

Company Focus

Sunway REIT

Bloomberg: SREIT MK | Reuters: SUNW.KL

Refer to important disclosures at the end of this report

Malaysia Equity Research

12 Aug 2015

BUY

Last Traded Price: RM1.53 KLCI : 1,636.71
Price Target : RM1.75 (14% upside)

Shariah Compliant : No

Reason for Report : 4Q15/FY15 Results

Potential Catalyst: Yield accretive asset injections

Where we differ: Largely in line with consensus

Analyst

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Price Relative



Forecasts and Valuation

FY Jun (RM m)	2015A	2016F	2017F	2018F
Gross Revenue	453	518	576	618
Net Property Inc	341	393	443	478
Total Return	541	277	320	354
Distribution Inc	256	286	320	354
EPU (sen)	18.5	9.3	10.6	11.8
EPU Gth (%)	31	(50)	14	11
DPU (sen)	8.7	9.6	10.6	11.8
DPU Gth (%)	4	10	11	11
NAV per shr (sen)	135.6	135.9	136.2	136.5
PE (X)	8.3	16.4	14.4	13.0
Distribution Yield (%)	5.7	6.3	6.9	7.7
P/NAV (x)	1.1	1.1	1.1	1.1
Aggregate Leverage (%)	33.3	35.5	35.7	35.9
ROAE (%)	14.1	6.9	7.8	8.6

Distn. Inc Chng (%):		(3)	(1)	0
Consensus DPU (sen):		9.7	10.3	N/A
Other Broker Recs:		B: 6	S: 0	H: 8

ICB Industry : Real Estate

ICB Sector: Real Estate Investment Trusts

Principal Business: Retail REIT with diversification in hospitality and office assets primarily in Bandar Sunway, Selangor. It also has properties in Penang and Perak.

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

New earnings stream in FY16

- 4Q15 was slightly lower due to weak office and hotel performances
- Declared 2.05 sen DPU, ex-date 24 Aug
- Expect decent DPU growth in FY16 with new contributions from Sunway Putra in FY16
- Maintain BUY, RM1.75 TP

Finishing on the soft side. SREIT's 4Q15 distributable income of RM60.2m (+1.3% y-o-y, -3.7% q-o-q) brought FY15's distributable income to RM256.2m, which was in line at 98.5% of our projections. There was some softness in the office and hospitality assets, as some anchor tenants at Putra Tower and Sunway Tower had moved out as well as a drop in hotel visitations from weak market conditions. Thus, despite the injection of Sunway Hotel Georgetown Hotel and Wisma Sunway, NPI in the office segment fell 12% and hospitality by 3% in FY15. Nonetheless, core retail assets (70% of group NPI) did better, notching 11.4% NPI growth. Group NPI was up 6.2% y-o-y to RM340.8m, and NPI margins held steady at 75.2% (FY14: 75%). There was a revaluation gain of RM306.7m.

Improvements in sight. FY16 will see the start of contributions from Sunway Putra assets, in particular the 578k sq ft NLA mall which has already secured tenancies for 82% of space. We anticipate this asset to underpin DPU growth of 10% in FY16.

Potential acquisitions. We are keeping an eye out for potential acquisitions from sponsor Sunway Bhd, in line with its target for assets of RM7bn by 2017 (RM6.3bn currently). In our forecast, we have assumed the acquisition of the Sunway University campus at a yield of 6.3% in mid-2016, with DPU accretion of 0.4% in FY16 and 2.3% FY17.

Moderating our assumptions. We tweak our FY16-17F earnings to reflect a longer tenancy replenishment period for its office assets, plus some housekeeping adjustments. FY16F DPU is lowered by 1.6% as a result, but DPU growth remains decent. We have also introduced FY18F earnings.

Reiterate BUY and RM1.75 TP. After rolling forward our valuation window, our DDM-derived TP remains at RM1.75. This has factored higher risk-free rate assumption of 4.3% (from 4%) in light of the rising MGS yields, and a lower terminal growth assumption of 1.5% (from 1.75%).

