

Sunway Bhd (SWB MK)

FY18 slightly ahead on non-operating items

Neutral

Price: M\$1.62

28 Feb 2019

Price Target: M\$1.50

PT End Date: 30 Jun 2019

Results were slightly ahead, with FY18 core net profit up 8%Y/Y to come in at 10%/3% above JPM/consensus, but driven by non-operating items that more than offset weaker operating performance from deferred earnings and reclassifications. For its Prop Development business, management has set its FY19E pre-sales target at M\$1.3B (down 31%Y/Y), similar to peers (ex-SPSB) starting the year conservatively with flat-to-negative guidance. For FY18, management declared cash dividends of 5.5sen in-line with our forecast, which together with an additional 1:100 distribution of 48.5MM treasury shares, translates to a yield of 4.4%. **We are Neutral on SWB**, and at current valuations see better value in its peers. **Our top picks are ECW (OW) and SPSB (OW), and we are also OW on UEMS.**

- **4Q18 core net profit up 18% Y/Y (up 26% Q/Q)**, leaving full-year results 10%/3% ahead of JPM/consensus. Overall, FY18 results (up 8%Y/Y) was driven by non-operating items including lower interest expense, taxes and share of minorities paid, and higher interest income, which together more than offset weaker operating performance (down 18%) on deferred earnings under MFRS15 and reclassification of two subsidiaries under the JV line.
- **Segment operating performance updates:**
 - **Prop Development.** Full-year segment results remained weak (down 41%Y/Y) on lower domestic billings after a four year period (2015-18) of low launches, and a shift to completion recognition under MFRS15 for certain international projects, which resulted in deferred earnings of M\$104MM for the year. Group pre-sales (up 62% to M\$1.88B) was 11%/10% ahead of JPM/management's target for M\$1.7B supported by a pick-up in Singapore and China launches, with domestic projects (up 7% to M\$753MM) making 40% of the total. Group unbilled sales of M\$2.12B (M\$1.08B domestic) translates to 3.4x FY18 revenue (1.7x domestic), with inventories down 16%Y/Y to M\$185MM.
 - **Prop Investment.** 4Q18 segment results down 33%Y/Y and 32%Q/Q on a reclassification of the Velocity Mall and Velocity Hotel contribution to the JV line, with overall FY18 segment results still up 3%Y/Y on additional contribution from newly-opened assets including Sunway Geo (0.24MM sqft office).
 - **Construction.** 4Q18 operating profit down 9%Y/Y (FY18: up 9%) on lower billings in the quarter, but operating margins remained stable at 9.9% (FY18: 9.8%). Outstanding orderbook of M\$5.22B translates to 2.8x FY18 revenue, with M\$1.55B secured over the year, mainly from internal jobs (73% of total).
- **Updates on Education assets sale.** The proposed disposal of Education assets for M\$550MM to associate SREIT is expected to be complete in 2Q19, with pricing working out to M\$280psf, vs the M\$250psf that Paramount Corp (PAR MK, NC) received for the disposal of its Education assets in Oct-18. On our estimates, the disposal translates to an asset yield of 6.3% and will result in a FY19E/20E net earnings impact of +5%/-2%, based on a net gain on disposal of M\$43MM, while net gearing would fall 5.3ppts/4.6ppts to 39%/38%. SWB intends to use the proceeds from the transaction to repay borrowings and fund capex to expand its healthcare portfolio, with new hospitals under construction expected to be complete in mid-2019 and 2020.
- **Recent publications.** (1) Our 29 Jan-19 Malaysia Developers note titled "*National Housing Policy 2.0 – What's the impact?*" [here](#); (2) Our 9 Jan-19 Malaysia Developers note titled "*2019 outlook: Real value now in Developers (stay with quality); M-REITs have outperformed (stay with growth)*" [here](#). (3) Our Dec-18

Malaysia Developers/REITs slides titled “2019 outlook: Developers – At trough valuations but stay with quality here amid lack of strong catalysts; M-REITs – Not cheap but offers stability for now” [here](#).

