

Sunway Bhd (SWB MK)

Overweight

Price: M\$3.23

18 Nov 2014

Price Target: M\$4.10

PT End Date: 30 Jun 2015

Solid 9M14 beat, but all eyes on potential listing of construction arm

Sunway recorded solid 9M14 results, with core net income up 18%Y/Y, making 82% of our FY14E forecast and 80% of consensus, with outperformance at all of its three key divisions. While we expect the share price to react positively, the near-term driver in our view will likely be the unlocking of value via a potential listing of its construction arm in 2Q15, potentially translating to around 10%-12% implied yield. While we remain selective in the sector amid headwinds from a general slowdown in consumption from ongoing fiscal reforms (subsidy rationalisation and the Apr-15 introduction of the GST), we continue to like the long-term fundamentals for the company. Sunway has a zero-base start and strong landed township product in Iskandar, and benefits from the current construction capex cycle (MRT Line 1, Bus Rapid Transit) as well as from growth in investment properties, both under the group (Pinnacle offices) and Sunway REIT (Putra Place mall). Our Malaysia strategist has upgraded the property sector to Neutral from UW on near-term pre-GST sales lift and lack of further macroprudential measures. See "[Malaysia Strategy: Follow up to Year Ahead: Sector positioning for 2015 explained](#)". From a bottom up perspective, **Sunway remains our top developer pick.**

- **9M14 core net income up 18%Y/Y to M\$386MM**, making 82% of our full-year forecast of M\$470MM and 80% consensus, with the outperformance driven by Property development (up 43%Y/Y on higher margins from its matured Nexis commercial project) and Construction (up 34%Y/Y on both overseas sales and domestic progress billings). Property investment (up 8%Y/Y) in particular was propelled by 3Q14 growth of 43%Y/Y on rental income from the recently opened Pinnacle office tower and Monash University campus extension, and a recovery in the hotel and leisure businesses, which offset earlier weakness from the deconsolidation of REIT management contribution after the sale of a 20% stake in the unit.
- **Strong domestic property presales, bucking sector trend.** Pre-sales of M\$1.2B to Sep-14 was 70% of our FY14E forecast for M\$1.7B including overseas projects, with domestic sales of M\$1.1B stronger at 82% of our forecast for M\$1.43B. Key projects included the Velocity and Geo serviced apartments targeting the sub-M\$1MM affordable segment, and the more affluent South Quay, all in the Klang Valley. Unbilled sales of M\$2.8B as at Sep-14 translate to 2.4x historical property development revenue. We are forecasting a pre-sales growth of -6%Y/Y (-15%Y/Y from domestic projects alone) to M\$1.7B in FY14E, followed by a 22%Y/Y recovery to M\$2.1B in FY15E.
- **Sizeable construction order backlog.** Sep-14 orderbook of M\$3.3B came in at 2x historical construction revenue, with M\$881MM in internal projects secured so far this year.
- **Property investment.** The 600,000 sq ft Pinnacle office tower is now 50% occupied, but has yet to reach break even. Both Pinnacle office tower and Sunway REIT (due for 1HCY15 opening) should provide the impetus for a further lift in property investment earnings.
- **Potential 2Q15 listing of construction arm.** The proposed listing of Sunway Construction Group would involve Sunway selling a revised 28.7%-37.0% stake through an offer for sale. Based on our RNAV valuing the construction unit at M\$1.15B comprising book value plus revaluation gain, or M\$0.54/share of Sunway, we estimate the proposed offer for sale to unlock M\$330MM-M\$426MM for the company. For more details, please see our 22 Sep-14 note titled "[Value unlocking from proposed listing of construction arm; PT raised & remains our top property pick](#)".

- **Maintain OW.** Our Jun-15E PT of M\$4.10 is based on a 24% discount to RNAV on the potential unlocking of value from the listing of its construction arm. Sunway currently trades at a discount of 39%, compared to the historical sector mean of 29%, and remains our top sector pick.

