

Company Guide

Sunway REIT

Version 5 | Bloomberg: SREIT MK | Reuters: SUNW.KL

Refer to important disclosures at the end of this report

Malaysia Equity Research

28 Oct 2016

BUY

Last Traded Price (27 Oct 2016): RM1.77 (KLCI : 1,669.03)

Price Target 12-mth: RM1.95 (10% upside) (Prev RM1.80)

Shariah Compliant: No

Potential Catalyst: Yield-accretive acquisitions, higher reversions

Where we differ: Higher DPU accretion forecast compared to consensus

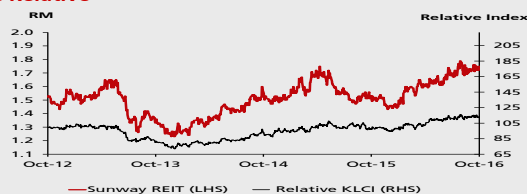
Analyst

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What's New

- In-line 1Q17 earnings
- Earnings boosted by improvements in the retail segment
- Retaining our positive outlook on rising Sunway Putra contributions, asset-enhancement work and asset-injection opportunities
- DPU of 2.27 sen declared with ex-date of 10 Nov

Price Relative



Forecasts and Valuation

FY Jun (RMm)	2016A	2017F	2018F	2019F
Gross Revenue	507	562	600	626
Net Property Inc	374	428	462	484
Total Return	271	306	338	354
Distribution Inc	271	306	338	354
EPU (sen)	8.92	10.2	11.2	11.8
EPU Gth (%)	(52)	14	10	5
DPU (sen)	9.19	10.2	11.2	11.8
DPU Gth (%)	5	11	10	5
NAV per shr (sen)	136	136	136	136
PE (X)	19.9	17.4	15.8	15.0
Distribution Yield (%)	5.2	5.7	6.3	6.7
P/NAV (x)	1.3	1.3	1.3	1.3
Aggregate Leverage (%)	35.5	35.7	35.9	36.2
ROAE (%)	6.5	7.5	8.2	8.6

Distn. Inc Chng (%):	0	0	0
Consensus DPU (sen):	9.20	10.0	10.1
Other Broker Recs:	B: 7	S: 1	H: 5

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

To keep for FY17

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 Sunway Pyramid Hotel, slated to be completed by 2QFY17. Furthermore, SunREIT could benefit further from the continued expectations of further monetary policy easing.

Asset enhancement underway. Management plans to embark on a refurbishment project for Sunway Pyramid Hotel which saw its occupancy rate dropping to 55% in 3QFY16 (3QFY15: 74%). The drop is mainly due to lower demand from corporates. The decline is mainly due to lower demand from corporates and the progressive closure of the hotel pre-prior to the commencement of its refurbishment plan. The project (with a budgeted capex of c.RM120m) is expected to commence progressively in April 2016 with full closure of the hotel by 4QFY16 for approximately 12 months with a budgeted capex of c.RM120m. The NPI foregone (FY15: RM18m) will be offset by the recent inclusion of assets.

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.

Valuation:

Our DDM-derived TP rises to RM1.95, with 7% cost of equity and 1% TG, as we adjust our risk-free rate assumption from 4.0% to 3.9% to reflect the compression in MGS yield.

Key Risks to Our View:

Pace of acquisitions. Sunway REIT's yields are on par with its larger M-REIT peers. The draw is the potential to secure steady acquisitions. On this note, any significant delay in acquisitions could hamper its share price appreciation, especially as its peers are also looking at asset growth.

At A Glance

Issued Capital (m shrs)	2,945
Mkt. Cap (RMm/US\$m)	5,213 / 1,252
Major Shareholders (%)	
Sunway Berhad	37.3
Employees Provident Fund	12.04
Skim Amanah Saham	9.88
Free Float (%)	39.7
3m Avg. Daily Val (US\$m)	1.4

ICB Industry : Real Estate / Real Estate Investment Trusts

WHAT'S NEW

Resilient earnings

- 1QFY17 net distributable income of RM72m (15% y-o-y) was largely in line with our expectations and consensus forecasts, taking into account contribution from Sunway Putra Mall (SPM) and improvement in NPI for the retail segment. NPI margins remained stable at 74.5%.
- A DPU of 2.27 sen was declared, implying a full payout.
- Management has received RM3.2m court award that is related to Sunway Putra which will be recognised in 2QFY17 following confirmation of the legal case closure.

