0	60.6	73.6	16.8	21.5
Non-tax deductible Items	0.0	0.0	0.0	nm	nm
Net Inc available for Dist.	66.6	62.3	75.6	13.5	21.3
Ratio (%)					
Net Prop Inc Margin	76.1	74.2	73.6		
Dist. Payout Ratio	99.3	99.1	99.3		

Source of all data: Company, AllianceDBS Research

DISCLOSURE

Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

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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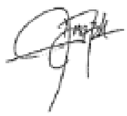

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