

Sunway Bhd (SWB MK)

1Q16: Steady operating performance & pre-sales forecast achievable

Neutral

Price: M\$3.03

27 May 2016

Price Target: M\$3.30

PT End Date: 30 Dec 2016

SWB's 1Q16 core net profit (-20% Y/Y) came in at 23%/19% of JPM/consensus FY16E forecast. Profits were dragged down by lower income from construction arm (due to its listing in Jul-15 which saw a reduction in the group's stake to 54%), though contributions from property investment and property development were stronger. First quarter is traditionally weaker and strong replenishment in construction order-book YTD will help improve earnings from the division going forward. Hence, we maintain our forecast. 1Q16 pre-sales rose 17% Y/Y coming in at 26% of our FY16E forecast which looks achievable helped also by the group's recently introduced easy payment schemes. SWB trades at 37% RNAV discount (versus the sector historical mean of 30%). **We prefer its peers, SP Setia (OW) and Eco World (OW)** which are trading at steeper RNAV discounts of 47% and 58% respectively and with strong mid-to-long term fundamentals. **SWB remains a Neutral.**

- **On a core basis for 1Q16, net income down 20% Y/Y against stable performance in revenue and operating profit (+2% Y/Y).** The fall in profits at the net level largely due to reduction in contribution from construction arm to 54% following its listing in Jul-15.
- **Steady core operating profit (+2% Y/Y) for 1Q16** as higher profits from property development (+39% Y/Y) and property investment (+69% Y/Y) compensated for lower construction contributions (-33% Y/Y). Property development segment benefited from sales and profit recognition from its Singapore project (Avant Parc), while property investments saw higher occupancy, rental and contributions from new assets, i.e. Sunway Pinnacle office tower, Sunway Putra Hotel and Sunway University New Academic Block. Construction profits fell with completion of civil and building projects in 2015 (i.e. includes the BRT)
- **1Q16 pre-sales up 7% Y/Y, strong construction order-book.** 1Q16 pre-sales rose 7% Y/Y to M\$263MM, of which 35% came from Iskandar and 16% from Singapore. This accounts for 26% of our FY16E pre-sales forecast of M\$1B and 19% of management's target of M\$1.4B. We believe our pre-sales forecast is achievable to be driven also by SWB's recent easy payment schemes (i.e. guaranteed loans of up to 88% for 15 years and deferred deposit payment). While this raises the risk premium for the stock due to transfer of funding risk of the purchaser from banks to developer in this case, SWB's net gearing estimated at 37% by end-FY16E we believe is comfortable. Construction order-book is strong at M\$5B (4x historical revenue) which includes M\$2B replenishment YTD, which will help improve income from the division going forward

Table 1: Sunway 1Q16 results summary

M\$ mn; year-end Mar	1Q16	1Q15	Y/Y	4Q15	Q/Q
Revenue	1,069	1,060	1%	1,399	-24%
Core Operating profit	150	147	2%	204	-27%
Operating margin	14.0%	13.9%		14.6%	
Net finance costs	-16	-11	42%	-22	-26%
Associates & JVs	43	38	12%	50	-14%
Core PBT	178	178	0%	244	-27%
Net income	102	147	-30%	215	-52%
Core net income	105	131	-20%	180	-42%
Core margin	9.8%	12.3%		12.9%	
Core EPS (sen)	5.59	7.10	-21%	9.63	-42%

Source: Company.

Table 2: Sunway 1Q16 core operating profit breakdown

M\$mn	1Q16	1Q15	Y/Y	4Q15	Q/Q
Prop development	56	40	39%	96	-42%
Prop investment	36	21	69%	45	-20%
Construction	36	53	-33%	27	33%
Trading & Manufacturing	9	14	-40%	12	-27%
Quarry	6	8	-16%	6	9%
Others	7	11	-35%	18	-60%
Core operating profit	150	147	2%	204	-27%

Source: Company.

Table 3: Sunway 1Q16 core operating margin breakdown

M\$mn	1Q16	1Q15	Y/Y	4Q15	Q/Q
Prop development	23.8%	22.2%	2 ppts	23.0%	1 ppts
Prop investment	21.5%	15.4%	6 ppts	24.5%	-3 ppts
Construction	11.4%	14.1%	-3 ppts	6.6%	5 ppts
Trading & Manufacturing	4.4%	7.4%	-3 ppts	5.7%	-1 ppts
Quarry	16.5%	14.1%	2 ppts	10.2%	6 ppts
Others	5.8%	9.2%	-3 ppts	14.0%	-8 ppts
Core operating margin	14.0%	13.9%	0 ppts	14.6%	-1 ppts

Source: Company.

