Equity | Malaysia | Real Estate

20 June 2013

Sunway

Next Leg Up

We see further upside for Sunway given compelling valuations at 12.7x FY14F PE and 1.2x PB, though the share price has risen by 55% ytd. Our view is supported by visible growth drivers, with unbilled sales of RM1.9bn, outstanding construction order book of RM4.4bn and 2.5m NLA of investment assets coming on-stream. Buy.

Buy

Price
RM3.70

Target price
RM5.20 (from RM3.90)

Market data

Bloomberg code	SWB MK
No. of shares (m)	1,292.5
Market cap (RMm)	4,924.5
52-week high/low (RM)	4.16 / 2.18
Avg daily turnover (RMm)	2.3
KLCI (pts)	1,772.88

Source: Bloomberg

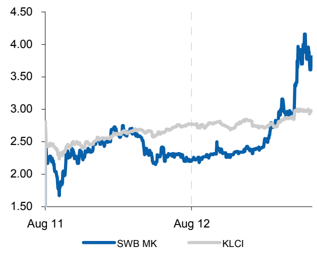
Valuation

Target price (RM)	5.20
Methodology	Sum-of-parts
Key assumptions	PE multiple (property) = 14x PE multiple (construction) = 15x
Implied FY14 PE (x)	17.8
Implied FY14 PBV (x)	1.6
Implied FY14 Yield (%)	1.3

Source: KAF

Performance

	1M	3M	12M
Absolute (%)	(1)	39	68
Rel market (%)	(1)	27	51



Source: Bloomberg

Financial Highlights

Year to Dec (RMm)	FY11A	FY12A	FY13F	FY14F	FY15F
Revenue	3,691.7	3,876.8	3,710.0	4,038.3	5,047.7
Pre-tax profit	498.5	728.2	528.6	609.6	759.1
Normalised net profit	327.1	350.6	380.5	431.1	504.0
Normalised EPS (RM)	0.23	0.24	0.26	0.29	0.34
EPS growth (%)	(2.4)	6.3	8.0	12.5	16.1
Gross DPS (RM)	-	0.08	0.08	0.09	0.11
PER (x)	15.0	15.4	14.3	12.7	10.9
ROE (%)	11.6	10.7	10.3	10.7	11.4
Net yield (%)	-	1.6	1.6	1.8	2.1
PB (x)	1.4	1.3	1.3	1.2	1.1

Source: Company, KAF

More to go

Sunway has emerged as the second-best performing stock among its property peers, rising 55% ytd. We believe the rerating has been driven partly by the Iskandar factor (given the large prime land bank it has accumulated), removal of political uncertainties and better earnings delivery. We are encouraged by its strong 1Q13 result with net profit up 40% yoy. Based on historical trends, second-half earnings tend to be stronger. Should the current run rate continue, full-year earnings could well exceed our and consensus' forecasts of RM381m.

A visible growth story

We revise our earnings upwards by 4% in FY13F, 3% in FY14F and 18% in FY15F. Some of our previous assumptions erred on the conservative side due to the election overhang. We now expect property sales to increase from RM1.1bn in FY13F to RM1.5bn each in FY14F-15F. We have also factored in higher sales from Iskandar, constituting about 13% of total sales in FY13F and 30-33% in FY14F-15F. For its construction division, we assume order book replenishments of RM1.8bn p.a. for FY13F-15F. Ytd, the group has replenished RM1.5bn or 75% of its RM2bn target. The four new investment assets in the pipeline coming on-stream from FY14F-15F have also been included.

Target price raised to RM5.20 (from RM3.90)

Our target price increases to RM5.20 following our earnings revision, a rolling forward of valuations to average FY14-15F earnings and adjusting for higher PE multiples to be more in line with current sector averages. We have also included the RNAV of the Pendas land, amounting to RM367m or RM0.24 per share, to better capture the potential from Iskandar.

Remains a top pick

We continue to like Sunway given: 1) its clear earnings drivers such as stronger property sales, higher order book replenishments and new investment assets coming on-stream, 2) compelling ex-REIT valuations at 10.2x FY13F PE and 1.1x PB, 3) it is still a cheaper proxy to Iskandar and 4) the compelling domestic cyclical exposure provided by the Group.

