

## Sunway Bhd (SWB MK)

**Neutral**

Price: M\$3.01

29 Aug 2016

Price Target: M\$3.30

PT End Date: 30 Dec 2016

1H16 in line with consensus; Prefer SWB to UEMS as a long-term beneficiary of HSR project in Johor

2Q16 core net income was down 3% Y/Y, bringing overall 1H16 core earnings (-11% Y/Y) to 55%/49% of our/consensus full-year forecast, with stronger profits from Prop development and others (healthcare, building materials and treasury operations) compensating for weaker Prop investment and Construction contributions. 1H16 total pre-sales made up 44% of management's target of M\$1.4B, with domestic pre-sales up 19% Y/Y (from a low base) and international projects contributing 25% of the total M\$613M. Unbilled sales of M\$2.0B, or 1.7x historical revenue, and Construction orderbook of M\$4.9B, or 4.0x historical revenue, help provide earnings visibility. SWB trades at a 37% RNAV discount, or between the mean and -1SD to the sector. Near-term catalysts for the property development segment remain limited due to the weak consumer environment and tighter lending/banking liquidity, but SWB benefits from a diversified earnings base with income stability from its REIT arm (Sunway REIT) and commercial assets, as well as a strong orderbook for its construction division. SWB is also a potential beneficiary of the High Speed Rail (HSR) project longer-term in Johor, given its projects near the alignment in Gerbang, Johor. **Maintain Neutral on SWB, which we also prefer to UEMS (Neutral) in Johor. Our top long-term developer pick is Eco World (OW).**

- **2Q16 core net income was down 3% Y/Y on higher finance costs and a lower Construction contribution**, but this was compensated for by stronger Prop development and others (healthcare, building materials and treasury operations). Overall 1H16 results were 55%/49% of our/consensus forecast.
- **Prop development profit was up 42% Y/Y in 1H16 on unit handover, pre-sales supported by international projects and easy payment schemes.** 1H16 overall pre-sales of M\$613M made up 44% of management's target of M\$1.4B on strong pre-sales from international projects in China and Singapore (together 25% of total). Domestic pre-sales also picked up, rising 19% Y/Y, to M\$449M, or 46% of our forecast, on a step-up in launches vs. a very low base last year (take-up rates at 50-80%, including bookings). While some of this was supported by SWB's easy-payment schemes, such as guaranteed loans (up to 88% financing for 15 years) and deferred deposit payments, the majority of homebuyers have still opted to take their mortgages with the banks. SWB's net gearing remains manageable, at 40%, with unbilled sales of M\$2.0B, or 1.7x historical revenue, providing earnings visibility.
- **Prop investments were down 17% Y/Y on gain on disposals in 1H15.** Excluding the M\$22.9M gain, adjusted 1H16 operating profit was up 22% Y/Y on a higher contribution from new assets such as Pinnacle office tower and Sunway University New Academic Block, as well as by the opening of Pyramid Hotel West and the Nickelodeon theme park.
- **Construction operating profit was down 36% Y/Y post-listing**, with overall 1H16 contributing 22% to group operating profit vs. 35% in 1H15. The segment was also affected by preliminary costs incurred on the MRT Package V201 for viaduct works, and lower recognition for ongoing projects. However, orderbook remains strong at M\$4.9B, or 4.0x historical revenue, including M\$2.4B in new order wins YTD.

Table 1: Sunway 2Q16 results summary

M\$ in millions	2Q16	2Q15	Y/Y	1Q16	Q/Q	1H16	1H15	Y/Y
Revenue	1,156	1,042	11%	1,069	8%	2,225	2,102	6%
<b>Core operating profit</b>	<b>161</b>	<b>139</b>	<b>16%</b>	<b>150</b>	<b>8%</b>	<b>311</b>	<b>309</b>	<b>1%</b>
Operating margin	14.0%	13.3%		14.0%		14.0%	14.7%	
Net finance costs	-16	-9	67%	-16	-3%	-32	-21	53%
Associates & JVs	58	151	-62%	43	36%	100	189	-47%
Core PBT	182	180	1%	178	2%	361	357	1%
Net income	154	238	-35%	102	51%	256	384	-33%
<b>Core net income</b>	<b>133</b>	<b>137</b>	<b>-3%</b>	<b>105</b>	<b>27%</b>	<b>237</b>	<b>267</b>	<b>-11%</b>
Core margin	11.5%	13.1%		9.8%		10.7%	12.7%	
Core EPS (sen)	7.11	7.32	-3%	5.59	27%	12.70	14.42	-12%

Source: Company data.