Table 4: Developer sector peer comparison

As at: 27 May-16	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
						CY16E	CY17E	CY16E	CY17E	FY16E	FY17E				
Eco World Develop	Oct	736	1.27	OW	1.90	22.7	12.1	105.3%	87.4%	0.0%	0.0%	0.9	3.5	3.00	-58%
IGB Corporation	Dec	788	2.41	UW	2.30	13.3	12.1	18.3%	9.6%	3.6%	3.6%	0.7	5.5	5.40	-55%
Mah Sing Group	Dec	885	1.50	N	1.50	11.0	10.3	-3.4%	6.8%	3.6%	3.9%	1.1	11.9	2.10	-29%
SP Setia	Dec	2,041	3.17	OW	3.80	13.1	10.5	-30.9%	25.3%	4.4%	5.5%	1.1	8.4	6.00	-47%
Sunway	Dec	1,457	3.02	N	3.30	12.6	11.1	-20.1%	13.7%	2.9%	3.3%	0.8	7.2	4.80	-37%
UEM Sunrise	Dec	1,156	1.04	N	1.10	16.4	16.6	12.1%	-1.5%	1.9%	2.9%	0.7	4.2	2.80	-63%
Weighted average		7,064				14.3	11.9	-17.6%	18.8%	3.0%	3.6%	0.9	7.1		-47%

Source: Bloomberg, J.P. Morgan estimates.

Investment Thesis

Longer-term, we continue to like Sunway for its integrated business, with strong assets and branding (property development land-bank, commercial assets via 36%-owned Sunway REIT), as well as its asset-light model, with the next asset recycling and hence further prospects for value unlocking likely in the next two to three years, upon maturity of its large recent and soon-to-be-completed commercial properties (i.e., Velocity mall, Pinnacle office tower).

However, we see limited catalysts over the near to medium term given the weak property market outlook. Hence, we are Neutral on Sunway Bhd.

Valuation

Our Dec-16E PT of M\$3.30 is based on a 30% discount to RNAV, in line with sector historical mean. We believe this is fair versus at over -1SD to historical mean for its peers, given its more diversified/integrated business providing support in the current slow down (i.e. stable to higher income from property investment and construction) and proven past efforts to unlock value (i.e. special dividends following the construction listing in 2015).

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%	Residential/commercial township	15	1,691	5	103	Discounted at WACC of 10%
Sunway South Quay	60%	Lakeside mixed development	40	3,087	7	271	Discounted at WACC of 10%
Sunway Monterez	60%	Residential	4	38	3	2	Discounted at WACC of 10%
Sunway Semenyih	70%	Residential	398	729	10	51	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	12	Discounted at WACC of 10%
Sunway Montana	100%	Residential	2	56	3	6	Discounted at WACC of 10%
Sunway Resort City	100%	Commercial	15	660	6	66	Discounted at WACC of 10%
Casa Kiara III	80%	Residential	3	210	3	18	Discounted at WACC of 10%
Sunway Velocity	85%	Mixed development	10	1,984	6	264	Discounted at WACC of 10%
Sunway Tower KL 1	100%	Office	1	240	3	19	Discounted at WACC of 10%
Bangi	100%	Residential	3	59	2	5	Discounted at WACC of 10%
Melawati	100%	Residential	2	43	2	4	Discounted at WACC of 10%
Sg Long	80%	Residential	111	277	4	22	Discounted at WACC of 10%
Mont Putra, Rawang	100%	Residential	163	156	6	13	Discounted at WACC of 10%
Kelana Jaya	100%	Mixed development	22	1,900	5	197	Discounted at WACC of 10%
Kampung Subang	80%	Industrial	6	110	5	20	Discounted at WACC of 10%
Sunway Alam Suria	100%	Residential	0	0	2	0	Discounted at WACC of 10%
			805	11,376		1,075	
Northern							
Sunway City Ipoh	65%	Residential	441	1,048	10	73	Discounted at WACC of 10%
Sunway Tunas, Balik Pulau	100%	Residential	9	60	2	6	Discounted at WACC of 10%
Sunway Betong, Balik Pulau	100%	Residential	20	110	2	10	Discounted at WACC of 10%
Paya Terubong	100%	Residential	24	1,500	6	143	Discounted at WACC of 10%
Sungai Ara	100%	Residential	81	849	8	81	Discounted at WACC of 10%
Bukit Mertajam	100%	Residential	53	725	5	69	Discounted at WACC of 10%
			627	4,293		382	
Singapore							
Novena	30%	Medical suites, retail, hotel	0	0	3	10	Discounted at WACC of 10%
Sembawang, Singapore	100%	Residential	0	0	2	0	Discounted at WACC of 10%
			0	0		10	
Johor							
Bukit Lenang	80%	Residential	65	698	5	60	Discounted at WACC of 10%
Medini	38%	Mixed development	656	11,293	10	424	Discounted at WACC of 10%
Pendas	60%	Mixed development	1,079	18,000	15	666	Discounted at WACC of 10%
			1,800	29,991		1,150	
China							
Sunway Guanghao	65%	Mixed development	4	67	2	4	Discounted at WACC of 10%
Tianjin Eco City	60%	Mixed development	17	1,060	6	38	Discounted at WACC of 10%
India							
Sunway OPUS Grand India	50%	Condos	24	702	5	26	Discounted at WACC of 10%
Sunway MAK Signature Residence (JV with M.A.K Builders)	60%	Residential	14	181	5	10	Discounted at WACC of 10%
Australia							
Wonderland Business Park (Sydney)	45%	Industrial	13	44	6	2	Discounted at WACC of 10%
			72	2,054		80	
Total			3,304	47,714		2,697	

