

## Sunway Bhd (SWB MK)

**Overweight**

Price: M\$3.00

25 Nov 2016

Price Target: M\$3.60

PT End Date: 30 Jun 2017

3Q16: Operating growth in all key divisions; a low risk play on the HSR theme - maintain OW

SWB's 3Q16 core net income rose 1% Y/Y, bringing 9M16 core earnings (-7% Y/Y) at 82%/75% of JPM's/consensus' forecasts for the full year. All key divisions (property development, property investment and construction) registered strong Y/Y growth in profits in 3Q16 at the operating level, though this was offset at the bottom-line by higher finance cost (+46% Y/Y) and lower associate income. 9M16 property development pre-sales rose 20% Y/Y, or broadly within expectations. We see SWB as a low-risk play on the HSR theme in Johor, with resilient earnings also from its construction and property investment/REIT segments (50-60% of earnings). **Maintain OW on SWB, which remains one of our top picks in the developer space besides Eco World (ECW MK; OW).** For more details, refer to our Malaysian Developers note of 24 Oct-16, titled "Key themes & positioning for 2017; Switch to the laggards – ECW top pick (OW), upgrade SWB to OW" [here](#).

- **3Q16 overall core net income up 1% Y/Y (+11% Q/Q)**, leaving cumulative 9M16 results at M\$385MM (down 7% Y/Y) or at 82%/75% of JPM's/consensus' full year forecast. For 9M16, higher property development profits and stable income from property investment helped compensate for higher finance costs and lower construction profits. In 3Q16 alone however, all key divisions showed improvement in profits Y/Y.
- **Property development profits up 31% Y/Y in 3Q16, pre-sales performance within expectations.** The rise in profits was driven by higher progress billings from local and Singapore projects. Total pre-sales of M\$864MM for 9M16 came in at 80% of our full year forecast. Of total pre-sales, domestic projects accounted for 71% (M\$616MM or at 78% of our full year forecast). Unbilled sales of M\$1.8B translate to 1.5x of FY15 historical revenue for the segment.
- **Property investment profits doubled Q/Q (+26% Y/Y in 3Q16).** This was driven by better occupancy at the new office block, Sunway Pinnacle, and additional contributions from the refurbished Sunway Putra Hotel (completed end-2015). Q/Q growth in turn was due to an increase in the number of visitors to the theme parks and higher hotel occupancy rates relative to the preceding quarter which was impacted by the fasting month.
- **Construction operating profit down 24% Y/Y for 9M16, but up 34% Y/Y in 3Q16.** To recap, 9M16 performance for the segment was earlier affected by preliminary costs incurred on the MRT Package V201 for viaduct works in 1H16. 3Q16 performance however improved with higher progress billings from ongoing local construction projects. Order-book remains strong at M\$4.8B, or at 3.9x historical revenue, including M\$2.6B in new order wins YTD.

Table 1: Sunway 3Q16 results summary

M\$ mn; year-end Dec	3Q16	3Q15	Y/Y	2Q16	Q/Q	9M16	9M15	Y/Y
Revenue	1,137	951	20%	1,156	-2%	3,362	3,053	10%
Core Operating profit	164	119	38%	161	2%	475	428	11%
Operating margin	14.4%	12.5%		14.0%		14.1%	14.0%	
Net finance costs	-3	16	-116%	-16	-83%	-34	-5	600%
Associates & JVs	47	32	48%	58	-19%	147	220	-33%
Core PBT	213	185	15%	182	17%	574	542	6%
Net income	144	133	8%	154	-7%	400	518	-23%
<b>Core net income</b>	<b>148</b>	<b>147</b>	<b>1%</b>	<b>133</b>	<b>11%</b>	<b>385</b>	<b>414</b>	<b>-7%</b>
Core margin	13.0%	15.5%		11.5%		11.5%	13.6%	
Core EPS (sen)	7.50	7.86	-5%	6.85	10%	19.94	22.28	-11%

Source: Company.

Table 2: Sunway 3Q16 core operating profit breakdown

M\$mn	3Q16	3Q15	Y/Y	2Q16	Q/Q	9M16	9M15	Y/Y
Prop development	45	35	31%	53	-15%	154	111	38%
Prop investment	50	40	26%	24	105%	111	113	-1%
Construction	31	23	34%	34	-8%	101	132	-24%
Trading & Manufacturing	11	5	110%	10	8%	30	20	50%
Quarry	7	11	-32%	12	-38%	25	34	-25%
Others	19	5	268%	28	-31%	54	18	206%
<b>Core operating profit</b>	<b>164</b>	<b>119</b>	<b>38%</b>	<b>161</b>	<b>2%</b>	<b>475</b>	<b>428</b>	<b>11%</b>

Source: Company.

