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# Results Review

## Sunway REIT — Neutral

REIT | Bloomberg Ticker: SREIT MK | Bursa Code: 5176

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**12-month upside potential**

| | |
|---|---|
| Previous target price | 1.40 |
| Revised target price | 1.34 |
| Current price (as at 29 Oct) | 1.36 |
| Capital upside (%) | -1.5 |
| Net distribution (%) | 6.1 |
| Total return (%) | 4.6 |

**Key stock information**

| | |
|---|---|
| Syariah-compliant? | No |
| Market Cap (RM m) | 3,973.1 |
| Units outstanding (m) | 2,921.4 |
| Free float (%) | 42.5 |
| 52-week high / low (RM) | 1.65 / 1.26 |
| 3-mth avg volume ('000) | 1,625.2 |
| 3-mth avg turnover (RM m) | 2.2 |

**Unit price performance**

| | 1M | 3M | 6M |
|---|---|---|---|
| Absolute (%) | -4.2 | 0.7 | -15.0 |
| Relative (%) | -6.3 | -1.4 | -19.6 |

**Unit price chart**


Source: Bloomberg

# 1QFY14: No let down

**Sunway REIT's 1QFY14 results came within expectations, with annualised realised net income making up 100.9% and 96.8% of ours and consensus full year forecasts. As results came within expectation, we keep our forecasts unchanged. Nonetheless, we lower our TP by 4.3% to RM1.34, as we raise the beta, We also roll forward our DDM-valuation model and lower our market risk premium from 5.6% to 5.5% to reflect the change in market required return. With no near term positive catalysts insight, we maintain our NEUTRAL call on Sunway REIT. Our revised TP now implies a yield of 6.2% for FY14.**

## 1QFY14 inline, hospitality segment get hit

- Sunway REIT's 1QFY14 realised net income (RNI) came within expectation, with annualised net income represents 100.9% and 96.8% of ours and consensus full year forecasts.
- 1QFY14 revenue grew by 0.4% y-o-y but contracted by 3.6% q-o-q, mainly driven by (1) solid performance from office segment (+7.7% y-o-y, and +3.4% q-o-q), and (2) additional income contribution from Sunway Medical Centre, which was acquired on 31 Dec 2012.
- Office segment revenue growth was mainly attributed to (1) the completion of asset enhancement initiative (AEI) at Menara Sunway, which leads to an NLA increase of 5%, (2) higher average occupancy rate at Sunway Tower (1QFY14: 88.3% vs 1QFY13: 81.3%) due to additional space taken up by an existing anchor tenant, and (3) higher rental reversion in Sunway Putra Tower due to alignment to the market rates arising from the low rental base.
- On q-o-q basis, 1QFY14 revenue was dragged by (1) weaker performance from its hotel due to market competition, and, (2) loss of income from Sunway Putra Mall as it was closed for major refurbishment in April 2013.
- On the positive side, its key asset, Sunway Pyramid Shopping Mall continues to do well by achieving a better tenancy mix, as it added a number of renowned international tenants such as Thomas Sabo, Swarovski Crystal, Armani Exchange and soon to be opened Sephora, Victoria Secret, H&M and TWG Tea Company.
- In terms of net property income (NPI), Sunway REIT achieved 5.8% y-o-y growth and a 1.8% q-o-q contraction. Given that the NPI growth is stronger than revenue growth, SREIT management has once again demonstrated good cost control capability. The cost savings stemmed from lower operating expenditure and utilities expenses at Sunway Pyramid as a result of energy saving upon the completion of the chiller retrofit exercise.
- 1QFY14 financing cost implies effective interest rate of 3.73% p.a.
- All in, 1QFY14 core EPU grew by 6.5% y-o-y but contracted marginally by 0.2% q-o-q.
- Sunway REIT declared its first interim DPU of 2.00 sen, which was 105.3% of its RNI in 1QFY14. This represents 24% of our full year DPU estimate of 8.32 sen. Out of this 2.00 sen DPU, 1.65 sen per unit is taxable while 0.35 sen per unit is non-taxable. The ex-date and entitlement date for the third interim DPU are 11 Nov and 28 Nov respectively