Table 2: Sunway 2Q16 core operating profit breakdown

M\$ in millions	2Q16	2Q15	Y/Y	1Q16	Q/Q	1H16	1H15	Y/Y
Prop development	53	37	45%	56	-5%	109	77	42%
Prop investment	24	29	-14%	36	-33%	61	73	-17%
Construction	34	56	-39%	36	-5%	70	109	-36%
Trading & Manufacturing	10	1	1458%	9	23%	19	15	28%
Quarry	12	16	-25%	6	83%	18	23	-22%
Others	28	2	1684%	7	294%	35	12	180%
<b>Core operating profit</b>	<b>161</b>	<b>139</b>	<b>16%</b>	<b>150</b>	<b>8%</b>	<b>311</b>	<b>309</b>	<b>1%</b>

Source: Company data.

Table 3: Sunway 2Q16 core operating margins

	2Q16	2Q15	Y/Y	1Q16	Q/Q	1H16	1H15	Y/Y
Prop development	16.8%	11.3%	6 ppts	23.8%	-7 ppts	19.8%	15.2%	5 ppts
Prop investment	15.2%	19.7%	-4 ppts	21.5%	-6 ppts	18.5%	25.7%	-7 ppts
Construction	13.6%	22.9%	-9 ppts	11.4%	2 ppts	12.4%	17.6%	-5 ppts
Trading & Manufacturing	4.8%	0.5%	4 ppts	4.4%	0 ppts	4.6%	4.7%	0 ppts
Quarry	19.3%	24.2%	-5 ppts	16.5%	3 ppts	18.2%	19.6%	-1 ppts
Others	18.3%	1.1%	17 ppts	5.8%	13 ppts	12.7%	4.8%	8 ppts
<b>Core operating margin</b>	<b>14.0%</b>	<b>13.3%</b>	<b>1 ppts</b>	<b>14.0%</b>	<b>0 ppts</b>	<b>14.0%</b>	<b>14.7%</b>	<b>-1 ppts</b>

Source: Company data.

Table 4: Developer peer comparison

As at: 24 Aug-16	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
						CY16E	CY17E	CY16E	CY17E	FY16E	FY17E	FY16E	FY16E		
Eco World Develop	Oct	783	1.34	OW	1.70	23.9	12.8	105.3%	86.9%	0.0%	0.0%	1.0	3.5%	2.70	-50%
IGB Corporation	Dec	884	2.68	UW	2.30	14.8	13.5	18.3%	9.6%	3.3%	3.3%	0.8	5.5%	5.40	-50%
Mah Sing Group	Dec	983	1.65	N	1.50	12.1	11.3	-3.4%	6.8%	3.3%	3.5%	1.2	11.9%	2.10	-21%
SP Setia	Dec	2,347	3.37	UW	2.80	14.1	13.3	-31.7%	6.3%	4.1%	4.4%	1.2	8.3%	5.70	-41%
Sunway	Dec	1,513	3.01	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	1,223	1.09	N	1.10	17.2	17.4	12.1%	-1.5%	1.8%	2.8%	0.8	4.2%	2.80	-61%
<b>Weighted average</b>		<b>7,733</b>				<b>15.1</b>	<b>13.2</b>	<b>-18.3%</b>	<b>10.9%</b>	<b>2.9%</b>	<b>3.2%</b>	<b>1.0</b>	<b>7.1%</b>		<b>-43%</b>

Source: Bloomberg, J.P. Morgan estimates.

Figure 1: Developer RNAV band



Source: Bloomberg, J.P. Morgan.

## Investment Thesis

Longer-term, we continue to like Sunway for its integrated business, with strong assets and branding (property development landbank, 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-16 PT of M\$3.30 is based on a 30% discount to RNAV, in line with the sector historical mean. We believe this is fair vs. over -1SD to the historical mean for peers, given its more diversified/integrated business, providing support in the current slowdown (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
<b>Klang Valley</b>							
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 Montez	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%
			<b>805</b>	<b>11,376</b>		<b>1,075</b>	
<b>Northern</b>							
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%
			<b>627</b>	<b>4,293</b>		<b>382</b>	
<b>Singapore</b>							
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%
			<b>0</b>	<b>0</b>		<b>10</b>	
<b>Johor</b>							
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%
			<b>1,800</b>	<b>29,991</b>		<b>1,150</b>	
<b>China</b>							
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%
<b>India</b>							
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%
<b>Australia</b>							
Wonderland Business Park (Sydney)	45%	Industrial	13	44	6	2	Discounted at WACC of 10%
			<b>72</b>	<b>2,054</b>		<b>80</b>	
<b>Total</b>			<b>3,304</b>	<b>47,714</b>		<b>2,697</b>	