Table 1: SWB 4Q18 results summary

M\$ mn; year-end Dec	4Q18	4Q17*	Y/Y	3Q18	Q/Q	FY18	FY17*	Y/Y
Revenue	1,370	1,627	-16%	1,445	-5%	5,410	5,239	3%
Core Operating profit	104	222	-53%	160	-35%	560	687	-18%
Operating margin	7.6%	13.7%		11.1%		10.3%	13.1%	
Net finance costs	85	51	66%	-3	-2585%	62	20	215%
Associates & JVs	64	11	469%	38	70%	229	200	15%
Core PBT	224	247	-9%	194	15%	762	800	-5%
Net income	192	173	11%	145	32%	659	621	6%
Core net income	184	156	18%	145	26%	591	547	8%
Core margin	13.4%	9.6%		10.1%		10.9%	10.4%	
Core EPS (sen)	3.79	3.18	19%	2.99	27%	12.14	22.14	-45%

Source: Company. * Restated.

Table 2: SWB 4Q18 core operating profit breakdown (excluding JVs/associates)

M\$ mn; year-end Dec	4Q18	4Q17*	Y/Y	3Q18	Q/Q	FY18	FY17*	Y/Y
Prop development	22	105	-79%	34	-34%	118	199	-41%
Prop investment	41	61	-33%	60	-32%	214	208	3%
Construction	48	53	-9%	48	1%	181	166	9%
Trading & Manufacturing	13	14	-9%	18	-26%	61	58	5%
Quarry	2	(1)	-471%	2	2%	11	7	41%
Others	(23)	(9)	143%	(2)	1102%	(25)	47	-153%
Core operating profit	104	222	-53%	160	-35%	560	687	-18%

Source: Company. * Restated.

Table 3: SWB 4Q18 core operating margins

	4Q18	4Q17*	Y/Y	3Q18	Q/Q	FY18	FY17*	Y/Y
Prop development	11.0%	25.4%	-14.4 ppts	17.4%	-6.4 ppts	19.0%	20.1%	-1.1 ppts
Prop investment	29.1%	24.7%	4.4 ppts	25.3%	3.7 ppts	26.3%	24.1%	2.2 ppts
Construction	9.9%	9.0%	0.8 ppts	10.2%	-0.4 ppts	9.8%	10.2%	-0.4 ppts
Trading & Manufacturing	5.4%	6.1%	-0.8 ppts	5.9%	-0.5 ppts	5.5%	5.8%	-0.3 ppts
Quarry	4.1%	-1.2%	5.3 ppts	4.2%	-0.1 ppts	4.7%	3.7%	1.0 ppts
Others	-9.7%	-4.8%	-4.9 ppts	-1.0%	-8.7 ppts	-3.1%	6.8%	-9.9 ppts
Core operating margin	7.6%	12.9%	-5.3 ppts	11.1%	-3.5 ppts	10.3%	12.8%	-2.4 ppts

Source: Company. * Restated.

Table 4: Developer domestic pre-sales

M\$mn; year-end Dec	4QCY18	4QCY17	Y/Y	3QCY18	Q/Q	CY18	CY17	Y/Y
Mah Sing Group	286	547	-48%	275	4%	1,503	1,802	-17%
SP Setia	1,355	890	52%	913	48%	3,673	2,551	44%
Sunway	199	472	-58%	380	-48%	753	702	7%
UEM Sunrise	522	572	-9%	231	126%	1,233	1,078	14%
TOTAL DEVELOPERS	2,362	2,481	-5%	1,799	31%	7,162	6,133	17%

Source: Companies.

Table 5: Developer peer comparison

As at: 28 Feb-19	FYE	Mkt cap (US\$m)	Price (M\$)	Rating	Target (M\$)	P/E		EPS growth		Net div yield		P/B	ROE	RNAV (M\$)	Prem/disc to RNAV
						CY19E	CY20E	CY19E	CY20E	FY19E	FY20E				
Eco World Develop	Oct	688	0.95	OW	1.60	9.7	7.8	63.3%	24.4%	2.2%	3.8%	0.6	6.8	2.80	-66%
Mah Sing Group	Dec	597	1.00	N	1.10	11.2	10.3	8.2%	8.7%	4.5%	4.9%	0.7	6.6	2.00	-50%
SP Setia	Dec	2,230	2.29	OW	3.60	17.1	10.4	50.9%	64.1%	4.4%	7.2%	0.8	4.5	6.30	-64%
Sunway	Dec	1,932	1.62	N	1.50	12.8	11.1	12.0%	15.2%	4.0%	4.6%	1.0	7.4	2.40	-33%
UEM Sunrise	Dec	915	0.82	OW	1.00	12.9	16.2	37.7%	-20.9%	1.9%	1.5%	0.5	3.9	2.90	-72%
Weighted average		6,362				13.8	11.2	31.5%	32.9%	3.7%	5.0%	0.8	5.7		-54%

Source: Bloomberg, J.P. Morgan estimates.