At A Glance

Issued Capital (m shrs)	2,938
Mkt. Cap (RMm/US\$m)	4,495 / 1,144
Major Shareholders	
Sunway Bhd (%)	36.1
Employees Provident Fund (%)	10.7
Skim Amanah Saham Bumiputera (%)	8.3
Free Float (%)	44.9
3m Avg. Daily Val (US\$m)	1.5

INVESTMENT THESIS

Profile	Rationale
<p>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 in the integrated Bandar Sunway township. The REIT also has a presence in Penang and Kuala Lumpur.</p>	<p>Sunway Putra revival to spark growth. The enhancement program on the mixed-use Sunway Putra asset will start to pay off in FY16 (ending June) with an estimated c.RM29m NPI contribution, adding c.7% to earnings. The 579k sq ft NLA mall will start contributing after reopening at end-May 2015, and works on the office and hotel portions are expected to be completed by end-2015.</p> <p>Visible asset pipeline from sponsor. Sunway REIT's sponsor and shareholder, Sunway Bhd (36% stake), 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.</p> <p>Resilient Sunway Pyramid within the township. Sunway REIT derives the bulk of its income (c.60% NPI) from its crown jewel, the 1.6m sq ft NLA Sunway Pyramid mall. High occupancy rates of 98-99% have been sustainable, and rental reversions robust at 11-12% per annum. The mall is located in the Sunway Resort City township, which also houses Sunway Resort, Hotel & Spa, Pyramid Tower hotel; Menara Sunway office tower, and Sunway Medical Centre.</p>
Valuation	Risks
<p>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 assuming a 8% cost of equity and 1.5% terminal growth.</p>	<p>Weak consumer sentiment post- implementation of GST. Weak consumer sentiment and GST implementation from 1 Apr 2015 have resulted in a slower retail sector, especially in the discretionary space. If this weakness extends, 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.</p> <p>Vacancy risk rising at Sunway Tower and Sunway Putra Tower. Sunway REIT saw anchor tenants move out of two of its office towers (Sunway Tower and Sunway Putra Tower), which resulted in occupancy rates dropping to 12 and 30%, respectively. Given the oversupply of office space in Kuala Lumpur, it may be challenging to secure new leases for the vacated space in the near term.</p>

Source: AllianceDBS

Conference call highlights

Putra Mall to ramp up. So far, tenants have been secured for 82.4% of NLA, with 70% already in place and the rest to progressively move in during the year. Management indicated that they are selective in picking quality tenants, and tenants were secured at target rent levels. The remaining c.17.6% of space is primarily at the highest two floors of the mall, with a cinema operator potentially taking up a portion if approvals are given.

Works at Putra Office done, hotel to complete at end-2015.

As of July, renovation works at the 317k sq ft NLA Putra offices are complete. The remaining work lies in room refurbishments at the hotel, as 284 of the 650 rooms (from 618 before) are still pending. Furthermore, club/lounge and meeting room facilities will be installed on the upper floor.

Expect challenges in replenishing tenancy at office assets.

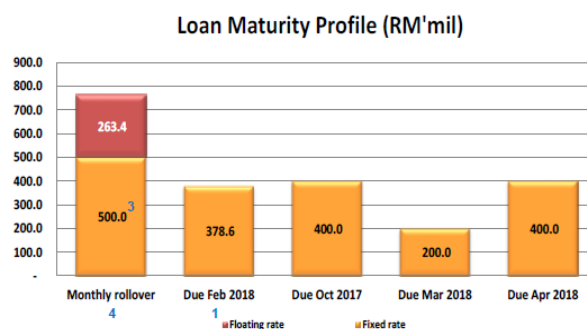
After anchor tenants at Sunway Tower and Putra Tower vacated, occupancies have fallen to 12% and 30% respectively. While acknowledging the competitive office space market, management is in negotiations with potential tenants for Sunway Tower, and replenishing Putra Tower is expected to be easier once refurbishment works on the adjacent hotel are completed.