Resilient performance from retail segment

- The highest contributing retail segment recorded a 1QFY17 NPI of RM71.5m (+17% y-o-y), as Sunway Pyramid's occupancy was steady at c.97.9% in 1QFY17 (1QFY16: 98.3%). The shift in occupancy level is due to the introduction of two anchor tenants and reshuffling of the mall's existing tenant mix. We understand that retail sales in Jan-Aug 2016 grew by 10% y-o-y. The percentage of lease expiring in Sunway Pyramid for FY17 is 19% of total portfolio NLA. Out of which, 59.6% of the leases expiring for the mall in FY17 were renewed in 1QFY17 at a single-digit rental reversion rate over the three-year tenancy term.
- The percentage of lease expiring in Sunway Carnival for FY17 is 28% of total portfolio NLA. Out of which, 60% of the leases expiring for the mall in FY17 were renewed in 1QFY17 at a single-digit rental reversion rate over the three-year tenancy term. The renewal has included the anchor tenant in the mall.
- It was disclosed that SPM's occupancy reached 85.2% (from 83.9%), and tenants such as TGV Cinema, Padini and Uniqlo have opened to help draw footfall. We look forward to higher contributions as we expect occupancy to reach c.90% by end-FY17.
- We expect SunREIT's retail assets to maintain its performance throughout FY17.

Hotel segment improving with plans for asset enhancement.

- The hospitality segment continues to progress with 1QFY17 NPI of RM15.4m registering a y-o-y decline of 22%, due to the closure of Sunway Pyramid Hotel (formerly known as Pyramid Tower East). Sunway Pyramid Hotel is undergoing refurbishment during the quarter, which is expected to complete by 2QFY17. Excluding the NPI contribution from Sunway Pyramid Hotel in 1QFY16, overall hotel portfolio's NPI grew by 13% y-o-y.
- Sunway Resort Hotel & Spa's average occupancy rate rose to 94.3% in 1QFY17 (1QFY16: 87.4%). The encouraging occupancy was attributable to strong Middle-Eastern tourists during the summer holiday season.
- The average occupancy rate for Sunway Putra Hotel has also improved to 69.0% in 1QFY17 (1QFY16: 36.5%) as the hotel was still undergoing refurbishment during the same period last year. Post completion of refurbishment in 2QFY16, the hotel has embarked on active marketing activities and promotional rates to regain market shares across all segments.

Office segment struggles

- The office segment remained a drag due to significant vacancies at Sunway Tower and Sunway Putra Tower, leading to 1QFY17 NPI of RM3.7m (- 9% y-o-y).
- We foresee the office segment facing challenges in filling up occupancies in the current oversupplied and weak market environment. Additionally, little headway was made in replenishing occupancies at Sunway Tower and Sunway Putra Tower after the departure of anchor tenants.

Quarterly / Interim Income Statement (RMm)

FY Jun	1Q2016	4Q2016	1Q2017	% chg yoy	% chg qoq
Gross revenue	121	124	129	6.3	4.3
Property expenses	(31.3)	(33.4)	(32.8)	4.9	(1.8)
Net Property Income	89.9	90.2	96.1	6.8	6.5
Other Operating expenses	(3.9)	(9.2)	(10.2)	157.7	10.4
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	N/A	N/A
Net Interest (Exp)/Inc	(21.5)	(21.5)	(21.8)	(1.3)	(1.0)
Exceptional Gain/(Loss)	(4.0)	1.20	2.59	N/A	N/A
Net Income	60.6	60.6	66.7	10.2	10.1
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	60.6	60.6	66.7	10.2	10.1
Total Return	60.6	60.6	66.7	10.2	10.1
Non-tax deductible Items	0.0	7.82	4.50	nm	(42.5)
Net Inc available for Dist.	62.3	70.7	71.7	15.1	1.4
Ratio (%)					
Net Prop Inc Margin	74.2	73.0	74.5		
Dist. Payout Ratio	99.1	112.4	106.7		

