

Company Guide

Sunway REIT

Edition 1 Version 1 | Bloomberg: SREIT MK | Reuters: SUNW.KL

Refer to important disclosures at the end of this report

Malaysia Equity Research

30 Jul 2015

BUY

Last Traded Price: RM1.55 (KLCI : 1,698.99)
Price Target : 12-Month RM 1.75 (13% upside)

Shariah Compliant: No

Potential Catalyst: Yield-accretive asset acquisitions

Where we differ: Largely in line with consensus

Analyst

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Price Relative



Forecasts and Valuation

FY Jun (RM m)	2014A	2015F	2016F	2017F
Gross Revenue	428	470	544	580
Net Property Inc	321	357	414	444
Total Return	411	245	278	306
Distribution Inc	245	260	294	322
EPU (sen)	14.1	8.3	9.2	10.1
EPU Gth (%)	0	(41)	12	9
DPU (sen)	8.4	8.8	9.8	10.6
DPU Gth (%)	1	5	11	9
NAV per shr (sen)	125.9	125.8	125.6	125.3
PE (X)	11.0	18.8	16.8	15.4
Distribution Yield (%)	5.4	5.7	6.3	6.9
P/NAV (x)	1.2	1.2	1.2	1.2
Aggregate Leverage (%)	31.1	37.7	38.5	38.7
ROAE (%)	11.4	6.6	7.3	8.0

Distn. Inc Chng (%):	0	0	0
Consensus DPU (sen):	9.5	N/A	N/A
Other Broker Recs:	B: 5	S: 0	H: 9

Source of all data: Company, AllianceDBS, Bloomberg Finance L.P

ONGOING ASSET GROWTH STORY

Anticipate several acquisitions in the next two years to drive growth. In line with its target of achieving RM7bn portfolio asset size by 2017 (RM5.6bn currently), we expect Sunway REIT to deliver on acquisitions in the next two years. Coupled with a strong track record of enhancing unitholders' value via accretive acquisition and asset enhancement initiatives, we see upside to an already impressive 8.3% DPU CAGR over FY15-17F.

Visible asset pipeline from sponsor. Sunway REIT's sponsor and shareholder (36% 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.

Sunway Putra revival to spark growth. The RM459m enhancement program on the mixed-use Sunway Putra asset will start to pay off in FY16 (ending June) with an estimated c.RM37m NPI contribution, or c.10% accretion in the first year. The 579k sq ft NLA mall will start contributing earnings to the REIT again after reopening at end-May 2015, and works on the office and hotel portions are expected to be completed by year end.

Valuation:

We have a BUY recommendation for Sunway Real Estate Investment Trust (REIT) with a RM1.75 price target, based on the two-stage DDM model which assumes 7.7% cost of equity and 1.75% terminal growth rate.

Key Risks to Our View:

Pace of acquisitions. Sunway REIT'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 stutter share price appreciation, especially as its peers are also looking at asset growth.

At A Glance

Issued Capital (m shrs)	2,938
Mkt. Cap (RMbn/US\$m)	4.55 / 1,198
Major Shareholders	
Sunway Bhd (%)	36.0
Employees Provident Fund (%)	10.7
Skim Amanah Saham Bumiputera (%)	8.1
Free Float (%)	39.7
3m Avg. Daily Val (US\$m)	1.6
ICB Industry : Real Estate / Real Estate Investment Trusts	

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

Sunway Pyramid a key earnings driver. Despite a diversified portfolio of 14 assets, Sunway REIT (SunREIT) derives the bulk of its income (c.60% NPI) from its crown jewel, the 1.6m sq ft NLA Sunway Pyramid retail asset. Located in the Sunway Resort City township, the Egyptian-themed mall is one of the better performing properties in its portfolio. The property sees strong visitation from locals and tourists, and enjoys sustained high occupancy rates of 98-99%. The property also enjoys robust rental reversions of 11-12% per annum. As a result of the strong recurring footfall and connectivity, we expect such trends to continue against the modest retail market outlook.