Investment Thesis

We continue to like Sunway for its integrated businesses (with about 60% of earnings from the Prop investment and Construction segments), strong branding, and good assets (landbank and commercial assets, including through its 40% stake in Sunway REIT). We also like its asset-light model, with the next round of asset recycling and potential value-unlocking likely coming from maturing large properties (i.e. Pinnacle office tower or Velocity Mall).

However, on valuations we are Neutral on SWB at current levels, and see better value in its peers. Within the sector, we prefer ECW (OW) and SPSB (OW).

Valuation

Our Jun-19 PT of M\$1.50 is based on a 40% discount to RNAV, or between -1SD and the historical sector mean.

Developer RNAV band



Source: Bloomberg, J.P. Morgan.

Sunway RNAV

Projects	% stake	Description	Undeveloped land (acres)	Remaining GDV (M\$ M)	Years to develop	Revaluation surplus (M\$ M)	Comments
Klang Valley							
Sunway Damansara	60%	Mixed township	15	1,691	5	141	Discounted at WACC of 10%
Sunway South Quay	100%	Mixed development	40	3,087	7	425	Discounted at WACC of 10%
Sunway Montez	60%	Residential	4	38	2	3	Discounted at WACC of 10%
Sunway Semenyih	70%	Residential	398	729	10	51	Discounted at WACC of 10%
Sunway Cheras	100%	Residential	6	17	2	2	Discounted at WACC of 10%
Sunway Duta	60%	Residential	3	120	3	9	Discounted at WACC of 10%
Sunway Montana	100%	Residential	2	56	3	8	Discounted at WACC of 10%
Sunway Resort City	100%	Commercial	15	660	6	89	Discounted at WACC of 10%
Sunway Velocity	85%	Mixed development	10	1,984	6	243	Discounted at WACC of 10%
Sunway Tower KL 1	100%	Office	1	240	3	33	Discounted at WACC of 10%
Sunway Velocity Two	50%	Mixed development	8	2,000	10	142	Discounted at WACC of 10%
Melawati	100%	Residential	2	43	2	6	Discounted at WACC of 10%
Sg Long	80%	Residential	111	277	4	27	Discounted at WACC of 10%
Mont Putra, Rawang	100%	Residential	163	156	6	19	Discounted at WACC of 10%
Sunway Serene Kelana Jaya	100%	Mixed development	18	1,450	5	219	Discounted at WACC of 10%
Sunway Industrial Park Subang	80%	Industrial	0	109	3	12	Discounted at WACC of 10%
Jalan Belfield-Kampung Attap-Istana	100%	Residential	5	1,100	6	158	Discounted at WACC of 10%
Lot One Kajang	100%	Residential	5	460	5	72	Discounted at WACC of 10%
USJ1 Subang Jaya	100%	Mixed development	15	1,400	5	235	Discounted at WACC of 10%
Sunway Wangsa Maju	55%	Residential	4	500	5	42	Discounted at WACC of 10%
			826	16,116		1,953	
Northern							
Sunway City Ipoh	65%	Residential	441	1,048	10	84	Discounted at WACC of 10%
Sunway Paya Terubong	100%	Residential	24	1,500	6	181	Discounted at WACC of 10%
Sunway Hills	100%	Residential	81	849	8	107	Discounted at WACC of 10%
Sunway Wellesley Bukit Mertajam	100%	Residential	51	710	5	91	Discounted at WACC of 10%
Sunway Tunas Balik Pulau	100%	Residential	9	60	2	7	Discounted at WACC of 10%
Sunway Betong Balik Pulau	100%	Residential	20	110	2	13	Discounted at WACC of 10%
			626	4,278		484	
Johor							
Bukit Lenang	80%	Residential	65	698	3	65	Discounted at WACC of 10%
Medini	60%	Mixed township	643	10,833	15	692	Discounted at WACC of 10%
Pendas	60%	Mixed township	1,079	18,000	20	815	Discounted at WACC of 10%
			1,787	29,531		1,571	
Singapore							
Rivercove Residences Sengkang	30%	Residential	5	1,967	4	24	Discounted at WACC of 10%
Brookvale Park Clementi	30%	Residential	9	3,000	4	36	Discounted at WACC of 10%
Canberra Link Sembawang	30%	Residential	4	1,500	4	16	Discounted at WACC of 10%
			18	6,467		77	
China							
Sunway Guanghao	65%	Mixed development	4	67	2	4	Discounted at WACC of 10%
Tianjin Eco City	60%	Mixed development	6	575	6	36	Discounted at WACC of 10%
India							
Sunway OPUS Grand India	50%	Condominiums	24	702	5	33	Discounted at WACC of 10%
Sunway MAK Signature Residence (JV with M.A.K Builders)	60%	Residential	14	181	5	8	Discounted at WACC of 10%
Australia							
Wonderland Business Park Sydney	45%	Industrial	13	44	3	2	Discounted at WACC of 10%
			61	1,569		82	
Total			3,318	57,961		4,167	