## Key takeaway from the conference call

- In terms of asset acquisition, management guided that making yield accretive acquisition is increasingly difficult due to the expansion of M-REITs yields in the recent months. Hence, they prefer to be more prudent as they anticipate more opportunities to emerge in the medium term as market softens. In short, SREIT will focus on AEI to deliver better DPU going forward.
- In addition, management hinted risk of lower (y-o-y) DPU in FY14, given that operating environment in the hospitality and office segments are getting increasingly competitive.
- On foreign shareholdings level, it has reduced marginally from 20.5% in June 2013 to 20.2% in Sept 2013.

## No change to our forecasts

- As results came within expectation, we keep our forecasts unchanged.

## Maintain NEUTRAL with lower TP of RM1.34 (-4.3%)

- We maintain our NEUTRAL call on Sunway REIT with a lower TP of RM1.34 (-4.3%), as we raise the beta from 0.83 to 0.87. We also roll forward our DDM-valuation model while revising our market risk premium from 5.6% to 5.5% to reflect the change in market required return. Post adjustments, our DDM-based TP implies a net yield of 6.2% for FY14.
- Key risks include:- (1) rising interest rate which could result to higher cost of equity that undermines our DDM valuation model, and (2) a sharp economic slowdown which will affect domestic consumptions and investment activities.

## SNAPSHOT OF FINANCIAL RESULTS

**Figure 1 : Results commentaries**

| | 1QFY14 | 1QFY13 | % y-o-y change | % q-o-q change | 3MFY14 | 3MFY13 | % y-o-y change | Comments |
|---|---|---|---|---|---|---|---|---|
| **Key financial highlights** | | | | | | | | |
| Gross rental income (RM m) | 100.2 | 99.8 | 0.4 | -3.6 | 100.2 | 99.8 | 0.4 | 1QFY14 revenue grew by 0.4% y-o-y but contracted by 3.6% q-o-q, mainly driven by solid performance from office segment and new income contribution from Sunway Medical Centre. The q-o-q contraction was mainly due to weaker performance from its hotel and loss of income from Sunway Putra Mall as it was closed for major refurbishment in April 2013. |
| Operating costs (RM m) | -23.0 | -26.9 | -14.4 | -9.1 | -23.0 | -26.9 | -14.4 | Operating costs were lowered by 14.4% y-o-y and 9.1% q-o-q, thanks to lower operating expenditure and utilities expenses from Sunway Pyramid as a result of energy saving upon the completion of the chiller retrofit exercise. |
| Net rental income (RM m) | 77.2 | 72.9 | 5.8 | -1.8 | 77.2 | 72.9 | 5.8 | |
| Others (RM m) | 0.5 | 0.3 | | | 0.5 | 0.3 | | |
| Total trust income (RM m) | 77.7 | 73.1 | 6.2 | -69.2 | 77.7 | 73.1 | 6.2 | |
| Financing cost (RM m) | -15.5 | -14.7 | 5.5 | -1.0 | -15.5 | -14.7 | 5.5 | |
| Other trust expenditure (RM m) | -6.7 | -6.4 | 5.3 | -13.9 | -6.7 | -6.4 | 5.3 | |
| Net income (RM m) | 55.4 | 52.0 | 6.5 | -75.8 | 55.4 | 52.0 | 6.5 | |
| Core net income (RM m) | 55.4 | 52.0 | 6.5 | -0.2 | 55.4 | 52.0 | 6.5 | All in, 1QFY14 core net income came within expectations, with annualised net income represents 100.9% and 96.8% of ours and consensus full year forecasts. |
| Realised net income (RM m) | 55.4 | 52.0 | 6.5 | -0.2 | 55.4 | 52.0 | 6.5 | |
| **Per share data** | | | | | | | | |
| EPS (sen) | 1.90 | 1.93 | -1.6 | -76.5 | 1.90 | 1.93 | -1.6 | |
| Core EPS (sen) | 1.90 | 1.93 | -1.6 | 3.8 | 1.90 | 1.93 | -1.6 | |
| Net DPU (sen) | 2.00 | 2.03 | | | 2.00 | 2.03 | | First interim DPU of 2.0 sen in line (ex-date: 12 Nov 2013, payment date: 28 Nov 2013) |
| NAV/share (RM) | 1.20 | 1.12 | | | 1.20 | 1.12 | | |
| **Other key indicators** | | | | | | | | |
| Gearing (x) | 0.31 | 0.33 | | | 0.31 | 0.33 | | |
| Net rental margin (%) | 77.0 | 73.1 | | | 77.0 | 73.1 | | |
| Core net margin (%) | 55.3 | 52.1 | | | 55.3 | 52.1 | | |
| Payout ratio (%) | 105.3 | 105.2 | | | 105.3 | 105.2 | | |
| Revenue by segment (RM m) | 100.2 | 99.8 | 0.4 | -3.6 | 100.2 | 99.8 | 0.4 | |
| Retail | 70.2 | 73.3 | -4.2 | -1.1 | 70.2 | 73.3 | -4.2 | |
| Hotel | 14.3 | 16.3 | -12.5 | -18.8 | 14.3 | 16.3 | -12.5 | |
| Office | 10.9 | 10.2 | 7.7 | 3.4 | 10.9 | 10.2 | 7.7 | Office segment revenue growth was mainly attributed to, (1) the completion of AEI at Menara Sunway which leads to an NLA increase of 5%, (2) higher average occupancy rate at Sunway Tower (1QFY14- 88.3% vs 1QFY13-81.3%) due to additional space taken up by an existing anchor tenant, and (3) higher rental reversion in Sunway Putra Tower due to alignment to the market rates arising from the low rental base. |
| Hospital | 4.8 | 0.0 | | | 4.8 | 0.0 | | |