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

## Sunway RNAV

	Value (M\$ M)	Comments
<b>Revaluation surplus</b>	<b>2,697</b>	
Book value as of 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
<b>Total RNAV</b>	<b>9,285</b>	
Number of shares (M)	1,761	
RNAV per share (M\$)	5.27	
<b>FD RNAV</b>		
<b>Warrants &amp; ESOS</b>		
Add proceeds from warrants & ESOS	931	258.5M outstanding warrants at M\$2.50/share and 133.6M ESOS
<b>Adjusted RNAV</b>	<b>10,215</b>	
Fully diluted shares (M)	2,148	With warrants and ESOS
<b>RNAV/share (M\$)</b>	<b>4.80</b>	
<b>PT (M\$)</b>	<b>3.30</b>	<b>30% discount to RNAV</b>

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.

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### Property

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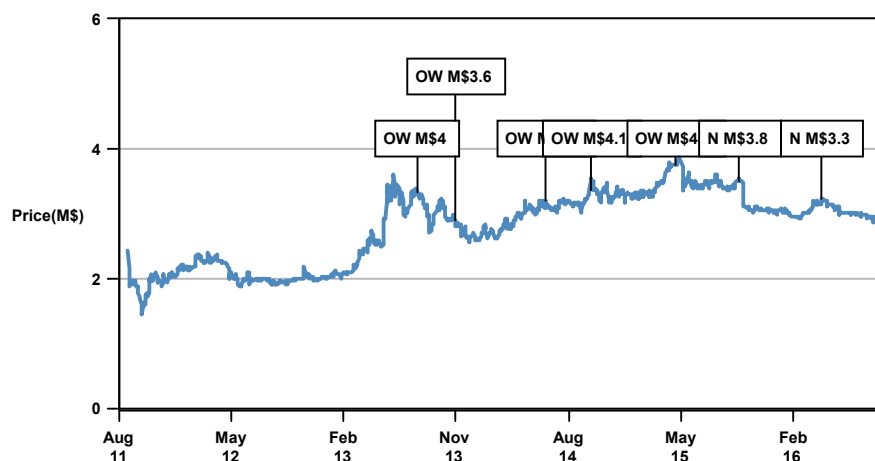
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Sunway Bhd (SWAY.KL, SWB MK) Price Chart



Date	Rating	Share Price (M\$)	Price Target (M\$)
26-Jul-13	OW	3.31	4.00
28-Oct-13	OW	2.88	3.60
05-Jun-14	OW	3.21	3.80
22-Sep-14	OW	3.36	4.10
17-Apr-15	OW	3.74	4.30
19-Sep-15	N	3.50	3.80
08-Apr-16	N	3.24	3.30

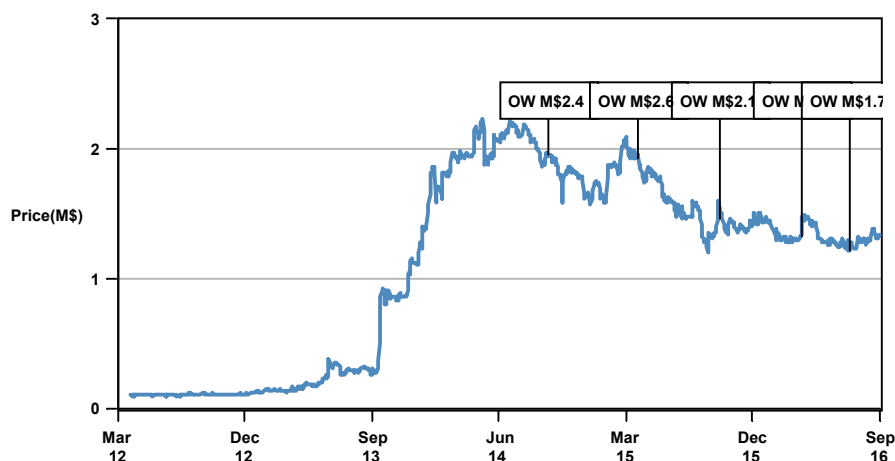
Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jul 26, 2013.

### 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.

### 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.

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