

Flash Note

Refer to important disclosures at the end of this report

Malaysia Equity Research

12 Aug 2016

Sunway REIT (SREIT MK) : BUY

Mkt. Cap: US\$1,233m | 3m Avg. Daily Val: US\$0.77m

Last Traded Price : RM1.68

Price Target 12-mth: RM1.80 (7% upside) (Prev RM1.80)

Shariah Compliant: No

Analyst

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Performing well in a challenging environment

- In-line 4Q16 earnings; supported by contribution from Sunway Putra Mall
- FY16 earnings improvement in retail and hotel segments dampened by lacklustre office segment
- We retain our positive outlook on rising Sunway Putra contributions, asset enhancement initiatives and asset injection opportunities
- DPU of 2.12 sen declared with ex-date of 25 Aug

Forecasts and Valuation

FY Jun (RMm)	2015A	2016A	2017F	2018F
Gross Revenue	453	507	562	600
Net Property Inc	341	374	428	462
Total Return	541	271	306	338
Distribution Inc	256	271	306	338
EPU (sen)	18.5	8.92	10.2	11.2
EPU Gth (%)	31	(52)	14	10
DPU (sen)	8.73	9.19	10.2	11.2
DPU Gth (%)	4	5	11	10
NAV per shr (sen)	136	136	136	136
PE (X)	9.1	18.8	16.5	15.0
Distribution Yield (%)	5.2	5.5	6.0	6.7
P/NAV (x)	1.2	1.2	1.2	1.2
Aggregate Leverage (%)	33.3	35.5	35.7	35.9
ROAE (%)	14.1	6.5	7.5	8.2

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P

Highlights

- FY16 net realised distributable income of RM262.5m was in line with our expectations and consensus forecasts, taking into account the contribution from Sunway Putra Mall (SPM) and improvement in NPI for the retail and hotel segments. However, the improvement in earnings for the hotel and retail segments was dragged down by the poor performance of the office segment
- 4QFY16 registered a net realised distributable income of RM60.6m (+7% y-o-y) and NPI of RM90.2m (+7% y-o-y), supported by the inclusion of the new asset, but NPI margin was dragged down to 73% (3QFY16: 74.2%) due to refurbishment costs for SPM. There was a revaluation gain of RM63.5m in the quarter
- A DPU of 2.12 sen was declared, which brings FY16 DPU to 9.18 sen, thus implying a full payout.

Earnings anchored by retail segment

- The retail segment (the biggest contributor) recorded FY16 revenue/NPI of RM382.8m/RM269.4m with y-o-y growth of 15%/14%, as Sunway Pyramid's occupancy was steady at c.98.3% in 4QFY16 (4QFY15: 98.1%). Decent renewals were also secured in FY16 for both Sunway Pyramid and Sunway Carnival.
- We are positive about the upcoming reversions in FY17 as a large portion of expiries are from Sunway Pyramid/Sunway Carnival (31%/12% of overall retail

leases by NLA). We forecast the reversion rates will be averaging in the mid- to high-single digits.

- It was disclosed that SPM's occupancy reached c.85%, and tenants such as TGV Cinema and H&M have opened to help draw footfall. We look forward to higher contributions and expect occupancy to reach c.90% by end-2016.

Hotel segment improving plans for asset enhancement.

- The hospitality segment continued to surprise on the upside amid a challenging environment, with FY16 revenue/NPI of RM72.8m/RM68.8m registering y-o-y growth of 19%/17%, due to strong performances from Sunway Resort Hotel & Spa and Sunway Putra Hotel. This was attributed to improved tourist arrivals that are backed by government initiatives to boost tourism, such as the implementation of the e-Visa system effective from 1 March 2016. In addition, Dewan Bandaraya Kuala Lumpur's (DBKL) decision to freeze approvals for new hotels is positive measure in curbing the excess supply of hotels in Kuala Lumpur. NPI was also boosted by new contribution from Sunway Hotel Georgetown.
- In view of the intensifying competition, management plans to embark on a refurbishment project for Pyramid Hotel East which saw its occupancy rate drop to 55.2% in 3QFY16 (3QFY15: 73.8%). The decline is mainly due to lower demand from corporates and the progressive closure of the hotel prior to the commencement of its refurbishment plan in 4QFY16. The project (with a budgeted capex of c.RM130m) commenced in April 2016, with full closure of the hotel in 4QFY16. The hotel is expected to reopen in 3QFY17. The NPI foregone (FY15: RM18m) will be offset by the recent inclusion of assets.