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

Sunway RNAV

	Value (M\$mn)	Comments
Revaluation surplus	4,167	
Book value as at Dec-18E	7,810	
Revaluation gain from investment properties	249	Valuing 40%-owned Sunway REIT at PT of M\$1.80
Revaluation gain from construction division	278	Valuing 54%-owned Sunway Construction Group at market price of M\$1.78/share
Outstanding cash obligation for land	(697)	
Total RNAV	11,807	
Number of shares (M)	4,874	
RNAV per share (M\$)	2.42	
PT (M\$) – rounded off	1.50	40% discount to RNAV

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

Risks to Rating and Price Target

Key upside risks include:

1. Reasonably-priced and accretive landbank acquisitions, especially in the more resilient Klang Valley, where pre-sales have held up better amid the slower consumer environment;
2. Asset recycling into 40%-owned Sunway REIT, resulting in value-unlocking for shareholders;
3. Stronger than expected property pre-sales or construction new orderbook

Key downside risks include: Slower than expected property pre-sales, and keen competition in the Iskandar region in Johor.

2019 II All-Asia Research Poll

Voting under way

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Other Companies Discussed in This Report (all prices in this report as of market close on 28 February 2019)
 Eco World Development (ECOW.KL/M\$0.95/Overweight), SP Setia (SETI.KL/M\$2.29/Overweight), UEM Sunrise Bhd (UMSB.KL/M\$0.82/Overweight)

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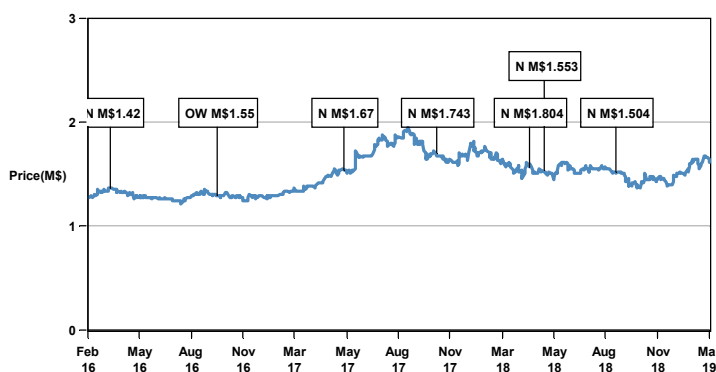
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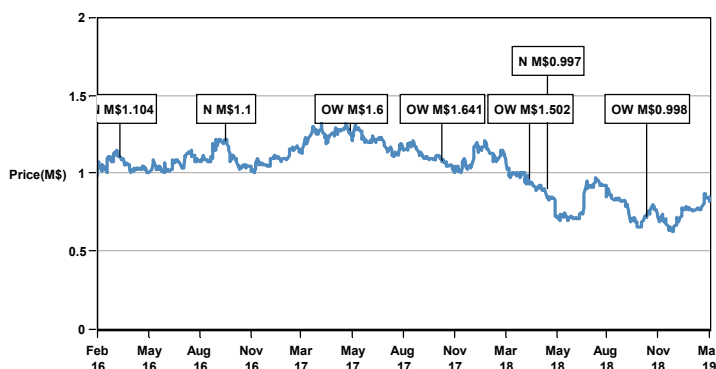
Sunway Bhd (SWAY.KL, SWB MK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jul 26, 2013. All share prices are as of market close on the previous business day.