*Source: Company, Alliance Research*

## Figure 2 : Key financial data

| FYE 30 June | FY12 | FY13 | FY14F | FY15F | FY16F |
|---|---|---|---|---|---|
| Revenue (RM m) | 406.4 | 415.9 | 427.0 | 453.5 | 485.7 |
| EBITDA (RM m) | 270.2 | 281.2 | 293.2 | 311.5 | 335.1 |
| EBIT (RM m) | 270.2 | 281.0 | 293.2 | 311.4 | 335.1 |
| Pretax profit (RM m) | 420.5 | 392.3 | 229.9 | 244.6 | 267.8 |
| Reported net profit (RM m) | 420.5 | 392.3 | 229.9 | 244.6 | 268.8 |
| Core net profit (RM m) | 190.3 | 218.8 | 229.9 | 244.6 | 267.8 |
| EPU (sen) | 15.6 | 14.0 | 7.9 | 8.3 | 9.1 |
| Core EPU (sen) | 7.1 | 7.8 | 7.9 | 8.3 | 9.1 |
| Alliance / Consensus (%) | | | 100.5 | 94.7 | 90.3 |
| Core EPU growth (%) | 12.8 | 10.6 | 0.5 | 6.1 | 9.1 |
| P/E (x) | 19.2 | 17.5 | 17.3 | 16.3 | 14.9 |
| EV/EBITDA (x) | 19.3 | 19.7 | 19.5 | 18.5 | 17.2 |
| ROE (%) | 6.3 | 6.6 | 6.9 | 7.3 | 7.9 |
| Gearing (%) | 33.4 | 32.0 | 33.8 | 34.3 | 33.9 |
| Net DPU (sen) | 7.5 | 8.3 | 8.3 | 8.8 | 9.6 |
| Net distribution yield (%) | 5.5 | 6.1 | 6.1 | 6.5 | 7.0 |
| NAV/share (RM) | 1.12 | 1.20 | 1.15 | 1.15 | 1.15 |
| P/NAV (x) | 1.2 | 1.1 | 1.2 | 1.2 | 1.2 |

*Source: Alliance Research, Bloomberg*

## Figure 3 : Previous-DDM valuation model

**DDM Valuation Model**

**Key Assumptions:**

| | |
|---|---|
| Market Risk Premium (MRP) | 5.6% |
| Beta (*B* ) | 0.83 |
| Risk free rate (Rf) | 4.0% |
| Constant DPU growth rate (g) | 2.0% |
| | |
| Cost of equity (r) = Rf + (*B* x MRP) | 8.6% |