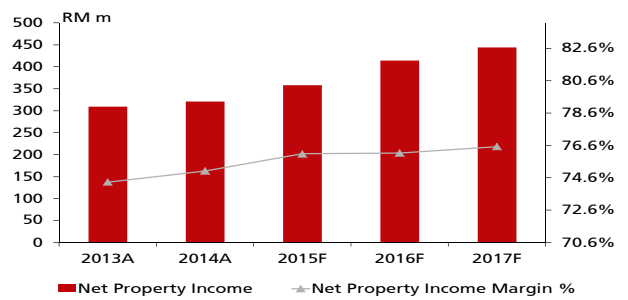
Growth of Sunway Resort City to accelerate performance going forward. We remain positive on the outlook for Sunway Resort City township. It is already registering strong visitations, of 40m per annum (estimate by the group). And, visitations will leap with the completion of the BRT-Sunway Line – a 6-km elevated bus rapid transit path that will connect seven key public transport stations. In addition, ongoing developments at Sunway Pyramid Phase 3 – an integrated retail and hotel project by the Sunway Group - will improve the township’s appeal to locals and tourists. SunREIT is expected to benefit from the ongoing rejuvenation of the township. And apart from Sunway Pyramid, the REIT has four other assets - Sunway Resort, Hotel & Spa, Pyramid Tower hotel; Menara Sunway office tower, and Sunway Medical Centre. All these properties are expected to perform strongly on the back of a growing population and higher visitations.

Visible acquisition pipeline. We remain excited on non-organic growth prospects originating from the sponsor. Within the Sunway Resort City, completed assets include the Sunway University Campus (with a recently completed new block), the Pinnacle office tower (90% occupied, with access to Menara Sunway via a link bridge), and the Monash University Campus. Outside of the township, there is the 97k sq ft NLA Sunway Giza Mall. Assets under development include Phase 3 of the Pyramid which will house 63k sq ft of retail NLA and 440 hotel rooms, and Sunway VeloCity mall with 880k sq ft NLA in Kuala Lumpur.

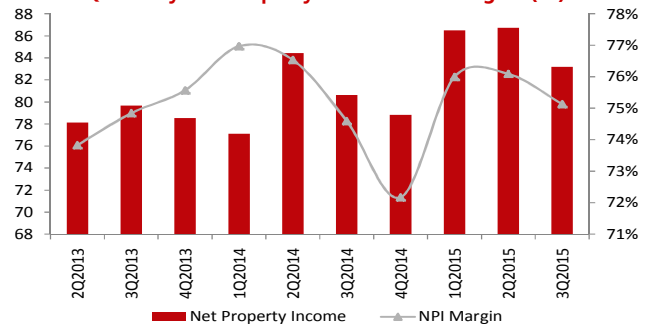
Temporary weakness in hospitality and office segments will moderate growth potential. SunREIT derives c.18% and c.8% of its NPI from its hospitality and office assets, respectively. We note a marked drop in office occupancy starting 2QFY15, after the anchor tenants moved out of Sunway Tower and Putra Tower, to 50% and 30%, respectively. The manager is looking to re-lease the vacant space, but that might not be easy given the weak outlook for office space in Kuala Lumpur. Occupancies were also weaker at all its hospitality assets in 3QFY15 on the back of weak consumer sentiment.

About 90% of debt cost at fixed rate. SunREIT’s borrowings comprise mostly several tranches of its fixed-rate 7-year commercial papers, with maturities ranging from late 2017 to 2018. Overall, about 90% of its borrowings are on fixed rates and the average maturity period is 1.9 years. Its average cost of debt is about 3.9%, but we anticipate this will inch up to 4.1% in FY16 as existing debt will be renewed at higher rates.

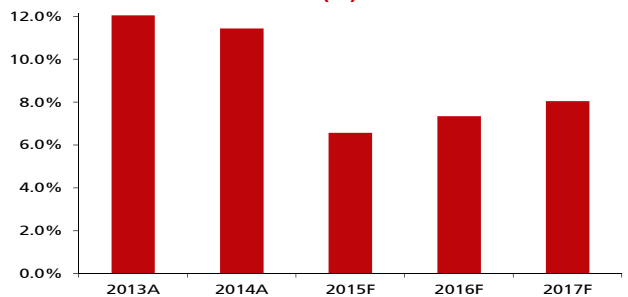
Net Property Income and Margins (%)



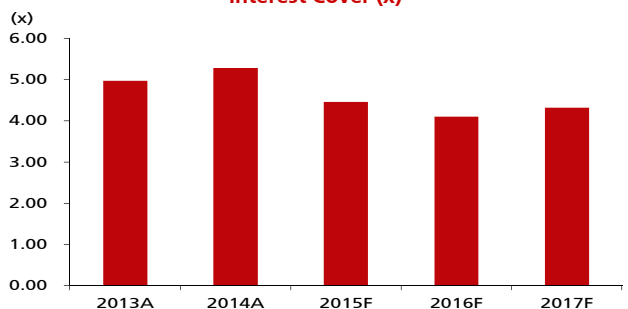
Quarterly Net Property Income and Margins (%)



