

Sunway Bhd (SWB MK)

FY15 results - Property investment & Construction held up; Property development weaker

Neutral

Price: M\$3.01

26 Feb 2016

Price Target: M\$3.80

PT End Date: 30 Jun 2016

SWB's FY15 core profit fell marginally by 1% Y/Y, coming in 9%/7% ahead of our forecast/consensus, due to stronger Construction profit and lower finance charges. On a Y/Y basis, FY15 profits were higher for both property investment and construction, though weaker for property development with domestic pre-sales also down 53% Y/Y, within expectations. Construction earnings have started to ease Y/Y and Q/Q in 4Q15 due to normalization in margins, and the weak consumer sentiment is unlikely to lift property development earnings/pre-sales significantly in 2016. Hence, **we maintain a Neutral, and prefer SP Setia (OW) and Eco World (OW) in the sector.**

- **FY15 core net profit down marginally by 1% Y/Y to M\$585MM, coming in 9%/7% above our/consensus forecast.** 3Q15 trends continued into 4Q15, with higher Property Investment and Construction contributions offsetting the lower Property Development profits. **SWB declared a second interim dividend of 6sen, bringing total dividend for FY15 at 49 sen (including the 12 sen dividend in-specie and special dividend of 26sen from the construction arm listing in Jul-15), which translates to a dividend yield of 16%.**
- **Prop Development down 27% Y/Y in FY15 (flat Y/Y in 4Q15), pre-sales fell significantly in line with management's guidance.** FY15 total pre-sales stood at M\$1.2B (versus management guidance of M\$1B) with domestic pre-sales (ex-land sales) at M\$753MM (down 53% Y/Y), with the bulk of pre-sales coming from the Klang Valley. Fewer projects under development also led to contribution to group operating profit falling from 45% in FY14 to 33% in FY15. On a Q/Q basis, profits improved by 179% helped by normalization in operating margins by 10ppt to 23%. Unbilled sales of M\$2.1B as at end-FY15 translate to 1.8x historical revenue. Management is guiding for total pre-sales of M\$1.4B for FY16E (domestic plus overseas contributions), or a rise of 17% Y/Y, which we believe could prove to be optimistic.
- **Prop Investment up 30% Y/Y on newly opened assets (+6% Y/Y in 4Q15).** The Pinnacle office tower (0.58MM sqft NLA) opened in Jan-15 to 50% occupancy, rising to 90% currently, and Sunway University opened a new academic block in Jun-15 as an extension of its existing campus.
- **Construction 4Q15 profit fell 44% Y/Y due to normalization in margins, though full year profits improved 26% Y/Y.** Operating margin fell in 4Q15 to 6.6% (down 5ppt Q/Q) after the strong margin lift in the last four quarters helped by higher margins from larger local infrastructure projects and the pre-cast division in Singapore. On a full year basis, operating margin still rose 4ppt Y/Y to 13% and this drove earnings growth on top of higher revenues for the period. Order-book remains strong at M\$3.7B, or at 3x historical FY15 revenue.
- **Maintain Neutral.** SWB trades at 41% discount to RNAV or close to -1SD to the sector historical mean. **Our top picks in the Developer space remain Eco World (OW) and SP Setia (OW).** To recap, SP Setia announced record profits helped by strong earnings contribution for the 14 month ended Dec-15 and declared total DPS of 23sen, translating to a yield a stronger than expected net dividend yield of 7.7% (6.6% on an annualized basis).