Retail scene a challenge, but reversions were strong. Like most other retail malls, SREIT was affected by the GST implementation and weak consumer sentiment. This was reflected in retail sales, which fell c.11% in 2QCY15, though a strong 1Q enabled 1HCY15 sales to record a 2-3% increase. Despite this, reversions at the Pyramid and Carnival malls were strong at low- to high- double digits on c.25% and c.67% of expiries respectively. This was the driver behind the strong retail NPI growth of 11%

Moving away from management fees in units. SREIT will change its previous trend of settling 50% of management fees in units, to only 25% in FY16 and phasing it out completely in FY17. We have factored this into our forecasts, which slightly lowers distribution income but also reduces the share base increase.

Status quo on borrowings. SREIT has a high proportion of 88% of overall debt on fixed rates, which is prudent. About RM763m (c.36%) of overall borrowings are on a near-term rollover basis, while RM1bn (c.47%) are in medium-term notes with maturities from Oct-2017 to Apr-2018. The remainder is in the form of a fully-hedged, USD term loan due Feb-2018.

Loan maturity schedule



Source: Company

Lowering our forecasts

Delayed tenant acquisitions and lower visitations. We adjust downwards our average occupancies at Sunway Tower and Putra Tower to 40-50% from c.70% to account for further delays in new tenant acquisitions. We also lower hotel occupancies by up to 5ppts to factor in the softer outlook. However, the slightly higher than expected rental growth at the retail segment (from Sunway Carnival) was a counter-balancing factor. Overall, FY16F DPU was cut by 1.6%.

Expecting one asset injection in FY16. SREIT's RM7bn asset target by 2017 looks within reach with the stable of completed assets within sponsor Sunway Bhd. With the completion of the new academic block for Sunway University, we view that the campus is a probable candidate for injection. Our assumptions conservatively assume 6.3% entry yield from mid-FY16, thus impacting our FY16F earnings with 0.4% DPU accretion and 2.3% in FY17F.

DDM valuation

Period	4Q15	FY16	FY17	FY18	Terminal
Payout (RM)	0.021	0.096	0.106	0.118	1.848
Discounted Dividend	0.021	0.089	0.091	0.093	1.469
Fair Value (RM)					1.75

Beta	0.61	Cost of Equity (RF + β *MRP)	8.0%
Risk free rate	4.3%	Terminal growth	1.50%
Market risk premium	6.0%		

Source: AllianceDBS

Sunway REIT

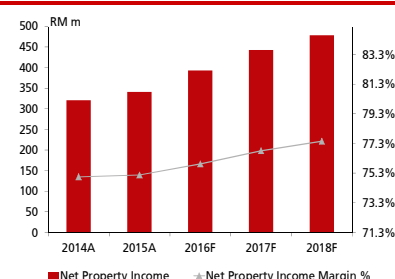
Key Assumptions

FY Jun	2014A	2015A	2016F	2017F	2018F
Lease Expiry Profile (%) of NLA	52.4	26.2	21.1	35.8	28.6
SP Rental Gth (%)	11.3	11.0	12.0	12.0	12.0
SP Annual Step Up Gth (%)	3.00	3.00	3.00	3.00	3.00

Segmental Breakdown

FY Jun	2014A	2015A	2016F	2017F	2018F
Revenues (RM m)					
Retail	301	333	371	397	426
Hotel	65	61	74	81	84
Office	43	39	40	51	58
Others	19	20	34	48	49
Total	428	453	518	576	618
NPI (RM m)					
Retail	213	237	267	290	315
Hotel	61	59	69	76	79
Office	28	25	24	32	37
Others	19	20	33	45	46
Total	321	341	393	443	478
NPI Margins (%)					
Retail	70.7	71.2	72.1	73.0	74.0
Hotel	94.1	95.8	93.7	93.9	93.9
Office	65.3	63.5	61.2	62.4	64.4
Others	100.0	100.0	96.4	94.7	94.7
Total	75.0	75.2	75.9	76.8	77.4

Margins Trend



Factoring in softer office earnings despite an additional asset due to longer vacant periods.

