

Sunway Bhd (SWB MK)

Overweight

Price: M\$3.52

26 May 2015

Price Target: M\$4.30

PT End Date: 31 Dec 2015

1Q15 results: Construction key driver; property in line

Sunway's construction arm, which is slated for listing by Jul-15, was the key driver behind the 21% Y/Y rise in 1Q15 core income. Property investment profits were stable, while the property development segment had a slow start, within expectations, due to a lack of new launches (in line with the industry, arising from pre-GST uncertainties). Value-unlocking and cash proceeds from the listing of the construction arm are estimated to translate into dividend yields of about 10% for FY15E, while the prospects for more aggressive landbanking in the Klang Valley are a potential longer-term catalyst, in our view. Sunway remains one of our top picks among developers. We are also OW on Eco World.

- **1Q15 core net profit was up 21%Y/Y, to M\$133MM**, representing 23% of our full-year forecast and consensus. This is after excluding one-off items, namely, gains of M\$23MM from the disposal of Sunway Hotel Georgetown and Wisma Sunway and a forex exchange loss of M\$6MM.
- **The construction segment was the key growth driver.** Construction operating profit rose 70% Y/Y, to M\$53MM (31% of the group total in 1Q15), driven by a 5% rise in revenue due to higher progress billings and revenue from the pre-cast concrete division, as well as a 5.5ppt rise in operating margin, to 14.1%, helped by higher local building projects. The total orderbook stood at M\$2.8B for the division (1.6x historical revenue). To recap, the IPO of the construction arm is slated for Jul-15, after which Sunway's stake will decline from 100% to 51%.
- **Slow start for property development.** 1Q15 property development profits fell 23% Y/Y due to slower progress billings during the quarter. Total new pre-sales fell 13% Y/Y, to M\$247MM, or 12% of our full-year forecast of M\$2.1B (1Q15 domestic pre-sales were M\$208MM, or 13% of our full-year forecast of M\$1.56B). The slow start was due to a lack of new launches during the quarter, in line with the overall industry trend, due to pre-GST uncertainty and caution (GST was implemented in Apr-15). We maintain our pre-sales forecast, as we expect momentum to pick up in coming quarters as launches are stepped up mainly from 2H15 onward. In terms of visibility, unbilled sales of M\$2.5B as of end-1Q15 translate into 2.1x historical property development revenue.
- **Stable contributions from property investment.** Headline property investment profits rose 116% Y/Y, boosted by the gains from asset disposals mentioned above. Stripping this out, the division showed stable Y/Y profits.
- **Maintain OW.** We like Sunway for its integrated business model with strong investment assets and branding. In the near term, the planned listing of its construction arm by Jul-15 is estimated to translate into a FY15E net dividend yield of about 10% at current levels from special cash dividends and dividends in specie in the listed construction arm. Sunway trades at a 37% discount to RNAV, or at -1SD to the sector's historical mean (sector trough of 44%). Prospects for more aggressive landbanking, especially in the more resilient Klang Valley market, are a potential longer-term catalyst, in our view, helped by the company's healthy balance sheet (net gearing of 32% as of end-1Q15). To recap, the group recently announced the acquisition of a 17-acre parcel in Kelana Jaya, Klang Valley, which will raise its Klang Valley GDV by 16%, to M\$13.1B, with project launch scheduled for sometime in 2016.

Table 1: 1Q15 results summary

M\$ in M, Year-end March	1Q15	1Q14	Y/Y	4Q14	Q/Q
Revenue	1,060	1,026	3%	1,478	-28%
Operating profit	170	116	47%	244	-30%
Operating margin	16.0%	11.3%		16.5%	
Core PBT	176	149	18%	263	-33%
Net income	147	104	41%	313	-53%
Core net income	133	110	21%	193	-31%
Core margin	12.6%	10.8%		13.0%	
Core EPS (sen)	7.23	6.27	15%	10.68	-32%

Source: Company data.