Source: Company, J.P. Morgan estimates.

Sunway RNAV

	Value (M\$ M)	Comments
Revaluation surplus	2,697	
Book value as at Dec-15	6,230	
Revaluation gain from investment properties	231	Valuing 36%-owned Sunway REIT at PT of M\$1.70
Revaluation gain from construction division	549	Valued at market price
Outstanding cash obligation for land	(422)	Discounted value for Iskandar land purchase
Total RNAV	9,285	
Number of shares (M)	1,761	
RNAV per share (M\$)	5.27	
FD RNAV		
Warrants & ESOS		
Add proceeds from warrants & ESOS	931	258.5M outstanding warrants at M\$2.50/share and 133.6M ESOS
Adjusted RNAV	10,215	
Fully diluted number of shares (M)	2,148	With warrants and ESOS
RNAV/share (M\$)	4.80	
PT (M\$)	3.30	30% discount to RNAV

Source: J.P. Morgan estimates.

Risks to Rating and Price Target

Key downside risks include: (1) slower-than-expected property sales, (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 (3) funding/balance sheet risk from its new property incentives (i.e. guaranteed loans and deferred payment schemes). Key upside risks include attractive, accretive land acquisitions, especially in the Klang Valley.

Real Estate

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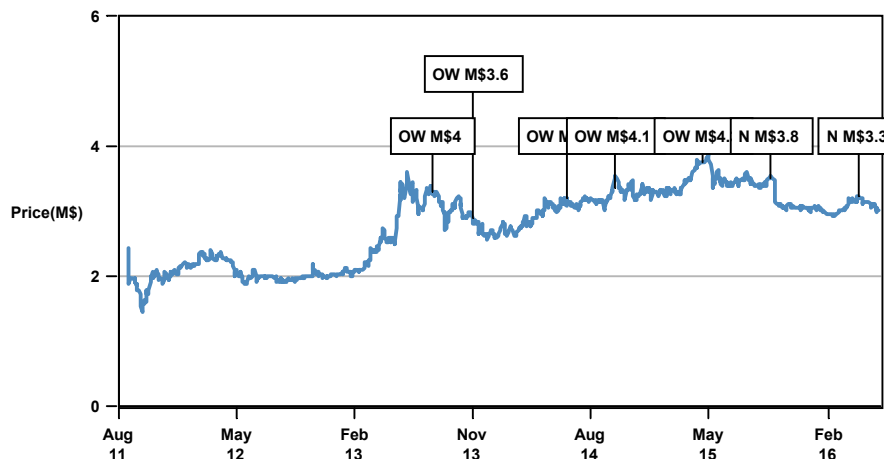
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Sunway Bhd (SWAY.KL, SWB MK) Price Chart



Date	Rating	Share Price (M\$)	Price Target (M\$)
26-Jul-13	OW	3.30	4.00
28-Oct-13	OW	2.88	3.60
05-Jun-14	OW	3.19	3.80
22-Sep-14	OW	3.36	4.10
17-Apr-15	OW	3.75	4.30
19-Sep-15	N	3.50	3.80
08-Apr-16	N	3.24	3.30

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

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