Source of all data: Company, AllianceDBS

Sunway REIT

CRITICAL DATA POINTS TO WATCH

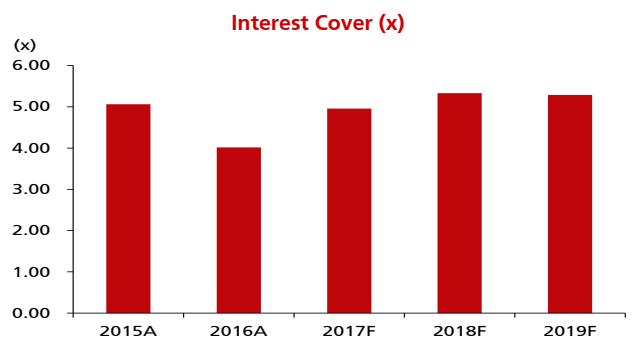
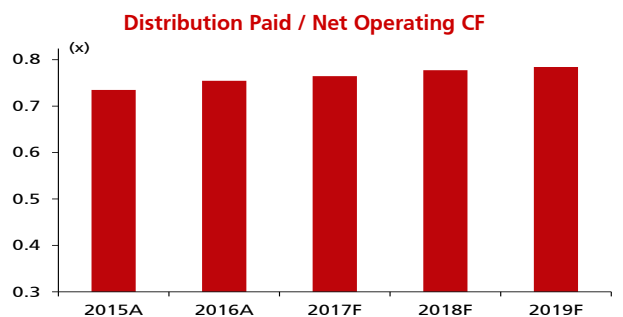
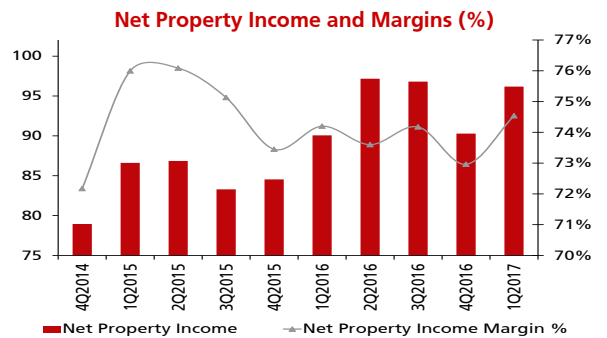
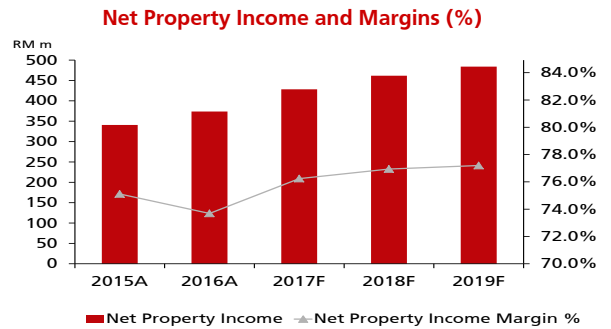
Earnings Drivers:

Performance at Sunway Pyramid a key earnings driver. Despite its diversified portfolio of 14 assets, SunREIT derives the bulk of its income (c.60% NPI) from its crown jewel, the 1.6m sq ft NLA Sunway Pyramid retail asset. Located in the Sunway Resort City township, the Egyptian-themed mall is one of the better performing properties in its portfolio. The property enjoys strong visitation from locals and tourists, and has sustained high occupancy rates of 98-99%. Rental reversions have averaged in the high single digits per annum. As a result of the strong recurring footfall and connectivity, we expect such trends to continue against a modest retail market outlook.

Sunway Resort City’s performance will accelerate going forward. We remain positive on the outlook for Sunway Resort City township. It is already registering strong visitations of 40m per annum. And, visitations should leap with the completion of the BRT-Sunway Line – a 6-km elevated bus rapid transit path that will connect seven key public transport stations. In addition, ongoing developments at Sunway Pyramid Phase 3 – an integrated retail and hotel project by the Sunway Group – will improve the township’s appeal to locals and tourists. SunREIT is expected to benefit from the ongoing rejuvenation of the township. And apart from Sunway Pyramid, the REIT has four other assets – Sunway Resort, Hotel & Spa, Pyramid Tower hotel, Menara Sunway office tower, and Sunway Medical Centre. All these properties are expected to perform strongly on the back of a growing population and higher visitations.

Asset-enhancement plans. Management plans to embark on a refurbishment project for Pyramid Tower East, which saw its occupancy rate dropping to 55% in 3QFY16 (3QFY15: 74%). The drop is mainly due to lower demand from corporates and the progressive closure of the hotel prior to the commencement of its refurbishment plan. The project (with a budgeted capex of c.RM120m) is expected to commence progressively in April 2016 with full closure of the hotel by 4QFY16 for approximately 12 months. The NPI foregone (FY15: RM18m) will be offset by the recent inclusion of assets.