Table 2: 1Q15 revenue breakdown

M\$ in M, Year-end March	1Q15	1Q14	Y/Y	4Q14	Q/Q
Prop development	181	222	-19%	496	-64%
Prop investment	139	136	2%	160	-13%
Construction	375	359	5%	478	-21%
Trading & Manufacturing	192	149	29%	169	14%
Quarry	54	48	11%	74	-28%
Others	119	111	7%	99	20%
Revenue	1,060	1,026	3%	1,478	-28%

Source: Company data.

Table 3: 1Q15 operating profit breakdown

M\$ in M, Year-end March	1Q15	1Q14	Y/Y	4Q14	Q/Q
Prop development	40	52	-23%	98	-59%
Prop investment	44	21	116%	50	-11%
Construction	53	31	71%	60	-12%
Trading & Manufacturing	14	9	55%	9	55%
Quarry	8	4	71%	16	-54%
Others	11	(1)	-951%	10	9%
Operating profit	170	116	47%	244	-30%

Source: Company data.

Table 4: 1Q15 operating margin breakdown

Year-end March	1Q15	1Q14	Y/Y	4Q14	Q/Q
Prop development	22.2%	23.4%	-1 ppts	19.8%	2 ppts
Prop investment	31.9%	15.1%	17 ppts	31.1%	1 ppts
Construction	14.1%	8.6%	5 ppts	12.6%	1 ppts
Trading & Manufacturing	7.4%	6.1%	1 ppts	5.4%	2 ppts
Quarry	14.1%	9.2%	5 ppts	22.1%	-8 ppts
Others	9.2%	-1.2%	10 ppts	10.1%	-1 ppts
Operating margin	16.0%	11.3%	5 ppts	16.5%	0 ppts

Source: Company data.

Table 5: Property sector peer comparison

As at: 26 May-15	FYE	Mkt cap (US\$ M)	Price (M\$)	Rating	PT (M\$)	P/E (x)		EPS growth		Net div yield		P/B (x)	ROE (%)	RNAV (M\$)	Prem/disc to RNAV
						CY15E	CY16E	CY15E	CY16E	FY15E	FY16E				
Eco World Develop	Oct	1,058	1.62	OW	2.60	32.3	14.1	98.0%	128.1%	0.0%	0.0%	1.2	4.9	3.20	-49%
IGB Corporation	Dec	1,050	2.87	UW	2.50	15.4	14.2	6.1%	8.1%	2.9%	3.1%	0.9	5.7	5.40	-47%
Mah Sing Group	Dec	1,125	2.12	N	2.20	12.7	11.0	-20.7%	15.0%	3.3%	3.9%	1.7	15.8	2.90	-27%
SP Setia	Oct	2,334	3.37	N	3.50	15.0	13.4	27.8%	11.4%	3.8%	4.2%	1.4	9.5	5.60	-40%
Sunway	Dec	1,674	3.52	OW	4.30	11.7	12.0	-0.7%	-2.2%	2.3%	2.3%	1.0	9.8	5.60	-37%
UEM Sunrise	Dec	1,404	1.11	N	1.50	14.6	18.8	0.7%	-22.5%	1.8%	2.3%	0.9	4.5	3.20	-65%
Weighted average		8,645				16.1	13.9	2.7%	12.0%	2.5%	2.8%	1.2	8.6		-44%

Source: Bloomberg, J.P. Morgan estimates.

Investment Thesis

We believe the outlook for developers remain subdued in the next six to nine months due to weak consumption trends arising from GST costs (introduced in Apr-15) and the weaker Ringgit. While Sunway Bhd has some exposure to Iskandar, Johor, where sales have been more heavily impacted by the 2013 cooling measures and rising competition, we believe it has 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:** The group owns prime investment properties via 36%-owned Sunway REIT, 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 after FY16/17.
2. **Diversified earnings base:** Unlike purer developers, property development accounts for a smaller 50% of Sunway Bhd's earnings. In Iskandar, it has started from a zero base (with its 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 13%/15% of new property sales over FY15/16.
3. **Construction sector growth:** Existing construction orderbook of M\$3.0B as of end-FY14 accounts for 1.8x historical revenue, with the group tendering for additional domestic projects. A higher proportion of domestic construction projects going forward should also contribute to stronger operating margins. The listing of the construction unit by Jul-15 should help unlock value, raise cash and translate into an estimated net dividend yield of 10% for FY15E (including special dividends and dividends in specie from shares in the construction IPO). Sunway Bhd will own 51% of the construction unit post-IPO vs. 100% currently.