Analyst

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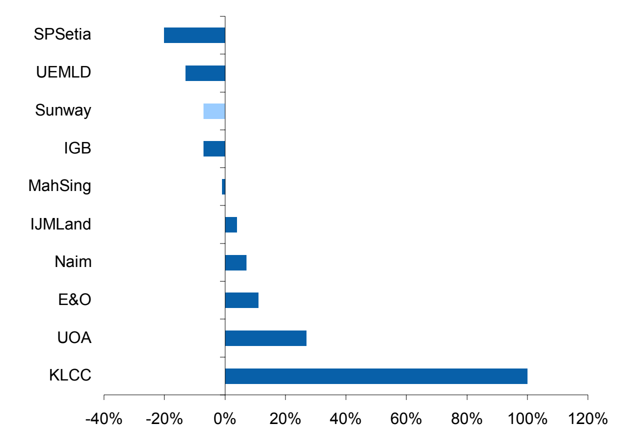
Next Leg Up

Despite Sunway's strong share price performance ytd, we believe the full potential of its three key divisions of property development, property investment and construction has yet to be fully priced in. The stock remains one of the cheapest property stocks in our coverage.

More to Go

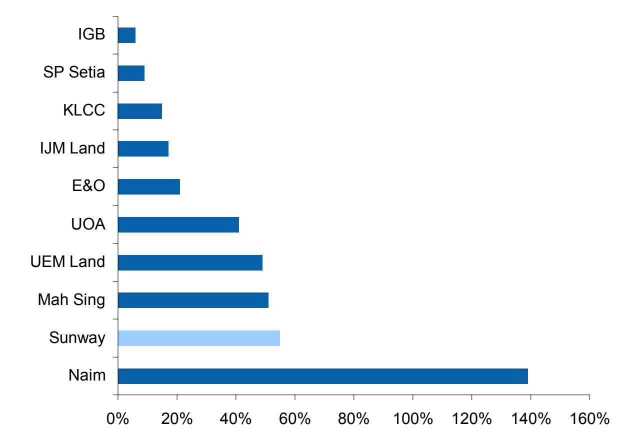
Sunway is the second-best performing stock in our coverage, up 55% ytd. This is in sharp contrast to its underperformance in 2012, when it pulled in the third-worst performance, declining 7%. We believe the rerating was driven by 1) the Iskandar factor, whereby Sunway has accumulated 1,858 acres of prime land with effective GDV of RM31bn, 2) better earnings delivery and 3) removal of political uncertainties post-elections.

Chart 1 : From bottom-three performer over 2012…



Source: Bloomberg, KAF

Chart 2 : …to second-best performer ytd

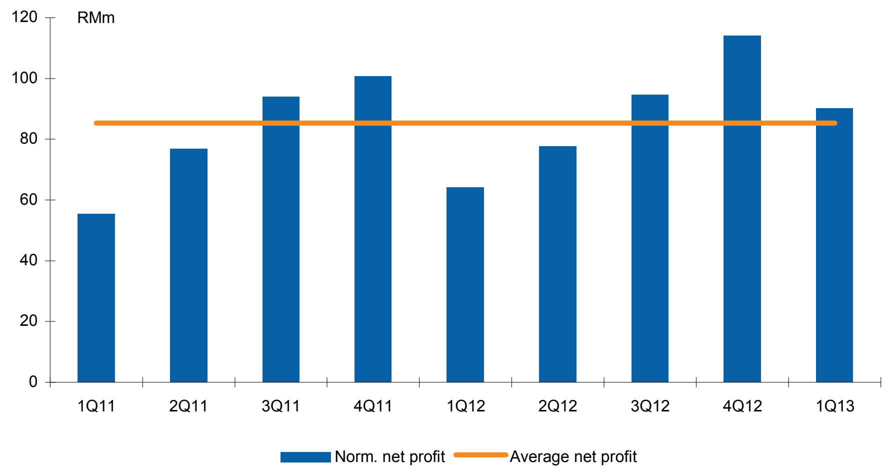


Source: Bloomberg, KAF

Earnings continued to gain traction in 1Q13, with normalised net profit surging 40% yoy to RM90m, driven largely by the property development and construction divisions. This is after 4Q12 normalised earnings improved by 13% yoy to RM114m, attributable to higher property sales and better performance at its property investment division due to seasonality.