Weakness in office segment will moderate growth potential. We foresee the office segment to face challenges in filling up occupancies in the current oversupplied and weak market environment. Additionally, little headway has been made in replenishing occupancies at Sunway Tower and Sunway Putra Tower after the departure of their anchor tenants.



Source: Company, AllianceDBS

Balance Sheet:

Sensible gearing levels. SunREIT has historically kept total debt/total assets ratio at 33-35%, which is a comfortable level. This leaves room to gear up for acquisition opportunities, but we believe any deals are likely to be funded by a mixture of debt and equity, given the manager's track record of conservative gearing levels. At present, of its RM2.1bn borrowings, RM1.4bn is from a commercial paper facility that will expire in four tranches between Oct 2017 and Apr 2018. The rest are on a monthly rollover basis. We also note that about half of SunREIT's manager fees are paid in units.

Share Price Drivers:

Acquisition newsflow. One of SunREIT's appeal is the availability of asset acquisition pipeline of completed investment properties from sponsor Sunway Bhd. Confirmation of injections at accretive yields will be key re-rating signals for the stock.

Yield spread. A REIT's attractiveness depends on its distribution yield relative to other fixed-income assets. A common benchmark is the REIT's yield spread over the indicative 10-year Malaysian Government Securities yield, which is currently stabilising near the 3.8% level.

Key Risks:

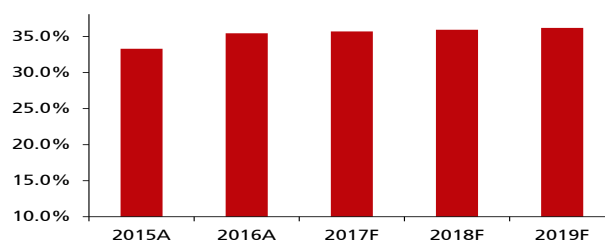
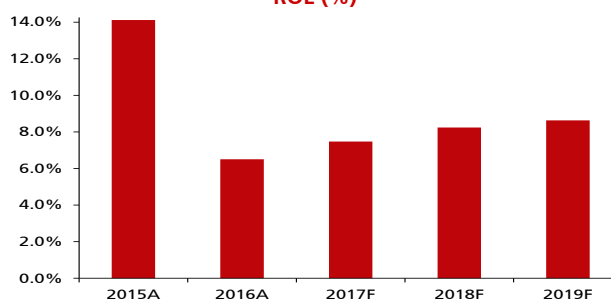
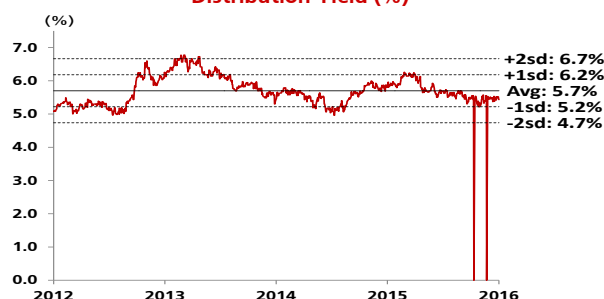
Pace of acquisitions. SunREIT's yields are on par with its larger M-REIT peers, so the draw is the potential to secure a steady stream of acquisitions. On this note, any significant delay in acquisitions could cap its share price appreciation, especially as its peers are also looking at asset growth.

Weak general sentiment. A dampened consumer sentiment may have a negative effect on the retail and hospitality sectors, in the form of lower retail spending, rental reversions and local tourist visits.

Office space oversupply. As the supply overhang of office space persists, it could be challenging to refill vacancies and rental rates may see negative growth

Company Background

Sunway REIT is a real estate investment trust with key assets in Bandar Sunway, Selangor, primarily the Sunway Pyramid mall. It also has hospitality and office assets, and is geographically diversified to the Penang and Perak states.