Table 1: Sunway 9M14 results summary

M\$ mn; year-end Dec	3Q14	3Q13	Y/Y	2Q14	Q/Q	9M14	9M13	Y/Y
Revenue	1,134	1,066	6%	1,205	-6%	3,364	3,205	5%
Core Operating profit	157	116	36%	140	13%	413	319	30%
Operating margin	13.9%	10.9%		11.6%		12.3%	9.9%	
Core PBT	191	159	20%	177	8%	516	435	19%
Net income	144	93	54%	183	-21%	430	354	22%
Core net income	149	124	20%	126	18%	386	325	18%
Core margin	13.2%	11.7%		10.5%		11.5%	10.2%	
Core EPS (sen)	8.34	7.59	10%	7.08	18%	21.70	22.84	-5%

Source: Company.

Table 2: Sunway 9M14 revenue breakdown

M\$mn	3Q14	3Q13	Y/Y	2Q14	Q/Q	9M14	9M13	Y/Y
Prop development	178	260	-32%	302	-41%	702	750	-6%
Prop investment	152	137	11%	146	4%	434	412	5%
Construction	488	377	30%	426	15%	1,273	1,179	8%
Trading & Manufacturing	159	152	5%	162	-2%	470	453	4%
Quarry	56	47	20%	58	-2%	162	147	10%
Others	100	93	8%	111	-10%	323	264	22%
Revenue	1,134	1,066	6%	1,205	-6%	3,364	3,205	5%

Source: Company.

Table 3: Sunway operating profit breakdown

M\$mn	3Q14	3Q13	Y/Y	2Q14	Q/Q	9M14	9M13	Y/Y
Prop development	79	62	28%	58	36%	189	132	43%
Prop investment	31	22	43%	27	17%	78	73	8%
Construction	22	15	42%	26	-15%	78	58	34%
Trading & Manufacturing	11	12	-7%	11	-2%	31	36	-15%
Quarry	7	5	28%	9	-28%	20	17	20%
Others	8	(0)	NM	9	-14%	16	3	465%
Core operating profit	157	116	36%	140	13%	413	319	30%

Source: Company.

Table 4: Property sector peer comparison

As at: 18 Nov-14	FYE	Mkt cap (M\$mn)	Price (M\$)	Rating	Target (M\$)	P/E		EPS growth		Net div yield		P/B	ROE	RNAV (M\$)	Prem/disc to RNAV
						CY14E	CY15E	CY14E	CY15E	FY14E	FY15E				
Eco World Develop#	Oct	1,102	1.65 ex (4.35 cum)	OW	2.40 ex (6.00 cum)	44.2	29.9	-54.4%	47.9%	0.0%	0.0%	1.2	6.1	3.00	-45%
IGB Corporation	Dec	3,925	2.94	UW	2.40	16.7	15.9	13.2%	4.7%	2.1%	2.1%	0.8	5.4	5.02	-41%
IJM Land*	Mar	5,347	3.43	OW	4.00	14.2	13.2	9.7%	7.2%	1.9%	2.3%	1.4	11.0	4.95	-31%
Mah Sing Group	Dec	3,394	2.30	N	2.60	11.1	9.5	22.7%	17.7%	4.3%	4.4%	1.3	18.7	3.73	-38%
SP Setia	Oct	8,250	3.25	N	3.20	15.6	12.5	19.3%	25.0%	3.7%	4.7%	1.3	10.6	5.11	-36%
Sunway	Dec	5,555	3.23	OW	4.10	13.4	12.0	-2.6%	11.5%	2.6%	2.9%	1.0	9.4	5.33	-39%
UEM Sunrise	Dec	8,122	1.79	UW	1.85	14.6	18.8	0.7%	-22.5%	2.2%	2.5%	1.3	6.9	3.20	-44%
Weighted average		35,694				15.4	14.6	7.6%	7.2%	2.7%	3.1%	1.2	9.7		-39%

Source: Bloomberg, J.P. Morgan estimates. * FY15E and FY16E for IJMLD MK. # Based on an ex-all price of M\$1.65 post-restructuring (M\$4.35 cum-all).