From historical trends, we note that Sunway's earnings tend to be stronger in the second half of the year. On average, quarterly net profit has been at RM85m levels. Hence, 1Q13 earnings, typically the weakest quarter, have actually surpassed the historical average. At the current quarterly run rate, we believe that normalised earnings for FY13 could surpass our revised forecast of RM381m, which is in line with consensus.

Chart 3 : Quarterly earnings trend



Source: Company, Bursa Malaysia, KAF

A Visible Growth Story

Despite its strong share price performance ytd, we believe the full earnings potential of Sunway's three key divisions, i.e. property development, investment and construction, has yet to be fully priced in. We have raised our FY13-15 forecasts by 3-18% as we had previously factored in conservative assumptions prior to GE-13 (Refer to *'Up the Ante'* section for more details). We remain positive on the stock based on the following reasons:

- **Clear earnings drivers.** We project Sunway's earnings to grow at a 3-year normalised CAGR of 13% (what period?). This will be underpinned by our expectations of stronger property sales, higher order book replenishments for its construction division and four new property investment assets coming on stream with an additional 2.45mil NLA. As at March 2013, effective unbilled sales amounted to RM1.9bn, which translates to 1.2x FY12 property development revenue. Its construction division boasts an outstanding order book of RM4.4bn, whereby 78% are external jobs. The group has also replenished RM1.5bn of its order book as at May 2013, constituting 75% of its full year target of RM2bn.
- **Ex-REIT valuations still compelling.** While Sunway has risen by 55% ytd versus Sunway REIT (SREIT) which is up a modest 7%, we believe it is merely compensating for its underperformance last year versus the REIT. Excluding SREIT, the stock trades at 10.2x FY13F PE and 1.1x PB, which is still compelling in our view. After all, Sunway is a proven township developer with quality investment assets, a reputable construction arm, and a trading and manufacturing division.

Table 1 : Sunway's valuations ex-REIT

	RMm
Sunway's market cap	4,782
Less: market value of Sunway REIT (34.3%)	1,635
Residual value (ex-REIT)	**3,147**
Norm. net profit (FY13F)	381
Less: Associate contribution - Sunway REIT	71
Residual norm. net profit	**310**
Shareholders' funds (FY13F)	3,863
Less: Investment in associates (Sunway REIT's portion)	901
Residual shareholders' funds (ex-REIT)	**2,962**
PER (x) - ex REIT	**10.2**
PB (x) - ex REIT	**1.1**

Source: KAF, Bloomberg

- **Cheaper proxy to Iskandar.** We believe the stock is still one of the cheapest proxies to Iskandar, trading at 14x FY13F PE and 1.3x PB, despite 57% of its total remaining GDV of RM54bn and 48% of remaining land bank of 3,861 acres being related to Iskandar. This compares to UEM Land with 68% of total remaining GDV and 62% remaining land bank being Iskandar-related. UEM Land trades at 25.8x FY13F PE and 2.5x PB. We have now factored in higher sales from Iskandar and for the portion of land (i.e. Pendas) where no launches have been assumed in our forecasts, we added its RNAV to our sum-of-the-parts target price. Hence, our forecasts should now better capture the potential from Sunway's Iskandar land bank.

Table 2 : Sunway remains one of the cheapest proxies to Iskandar

Company	Rec	Market cap	Share price			PER (x)		ROE (%)		P/B (x)		Yield (%)	
			Current	Target	% upside	FY13F	FY14F	FY13F	FY14F	FY13F	FY14F	FY13F	FY14F
UEM Land*	n.a.	13,542	3.12	3.79	0	25.8	24.1	9.6	9.7	2.5	2.4	1.1	1.2
Sunway Bhd	**BUY**	**4,782**	**3.70**	**5.20**	**41**	**14.3**	**12.7**	**10.3**	**10.7**	**1.3**	**1.2**	**2.2**	**2.5**
Eastern & Oriental	HOLD	2,080	1.88	1.80	(4)	16.5	15.5	9.3	9.2	1.5	1.4	2.4	2.6
WCT	BUY	2,537	2.49	3.08	24	17.8	13.9	9.6	11.7	1.6	1.5	2.7	3.5
IJM Land	HOLD	4,047	2.80	2.20	(21)	16.1	11.2	10.0	13.3	1.4	1.3	1.9	2.7
Mah Sing	BUY	3,177	2.82	2.97	5	12.1	11.4	17.9	17.9	1.6	1.7	4.6	5.8
Axis REIT	HOLD	1,780	3.9	3.8	(3)	19.3	21.1	8.4	8.2	1.5	1.7	5.2	4.7
SP Setia	HOLD	8,310	3.38	3.70	9	15.9	13.8	10.0	10.7	1.4	1.4	4.3	4.9
IGB Corp	BUY	3,422	2.44	3.80	56	15.0	14.6	5.8	5.7	0.9	0.8	4.1	4.2
Simple average						**15.9**	**14.3**	**10.2**	**10.9**	**1.4**	**1.4**	**3.4**	**3.9**