Aggregate Leverage (%)**ROE (%)****Distribution Yield (%)****PB Band (x)**

Source: Company, AllianceDBS

Sunway REIT

Key Assumptions

FY Jun	2015A	2016A	2017F	2018F	2019F
Lease Expiry Profile (%) of	26.2	6.91	38.3	22.0	17.3
SP Rental Gth (%)	11.0	8.00	10.0	12.0	12.0
SP Annual Step Up Gth	3.00	3.00	3.00	3.00	3.00

Segmental Breakdown

FY Jun	2015A	2016A	2017F	2018F	2019F
Revenues (RMm)					
Retail	333	383	398	421	443
Hotel	61.3	72.8	66.4	79.2	81.4
Office	39.1	30.3	49.4	50.5	51.6
Others	20.4	21.1	47.5	49.1	50.7
Total	453	507	562	600	626
(RMm)					
Retail	237	269	291	310	328
Hotel	58.7	68.8	61.7	74.1	76.1
Office	24.8	14.5	30.7	31.3	32.0
Others	20.4	21.1	45.0	46.5	48.0
Total	341	374	428	462	484
Margins (%)					
Retail	71.2	70.4	73.1	73.6	74.0
Hotel	95.8	94.5	92.9	93.6	93.5
Office	63.5	47.9	62.2	61.9	62.0
Others	100.0	100.0	94.7	94.7	94.7
Total	75.2	73.7	76.3	77.0	77.2

Income Statement (RMm)

FY Jun	2015A	2016A	2017F	2018F	2019F
Gross revenue	453	507	562	600	626
Property expenses	(113)	(133)	(133)	(138)	(143)
Net Property Income	341	374	428	462	484
Other Operating expenses	0.0	(27.4)	0.0	0.0	0.0
Other Non Opg (Exp)/Inc	(32.9)	0.0	(36.0)	(37.1)	(38.0)
Net Interest (Exp)/Inc	(67.3)	(86.2)	(86.4)	(86.6)	(91.5)
Exceptional Gain/(Loss)	307	2.26	0.0	0.0	0.0
Net Income	547	262	306	338	354
Tax	(5.9)	0.0	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	541	262	306	338	354
Total Return	541	271	306	338	354
Non-tax deductible Items	14.1	8.51	0.0	0.0	0.0
Net Inc available for Dist.	256	271	306	338	354
Growth & Ratio					
Revenue Gth (%)	6.0	11.8	10.8	6.8	4.5
N Property Inc Gth (%)	6.2	9.7	14.6	7.8	4.8
Net Inc Gth (%)	31.7	(51.5)	16.6	10.4	4.9
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	75.2	73.7	76.3	77.0	77.2
Net Income Margins (%)	119.4	51.8	54.5	56.4	56.6
Dist to revenue (%)	56.5	53.4	54.5	56.4	56.6
Managers & Trustee's fees	0.0	5.4	0.0	0.0	0.0
ROAE (%)	14.1	6.5	7.5	8.2	8.6
ROA (%)	9.0	4.0	4.5	4.9	5.1
ROCE (%)	5.8	5.4	6.5	6.9	7.2
Int. Cover (x)	5.1	4.0	5.0	5.3	5.3

Source: Company, AllianceDBS

Quarterly / Interim Income Statement (RMm)

FY Jun	1Q2016	2Q2016	3Q2016	4Q2016	1Q2017
Gross revenue	121	132	130	124	129
Property expenses	(31.3)	(34.8)	(33.7)	(33.4)	(32.8)
Net Property Income	89.9	97.1	96.7	90.2	96.1
Other Operating expenses	(3.9)	(3.9)	(10.3)	(9.2)	(10.2)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(21.5)	(21.6)	(21.6)	(21.5)	(21.8)
Exceptional Gain/(Loss)	(4.0)	2.06	2.95	1.20	2.59
Net Income	60.6	73.6	67.7	60.6	66.7
Tax	0.0	0.0	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	60.6	73.6	67.7	60.6	66.7
Total Return	60.6	73.6	67.7	60.6	66.7
Non-tax deductible Items	0.0	0.0	0.0	7.82	4.50
Net Inc available for Dist.	62.3	75.6	69.7	70.7	71.7
Growth & Ratio					
Revenue Gth (%)	5	9	(1)	(5)	4
N Property Inc Gth (%)	7	8	0	(7)	7
Net Inc Gth (%)	6	21	(8)	(10)	10
Net Prop Inc Margin (%)	74.2	73.6	74.2	73.0	74.5
Dist. Payout Ratio (%)	99.1	99.3	99.4	112.4	106.7

Balance Sheet (RMm)

