Malaysia Company Guide

Sunway REIT

Version 4 | Bloomberg: SREIT MK | Reuters: SUNW.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

28 Jun 2016

BUY

Last Traded Price: RM1.62 (KLCI : 1,629.52)
Price Target : RM1.80 (11% upside) (Prev RM1.70)

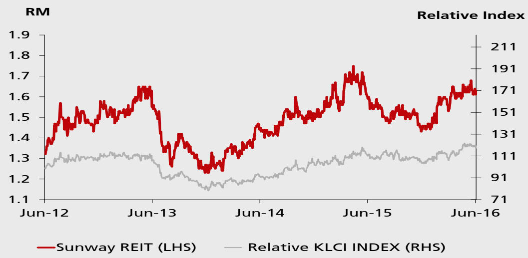
Potential Catalyst: Yield-accretive acquisitions
Where we differ: Higher DPU accretion forecast compared to consensus

Analyst
Inani ROZIDIN +603 2604 3905 inanirozidin@alliancedbs.com

What's New

- **Long-term extension plan for Sunway Carnival Mall**
- **Retaining our positive outlook on rising Sunway Putra contributions, asset-enhancement work and asset-injection opportunities**
- **TP raised on lower risk-free rate assumption**

Price Relative



Forecasts and Valuation

FY Jun (RMm)	2015A	2016F	2017F	2018F
Gross Revenue	453	511	562	600
Net Property Inc	341	388	428	462
Total Return	541	271	306	338
Distribution Inc	256	280	306	338
EPU (sen)	18.5	9.12	10.2	11.2
EPU Gth (%)	31	(51)	11	10
DPU (sen)	8.73	9.41	10.2	11.2
DPU Gth (%)	4	8	8	10
NAV per shr (sen)	136	136	136	136
PE (X)	8.8	17.8	15.9	14.4
Distribution Yield (%)	5.4	5.8	6.3	6.9
P/NAV (x)	1.2	1.2	1.2	1.2
Aggregate Leverage (%)	33.3	35.5	35.7	35.9
ROAE (%)	14.1	6.7	7.5	8.2
Distn. Inc Chng (%):		0	0	0
Consensus DPU (sen):		8.80	9.50	10.0
Other Broker Recs:		B: 4	S: 1	H: 7

Source of all data: Company, AllianceDBS Research, Bloomberg Finance L.P

Noteworthy prospects

TP raised on lower risk-free rate assumption. Given the prevalent risk-off environment particularly following the Brexit and expectation of continued easy monetary policies, our house risk-free rate assumption (based on 10-year MGS yield) has been lowered to 4.0% (from 4.3%).

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.

Valuation:

Our DDM-derived TP is revised to RM1.80, following the change in our risk-free rate assumption, with 8% cost of equity and 1.5% terminal growth. This stock provides an FY17F (FYE Jun) yield of c.6.2%. We reiterate BUY on SunREIT, premised on its strong DPU growth prospects and asset growth potential.

Key Risks to Our View:

Slower-than-anticipated assets injection from sponsor, weak rental reversion amid dampened consumer sentiment and vacancy risk for office space amid oversupply conditions are the key risks to the earnings prospects of SunREIT.

At A Glance

Issued Capital (m shrs)	2,942
Mkt. Cap (RMm/US$m)	4,767 / 1,165
Major Shareholders (%)	
Sunway Bhd	37.3
Employees Provident Fund	12.04
Skim Amanah Saham	9.88
Free Float (%)	39.7
3m Avg. Daily Val (US$m)	0.54
ICB Industry : Real Estate / Real Estate Investment Trusts	

WHAT'S NEW

Resilient performance

Plans to expand Sunway Carnival Mall

SunREIT announced that it has entered into a sale and purchase agreement with Commercial Parade Sdn Bhd, an indirect wholly-owned subsidiary of Sunway Berhad, for the acquisition of a piece of 3.3-acre (143.2k sf) vacant land for RM17.2m. The acquisition will be funded by cash and the land is located at Seberang Perai, Penang, adjacent to Sunway Carnival Shopping Mall. This is to facilitate future expansion plans of the existing Sunway Carnival mall. The acquisition is expected to be completed by 1HFY17, pending the SC's approvals.

We are positive about the news in the long term, albeit there is minimal near-term earnings impact with the acquisition still subject to the SC's approval as the REIT guidelines do not permit such greenfield asset injection. The acquisition will not come to fruition without the SC's approval. Moreover, the project is still in the preliminary stages, with the size and cost of the extension not finalised. We do not expect the extension to be accretive in the near term, as construction will probably begin in 1HFY18 with a completion period of 3-4 years. As such, we have not imputed this into our forecasts.