Source: Bloomberg, KAF *Bloomberg consensus' forecasts (priced as at 13 June 2013)

- **Triple play on domestic cyclicals.** Another attractive trait of Sunway is the exposure it provides to three key sectors that are beneficiaries of a strong domestic economy. Hence, we opine that Sunway should not be seen as just a pure property developer, given that it has a strong property investment division with an established REIT, coupled with a reputable construction arm.

Target price raised to RM5.20

Our target price is raised to RM5.20 from RM3.90 upon earnings revision and adjusting for higher PE multiples (in line with current sector averages), and inclusion of Iskandar land. For the property sector, we have used 14x PE (from 12x), while for construction we assume 15x PE (from 11x) and building materials at 12x PE (from 8x). We have also rolled forward valuations to average FY14F-15F earnings (previously average FY13-15F earnings) and included the RNAV of the Pendas land of 1,079 acres at an average price of RM13psf (based on acquisition price). Based on Sunway's 60% stake, this works out to be RM367m or RM0.24 per share.

Table 3 : Target price derivation

	Value (RMm)	Remarks
Property development and investment assets	3,813	14x PE on average FY14-15F earnings
REIT (34.36% stake)	1,635	Market value as at 13 June 2013
Construction	992	15x PE on average FY14-15F earnings
Building materials, quarrying, trading and manufacturing	571	12x PE on average FY14-15F earnings
RNAV of Pendas Land	367	1,079 acres at RM13psf
Gopeng (19.3% stake)	27	Market value as at 13 June 2013
Equity value	**7,376**	
Cash proceeds from warrants conversion	724	
No. of diluted shares (mil)	1,551	
Equity value per share (fully diluted)	**5.20**	

Source: KAF, Bloomberg

Given the 41% upside from current levels, we reiterate our Buy call on Sunway. The stock remains one of our top picks in the property sector.

Up the ante

We have factored in higher property sales, order book replenishments and the new property investment assets into our forecasts, which are raised by 3-18% over FY13F-15F. Higher property sales from Iskandar are also imputed in our estimates.

Earnings revision

We have revised our earnings estimates upwards by 4% to RM381m in FY13F, assuming higher revenue recognition from its property projects. Our FY14F and FY15F estimates are raised by 3% and 18% to RM431m and RM504m respectively. This is mainly driven by our assumptions of higher property sales, order book replenishments and new investment assets coming on-stream.

Table 4 : Earnings revision

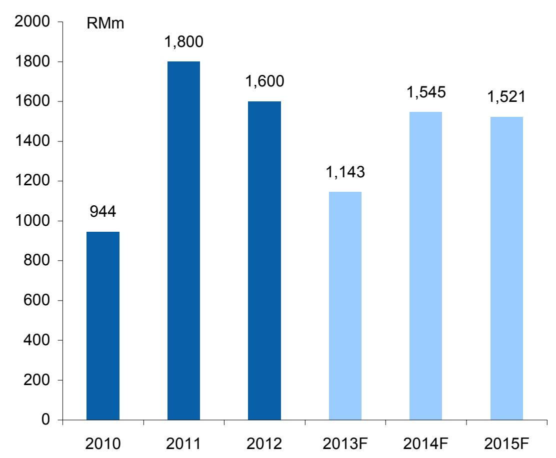
	Original			Revised			Change		
	FY13F	FY14F	FY15F	FY13F	FY14F	FY15F	FY13F	FY14F	FY15F
Turnover	3,875	4,200	4,565	3,710	4,038	5,048	-4%	-4%	11%
EBIT	466	526	612	474	534	711	2%	2%	16%
Pretax profit	507	592	649	529	610	759	4%	3%	17%
Net profit	**365**	**418**	**428**	**381**	**431**	**504**	**4%**	**3%**	**18%**
Normalised net profit	**365**	**418**	**428**	**381**	**431**	**504**	**4%**	**3%**	**18%**

Source: KAF

We forecast property sales to increase from RM1.1bn in FY13F to RM1.5bn in FY14F and FY15F (from our previous assumption of RM1.3bn-1.4bn), driven by a strong domestic economy, pent-up demand post-elections, meaningful launches in Iskandar and our expectations of a relatively low interest rate environment.

