J.P.Morgan

Asia Pacific Equity Research

12 May 2015

# Sunway Bhd (SWB MK)

## Starts land-banking in Klang Valley; a positive strategy

**Overweight**

**Price:** M$3.40

**11 May 2015**

**Price Target:** M$4.30

**PT End Date: 31 Dec 2015**

Sunway Bhd announced the acquisition of 17 acres in Kelana Jaya, Klang Valley for a mixed development M$1.8B project comprising serviced apartments with a commercial podium. We believe this signals the group's strategy to start to replenish its land-bank in the more resilient Klang Valley region or diversifying its risk from Johor. This is timely during the current period of softer market conditions, with further land-banking especially in Klang Valley crucial as a catalyst for the stock's longer term out-performance in our view, beyond the near term catalyst from value unlocking with the IPO of its construction arm by Jul-15. The project will increase its Klang Valley GDV by 16% to M$13.1B, and add an estimated 1.6% to our fully diluted RNAV of M$5.60. Sunway (OW) remains one of our top picks in the developer space, and currently trades at 39% discount to RNAV, or at -1SD to historical mean for the sector. We are also OW on **Eco World (OW)**.

- **Acquires 17 acres in Klang Valley for M$1.8B GDV mixed development.** The land is located within the mature Kelana Jaya neighbourhood close to Bandar Sunway, and will be developed over five years into seven blocks of serviced apartments above a commercial podium, with a GDV of M$1.8B and a target 2016 launch. The site is currently bounded by the major LDP highway, the Subang National Golf Club (KGNS) and a 15 acre water retention pond that Sunway plans to beautify to improve recreational facilities for future residents of the project.

- **Pricing.** Sunway will pay a total of M$286MM for the land, translating to a price of M$386psf (or M$127psf on a per plot ratio per saleable area based on 4x plot ratio). This is close to the M$350psf that Tropicana Corp fetched in Oct-14 for a disposal of 2.5 acres in nearby Subang Jaya, and compares to the M$104psf that Mah Sing paid in Oct-09 (6 years ago post the 2008 crisis and before the strong run-up in property and land prices) to acquire 19.6 acres of industrial land in the adjacent Sungai Way for its Icon City PJ project. The group is targeting an average selling price of M$800psf for the development, which we estimate should enable the project to fetch operating margins of at least 15-20%. Selling price at M$800psf is fair though at the higher-end of developments in surrounding areas and high rise developments are a much more competitive market (versus landed properties even in Klang Valley), but Sunway's strong branding and track record for mixed developments provides it a edge, in our view.

- **Diversifies risk from Johor, with potential 1.6% RNAV accretion.** We feel the acquisition enables Sunway to diversify away some risk from the challenging market environment of the Iskandar region in Johor, which currently makes up 69% of domestic GDV (60% of total GDV including overseas projects in China and mainly Singapore). On our estimates, the project could add a further 1.6% to our fully diluted RNAV of M$5.60. Assuming 80% debt funding, the acquisition could raise our FY15E net gearing estimate from 29% to 33%.

- **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 to a FY15E net dividend yield of about 10% at current levels from special cash dividends and dividend in specie in the listed construction arm. Sunway trades at 39% discount to RNAV, or at -1SD to the sector's historical mean (sector trough of 44%).