Table 1: Sunway FY15 results summary

| M\$ mn: year-end Mar | 4Q15 | 4Q14 | Y/Y | 3Q15 | Q/Q | FY15 | FY14 | Y/Y |
|------------------------|------------|------------|-------------|------------|------------|------------|------------|------------|
| Revenue | 1,399 | 1,194 | 17% | 951 | 47% | 4,451 | 4,558 | -2% |
| Core Operating profit | 204 | 223 | -9% | 119 | 72% | 631 | 636 | -1% |
| Operating margin | 14.6% | 18.7% | | 12.5% | | 14.2% | 14.0% | |
| Net finance costs | -22 | -7 | 200% | 16 | -238% | -27 | -30 | -12% |
| Associates & JVs | 50 | 45 | 11% | 32 | 57% | 270 | 233 | 16% |
| Core PBT | 243 | 255 | -5% | 185 | 31% | 784 | 771 | 2% |
| Net income | 215 | 304 | -29% | 133 | 61% | 732 | 734 | 0% |
| Core net income | 174 | 269 | -35% | 147 | 18% | 585 | 592 | -1% |
| Core margin | 12.4% | 15.4% | | 15.5% | | 13.2% | 12.5% | |
| Core EPS (sen) | 9.28 | 10.17 | -9% | 7.86 | 18% | 31.52 | 31.87 | -1% |

Source: Company.

Table 2: Sunway FY15 core operating profit breakdown

| M\$mn | 4Q15 | 4Q14 | Y/Y | 3Q15 | Q/Q | FY15 | FY14 | Y/Y |
|------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Prop development | 96 | 97 | 0% | 35 | 179% | 208 | 286 | -27% |
| Prop investment | 45 | 43 | 6% | 40 | 15% | 158 | 121 | 30% |
| Construction | 27 | 48 | -44% | 23 | 14% | 159 | 126 | 26% |
| Trading & Manufacturing | 12 | 9 | 29% | 5 | 118% | 32 | 40 | -20% |
| Quarry | 6 | 16 | -64% | 11 | -45% | 40 | 37 | 8% |
| Others | 18 | 10 | 75% | 5 | 238% | 35 | 26 | 37% |
| Core operating profit | 204 | 223 | -9% | 119 | 72% | 631 | 636 | -1% |

Source: Company.

Table 3: Sunway FY15 core operating margin breakdown

| M\$mn | 4Q15 | 4Q14 | Y/Y | 3Q15 | Q/Q | FY15 | FY14 | Y/Y |
|------------------------------|--------------|--------------|----------------|--------------|---------------|--------------|--------------|---------------|
| Prop development | 23.0% | 19.5% | 4 ppts | 12.7% | 10 ppts | 17.4% | 23.9% | -6 ppts |
| Prop investment | 24.5% | 26.7% | -2 ppts | 23.0% | 1 ppts | 24.6% | 20.4% | 4 ppts |
| Construction | 6.6% | 23.0% | -16 ppts | 11.9% | -5 ppts | 13.0% | 8.5% | 4 ppts |
| Trading & Manufacturing | 5.7% | 5.4% | 0 ppts | 4.1% | 2 ppts | 4.9% | 6.3% | -1 ppts |
| Quarry | 10.2% | 22.1% | -12 ppts | 15.8% | -6 ppts | 16.3% | 15.5% | 1 ppts |
| Others | 14.0% | 10.1% | 4 ppts | 4.6% | 9 ppts | 7.0% | 6.1% | 1 ppts |
| Core operating margin | 14.6% | 18.5% | -4 ppts | 12.5% | 2 ppts | 14.2% | 13.9% | 0 ppts |

Source: Company.

Table 4: Property sector peer comparison

| As at: 26 Feb-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 | 730 | 1.30 | OW | 2.10 | 19.2 | 14.5 | 150.1% | 32.8% | 0.0% | 0.0% | 0.9 | 4.5 | 3.00 | -57% |
| IGB Corporation | Dec | 760 | 2.40 | UW | 2.50 | 11.9 | 11.2 | 8.1% | 6.4% | 3.8% | 4.1% | 0.7 | 6.0 | 5.40 | -56% |
| Mah Sing Group | Dec | 749 | 1.31 | N | 1.40 | 9.3 | 9.4 | 7.6% | -2.0% | 4.6% | 4.5% | 1.0 | 14.1 | 2.00 | -35% |
| SP Setia | Oct | 1,872 | 3.00 | OW | 3.80 | 11.8 | 10.2 | -13.1% | 28.2% | 3.9% | 5.0% | 1.2 | 10.2 | 5.80 | -48% |
| Sunway | Dec | 1,272 | 3.01 | N | 3.80 | 12.2 | 10.9 | -10.2% | 11.9% | 2.6% | 2.9% | 0.9 | 8.3 | 5.10 | -41% |
| UEM Sunrise | Dec | 1,088 | 1.01 | N | 1.20 | 13.7 | 12.3 | 25.2% | 11.5% | 2.5% | 3.0% | 0.8 | 5.0 | 2.70 | -63% |
| Weighted average | | 6,470 | | | | 12.8 | 11.2 | -5.8% | 12.5% | 3.0% | 3.5% | 0.9 | 8.3 | | -49% |