ROE (%)



Interest Cover (x)



Source: Company, AllianceDBS

Balance Sheet:

Sensible gearing levels. SunREIT has historically kept total debt/total assets ratio at 33-35%, which is a comfortable level. This leaves room to gear up for acquisition opportunities, but we believe any deals are likely to be funded by a mixture of debt and equity, given the manager's track record of conservative gearing levels. At present, of its RM2.1bn borrowings, RM1.4bn is from a commercial paper facility that will expire in four tranches between Oct 2017 and Apr 2018. The rest are on a monthly rollover basis. We also note that about half of SunREIT's manager fees are paid in units.

Share Price Drivers:

Acquisition newsflow. One of SunREIT's appeal is the availability of asset acquisition pipeline of completed investment properties from sponsor Sunway Bhd. Confirmation of injections at accretive yields will be key re-rating signals for the stock.

Yield spread. A REIT's attractiveness depends on its distribution yield relative to other fixed-income assets. A common benchmark is the REIT's yield spread over the indicative 10-year Malaysian Government Security yield, which is currently stabilising near the 4% level.

Key Risks:

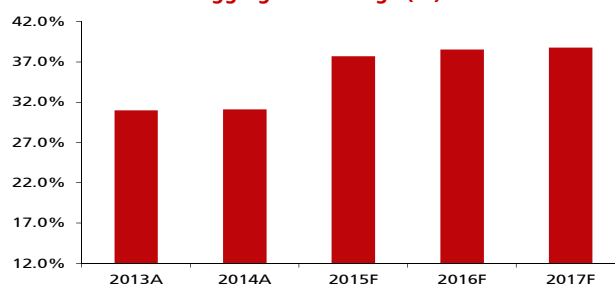
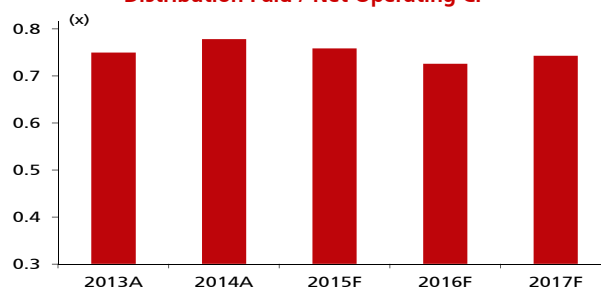
Weak consumer sentiment post-implementation of GST. The weak consumer sentiment and GST effective 1 Apr 2015 have resulted in a slower retail sector, especially in the discretionary space. If the weakness is extended, it might hurt tenant sales performance and their capacity to stomach higher reversions going forward. Weak sentiment could also potentially affect hospitality assets, as tourism and visitations have continued to slow down since early 2014.

Vacancy risk rising at Sunway Tower and Sunway Putra Tower.

SunREIT saw anchor tenants move out of two of its office towers (Sunway Tower and Sunway Putra Tower), which resulted in occupancy rates dropping to 30-50%, respectively. Given the oversupply of office space in Kuala Lumpur, it would be challenging to secure new leases for the vacated space in the near term.

COMPANY BACKGROUND

Sunway REIT is a real estate investment trust (REIT) with exposure to the retail, hospitality and office segments. Its earnings are primarily driven by retail assets, led by its crown jewel Sunway Pyramid, a 1.6m-sq ft NLA mall centred in the integrated Bandar Sunway township. The REIT also has presence in Penang and Kuala Lumpur.