Investment Thesis

We are cautious on the outlook for property developers in 2014 following Budget cooling measures that are expected to impact Iskandar-focused stocks most. While Sunway Bhd (SWB) has some exposure to Iskandar, we believe it commands an edge in terms of location, product concept (landed township) and execution in Iskandar, and that its diversified earnings base will also provide support. We continue to like its long-term fundamentals in view of the following:

1. **Strong commercial asset backing:** Via 34%-owned Sunway REIT, the group owns prime investment properties, with prospects for unlocking value and raising cash here in the next phase of asset injection into its REIT vehicle, which we believe is likely from FY15/16.

2. **Diversified earnings base:** Unlike purer developers, property development accounts for a smaller 50% of SWB's earnings. In Iskandar, SWB is starting from a zero base (with a recent maiden launch in Jul-14), so we believe it has more to gain than to lose, as opposed to the existing Iskandar dominant player, UEM. For now, we have more conservatively forecast that the Medini, Iskandar projects will account for no more than 12%/18% of new property sales over FY14E/15E.
3. **Construction sector growth:** Existing construction order-book of M\$3.7B accounts for 2.3x historical revenue with the group tendering for an additional over M\$2B worth of domestic projects. Higher proportion of domestic construction projects going forward should also contribute to stronger operating margins forecast at 5-6% over FY14E/16E (versus 3-5% over last 3 years).

Valuation

Our Jun-15E PT of M\$4.10 is based on a 24% discount to RNAV. This is the average of the historical mean (28.5%) and +1SD to mean discount (19%) for the sector, which we believe is fair given efforts to unlock value from the proposed IPO of the construction arm, and in view of Sunway's strong fundamentals and rising status as one of the emerging/preferred sector proxies, in our view.

Table 5: Sunway RNAV

Projects	% stake	Description	Undeveloped land (acres)	Remaining GDV (M\$ M)	Years to develop	Revaluation surplus (M\$ M)	Comments
Selangor/KL							
Sunway Damansara	60%	Residential/commercial township	15	1,691	5	141	Discounted at WACC of 10%
Sunway South Quay	60%	Lakeside mixed development	52	3,990	7	335	Discounted at WACC of 10%
Sunway Monterezz	60%	Residential	5	44	3	4	Discounted at WACC of 10%
Sunway Semenyih	70%	Residential	398	729	10	71	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	2	Discounted at WACC of 10%
Sunway Montana	100%	Residential	2	56	3	4	Discounted at WACC of 10%
Sunway Alam Suria	100%	Residential	1	12	2	5	Discounted at WACC of 10%
Sunway Resort City	100%	Commercial	15	660	6	81	Discounted at WACC of 10%
Casa Kiara III	80%	Residential	3	210	3	21	Discounted at WACC of 10%
Sunway Velocity	85%	Mixed development	18	2,859	6	343	Discounted at WACC of 10%
Sunway Tower KL 1	100%	Office	1	240	3	24	Discounted at WACC of 10%
Bangi	100%	Residential	3	59	2	6	Discounted at WACC of 10%
Melawati	100%	Residential	2	43	2	9	Discounted at WACC of 10%
Sg Long	80%	Residential	111	277	4	29	Discounted at WACC of 10%
Mont Putra, Rawang	100%		163	156	6	17	Discounted at WACC of 10%
Perak							
Sunway City Ipoh	65%	Residential	895	1,048	10	97	Discounted at WACC of 10%
Penang							
Sunway City Penang	100%	Residential	16	172	2	20	Discounted at WACC of 10%
Sunway Grand	100%	Residential	12	186	2	22	Discounted at WACC of 10%
Sungai Ara	100%	Residential	56	849	3	101	Discounted at WACC of 10%
Bukit Mertajam	100%	Residential	42	694	2	82	Discounted at WACC of 10%
S'pore							
Novena	30%	Medical suites, retail, hotel	2	2,242	3	177	Discounted at WACC of 10%
Sembawang, Singapore	100%		1	75	2	-	Discounted at WACC of 10%
Johor							
Bukit Lenang	80%	Residential	88	932	5	106	Discounted at WACC of 10%
Medini	38%	Mixed development	691	12,000	10	890	Discounted at WACC of 10%
Pendas	60%	Mixed development	1,079	18,000	15	1,411	Discounted at WACC of 10%
China							
Sunway Guanghao	65%	Mixed development	4	67	2	5	Discounted at WACC of 10%
Tianjin Eco City	60%	Mixed development	91	5,344	6	438	Discounted at WACC of 10%
India							
Sunway OPUS Grand India	50%	Condos	24	702	5	39	Discounted at WACC of 10%
Sunway MAK Signature Residence (JV with M.A.K Builders)	60%		14	181	5	14	Discounted at WACC of 10%
Australia							
Wonderland Business Park (Sydney)	45%		48	378	6	16	Discounted at WACC of 10%
Total			3,861	54,032		4,513.3	