Income Statement (RM m)

FY Jun	2014A	2015A	2016F	2017F	2018F
Gross revenue	428	453	518	576	618
Property expenses	(107)	(113)	(125)	(134)	(139)
Net Property Income	321	341	393	443	478
Other Operating	0	0	0	0	0
Other Non Opg (Exp)/Inc	(28)	(33)	(35)	(36)	(38)
Net Interest (Exp)/Inc	(61)	(67)	(81)	(86)	(86)
Exceptional Gain/(Loss)	179	307	0	0	0
Net Income	411	547	277	320	354
Tax	0	(6)	0	0	0
Minority Interest	0	0	0	0	0
Preference Dividend	0	0	0	0	0
Net Income After Tax	411	541	277	320	354
Total Return	411	541	277	320	354
Non-tax deductible Items	13	14	9	0	0
Net Inc available for Dist.	245	256	286	320	354
Growth & Ratio					
Revenue Gth (%)	2.8	6.0	14.3	11.2	7.1
N Property Inc Gth (%)	3.8	6.2	15.5	12.5	8.0
Net Inc Gth (%)	4.8	31.7	(48.8)	15.5	10.7
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	75.0	75.2	75.9	76.8	77.4
Net Income Margins (%)	96.1	119.4	53.4	55.5	57.3
Dist to revenue (%)	57.2	56.5	55.1	55.5	57.3
Managers & Trustee's fees to sales %	0.0	0.0	0.0	0.0	0.0
ROAE (%)	11.4	14.1	6.9	7.8	8.6
ROA (%)	7.6	9.0	4.2	4.7	5.2
ROCE (%)	6.0	5.8	6.1	6.7	7.2
Int. Cover (x)	5.3	5.1	4.8	5.1	5.5

Source: Company, AllianceDBS

Quarterly / Interim Income Statement (RM m)

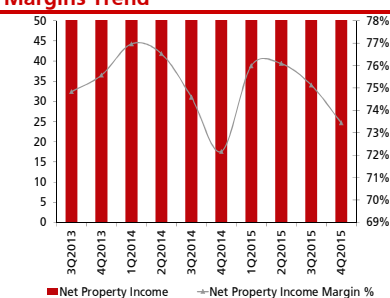
FY Jun	4Q2014	1Q2015	2Q2015	3Q2015	4Q2015
Gross revenue	109	114	114	111	115
Property expenses	(30)	(27)	(27)	(28)	(31)
Net Property Income	79	86	87	83	84
Other Operating	(7)	(7)	(7)	(9)	(7)
Other Non Opg (Exp)/Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(16)	(16)	(17)	(18)	(20)
Exceptional Gain/(Loss)	0	0	0	2	0
Net Income	56	63	63	59	57
Tax	0	0	0	0	0
Minority Interest	0	0	0	0	0
Net Income after Tax	56	63	63	59	57
Total Return	235	63	63	59	364
Non-tax deductible Items	0	0	0	0	0
Net Inc available for Dist.	59	67	67	63	60
Growth & Ratio					
Revenue Gth (%)	1	4	0	(3)	4
N Property Inc Gth (%)	(2)	10	0	(4)	1
Net Inc Gth (%)	(4)	13	(1)	(6)	(3)
Net Prop Inc Margin (%)	72.2	76.0	76.1	75.1	73.4
Dist. Payout Ratio (%)	100.1	99.2	99.3	99.5	98.7

Balance Sheet (RM m)

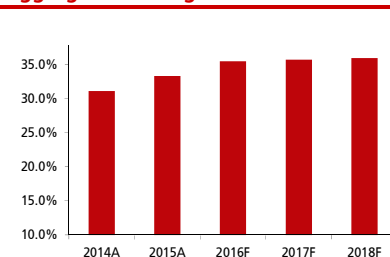
FY Jun	2014A	2015A	2016F	2017F	2018F
Investment Properties	5,520	6,324	6,697	6,726	6,754
Other LT Assets	3	5	8	10	12
Cash & ST Invt	67	81	90	95	101
Inventory	0	0	0	0	0
Debtors	12	20	23	26	27
Other Current Assets	4	0	0	0	0
Total Assets	5,606	6,430	6,818	6,857	6,895
ST Debt	742	763	793	823	853
Creditor	3	0	4	4	4
Other Current Liab	113	223	223	223	223
LT Debt	1,000	1,379	1,624	1,624	1,624
Other LT Liabilities	60	83	83	83	83
Unit holders' funds	3,688	3,982	4,091	4,100	4,109
Minority Interests	0	0	0	0	0
Total Funds & Liabilities	5,606	6,430	6,818	6,857	6,895
Non-Cash Wkg. Capital	(100)	(203)	(203)	(201)	(199)
Net Cash/(Debt)	(1,675)	(2,061)	(2,327)	(2,352)	(2,376)
Ratio					
Current Ratio (x)	0.1	0.1	0.1	0.1	0.1
Quick Ratio (x)	0.1	0.1	0.1	0.1	0.1
Aggregate Leverage (%)	31.1	33.3	35.5	35.7	35.9
Z-Score (X)	1.7	1.4	1.4	1.4	1.4