**Table 1: Property sector peer comparison**

| As at: 11 May-15 | FYE | Mkt cap (US$mn) | Price (M$) | Rating | Target (M$) | P/E CY15E | P/E CY16E | EPS growth CY15E | EPS growth CY16E | Net div yield FY15E | Net div yield FY16E | P/B FY15E | ROE FY15E | RNAV (M$) | Prem/disc to RNAV |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Eco World Develop | Oct | 968 | 1.77 | OW | 2.60 | 35.2 | 15.4 | 98.0% | 128.1% | 0.0% | 0.0% | 1.3 | 4.9 | 3.20 | -45% |
| IGB Corporation | Dec | 1,071 | 2.89 | UW | 2.50 | 15.5 | 14.3 | 6.1% | 8.1% | 2.9% | 3.1% | 0.9 | 5.7 | 5.40 | -46% |
| Mah Sing Group | Dec | 1,146 | 2.15 | N | 2.20 | 12.9 | 11.2 | -20.7% | 15.0% | 3.3% | 3.8% | 1.7 | 15.8 | 2.90 | -26% |
| SP Setia | Oct | 2,435 | 3.45 | N | 3.50 | 15.3 | 13.7 | 27.8% | 11.4% | 3.7% | 4.1% | 1.5 | 9.5 | 5.60 | -38% |
| Sunway | Dec | 1,650 | 3.40 | OW | 4.30 | 11.3 | 11.6 | -0.7% | -2.2% | 2.4% | 2.3% | 1.0 | 9.8 | 5.60 | -39% |
| UEM Sunrise | Dec | 1,650 | 1.31 | N | 1.50 | 14.6 | 18.8 | 0.7% | -22.5% | 1.5% | 1.9% | 1.0 | 4.5 | 3.20 | -59% |
| **Weighted average** | | **8,921** | | | | **16.3** | **14.2** | **2.1%** | **11.9%** | **2.5%** | **2.8%** | **1.2** | **8.5** | | **-42%** |

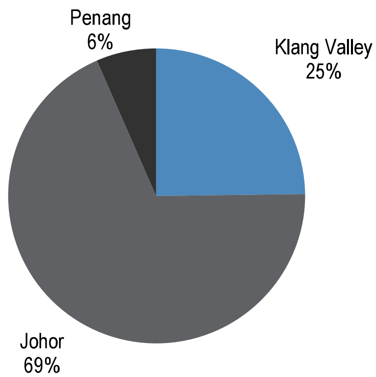
Source: Bloomberg, J.P. Morgan estimates.

**Table 2: Recent land transactions**

| DATE | SUBJECT LAND | VENDOR | PURCHASER | ACRES | HOLDING | PRICE (M$MN) | PRICE (M$psf) | GDV (M$MN) | PROJECT |
|---|---|---|---|---|---|---|---|---|---|
| May-15 | Kelana Jaya | Kelana Resorts Sdn Bhd | Sunway | 17.0 | Mixed | 286.0 | 386.30 | 1,800 | Mixed |
| Oct-14 | Subang Jaya | Tropicana Corporation | Mediaraya Sdn Bhd | 2.5 | Freehold | 37.5 | 349.80 | | |
| Aug-14 | Puchong | Huges Development Sdn Bhd | Mah Sing Group | 88.7 | 99yr lease | 656.9 | 170.00 | 9,300 | Mixed |
| Mar-14 | SS13 Shah Alam | Enchanting View Sdn Bhd | Mah Sing Group | 85.4 | 99yr lease | 327.5 | 88.00 | 2,500 | Residential |
| Jul-10 | Bukit Jelutong | Azeera Properties | Mah Sing Group | 11.0 | Freehold | 31.9 | 66.80 | | Industrial |
| Oct-09 | Sungai Way | Panasonic HA Air-Conditioning (M) Sdn Bhd | Mah Sing Group | 19.6 | 99yr lease | 89.0 | 104.20 | 838 | Mixed |

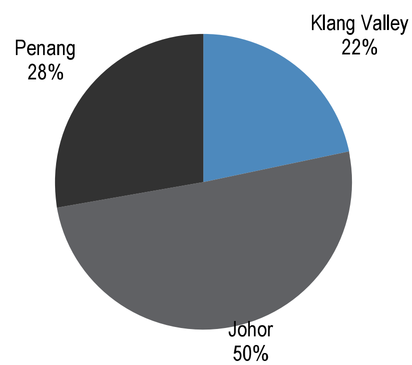
Source: Companies, Press reports.

**Figure 1: Sunway domestic GDV breakdown (pre-Kelana Jaya)**




Source: Company, J.P. Morgan estimates.

**Figure 2: Sunway domestic landbank breakdown (pre-Kelana Jaya)**




Source: Company, J.P. Morgan estimates.