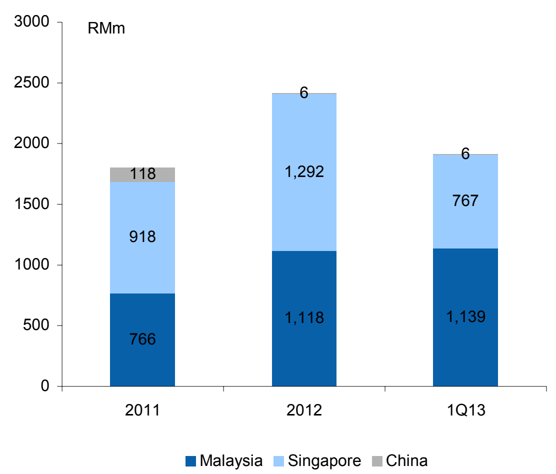
Higher property sales from Iskandar, mainly from Bukit Lenang and Medini, have been factored in. This constitutes 13% of total property sales for FY13F, 30% for FY14F and 33% for FY15F.

Chart 4 : Effective property sales



Source: Company, KAF

Chart 5 : Effective unbilled sales



Source: Company, KAF

We have also included the four new investment assets coming on-stream over FY14 and FY15, with an additional 2.45m sq. ft. NLA, into our forecasts. This includes The Pinnacle (Grade A office building) expected to complete in early 2014, while Sunway Velocity shopping mall, Sunway Pyramid 3 and Sunway University's new academic block are targeted for completion in 2015.

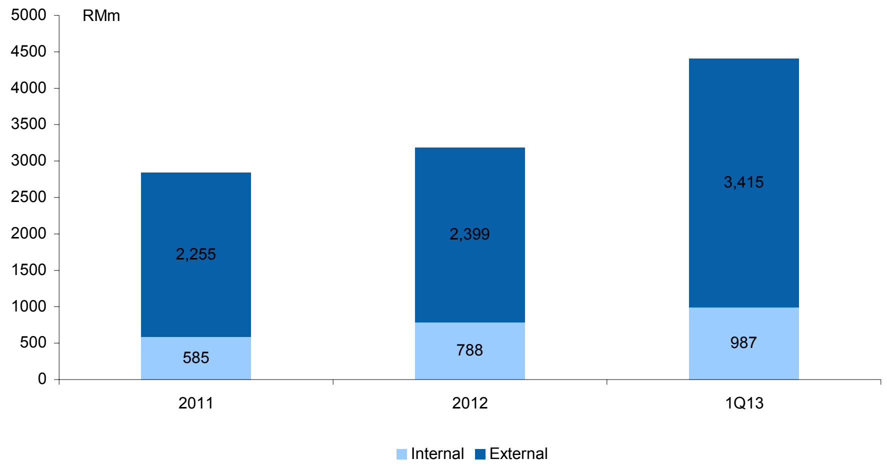
Table 5 : Investment properties in the pipeline

Investment property	Type	Location	GDV (RMmil)	NLA (sq ft)	Expected completion
The Pinnacle	25-storey Grade A office building	Bandar Sunway	350	560,000	Early 2014
Sunway Velocity	Shopping mall	Kuala Lumpur	1,600	1,000,000	End 2015
Sunway Pyramid 3	Hotel & shopping mall extension	Bandar Sunway	500	220,000	Early 2015
Sunway University - new academic block	12-storey academic block	Bandar Sunway	300	670,000	Mid 2015
Total			**2,750**	**2,450,000**	

Source: Company

For the construction division, we assume an order book replenishment of RM1.8bn p.a. over FY13F-15F. We had previously assumed RM1.2bn p.a. for FY14-15F. The group's internal target for FY13F is RM2bn, of which 75% has been achieved as at May 2013.