Source: Company data, J.P. Morgan estimates.

Table 6: Sunway RNAV

	Value (M\$ M)	Comments
Revaluation surplus	4,513.3	
Book value as at Dec-14	5,273.7	
Revaluation gain from investment properties	358.5	Valuing 34%-owned Sunway REIT at PT of M\$1.60
Revaluation gain from construction division	734.7	Valued at 12.5x P/E on FY14E
Outstanding cash obligation for land	(515.8)	Discounted value for Iskandar land purchase
Total RNAV	10,364.3	
Number of shares (millions)	1,723.5	
RNAV per share	6.01	
FD RNAV		
<u>Warrants & ESOS</u>		
Add proceeds from warrants & ESOS		258.5mn outstanding warrants at M\$2.50/share and 133.6MM ESOS
	1,084.7	
Adjusted RNAV	11,449.0	
Fully diluted number of shares	2,146.7	With warrants and ESOS
RNAV per share	5.33	
RNAV per share (24% discount to RNAV)	4.10	Rounded off

Source: Company data, J.P. Morgan estimates.

Figure 1: Property sector RNAV band



Source: Bloomberg, J.P. Morgan estimates.

Risks to Rating and Price Target

Key downside risks include:

1. Slower-than-expected property sales versus our forecast following the Budget 2014 property cooling measures.
2. Rising competition in Iskandar. Medini projects, which have yet to be launched and currently have no earnings contribution, account for an estimated 23% of our base-case RNAV.

Real Estate

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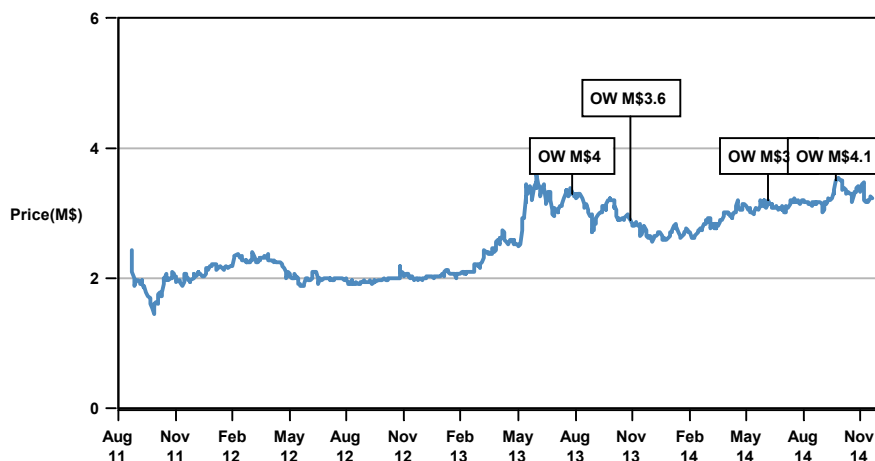
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Sunway Bhd (SWAY.KL, SWB MK) Price Chart



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	3.52	4.10

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

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