Valuation

Our Dec-15 PT of M\$4.30 is based on a 23% discount to RNAV, which is the average of the historical mean and a +1SD discount for the sector. We believe this is fair, given efforts to unlock value from the proposed IPO of the construction arm, and given Sunway's strong fundamentals and rising status as one of the emerging/preferred sector proxies.

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	145	Discounted at WACC of 10%
Sunway South Quay	60%	Lakeside mixed development	52	3,990	7	298	Discounted at WACC of 10%
Sunway Monterez	60%	Residential	5	44	3	4	Discounted at WACC of 10%
Sunway Semenyih	70%	Residential	398	729	10	75	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	17	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	0	Discounted at WACC of 10%
Sunway Resort City	100%	Commercial	15	660	6	84	Discounted at WACC of 10%
Casa Kiara III	80%	Residential	3	210	3	16	Discounted at WACC of 10%
Sunway Velocity	85%	Mixed development	18	2,859	6	314	Discounted at WACC of 10%
Sunway Tower KL 1	100%	Office	1	240	3	26	Discounted at WACC of 10%
Bangi	100%	Residential	3	59	2	6	Discounted at WACC of 10%
Melawati	100%	Residential	2	43	2	0	Discounted at WACC of 10%
Sg Long	80%	Residential	111	277	4	31	Discounted at WACC of 10%
Mont Putra, Rawang	100%		163	156	6	18	Discounted at WACC of 10%
Perak							
Sunway City Ipoh	65%	Residential	895	1,048	10	98	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	99	Discounted at WACC of 10%
Bukit Mertajam	100%	Residential	42	694	2	81	Discounted at WACC of 10%
S'pore							
Novena	30%	Medical suites, retail, hotel	2	2,242	3	138	Discounted at WACC of 10%
Sembawang, Singapore	100%		1	75	2	0	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	945	Discounted at WACC of 10%
Pendas	60%	Mixed development	1,079	18,000	15	1,181	Discounted at WACC of 10%
China							
Sunway Guanghao	65%	Mixed development	4	67	2	6	Discounted at WACC of 10%
Tianjin Eco City	60%	Mixed development	91	5,344	6	454	Discounted at WACC of 10%
India							
Sunway OPUS Grand India	50%	Condos	24	702	5	41	Discounted at WACC of 10%
Sunway MAK Signature Residence (JV with M.A.K Builders)	60%		14	181	5	15	Discounted at WACC of 10%
Australia							
Wonderland Business Park (Sydney)	45%		48	378	6	17	Discounted at WACC of 10%
Total			3,861	54,032		4,261	

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

Sunway RNAV

	Value (M\$ M)	Comments
Revaluation surplus	4,261	
Book value as of Dec-14	6,033	
Revaluation gain from investment properties	432	Valuing 34%-owned Sunway REIT at PT of M\$1.82
Revaluation gain from construction division	760	Valued at 12.5x P/E on FY14E
Outstanding cash obligation for land	(491)	Discounted value for Iskandar land purchase
Total RNAV	10,994	
Number of shares (millions)	1,724	
RNAV per share	6.38	
FD RNAV		
<u>Warrants & ESOS</u>		
Add proceeds from warrants & ESOS	1,085	258.5mn outstanding warrants at M\$2.50/share and 133.6M ESOS
Adjusted RNAV	12,079	
Fully diluted number of shares (millions)	2,147	With warrants and ESOS
RNAV/share (M\$)	5.60	
PT (M\$)	4.30	23% discount to RNAV

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

Property sector RNAV band



Source: Bloomberg, J.P. Morgan calculations.