Table 3: Sunway 3Q16 core operating margins

M\$mn	3Q16	3Q15	Y/Y	2Q16	Q/Q	9M16	9M15	Y/Y
Prop development	18.3%	12.7%	6 ppts	16.8%	1 ppts	19.3%	14.3%	5 ppts
Prop investment	26.4%	23.0%	3 ppts	15.2%	11 ppts	21.3%	24.7%	-3 ppts
Construction	10.9%	11.9%	-1 ppts	13.6%	-3 ppts	11.9%	16.2%	-4 ppts
Trading & Manufacturing	5.5%	4.1%	1 ppts	4.8%	1 ppts	4.9%	4.5%	0 ppts
Quarry	13.4%	15.8%	-2 ppts	19.3%	-6 ppts	16.5%	18.2%	-2 ppts
Others	12.6%	4.6%	8 ppts	18.3%	-6 ppts	12.7%	4.7%	8 ppts
<b>Core operating margin</b>	<b>14.4%</b>	<b>12.5%</b>	<b>2 ppts</b>	<b>14.0%</b>	<b>0 ppts</b>	<b>14.1%</b>	<b>14.0%</b>	<b>0 ppts</b>

Source: Company.

Table 4: Developers 3Q16 domestic pre-sales

M\$mn; year-end Dec	3QCY16	3QCY15	Y/Y	2QCY16	Q/Q	9MCY16	9MCY15	Y/Y
Mah Sing Group	632	640	-1%	361	75%	1,401	1,601	-12%
SP Setia	819	562	46%	732	12%	1,815	1,699	7%
Sunway	167	121	38%	265	-37%	616	498	24%

Source: Companies.

Table 5: Developers peer comparison

As at: 25 Nov-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
						CY17E	CY18E	CY17E	CY18E	FY17E	FY18E				
Eco World Develop	Oct	853	1.36	OW	1.80	14.3	11.8	59.8%	21.1%	0.0%	0.0%	0.9	6.6	2.80	-51%
IGB Corporation	Dec	740	2.47	UW	2.35	12.4	11.6	9.6%	7.3%	3.5%	3.5%	0.7	5.8	5.40	-54%
Mah Sing Group	Dec	821	1.52	N	1.60	10.4	10.6	6.8%	-1.3%	3.8%	3.8%	1.0	11.8	2.20	-31%
SP Setia	Dec	2,118	3.31	UW	3.10	13.0	13.8	6.3%	-5.3%	4.4%	4.2%	1.1	8.6	5.80	-43%
Sunway	Dec	1,367	3.00	OW	3.60	11.0	10.8	13.7%	1.6%	3.3%	3.4%	0.8	7.8	5.00	-40%
UEM Sunrise	Dec	1,069	1.05	N	1.10	21.5	16.3	22.8%	31.8%	2.9%	3.3%	0.7	3.2	2.80	-63%
<b>Weighted average</b>		<b>6,968</b>				<b>13.7</b>	<b>12.7</b>	<b>11.7%</b>	<b>1.6%</b>	<b>3.3%</b>	<b>3.3%</b>	<b>0.9</b>	<b>7.4</b>		<b>-46%</b>

Source: Bloomberg, J.P. Morgan estimates.

Figure 1: Developer RNAV band



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). We also see SWB as a low-risk play on the HSR theme in Johor, with resilient earnings also from its construction and property investment/REIT segments (50-60% of earnings). We are OW on SWB.

## Valuation

Our Jun-17E PT of M\$3.60 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
<b>Klang Valley</b>							
Sunway Damansara	60%	Residential/commercial township	15	1,691	5	114	Discounted at WACC of 10%
Sunway South Quay	60%	Lakeside mixed development	40	3,087	7	0	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	56	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	13	Discounted at WACC of 10%
Sunway Montana	100%	Residential	2	56	3	7	Discounted at WACC of 10%
Sunway Resort City	100%	Commercial	15	660	6	70	Discounted at WACC of 10%
Casa Kiara III	80%	Residential	3	210	3	17	Discounted at WACC of 10%
Sunway Velocity	85%	Mixed development	10	1,984	6	254	Discounted at WACC of 10%
Sunway Tower KL 1	100%	Office	1	240	3	20	Discounted at WACC of 10%
Bangi	100%	Residential	3	59	2	3	Discounted at WACC of 10%
Melawati	100%	Residential	2	43	2	5	Discounted at WACC of 10%
Sg Long	80%	Residential	111	277	4	24	Discounted at WACC of 10%
Mont Putra, Rawang	100%	Residential	163	156	6	14	Discounted at WACC of 10%
Kelana Jaya	100%	Mixed development	22	1,900	5	216	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>839</b>	
<b>Northern</b>							
Sunway City Ipoh	65%	Residential	441	1,048	10	78	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	11	Discounted at WACC of 10%
Paya Terubong	100%	Residential	24	1,500	6	156	Discounted at WACC of 10%
Sungai Ara	100%	Residential	81	849	8	88	Discounted at WACC of 10%
Bukit Mertajam	100%	Residential	53	725	5	75	Discounted at WACC of 10%
			<b>627</b>	<b>4,293</b>		<b>415</b>	
<b>Singapore</b>							
Novena	30%	Medical suites, retail, hotel	0	0	3	7	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>7</b>	
<b>Johor</b>							
Bukit Lenang	80%	Residential	65	698	5	62	Discounted at WACC of 10%
Medini	38%	Mixed development	656	11,293	10	455	Discounted at WACC of 10%
Pendas	60%	Mixed development	1,079	18,000	15	735	Discounted at WACC of 10%
			<b>1,800</b>	<b>29,991</b>		<b>1,253</b>	
<b>China</b>							
Sunway Guanghao	65%	Mixed development	4	67	2	5	Discounted at WACC of 10%
Tianjin Eco City	60%	Mixed development	17	1,060	6	43	Discounted at WACC of 10%
<b>India</b>							
Sunway OPUS Grand India	50%	Condos	24	702	5	29	Discounted at WACC of 10%
Sunway MAK Signature Residence (JV with M.A.K Builders)	60%	Residential	14	181	5	11	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>89</b>	
<b>Total</b>			<b>3,304</b>	<b>47,714</b>		<b>2,602</b>	