Source: Company, AllianceDBS

Margins Trend



Aggregate Leverage



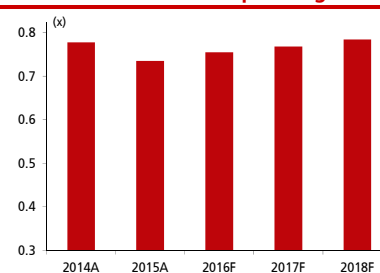
Sunway REIT

Cash Flow Statement (RM m)

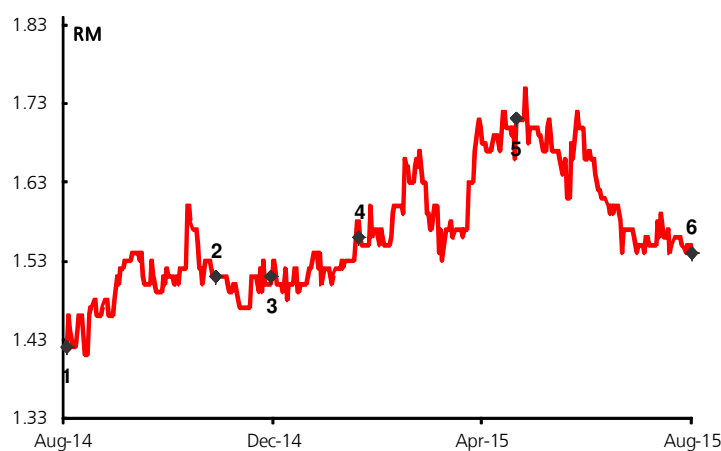
FY Jun	2014A	2015A	2016F	2017F	2018F
Pre-Tax Income	411	547	277	320	354
Dep. & Amort.	0	0	1	1	1
Tax Paid	0	(6)	0	0	0
Associates & JV Inc/(Loss)	0	0	0	0	0
Chg in Wkg.Cap.	17	101	1	(2)	(2)
Other Operating CF	(114)	(295)	90	86	86
Net Operating CF	315	348	368	405	440
Net Invnt in Properties	(121)	(404)	(376)	(32)	(32)
Other Invts (net)	0	0	0	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc. & JVs	0	0	0	0	0
Other Investing CF	2	3	2	3	3
Net Investing CF	(118)	(401)	(374)	(29)	(29)
Distribution Paid	(245)	(255)	(278)	(311)	(346)
Chg in Gross Debt	106	393	275	30	30
New units issued	0	0	102	0	0
Other Financing CF	(62)	(72)	(84)	(89)	(90)
Net Financing CF	(201)	65	15	(371)	(405)
Currency Adjustments	0	0	0	0	0
Chg in Cash	(5)	12	9	5	6
Operating CFPS (sen)	10.2	8.4	12.4	13.5	14.7
Free CFPS (sen)	6.6	(1.9)	(0.3)	12.4	13.6

Source: Company, AllianceDBS

Distribution Paid / Net Operating CF



Target Price & Ratings History



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

S.No.	Date	Closing Price	Target Price	Rating
1:	12 Aug 14	1.42	1.55	Buy
2:	07 Nov 14	1.51	1.60	Buy
3:	09 Dec 14	1.51	1.60	Buy
4:	29 Jan 15	1.56	1.75	Buy
5:	30 Apr 15	1.71	1.75	Buy
6:	10 Aug 15	1.54	1.75	Buy

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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