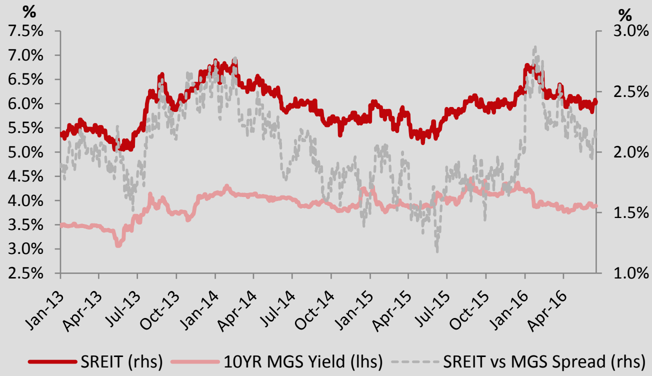
TP revision on lower risk-free rate assumption

Several factors have led us to lower our house's assumption on risk-free rate which is based on the benchmark 10-year MGS yield. Firstly, central banks of major economies (US, Japan and Europe) have continued to adopt loose monetary stance despite keeping interest rate near zero level for close to a decade post-Global Financial Crisis. This was mainly due to tame inflationary pressure and weak economic growth trajectory. On 15 June 2016, US Fed maintained its interest rates at the FOMC Meeting, and indicated that it still plans to raise rates twice in CY16, though it telegraphed slower economic growth would slow the pace of monetary policy tightening in future years. Note that expectation of the number of rate hikes in CY16 has reduced to two from four earlier this year.

Secondly, investors have generally turned risk-off amid weak earnings growth and macro uncertainty. In particular, recent Brexit event has triggered massive sell-off in risk assets in favour of safe haven assets.

Taking these factors into account, AllianceDBS' risk free-rate assumption has been lowered from 4.3% to 4.0%. Note that the 10-year MGS yield has retraced from a high of 4.45% in August 2015 to the present level of 3.8%-3.9% since the last US Fed rate hike in Dec 2015.

Exhibit 1: SREIT yield vs 10yr MGS spread



Source: Bloomberg, AllianceDBS Research

Our TP increases by 6%, following the change in our 10-year MGS yield assumptions. We maintain our BUY recommendation.

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.

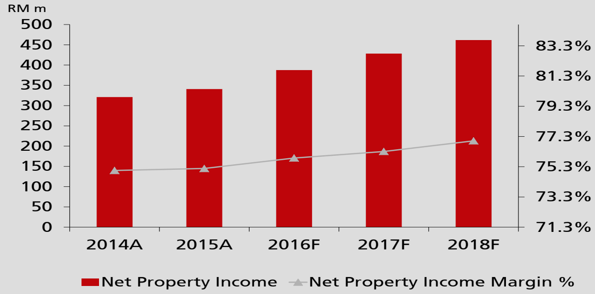
Sunway Resort City's performance will accelerate going forward. We remain positive on the outlook for Sunway Resort City township. It is already registering strong visitations of 40m per annum. And, visitations should leap with the completion of the BRT-Sunway Line – a 6-km elevated bus rapid transit 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 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.

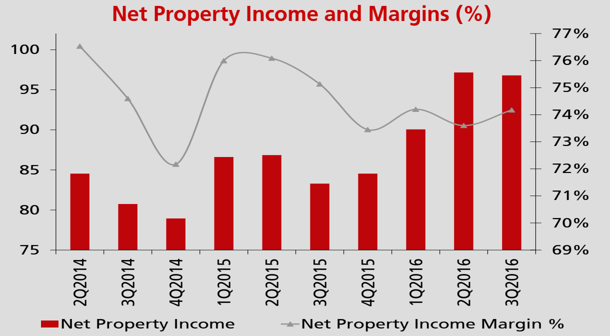
Weakness in office segment will moderate growth potential. We foresee the office segment to face challenges in filling up vacancies in the current oversupplied and weak market environment. Additionally, little headway has been made in replenishing occupancies at Sunway Tower and Sunway Putra Tower after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

About 94% of debt is locked in at fixed rates. SunREIT's borrowings comprise mostly several tranches of its fixed-rate 7-year commercial papers, with maturities ranging from late-2017 to 2018. Overall, about 94% of its borrowings are on fixed rates with an average cost of debt of c.3.88%, but we anticipate this will inch up to c.4% in FY17 as existing debt will be renewed at higher rates.