Source: Bloomberg, J.P. Morgan estimates.

Investment Thesis

We 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 recently completed and soon-to-be-completed commercial properties (i.e. Velocity mall, Pinnacle office).

However, we see limited catalysts over the near to medium term, and the shares have also outperformed strongly and versus peers. Hence, we are Neutral on Sunway Bhd.

Valuation

Our Jun-16E PT of M\$3.80 is based on a 25% discount to RNAV, the average of the historical mean and a +1SD discount to the sector. We believe this is fair, given efforts to unlock value from the recent construction arm listing, and given Sunway's strong fundamentals and rising status as one of the emerging/preferred sector proxies.

Sunway RNAV

| 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 | 141 | Discounted at WACC of 10% |
| Sunway South Quay | 60% | Lakeside mixed development | 52 | 3,990 | 7 | 287 | Discounted at WACC of 10% |
| Sunway Montereaz | 60% | Residential | 5 | 44 | 3 | 4 | Discounted at WACC of 10% |
| Sunway Semenyih | 70% | Residential | 398 | 729 | 10 | 71 | 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 | 16 | 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 | 79 | 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 | 306 | Discounted at WACC of 10% |
| Sunway Tower KL 1 | 100% | Office | 1 | 240 | 3 | 25 | 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 | 29 | Discounted at WACC of 10% |
| Mont Putra, Rawang | 100% | | 163 | 156 | 6 | 17 | Discounted at WACC of 10% |
| Perak | | | | | | | |
| Sunway City Ipoh | 65% | Residential | 895 | 1,048 | 10 | 93 | Discounted at WACC of 10% |
| Penang | | | | | | | |
| Sunway City Penang | 100% | Residential | 16 | 172 | 2 | 19 | Discounted at WACC of 10% |
| Sunway Grand | 100% | Residential | 12 | 186 | 2 | 21 | Discounted at WACC of 10% |
| Sungai Ara | 100% | Residential | 56 | 849 | 3 | 94 | Discounted at WACC of 10% |
| Bukit Mertajam | 100% | Residential | 42 | 694 | 2 | 77 | Discounted at WACC of 10% |
| S'pore | | | | | | | |
| Novena | 30% | Medical suites, retail, hotel | 2 | 2,242 | 3 | 121 | 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 | 103 | Discounted at WACC of 10% |
| Medini | 38% | Mixed development | 691 | 12,000 | 10 | 786 | Discounted at WACC of 10% |
| Pendas | 60% | Mixed development | 1,079 | 18,000 | 15 | 970 | Discounted at WACC of 10% |
| China | | | | | | | |
| Sunway Guanghao | 65% | Mixed development | 4 | 67 | 2 | 5 | Discounted at WACC of 10% |
| Tianjin Eco City | 60% | Mixed development | 91 | 5,344 | 6 | 256 | Discounted at WACC of 10% |
| India | | | | | | | |
| Sunway OPUS Grand India | 50% | Condos | 24 | 702 | 5 | 38 | Discounted at WACC of 10% |
| Sunway MAK Signature Residence (JV with M.A.K Builders) | 60% | | 14 | 181 | 5 | 14 | Discounted at WACC of 10% |
| Australia | | | | | | | |
| Wonderland Business Park (Sydney) | 45% | | 48 | 378 | 6 | 16 | Discounted at WACC of 10% |
| Total | | | 3,861 | 54,032 | | 3,814 | |

Source: Company, J.P. Morgan estimates.