Date	Rating	Share Price (M\$)	Price Target (M\$)
08-Apr-16	N	1.38	1.42
14-Oct-16	OW	1.30	1.55
26-May-17	N	1.54	1.67
06-Nov-17	N	1.70	1.74
18-Apr-18	N	1.57	1.80
14-May-18	N	1.54	1.55
18-Sep-18	N	1.52	1.50

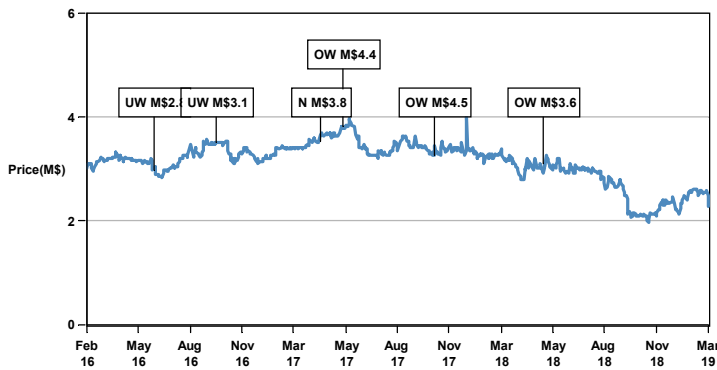
UEM Sunrise Bhd (UMSB.KL, UEMS MK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Mar 21, 2013. All share prices are as of market close on the previous business day.

Date	Rating	Share Price (M\$)	Price Target (M\$)
08-Apr-16	N	1.11	1.10
14-Oct-16	N	1.21	1.10
26-May-17	OW	1.28	1.60
07-Nov-17	OW	1.09	1.64
12-Apr-18	OW	0.97	1.50
14-May-18	N	0.90	1.00
08-Nov-18	OW	0.73	1.00

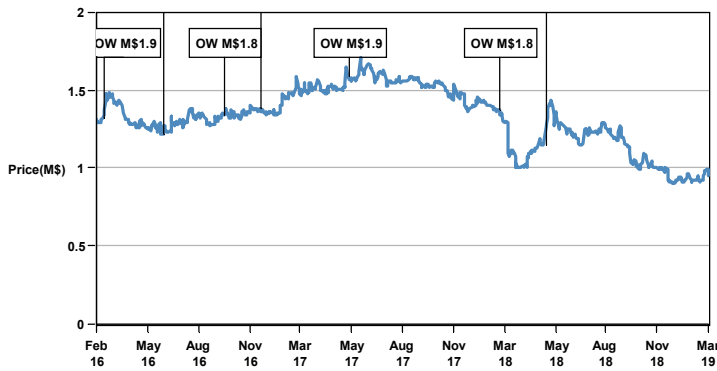
SP Setia (SETI.KL, SPSB MK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Aug 12, 2003. All share prices are as of market close on the previous business day.

Date	Rating	Share Price (M\$)	Price Target (M\$)
27-Jun-16	UW	2.98	2.80
14-Oct-16	UW	3.50	3.10
17-Apr-17	N	3.55	3.80
26-May-17	OW	3.80	4.40
01-Nov-17	OW	3.27	4.50
14-May-18	OW	3.11	3.60

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



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Sep 16, 2014. All share prices are as of market close on the previous business day.

Date	Rating	Share Price (M\$)	Price Target (M\$)
14-Mar-16	OW	1.32	1.90
28-Jun-16	OW	1.22	1.70
14-Oct-16	OW	1.34	1.80
20-Dec-16	OW	1.38	1.80
26-May-17	OW	1.59	1.90
20-Feb-18	OW	1.37	1.80
14-May-18	OW	1.15	1.60

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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