Equity value per share (RM) = Present value of future dividend + Terminal value

$$= D0 + \frac{D1}{(1+r)^{n}} + \frac{D2}{(1+r)^{n+1}} + \frac{D3}{(1+r)^{n+1}} + \left[ \frac{D3 \times (1+g)}{(r-g)} \times \frac{1}{(1+r)^{n+1}} \right]$$

$$= 0.020 + \frac{0.083}{(1.086)^{1}} + \frac{0.088}{(1.086)^{2}} + \frac{0.096}{(1.086)^{3}} + \left[ \frac{0.096 \times (1.02)}{(0.086 - 0.02)} \times \frac{1}{(1.086)^{2}} \right]$$

$$= 0.020 + 0.077 + 0.075 + 0.075 + 1.154$$

$$= 1.40$$

* n = period

*Source: Alliance Research, Bloomberg*

## Figure 4 : Revised-DDM valuation model

**DDM Valuation Model**

**Key Assumptions:**

| | |
|---|---|
| Market Risk Premium (MRP) | 5.5% |
| Beta (*B* ) | 0.87 |
| Risk free rate (Rf) | 4.0% |
| Constant DPU growth rate (g) | 2.0% |
| | |
| Cost of equity (r) = Rf + (*B* x MRP) | 8.8% |

Equity value per share (RM) = Present value of future dividend + Terminal value

$$= D0 + \frac{D1}{(1+r)^{n}} + \frac{D2}{(1+r)^{n+1}} + \frac{D3}{(1+r)^{n+1}} + \left[ \frac{D3 \times (1+g)}{(r-g)} \times \frac{1}{(1+r)^{n+1}} \right]$$

$$= 0.020 + \frac{0.063}{(1.088)^{1}} + \frac{0.088}{(1.088)^{2}} + \frac{0.096}{(1.088)^{3}} + \left[ \frac{0.097 \times (1.02)}{(0.088 - 0.02)} \times \frac{1}{(1.088)^{3}} \right]$$

$$= 0.020 + 0.058 + 0.074 + 0.074 + 1.118$$

$$= 1.34$$

* n = period

*Source: Alliance Research, Bloomberg*

# DISCLOSURE

## Stock rating definitions

| | | |
|---|---|---|
| Strong buy | - | High conviction buy with expected 12-month total return (including dividends) of 30% or more |
| Buy | - | Expected 12-month total return of 15% or more |
| Neutral | - | Expected 12-month total return between -15% and 15% |
| Sell | - | Expected 12-month total return of -15% or less |
| Trading buy | - | Expected 3-month total return of 15% or more arising from positive newsflow. However, upside may not be sustainable |

## Sector rating definitions

| | | |
|---|---|---|
| Overweight | - | Industry expected to outperform the market over the next 12 months |
| Neutral | - | Industry expected to perform in-line with the market over the next 12 months |
| Underweight | - | Industry expected to underperform the market over the next 12 months |

## Commonly used abbreviations

Adex = advertising expenditure
bn = billion
BV = book value
CF = cash flow
CAGR = compounded annual growth rate
Capex = capital expenditure
CY = calendar year
Div yld = dividend yield
DCF = discounted cash flow
DDM = dividend discount model
DPS = dividend per share
EBIT = earnings before interest & tax
EBITDA = EBIT before depreciation and amortisation

EPS = earnings per share
EV = enterprise value
FCF = free cash flow
FV = fair value
FY = financial year
m = million
M-o-m = month-on-month
NAV = net assets value
NM = not meaningful
NTA = net tangible assets
NR = not rated
p.a. = per annum
PAT = profit after tax

PBT = profit before tax
P/B = price / book ratio
P/E = price / earnings ratio
PEG = P/E ratio to growth ratio
q-o-q = quarter-on-quarter
RM = Ringgit
ROA = return on assets
ROE = return on equity
TP = target price
trn = trillion
WACC = weighted average cost of capital
y-o-y = year-on-year
YTD = year-to-date

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