Aggregate Leverage (%)**Distribution Paid / Net Operating CF****Distribution Yield (%)****P/Bk NAV (x)**

Source: Company, AllianceDBS

Sunway REIT

Key Assumptions

FY Jun	2013A	2014A	2015F	2016F	2017F
Lease Expiry Profile (%) of NLA	25.6	52.4	21.4	23.0	34.3
SP Rental Gth (%)	12.0	11.3	12.0	12.0	12.0
SP Annual Step Up Gth (%)	3.0	3.0	3.0	3.0	3.0

Segmental Breakdown

FY Jun	2013A	2014A	2015F	2016F	2017F
Revenues (RM m)					
Retail	296	301	326	368	392
Hotel	69	65	71	80	84
Office	41	43	41	52	58
Others	10	19	32	45	46
Total	416	428	470	544	580
NPI (RM m)					
Retail	205	213	234	264	284
Hotel	66	61	67	75	79
Office	29	28	26	33	36
Others	10	19	31	42	44
Total	309	321	357	414	444
NPI Margins (%)					
Retail	69.4	70.7	71.7	71.7	72.5
Hotel	95.2	94.1	94.0	94.0	94.1
Office	69.2	65.3	63.7	64.1	63.3
Others	100.0	100.0	96.6	95.1	95.1
Total	74.3	75.0	76.1	76.1	76.5

Income Statement (RM m)

FY Jun	2013A	2014A	2015F	2016F	2017F
Gross revenue	416	428	470	544	580
Property expenses	(107)	(107)	(112)	(130)	(136)
Net Property Income	309	321	357	414	444
Other Operating expenses	0	0	0	0	0
Other Non Opg (Exp)/Inc	(28)	(28)	(32)	(35)	(35)
Net Interest (Exp)/Inc	(62)	(61)	(80)	(101)	(103)
Exceptional Gain/(Loss)	173	179	0	0	0
Net Income	392	411	245	278	306
Tax	0	0	0	0	0
Minority Interest	0	0	0	0	0
Preference Dividend	0	0	0	0	0
Net Income After Tax	392	411	245	278	306
Total Return	392	411	245	278	306
Non-tax deductible Items	12	13	15	16	16
Net Inc available for Dist.	231	245	260	294	322
Growth & Ratio					
Revenue Gth (%)	2.3	2.8	9.8	15.8	6.6
N Property Inc Gth (%)	3.3	3.8	11.3	15.9	7.1
Net Inc Gth (%)	(6.7)	4.8	(40.3)	13.5	9.8
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	74.3	75.0	76.1	76.1	76.5
Net Income Margins (%)	94.3	96.1	52.2	51.2	52.7
Dist to revenue (%)	55.5	57.2	55.5	54.1	55.5
Operating expenses (%)	0.0	0.0	0.0	0.0	0.0
ROAE (%)	12.0	11.4	6.6	7.3	8.0
ROA (%)	7.9	7.6	4.1	4.3	4.7
ROCE (%)	6.3	6.0	6.1	6.6	7.0
Int. Cover (x)	5.0	5.3	4.5	4.1	4.3

Source: Company, AllianceDBS

Quarterly / Interim Income Statement (RM m)

FY Jun	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015
Gross revenue	108	109	114	114	111
Property expenses	(27)	(30)	(27)	(27)	(28)
Net Property Income	81	79	86	87	83
Other Operating expenses	(6)	(7)	(7)	(7)	(9)
Other Non Opg (Exp)/Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(16)	(16)	(16)	(17)	(18)
Exceptional Gain/(Loss)	0	0	0	0	2
Net Income	58	56	63	63	59
Tax	0	0	0	0	0
Minority Interest	0	0	0	0	0
Net Income after Tax	58	56	63	63	59
Total Return	58	56	63	63	59
Non-tax deductible Items	0	0	0	0	0
Net Inc available for Dist.	61	59	67	67	63
Growth & Ratio					
Revenue Gth (%)	(2)	1	4	0	(3)
N Property Inc Gth (%)	(5)	(2)	10	0	(4)
Net Inc Gth (%)	(6)	(4)	13	(1)	(6)
Net Prop Inc Margin (%)	74.6	72.2	76.0	76.1	75.1
Dist. Payout Ratio (%)	99.1	100.1	99.2	99.3	99.5

Balance Sheet (RM m)