Sunway RNAV

| | Value (M\$ M) | Comments |
|---|---------------|--|
| Revaluation surplus | 3,814 | |
| Book value as at Dec-15E | 5,540 | |
| Revaluation gain from investment properties | 462 | Valuing 36%-owned Sunway REIT at PT of M\$1.70 |
| Revaluation gain from construction division | 629 | Valued at market price |
| Outstanding cash obligation for land | (491) | Discounted value for Iskandar land purchase |
| Total RNAV | 9,954 | |
| Number of shares (M) | 1,761 | |
| RNAV per share (M\$) | 5.65 | |
| FD RNAV | | |
| Warrants & ESOS | | |
| Add proceeds from warrants & ESOS | 1,085 | 258.5M outstanding warrants at M\$2.50/share and 133.6M ESOS |
| Adjusted RNAV | 11,039 | |
| Fully diluted number of shares (M) | 2,147 | With warrants and ESOS |
| RNAV/share (M\$) | 5.10 | |
| PT (M\$) | 3.80 | 25% discount to RNAV |

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

Risks to Rating and Price Target

Key downside risks include: (1) slower-than-expected property sales due to weak consumer sentiment following the introduction of GST on 1-Apr-15 and the weaker Ringgit; and (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. Key upside risks include attractive, accretive land acquisitions, especially in the Klang Valley.

Real Estate

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Other Companies Discussed in This Report (all prices in this report as of market close on 26 February 2016)
 Eco World Development (ECOW.KL/M\$1.30/Overweight), SP Setia (SETI.KL/M\$3.00/Overweight)

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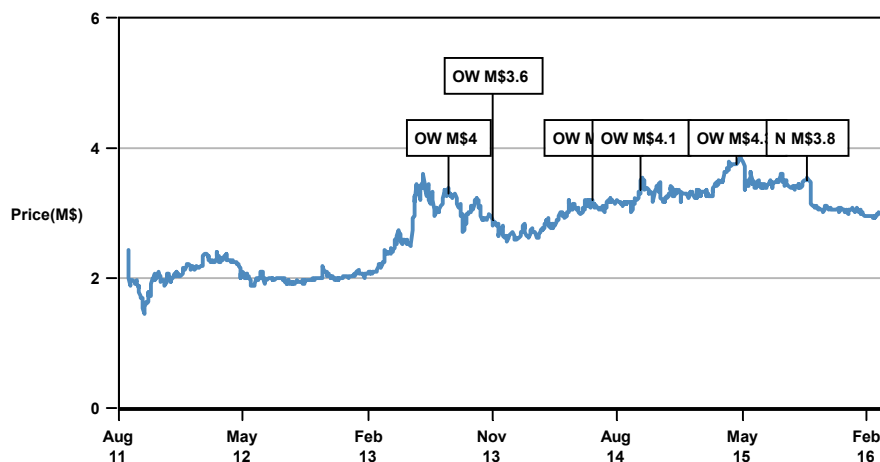
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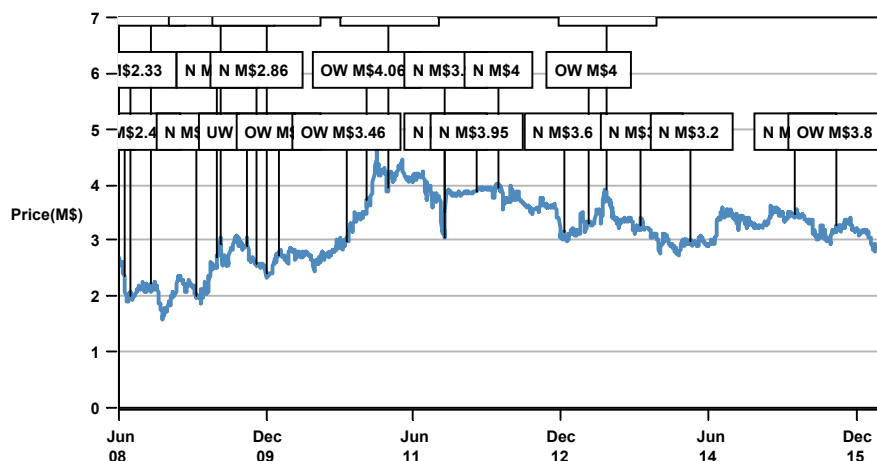
Sunway Bhd (SWAY.KL, SWB MK) Price Chart



| Date | Rating | Share Price (M\$) | Price Target (M\$) |
|-----------|--------|-------------------|--------------------|
| 26-Jul-13 | OW | 3.30 | 4.00 |
| 28-Oct-13 | OW | 2.88 | 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 |