Risks to Rating and Price Target

Key downside risks include:

1. Slower-than-expected property sales due to weak consumer sentiment following the recent introduction of GST since 1-Apr-15.
2. Rising competition in Iskandar, with supply expansion affecting the high-rise, high-density segment in particular. For Sunway, its low-density Medini project in Iskandar accounts for 20% of our base-case RNAV and was launched only in Jul-14, with no significant earnings contribution yet.

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Other Companies Discussed in This Report (all prices in this report as of market close on 26 May 2015)

Eco World Development (ECOW.KL/M\$1.62/Overweight)

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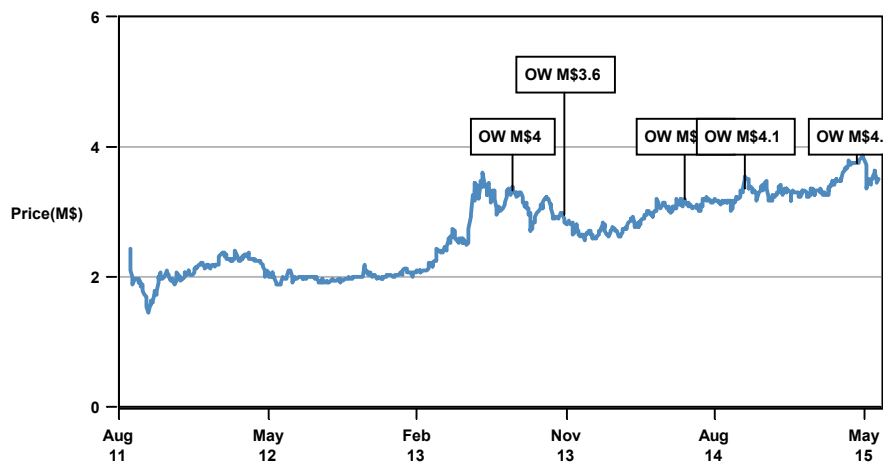
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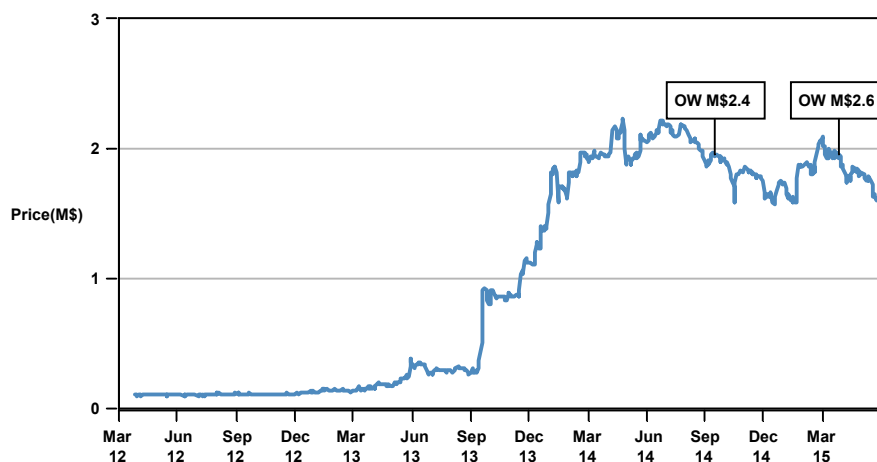
Sunway Bhd (SWAY.KL, SWB MK) Price Chart



Date	Rating	Share Price (M\$)	Price Target (M\$)
26-Jul-13	OW	3.31	4.00
28-Oct-13	OW	2.95	3.60
05-Jun-14	OW	3.21	3.80
22-Sep-14	OW	3.36	4.10
17-Apr-15	OW	3.75	4.30

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

Eco World Development (ECOW.KL, ECW MK) Price Chart



Date	Rating	Share Price (M\$)	Price Target (M\$)
16-Sep-14	OW	1.96	2.40
27-Mar-15	OW	1.95	2.60

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Sep 16, 2014.

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