## Investment Thesis

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 9% for FY15E (including special dividends and dividend 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 | 60% | | 14 | 181 | 5 | 15 | Discounted at WACC of 10% |
| (JV with M.A.K Builders) | | | | | | | 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 at Dec-14 | 6,033 | |
| Revaluation gain from investment properties | 432 | Valuing 34%-owned Sunway REIT at PT of M$1.60 |
| 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** | | |
| Warrants & ESOS | | |
| Add proceeds from warrants & ESOS | 1,085 | 258.5mn outstanding warrants at M$2.50/share and 133.6M ESOS |
| **Adjusted RNAV** | **12,079** | |
| Fully diluted number of shares (M) | 2,147 | With warrants and ESOS |
| **RNAV/share (M$)** | **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.

**Real Estate**

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**Other Companies Discussed in This Report** (all prices in this report as of market close on 11 May 2015)
Eco World Development (ECOW.KL/M$1.77/Overweight)

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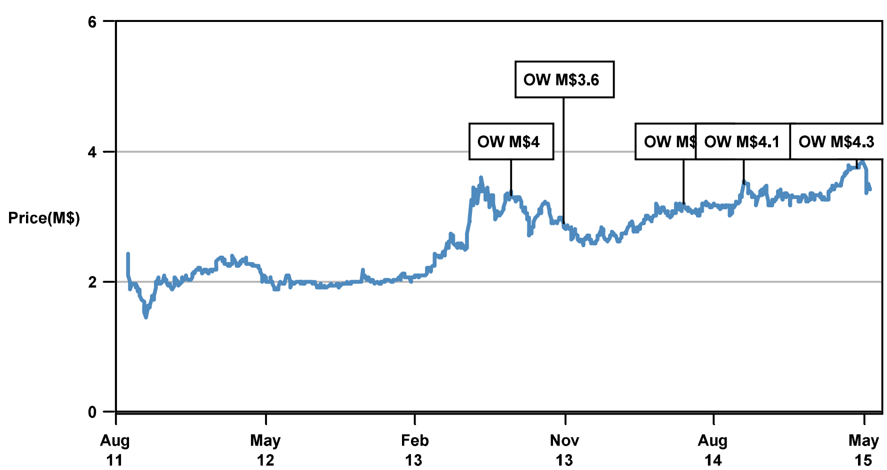
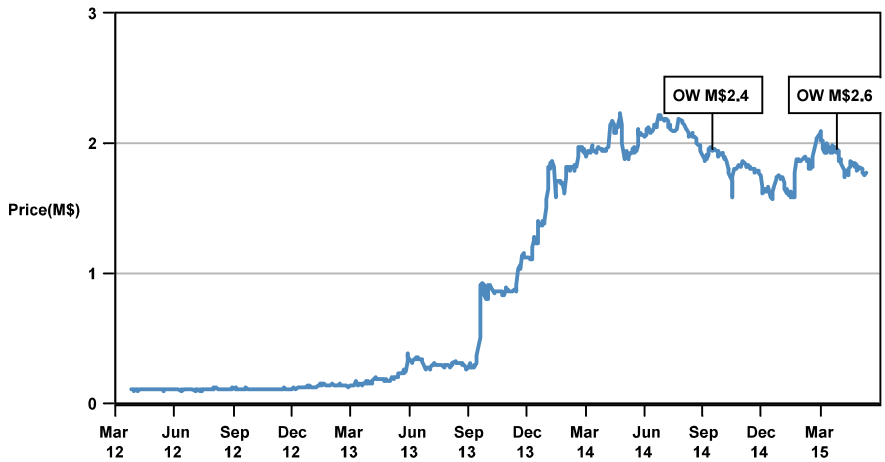



| Date | Rating | Share Price (M$) | Price Target (M$) |
|---|---|---|---|
| 26-Jul-13 | OW | 3.31 | 4.00 |
| 28-Oct-13 | OW | 2.88 | 3.60 |
| 05-Jun-14 | OW | 3.21 | 3.80 |
| 22-Sep-14 | OW | 3.52 | 4.10 |
| 17-Apr-15 | OW | 3.75 | 4.30 |

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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