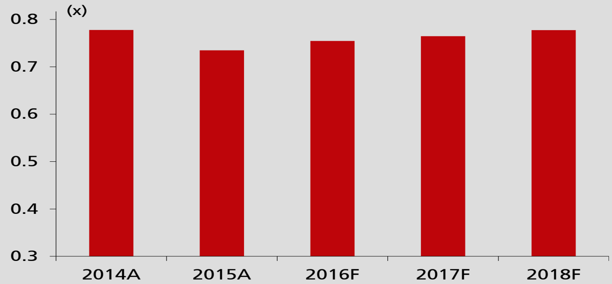
Net Property Income and Margins (%)



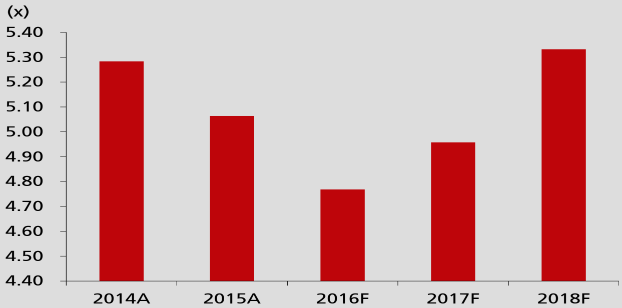
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, AllianceDBS Research

Balance Sheet:

Manageable gearing level. 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 maintaining conservative gearing levels. At present, of its c.RM2.2bn borrowings, RM1bn is from a commercial paper facility that will expire in four tranches between late-2017 and 1H2018. The rest are on a monthly rollover basis. We also note that about half of manager's fees are paid in units.

Share Price Drivers:

Acquisition newsflow. One of SunREIT's appeals is the availability of an asset acquisition pipeline of completed investment properties from sponsor Sunway Bhd. Confirmation of injections at accretive yields will be key re-rating catalysts 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 4.0% 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 share price appreciation, especially as its peers are also looking at asset growth.

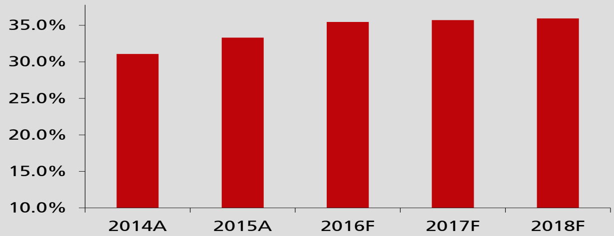
Weak general sentiment. Dampened consumer sentiment may have negative effects on the retail and hospitality sectors, in the form of lower retail spending, rental reversions and local tourist visits.

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.

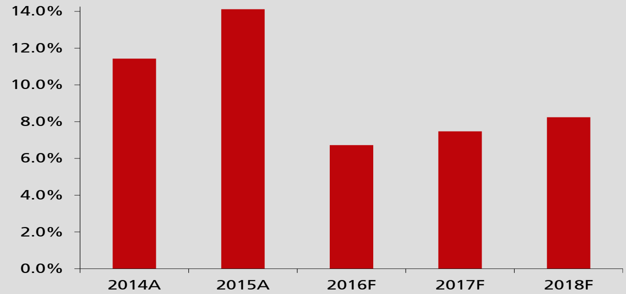
Company Background

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.

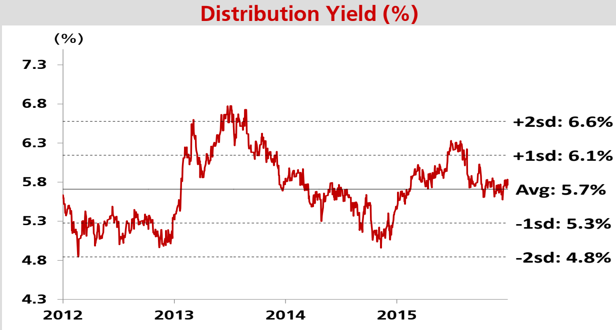
Aggregate Leverage (%)



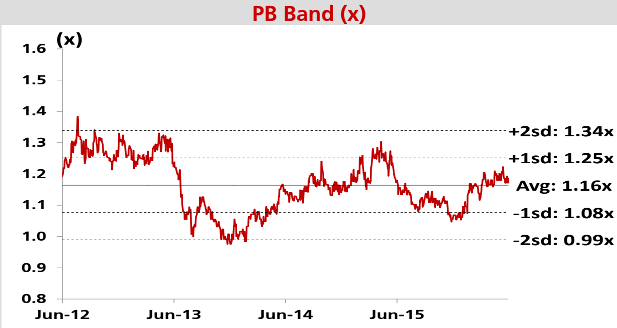
ROE (%)