Struggling office segment

- The office segment was a major drag due to significant vacancies at Sunway Tower and Sunway Putra Tower, leading to FY16 revenue/NPI of RM30.3m/RM14.5m (-23%/-42% y-o-y).
- We foresee that the office segment will face challenges in filling up occupancies in the current oversupplied and weak market environment. Additionally, some progress was made in replenishing occupancies at Sunway Tower and Sunway Putra Tower after the departure of anchor tenants. New tenants have been secured for Sunway Tower/Sunway Putra Tower – equivalent to 13%/9% of individual property NLA.

Valuation

Our DDM-derived TP is RM1.80, with 8% cost of equity and 1.5% terminal growth. This stock provides an FY17F (FYE Jun) yield of c.6%. We reiterate BUY on SunREIT, premised on its DPU prospects and asset growth potential.

Key risk

Slower-than-anticipated assets injection from its sponsor, weak rental reversion amid dampened consumer sentiment, and vacancy risk for office space amid an oversupplied market are the key earnings risks for SunREIT.

Outlook

Still positive about its prospects. We remain positive on Sunway REIT (SunREIT). Its DPU remains attractive in the near to medium term, following the completion of refurbishment works for Sunway Putra assets (mall, office and hotel) and full-year income contribution from Sunway Hotel Georgetown. Furthermore, we expect further earnings accretion from the asset enhancement work done on Pyramid Tower East, slated to be completed by 3QFY17.

Visible sponsor asset pipeline. Sunway REIT's sponsor and shareholder (37% stake) Sunway Bhd has a large pipeline of potential assets for injection under its "build-own-operate" model. Future injections could include Sunway University and Monash University campuses, The Pinnacle office tower, Sunway Giza mall, Sunway VeloCity mall and Sunway Pyramid Phase 3. These underpin an attractive growth pipeline for the REIT. We are optimistic about potential injections from sponsor Sunway Bhd to meet the REIT's RM7bn asset target by 2017.

Quarterly / Interim Income Statement (RMm)

FY Jun	4Q2015	3Q2016	4Q2016	% chg yoy	% chg qoq
Gross revenue	115	130	124	7.5	(5.2)
Property expenses	(30.5)	(33.7)	(33.4)	9.5	(0.7)
Net Property Income	84.4	96.7	90.2	6.8	(6.7)
Other Operating expenses	(7.3)	(10.3)	(9.2)	25.6	(10.8)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	N/A	N/A
Net Interest (Exp)/Inc	(20.0)	(21.6)	(21.5)	7.5	(0.2)
Exceptional Gain/(Loss)	0.0	2.95	1.20	N/A	N/A
Net Income	57.1	67.7	60.6	6.2	(10.5)
Tax	0.0	0.0	0.0	N/A	N/A
Minority Interest	0.0	0.0	0.0	N/A	N/A
Net Income after Tax	57.1	67.7	60.6	6.2	(10.5)
Total Return	364	67.7	60.6	(83.3)	(10.5)
Non-tax deductible Items	0.0	0.0	7.82	nm	nm
Net Inc available for Dist.	60.2	69.7	70.7	17.5	1.4
Ratio (%)					
Net Prop Inc Margin	73.4	74.2	73.0		
Dist. Payout Ratio	98.7	99.4	112.4		

Source of all data: Company, AllianceDBS

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	10 Aug 15	1.54	1.75	BUY
2:	12 Aug 15	1.50	1.75	BUY
3:	29 Oct 15	1.49	1.75	BUY
4:	30 Oct 15	1.53	1.70	BUY
5:	28 Apr 16	1.62	1.70	BUY
6:	28 Jun 16	1.66	1.80	BUY

Note: Share price and Target price are adjusted for corporate actions.

Source: AllianceDBS

Analyst: Inani ROZIDIN

DISCLOSURE

Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

Commonly used abbreviations

Adex = advertising expenditure	EPS = earnings per share	PBT = profit before tax
bn = billion	EV = enterprise value	P/B = price / book ratio
BV = book value	FCF = free cash flow	P/E = price / earnings ratio
CF = cash flow	FV = fair value	PEG = P/E ratio to growth ratio
CAGR = compounded annual growth rate	FY = financial year	q-o-q = quarter-on-quarter
Capex = capital expenditure	m = million	RM = Ringgit
CY = calendar year	M-o-m = month-on-month	ROA = return on assets
Div yld = dividend yield	NAV = net assets value	ROE = return on equity
DCF = discounted cash flow	NM = not meaningful	TP = target price
DDM = dividend discount model	NTA = net tangible assets	trn = trillion
DPS = dividend per share	NR = not rated	WACC = weighted average cost of capital
EBIT = earnings before interest & tax	p.a. = per annum	y-o-y = year-on-year
EBITDA = EBIT before depreciation and amortisation	PAT = profit after tax	YTD = year-to-date

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