FY Jun	2013A	2014A	2015F	2016F	2017F
Investment Properties	5,184	5,520	6,274	6,363	6,393
Other LT Assets	9	3	4	4	5
Cash & ST Invt	59	67	65	71	78
Inventory	0	0	0	0	0
Debtors	13	12	15	17	18
Other Current Assets	5	4	4	4	4
Total Assets	5,270	5,606	6,361	6,461	6,498
ST Debt	315	742	792	822	852
Creditor	3	3	3	4	4
Other Current Liab	85	113	113	113	113
LT Debt	1,318	1,000	1,605	1,665	1,665
Other LT Liabilities	42	60	60	60	60
Unit holders' funds	3,506	3,688	3,788	3,797	3,803
Minority Interests	0	0	0	0	0
Total Funds & Liabilities	5,270	5,606	6,361	6,461	6,498
Non-Cash Wkg. Capital	(70)	(100)	(97)	(95)	(94)
Net Cash/(Debt)	(1,574)	(1,675)	(2,332)	(2,416)	(2,440)
Ratio					
Current Ratio (x)	0.2	0.1	0.1	0.1	0.1
Quick Ratio (x)	0.2	0.1	0.1	0.1	0.1
Aggregate Leverage (%)	31.0	31.1	37.7	38.5	38.7
Z-Score (X)	1.9	1.8	1.4	1.4	1.4

Source: Company, AllianceDBS

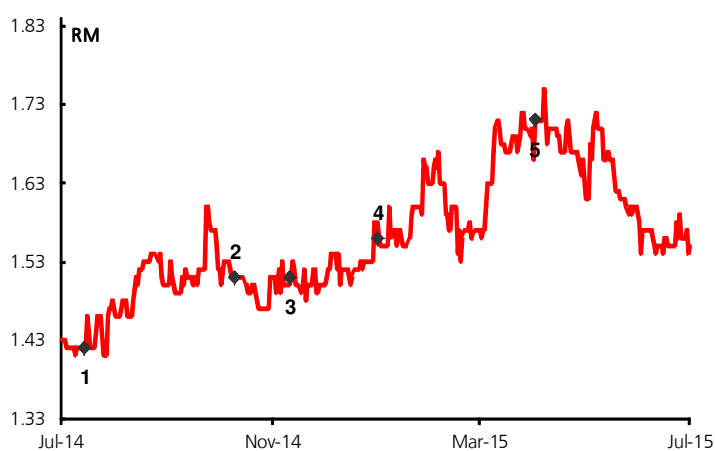
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Cash Flow Statement (RM m)

FY Jun	2013A	2014A	2015F	2016F	2017F
Pre-Tax Income	392	411	245	278	306
Dep. & Amort.	0	0	0	1	1
Tax Paid	0	0	0	0	0
Associates & JV Inc/(Loss)	0	0	0	0	0
Chg in Wkg.Cap.	31	17	(3)	(2)	(1)
Other Operating CF	(126)	(114)	95	117	119
Net Operating CF	297	315	338	394	424
Net Invnt in Properties	(373)	(121)	(755)	(91)	(30)
Other Invnts (net)	0	0	0	0	0
Invnts in Assoc. & JV	0	0	0	0	0
Div from Assoc. & JVs	0	0	0	0	0
Other Investing CF	1	2	2	2	2
Net Investing CF	(372)	(118)	(753)	(89)	(28)
Distribution Paid	(223)	(245)	(256)	(286)	(315)
Chg in Gross Debt	65	106	655	90	30
New units issued	317	0	96	0	0
Other Financing CF	(52)	(62)	(82)	(103)	(105)
Net Financing CF	107	(201)	412	(299)	(390)
Currency Adjustments	0	0	0	0	0
Chg in Cash	33	(5)	(2)	7	6
Operating CFPS (sen)	9.6	10.2	11.5	13.1	14.0
Free CFPS (sen)	(2.7)	6.6	(14.0)	10.1	13.0

Source: Company, AllianceDBS

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

Source: AllianceDBS

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	EPS = earnings per share	PBT = profit before tax
bn = billion	EV = enterprise value	P/B = price / book ratio
BV = book value	FCF = free cash flow	P/E = price / earnings ratio
CF = cash flow	FV = fair value	PEG = P/E ratio to growth ratio
CAGR = compounded annual growth rate	FY = financial year	q-o-q = quarter-on-quarter
Capex = capital expenditure	m = million	RM = Ringgit
CY = calendar year	M-o-m = month-on-month	ROA = return on assets
Div yld = dividend yield	NAV = net assets value	ROE = return on equity
DCF = discounted cash flow	NM = not meaningful	TP = target price
DDM = dividend discount model	NTA = net tangible assets	trn = trillion
DPS = dividend per share	NR = not rated	WACC = weighted average cost of capital
EBIT = earnings before interest & tax	p.a. = per annum	y-o-y = year-on-year
EBITDA = EBIT before depreciation and amortisation	PAT = profit after tax	YTD = year-to-date

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Wong Ming Tek, Executive Director

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