Distribution Yield (%)



PB Band (x)



Source: Company, AllianceDBS Research

Key Assumptions

FY Jun	2014A	2015A	2016F	2017F	2018F
Lease Expiry Profile (%) of NLA	52.4	26.2	6.91	38.3	22.0
SP Rental Gth (%)	11.3	11.0	8.00	10.0	12.0
SP Annual Step Up Gth (%)	3.00	3.00	3.00	3.00	3.00

Segmental Breakdown

FY Jun	2014A	2015A	2016F	2017F	2018F
Revenues (RMm)					
Retail	301	333	378	398	421
Hotel	64.6	61.3	63.1	66.4	79.2
Office	43.1	39.1	36.4	49.4	50.5
Others	19.3	20.4	33.8	47.5	49.1
Total	**428**	**453**	**511**	**562**	**600**
Operating Profit (RMm)					
Retail	213	237	274	291	310
Hotel	60.8	58.7	58.7	61.7	74.1
Office	28.2	24.8	22.3	30.7	31.3
Others	19.3	20.4	32.5	45.0	46.5
Total	**321**	**341**	**388**	**428**	**462**
Operating Profit Margins					
Retail	70.7	71.2	72.6	73.1	73.6
Hotel	94.1	95.8	93.0	92.9	93.6
Office	65.3	63.5	61.1	62.2	61.9
Others	100.0	100.0	96.4	94.7	94.7
Total	**75.0**	**75.2**	**75.9**	**76.3**	**77.0**

Income Statement (RMm)

FY Jun	2014A	2015A	2016F	2017F	2018F
Gross revenue	428	453	511	562	600
Property expenses	(107)	(113)	(123)	(133)	(138)
Net Property Income	**321**	**341**	**388**	**428**	**462**
Other Operating expenses	0.0	0.0	0.0	0.0	0.0
Other Non Opg (Exp)/Inc	(28.2)	(32.9)	(35.0)	(36.0)	(37.1)
Net Interest (Exp)/Inc	(60.8)	(67.3)	(81.3)	(86.4)	(86.6)
Exceptional Gain/(Loss)	179	307	0.0	0.0	0.0
Net Income	**411**	**547**	**271**	**306**	**338**
Tax	0.0	(5.9)	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	**411**	**541**	**271**	**306**	**338**
Total Return	411	541	271	306	338
Non-tax deductible Items	12.9	14.1	8.51	0.0	0.0
Net Inc available for Dist.	245	256	280	306	338
Growth & Ratio					
Revenue Gth (%)	2.8	6.0	12.7	9.9	6.8
N Property Inc Gth (%)	3.8	6.2	13.7	10.5	7.8
Net Inc Gth (%)	4.8	31.7	(49.9)	12.8	10.4
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	75.0	75.2	75.9	76.3	77.0
Net Income Margins (%)	96.1	119.4	53.1	54.5	56.4
Dist to revenue (%)	57.2	56.5	54.8	54.5	56.4
Managers & Trustee's fees	0.0	0.0	0.0	0.0	0.0
ROAE (%)	11.4	14.1	6.7	7.5	8.2
ROA (%)	7.6	9.0	4.1	4.5	4.9
ROCE (%)	6.0	5.8	6.1	6.5	6.9
Int. Cover (x)	5.3	5.1	4.8	5.0	5.3

Source: Company, AllianceDBS Research

Quarterly / Interim Income Statement (RMm)

FY Jun	3Q2015	4Q2015	1Q2016	2Q2016	3Q2016
Gross revenue	111	115	121	132	130
Property expenses	(27.5)	(30.5)	(31.3)	(34.8)	(33.7)
Net Property Income	83.2	84.4	89.9	97.1	96.7
Other Operating expenses	(8.8)	(7.3)	(3.9)	(3.9)	(10.3)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(17.6)	(20.0)	(21.5)	(21.6)	(21.6)
Exceptional Gain/(Loss)	2.11	0.0	(4.0)	2.06	2.95
Net Income	**58.9**	**57.1**	**60.6**	**73.6**	**67.7**
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	**58.9**	**57.1**	**60.6**	**73.6**	**67.7**
Total Return	58.9	364	60.6	73.6	67.7
Non-tax deductible Items	0.0	0.0	0.0	0.0	0.0
Net Inc available for Dist.	62.5	60.2	62.3	75.6	69.7
Growth & Ratio					
Revenue Gth (%)	(3)	4	5	9	(1)
N Property Inc Gth (%)	(4)	1	7	8	0
Net Inc Gth (%)	(6)	(3)	6	21	(8)
Net Prop Inc Margin (%)	75.1	73.4	74.2	73.6	74.2
Dist. Payout Ratio (%)	99.5	98.7	99.1	99.3	99.4

