

## Sunway Bhd (SWB MK)

**Overweight**

Price: M\$3.33

25 Feb 2015

Price Target: M\$4.10

PT End Date: 30 Jun 2015

FY14 produces solid beat; remains our top pick

FY14 core net income up 23%Y/Y to a solid beat, coming in 26% above our full-year forecast and 18% above consensus, and we expect a favourable share price reaction. The proposed listing of its construction arm is on schedule for a mid-2015 listing, which potentially translates to around 10%-12% implied yield. From a country perspective, we have turned less bearish on the property space given the benign interest rate environment (potential OPR cut, see "[Malaysia Strategy Flash: Our economist expects a 25bps OPR cut in May, what are the implications?](#)") However, we remain selective in the developer space, and like the stock for its diversified earnings base, with exposure to both growth from new and incoming investment properties (Pinnacle office and Velocity Mall under the group, and Putra Mall under the REIT) as well as the current construction capex cycle benefiting both its construction arm (MRT Line 1, Bus Rapid Transit) and quarry unit (construction and highways). As a developer, Sunway has long-term fundamental drivers, with a low entry cost and low sales base in the more difficult Johor market (10% of FY14 pre-sales), and products targeting the more resilient landed township segment where demand is holding better and where competition is less keen. Remains our top pick in the developer space.

- **Domestic pre-sales of M\$1.59B came in 18% above forecast**, making 93% of total pre-sales on a move to more domestic and in particular Klang Valley launches, which made up 73% of the total. The more difficult Johor market contributed only M\$0.18B – but this was out of launches of just M\$0.29B, comprising Citrine offices (Jul-14 launch, 81% take-up to Dec-14) and serviced apartments (Nov-14 launch, 33% take-up). Pre-sales were also driven by more product launches in the sub-M\$1MM per unit affordable segment, supporting our argument that projects in this segment should see more resilient demand. Key launches here included V-Residences 2 and Geo Residences 2 in the Klang Valley, Wellesley landed in Penang, and Citrine in Johor. Unbilled sales of M\$2.5B translates to 2x FY14 segment revenue.
- **Proposed listing on track for mid-2015 listing; M\$1.1B in new jobs keeps construction orderbook at M\$3.1B**, with 80% of new contracts coming from internal jobs. Overall, internal jobs make up 37% of the total M\$3.1B orderbook, which in turn stands at 1.8x FY14 segment revenue. To recap, the proposed listing of Sunway Construction Group (SCG) will involve Sunway selling a revised 28.7%-37.0% stake through an offer for sale. Based on our RNAV valuing the construction segment at M\$1.15B, or M\$0.54/share, comprising book value plus revaluation gain, we estimate the listing will unlock M\$330MM-M\$426MM for the company, translating to around 10%-12% implied yield. For more details, please see our 22 Sep-14 note [here](#).
- **Property investment growth intact.** On the group side, EBIT growth came from the opening of the Monash University Malaysia campus extension. Under the REIT, growth came from a recovery in the hotel segment and full-year contribution from double-digit rental reversions achieved in FY14 (ending Jun). Going forward, we expect growth to come from the newly opened Pinnacle Tower (600,000 sqft Grade A office space in the lower competition Bandar Sunway area), the coming reopening of Putra Mall (2Q15), and future opening of Velocity Mall (under construction, opening end-2015/2016).

**Table 1: Sunway Bhd results summary**

M\$ mn: year-end Mar	4Q14	4Q13	Y/Y	3Q14	Q/Q	FY14	FY13	Y/Y
Revenue	1,478	1,322	12%	1,134	30%	4,842	4,528	7%
Core Operating profit	244	153	60%	157	55%	657	471	39%
Operating margin	16.5%	11.5%		13.9%		13.6%	10.4%	
Core PBT	263	227	16%	191	38%	780	661	18%
Net income	313	1,139	-73%	144	118%	743	1,493	-50%
Core net income	193	157	22%	149	29%	578	483	20%
Core margin	13.0%	11.9%		13.2%		11.9%	10.7%	
Core EPS (sen)	10.68	8.78	22%	8.34	28%	32.38	31.62	2%

Source: Company.

**Table 2: Sunway Bhd revenue breakdown**

M\$mn	4Q14	4Q13	Y/Y	3Q14	Q/Q	FY14	FY13	Y/Y
Prop development	496	417	19%	178	179%	1,198	1,167	3%
Prop investment	160	166	-3%	152	6%	594	578	3%
Construction	478	443	8%	488	-2%	1,751	1,622	8%
Trading & Manufacturing	169	134	26%	159	6%	639	587	9%
Quarry	74	51	47%	56	32%	237	198	20%
Others	99	112	-11%	100	-1%	422	376	12%
<b>Revenue</b>	<b>1,478</b>	<b>1,322</b>	<b>12%</b>	<b>1,134</b>	<b>30%</b>	<b>4,842</b>	<b>4,528</b>	<b>7%</b>

Source: Company.

**Table 3: Sunway Bhd core operating profit breakdown**

M\$mn	4Q14	4Q13	Y/Y	3Q14	Q/Q	FY14	FY13	Y/Y
Prop development	98	96	2%	79	24%	287	228	26%
Prop investment	50	39	29%	31	60%	128	111	15%
Construction	60	(11)	-645%	22	176%	139	47	193%
Trading & Manufacturing	9	10	-12%	11	-16%	40	47	-14%
Quarry	16	4	281%	7	147%	37	21	74%
Others	10	14	-29%	8	28%	26	17	53%
<b>Core operating profit</b>	<b>244</b>	<b>153</b>	<b>60%</b>	<b>157</b>	<b>55%</b>	<b>657</b>	<b>471</b>	<b>39%</b>

Source: Company.