Source: Company, J.P. Morgan estimates.

## Sunway RNAV

	Value (M\$ M)	Comments
<b>Revaluation surplus</b>	<b>2,602</b>	
Book value as at Dec-16E	6,519	
Revaluation gain from investment properties	340	Valuing 36%-owned Sunway REIT at PT of M\$1.70
Revaluation gain from construction division	855	Valued at M\$1.68/share
Outstanding cash obligation for land	(422)	Discounted value for Iskandar land purchase
<b>Total RNAV</b>	<b>9,895</b>	
Number of shares (M)	1,761	
RNAV per share (M\$)	5.62	
<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>10,826</b>	
Fully diluted number of shares (M)	2,148	With warrants and ESOS
<b>RNAV/share (M\$)</b>	<b>5.00</b>	Rounded from M\$5.04
<b>PT (M\$)</b>	<b>3.60</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) keen 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), though this scheme has ended as at Sep-16. Key upside risks include attractive, accretive land acquisitions, especially in the Klang Valley.

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### Real Estate

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## Other Companies Discussed in This Report (all prices in this report as of market close on 25 November 2016)

Eco World Development (ECOW.KL/M\$1.36/Overweight)

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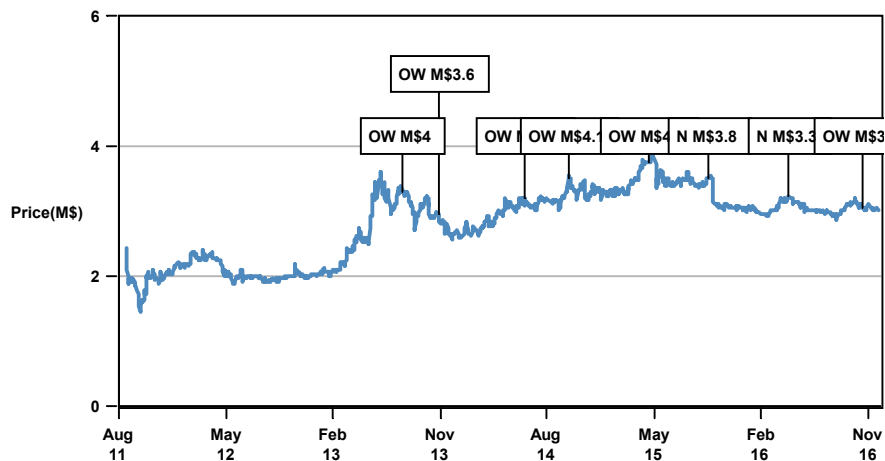
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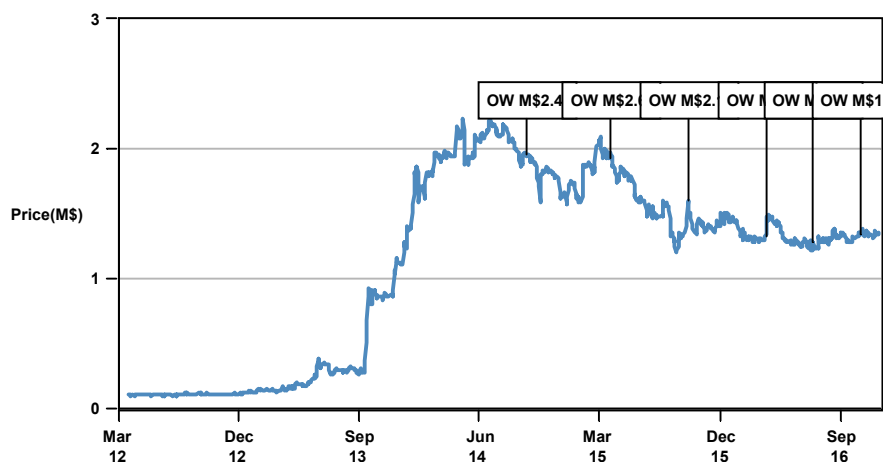
Sunway Bhd (SWAY.KL, SWB MK) Price Chart



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	3.21	3.80
22-Sep-14	OW	3.52	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
14-Oct-16	OW	3.06	3.60

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	1.93	2.60
19-Sep-15	OW	1.60	2.10
14-Mar-16	OW	1.32	1.90
28-Jun-16	OW	1.27	1.70
14-Oct-16	OW	1.34	1.80

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Sep 16, 2014.

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