Balance Sheet (RMm)

FY Jun	2014A	2015A	2016F	2017F	2018F
Investment Properties	5,520	6,324	6,697	6,726	6,754
Other LT Assets	3.04	5.27	7.60	9.92	12.3
Cash & ST Invts	67.1	80.6	88.9	92.3	97.9
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	12.1	20.2	22.7	25.0	26.7
Other Current Assets	4.23	0.0	0.0	0.0	0.0
Total Assets	**5,606**	**6,430**	**6,816**	**6,853**	**6,891**
ST Debt	742	763	793	823	853
Creditor	3.31	0.0	3.53	3.81	3.95
Other Current Liab	113	223	223	223	223
LT Debt	1,000	1,379	1,624	1,624	1,624
Other LT Liabilities	60.3	83.0	83.0	83.0	83.0
Unit holders' funds	3,688	3,982	4,090	4,097	4,105
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**5,606**	**6,430**	**6,816**	**6,853**	**6,891**
Non-Cash Wkg. Capital	(99.7)	(203)	(204)	(202)	(200)
Net Cash/(Debt)	(1,675)	(2,061)	(2,328)	(2,355)	(2,379)
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 (%)	31.1	33.3	35.5	35.7	35.9
Z-Score (X)	1.8	1.5	1.4	1.4	1.4

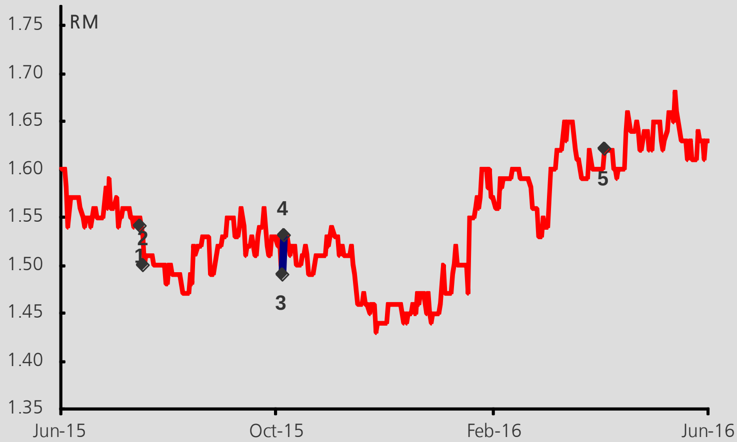
Source: Company, AllianceDBS Research

Cash Flow Statement (RMm)

FY Jun	2014A	2015A	2016F	2017F	2018F
Pre-Tax Income	411	547	271	306	338
Dep. & Amort.	0.36	0.36	0.91	1.19	1.47
Tax Paid	0.0	(5.9)	0.0	0.0	0.0
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	17.0	101	0.97	(2.0)	(1.6)
Other Operating CF	(114)	(295)	89.8	86.4	86.6
Net Operating CF	**315**	**348**	**363**	**392**	**424**
Net Invt in Properties	(121)	(404)	(376)	(32.3)	(32.3)
Other Invts (net)	0.0	0.0	0.0	0.0	0.0
Invts 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	2.28	3.34	2.48	2.80	2.92
Net Investing CF	**(118)**	**(401)**	**(374)**	**(29.5)**	**(29.4)**
Distribution Paid	(245)	(255)	(274)	(299)	(330)
Chg in Gross Debt	106	393	275	30.0	30.0
New units issued	0.0	0.0	102	0.0	0.0
Other Financing CF	(62.4)	(72.0)	(83.8)	(89.2)	(89.5)
Net Financing CF	**(201)**	**65.1**	**19.2**	**(359)**	**(389)**
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	(4.7)	11.6	8.32	3.43	5.57
Operating CFPS (sen)	10.2	8.40	12.2	13.1	14.1
Free CFPS (sen)	6.64	(1.9)	(0.4)	11.9	13.0

Source: Company, AllianceDBS Research

Target Price & Ratings History



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

S.No.	Date	Closing Price	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

Source: AllianceDBS Research