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

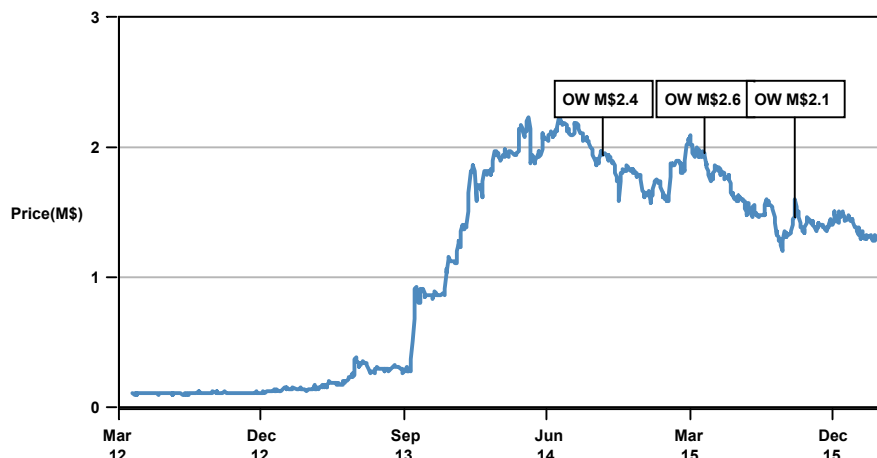
SP Setia (SETI.KL, SPSB MK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jun 24, 2008.

| Date | Rating | Share Price (M\$) | Price Target (M\$) |
|-----------|--------|-------------------|--------------------|
| 24-Jun-08 | N | 2.36 | 2.46 |
| 16-Jul-08 | N | 2.01 | 2.33 |
| 25-Sep-08 | N | 2.21 | 2.00 |
| 19-Mar-09 | N | 2.01 | 1.80 |
| 02-Jun-09 | N | 2.71 | 2.40 |
| 18-Jun-09 | UW | 2.96 | 2.53 |
| 17-Sep-09 | UW | 2.92 | 2.60 |
| 30-Oct-09 | N | 2.58 | 2.86 |
| 04-Dec-09 | OW | 2.40 | 2.86 |
| 14-Jan-10 | OW | 2.73 | 3.00 |
| 23-Sep-10 | OW | 2.99 | 3.46 |
| 10-Dec-10 | OW | 3.72 | 4.06 |
| 28-Feb-11 | OW | 3.94 | 4.50 |
| 22-Sep-11 | N | 3.06 | 3.50 |
| 28-Sep-11 | N | 3.50 | 3.90 |
| 20-Jan-12 | N | 3.88 | 3.95 |
| 10-Apr-12 | N | 3.96 | 4.00 |
| 13-Dec-12 | N | 3.15 | 3.60 |
| 14-Mar-13 | OW | 3.30 | 4.00 |
| 15-May-13 | OW | 3.91 | 4.60 |
| 23-Sep-13 | N | 3.28 | 3.50 |
| 26-Mar-14 | N | 2.98 | 3.20 |
| 17-Apr-15 | N | 3.49 | 3.50 |
| 19-Sep-15 | OW | 3.28 | 3.80 |

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.

| Date | Rating | Share Price (M\$) | Price Target (M\$) |
|-----------|--------|-------------------|--------------------|
| 16-Sep-14 | OW | 1.94 | 2.40 |
| 27-Mar-15 | OW | 1.95 | 2.60 |
| 19-Sep-15 | OW | 1.46 | 2.10 |

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