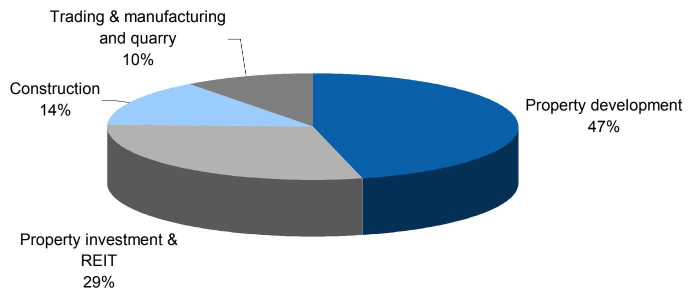
Chart 6 : Outstanding construction order book is at RM4.4bn (1Q13)



Source: Company, KAF

We project that the largest share of Sunway's earnings over FY13F-15F will be from property development (47%), followed by property investment (29%), construction (14%) and trading, manufacturing and quarry (10%).

Chart 7 : Earnings contribution by segment (based on average FY13-15F)



Source: KAF

Table 6 : Key assumptions

RMm	FY11	FY12	FY13F	FY14F	FY15F
Property sales (effective)	1,800	1,600	1,143	1,545	1,521
Unbilled sales (effective)	1,802	2,416			
Order book replenishment	1,706	1,900	1,800	1,800	1,800
Outstanding order book	2,840	3,187	3,712	3,953	4,174

Source: Company, KAF

What about the rights issue?

Sunway's proposed 1-for-3 rights issue at an issue price of RM1.70 to raise up to RM1bn has been approved by Bursa Malaysia and is now pending shareholders' approval at an EGM scheduled on 27 June 2013.

Based on our assumption that all current shareholders (ex-warrants and ESOS) will accept the rights issue, an additional 431m shares will be issued with proceeds of RM732m. Simply assuming that the proceeds are used to pare down borrowings, we estimate that FY13F EPS and ROE dilution will be 18% and 16% respectively. However, the effective cost for investors subscribing to the rights would also be lower. At RM3.70, with a 1-for-3 ratio, we estimate that the average cost per share will fall to RM3.20 (14% lower). Hence, the PE multiple will increase to 15.1x FY13F post-rights, from 14.3x currently.

However, part of the proceeds will also be used for working capital and capex. If 70% (RM513m) is channelled for this, it could potentially fund a GDV of about RM2bn. Assuming a PBT margin of 18%, tax rate of 25% and duration of 5 years, we calculate that FY13F EPS and ROE dilution will reduce to 10% and 7% respectively. In this scenario, the PE multiple would actually decline to 13.7x FY13F post-rights, from 14.3x or by a lower 4%.

Table 7 : Potential impact of proposed rights issue

	Pre rights issue	Post rights issue (assuming proceeds are used solely for debt repayment)	Post rights issue (assuming proceeds used for working capital and capex)
EPS (RM)	0.26	0.21	0.23
ROE (%)	10.3	8.6	9.6
PE (x)	14.3	15.1	13.7

Source: KAF

Income statement

FYE December (RMm)	2011A	2012A	2013F	2014F	2015F
Turnover	3,691.7	3,876.8	3,710.0	4,038.3	5,047.7
EBITDA	**396.6**	**412.7**	**549.6**	**649.6**	**862.0**
Depreciation & Amortisation	(90.7)	(89.9)	(75.5)	(115.3)	(151.3)
EBIT	**305.9**	**322.8**	**474.1**	**534.3**	**710.8**
Net interest	(53.4)	(77.5)	(76.9)	(81.2)	(83.9)
Associates	185.6	301.2	131.4	156.5	132.2
Exceptional items	60.4	181.8	-	-	-
Pretax profit	**498.5**	**728.2**	**528.6**	**609.6**	**759.1**
Taxation	(69.6)	(128.5)	(109.4)	(129.1)	(178.7)
Profit after tax	**429.0**	**599.7**	**419.1**	**480.5**	**580.4**
Minority interest	(41.4)	(67.4)	(38.6)	(49.4)	(76.5)
Net profit	**387.6**	**532.3**	**380.5**	**431.1**	**504.0**
Normalised net profit	**327.1**	**350.6**	**380.5**	**431.1**	**504.0**