**Table 4: Property sector peer comparison**

As at: 25 Feb-15	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
						CY15E	CY16E	CY15E	CY16E	FY15E	FY16E				
Eco World Develop#	Oct	3,244	2.47	OW	3.00	31.0	15.9	47.9%	95.0%	0.0%	0.0%	1.2	7.8	3.00	-43%
IGB Corporation	Dec	3,845	2.88	UW	2.40	15.6	14.4	4.7%	8.1%	2.2%	2.2%	0.8	5.6	5.02	-43%
IJM Land*	Mar	5,690	3.65	OW	4.00	14.1	11.7	7.2%	20.8%	2.2%	3.0%	1.3	12.5	4.95	-26%
Mah Sing Group	Dec	3,898	2.03	N	2.20	13.8	12.0	10.3%	15.3%	2.9%	3.3%	1.5	15.6	2.66	-24%
SP Setia	Oct	8,794	3.46	N	3.20	13.3	13.7	25.0%	-3.0%	4.4%	5.3%	1.4	12.2	5.11	-32%
Sunway	Dec	5,721	3.32	OW	4.10	12.3	12.5	11.5%	-0.9%	2.8%	2.8%	1.0	8.9	5.33	-38%
UEM Sunrise	Dec	6,262	1.38	UW	1.70	13.9	15.7	-22.5%	-11.9%	3.3%	3.6%	1.0	5.9	3.30	-58%
<b>Weighted average</b>		<b>37,453</b>				<b>15.2</b>	<b>13.6</b>	<b>10.7%</b>	<b>11.0%</b>	<b>2.9%</b>	<b>3.3%</b>	<b>1.2</b>	<b>10.0</b>		<b>-38%</b>

Source: Bloomberg, J.P. Morgan estimates.

## 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:

- 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.
- 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 will 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 narrower 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.

## Sunway RNAV

Projects	% stake	Description	Undeveloped land (acres)	Remaining GDV (M\$ M)	Years to develop	Revaluation surplus (M\$ M)	Comments
<b>Selangor/KL</b>							
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 Monterez	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%
<b>Perak</b>							
Sunway City Ipoh	65%	Residential	895	1,048	10	97	Discounted at WACC of 10%
<b>Penang</b>							
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%
<b>S'pore</b>							
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%
<b>Johor</b>							
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%
<b>China</b>							
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%
<b>India</b>							
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%
<b>Australia</b>							
Wonderland Business Park (Sydney)	45%		48	378	6	16	Discounted at WACC of 10%
<b>Total</b>			<b>3,861</b>	<b>54,032</b>		<b>4,513.3</b>	

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

## Sunway RNAV

	Value (M\$ M)	Comments
<b>Revaluation surplus</b>	<b>4,513.3</b>	
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
<b>Total RNAV</b>	<b>10,364.3</b>	
Number of shares (millions)	1,723.5	
<b>RNAV per share</b>	<b>6.01</b>	
<b>FD RNAV</b>		
<u>Warrants &amp; ESOS</u>		
Add proceeds from warrants & ESOS		258.5mn outstanding warrants at M\$2.50/share and 133.6MM ESOS
	1,084.7	
<b>Adjusted RNAV</b>	<b>11,449.0</b>	
Fully diluted number of shares	2,146.7	With warrants and ESOS
<b>RNAV per share</b>	<b>5.33</b>	
<b>RNAV per share (24% discount to RNAV)</b>	<b>4.10</b>	<b>Rounded off</b>

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

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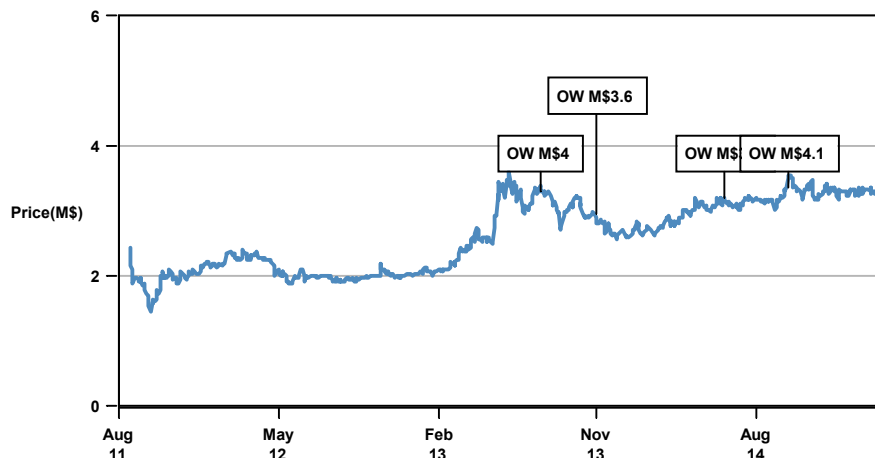
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Sunway Bhd (SWAY.KL, SWB MK) Price Chart



Date	Rating	Share Price (M\$)	Price Target (M\$)
26-Jul-13	OW	3.30	4.00
28-Oct-13	OW	2.95	3.60
05-Jun-14	OW	3.19	3.80
22-Sep-14	OW	3.36	4.10

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.  
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