FY Jun	2015A	2016A	2017F	2018F	2019F
Investment Properties	6,324	6,697	6,726	6,754	6,783
Other LT Assets	5.27	7.60	9.92	12.3	14.6
Cash & ST Invts	80.6	88.9	92.3	97.9	100
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	20.2	22.7	25.0	26.7	27.9
Other Current Assets	0.0	0.0	0.0	0.0	0.0
Total Assets	6,430	6,816	6,853	6,891	6,926
ST Debt	763	793	823	853	853
Creditor	0.0	3.53	3.81	3.95	4.08
Other Current Liab	223	223	223	223	223
LT Debt	1,379	1,624	1,624	1,624	1,654
Other LT Liabilities	83.0	83.0	83.0	83.0	83.0
Unit holders' funds	3,982	4,090	4,097	4,105	4,109
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	6,430	6,816	6,853	6,891	6,926
Non-Cash Wkg. Capital	(203)	(204)	(202)	(200)	(199)
Net Cash/(Debt)	(2,061)	(2,328)	(2,355)	(2,379)	(2,407)
Ratio					
Current Ratio (x)	0.1	0.1	0.1	0.1	0.1
Quick Ratio (x)	0.1	0.1	0.1	0.1	0.1
Aggregate Leverage (%)	33.3	35.5	35.7	35.9	36.2
Z-Score (X)	1.6	1.5	1.5	1.5	1.5

Source: Company, AllianceDBS

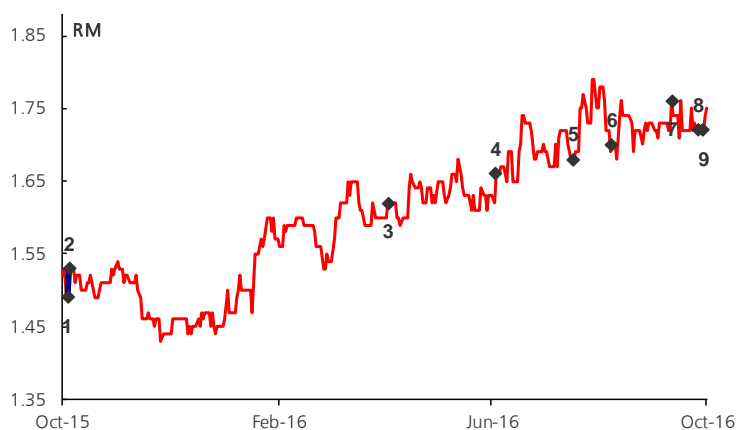
Sunway REIT

Cash Flow Statement (RMm)

FY Jun	2015A	2016A	2017F	2018F	2019F
Pre-Tax Income	547	271	306	338	354
Dep. & Amort.	0.36	0.91	1.19	1.47	1.75
Tax Paid	(5.9)	0.0	0.0	0.0	0.0
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	101	0.97	(2.0)	(1.6)	(1.1)
Other Operating CF	(295)	89.8	86.4	86.6	91.5
Net Operating CF	348	363	392	424	447
Net Invt in Properties	(404)	(376)	(32.3)	(32.3)	(32.3)
Other Invt (net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	3.34	2.48	2.80	2.92	3.34
Net Investing CF	(401)	(374)	(29.5)	(29.4)	(29.0)
Distribution Paid	(255)	(274)	(299)	(330)	(350)
Chg in Gross Debt	393	275	30.0	30.0	30.0
New units issued	0.0	102	0.0	0.0	0.0
Other Financing CF	(72.0)	(83.8)	(89.2)	(89.5)	(94.9)
Net Financing CF	65.1	19.2	(359)	(389)	(415)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	11.6	8.32	3.43	5.57	2.49
Operating CFPS (sen)	8.40	12.3	13.1	14.1	14.9
Free CFPS (sen)	(1.9)	(0.5)	11.9	13.0	13.8

Source: Company, AllianceDBS

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	29 Oct 15	1.49	1.75	BUY
2:	30 Oct 15	1.53	1.70	BUY
3:	28 Apr 16	1.62	1.70	BUY
4:	28 Jun 16	1.66	1.80	BUY
5:	11 Aug 16	1.68	1.80	BUY
6:	02 Sep 16	1.70	1.80	BUY
7:	06 Oct 16	1.76	1.80	BUY
8:	21 Oct 16	1.72	1.80	BUY
9:	24 Oct 16	1.72	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

DISCLAIMER

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