Source: Company, KAF forecasts

Balance sheet

FYE December (RMm)	2011A	2012A	2013F	2014F	2015F
Non-current assets					
Property, Plant and Equipment	960.6	806.9	1,231.4	1,616.1	1,964.8
Investment properties	888.9	1,150.3	1,150.3	1,150.3	1,150.3
Land held for development	1,017.3	1,042.3	1,042.3	1,042.3	1,042.3
Investment in associates & jointly controlled entity	1,332.5	1,580.5	1,711.9	1,868.3	2,000.6
Goodwill	326.5	318.7	318.7	318.7	318.7
Deferred tax assets	33.3	31.8	31.8	31.8	31.8
Total non-current assets	**4,559.0**	**4,930.5**	**5,486.4**	**6,027.6**	**6,508.6**
Current assets					
Properties under development	669.3	600.2	531.2	462.1	393.0
Inventories	451.8	626.0	599.0	652.1	815.1
Total Receivables	1,319.1	1,400.1	1,339.9	1,458.4	1,823.0
Tax recoverable	67.6	47.8	47.8	47.8	47.8
Deposits, cash and bank balances	776.7	1,140.2	1,014.6	901.1	859.2
Total current assets	**3,284.6**	**3,814.3**	**3,532.4**	**3,521.4**	**3,938.0**
Total Assets	**7,843.6**	**8,744.9**	**9,018.9**	**9,549.0**	**10,446.6**
Current liabilities					
Total Payables	2,005.6	1,605.1	1,536.0	1,671.9	2,089.9
Bank borrowings	319.2	782.7	782.7	782.7	782.7
Other liabilities	1.6	-	-	-	-
Taxation	27.1	31.0	31.0	31.0	31.0
Total current liabilities	**2,353.4**	**2,418.8**	**2,349.8**	**2,485.7**	**2,903.6**
Financed by:					
Share capital	1,292.5	1,292.5	1,292.5	1,292.5	1,292.5
Share premium & Reserves	1,724.4	2,265.9	2,570.3	2,915.2	3,318.3
Shareholders' funds	**3,016.9**	**3,558.4**	**3,862.8**	**4,207.7**	**4,610.8**
Minority interest	327.3	310.0	348.6	398.0	474.5
Long-term bank borrowings	1,934.5	1,964.2	1,964.2	1,964.2	1,964.2
Other liabilities	154.9	444.0	444.0	444.0	444.0
Deferred tax liabilities	56.6	49.4	49.4	49.4	49.4
Total Liabilities & Shareholders' Funds	**7,843.6**	**8,744.9**	**9,018.9**	**9,549.0**	**10,446.6**

Source:Company, KAF forecasts

Cash flow statement

FYE December (RMm)	2011A	2012A	2013F	2014F	2015F
Cashflow from operations (CFO)					
Pretax profit	498.5	728.2	528.6	609.6	759.1
Tax paid	(117.0)	(92.8)	(109.4)	(129.1)	(178.7)
Others	(124.9)	293.3	21.1	40.0	102.9
Net change in working capital	122.9	(586.5)	87.2	33.4	(40.5)
CFO	**399.0**	**386.1**	**527.4**	**553.9**	**642.9**
Cashflow from investing (CFI)					
Purchase of property, plant and equipment (Capex)	(337.2)	(465.5)	(500.0)	(500.0)	(500.0)
Investments	(54.2)	(247.3)	-	-	-
Others	98.5	355.1	-	-	-
CFI	**(293.0)**	**(357.7)**	**(500.0)**	**(500.0)**	**(500.0)**
Cashflow from financing (CFF)					
Interest paid	(66.4)	(115.7)	(114.9)	(114.9)	(114.9)
Interest received	27.5	27.1	38.0	33.8	31.0
Repayment of term loans	(44.9)	-	-	-	-
Dividends paid	(39.5)	(38.9)	(76.1)	(86.2)	(100.8)
Others	(73.0)	374.4	-	-	-
CFF	**(196.3)**	**246.9**	**(153.0)**	**(167.4)**	**(184.7)**
Net change in cash and cash equivalents	**(90.2)**	**275.2**	**(125.7)**	**(113.5)**	**(41.8)**

Source:Company, KAF forecasts

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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