

18 March 2016

# Sunway REIT

## Poised for growth, but limited upside

**Hold** (from Buy)

**Price**  
RM1.58

**Target price**  
RM1.70

The impact from growing vacancies within SunREIT's office segment does not appear as significant to us, while the group is still poised for growth via its retail segment and pipeline of potential injections from Sunway Bhd. Given that there is now limited upside to our TP of RM1.70, we downgrade the stock to a Hold.

### Market data

Bloomberg code	SREIT MK
No. of shares (m)	2,941
Market cap (RMm)	4,647
52-week high/low (RM)	1.65 / 1.41
Avg daily turnover (RMm)	4.0
KLCI (pts)	1,703

Source: Bloomberg

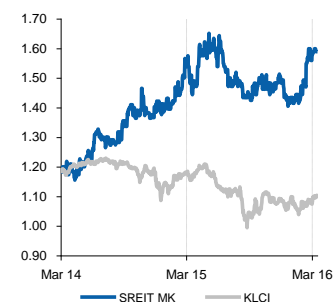
### Valuation

Target price (RM)	1.70
Methodology	DDM
Key assumptions	g = 4.0%
	COE = 9.3%
Implied FY16 PE (x)	19.1
Implied FY16 PBV (x)	1.3
Implied FY16 Yield (%)	5.2

Source: KAF

### Performance

	1M	3M	12M
Absolute (%)	1	11	9
Rel market (%)	(1)	8	15



Source: Bloomberg

### Analyst

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### Financial Highlights

FYE Jun (RMm)	FY14	FY15	FY16F	FY17F	FY18F
Revenue	427.8	453.5	511.1	508.5	554.5
Reported net profit	411.1	541.4	262.4	262.4	293.5
Normalised net profit	232.0	242.0	262.4	262.4	293.5
EPS (sen)	7.9	8.2	8.9	8.9	10.0
Gross DPS (sen)	8.4	8.7	8.9	8.9	10.0
P/E (x)	12.1	9.2	19.1	19.1	17.0
ROE (%)	11.4	14.1	6.6	6.6	7.4
Dividend yield (%)	5.2	5.5	5.6	5.6	6.2
Net gearing (%)	32.1	34.3	34.1	34.1	34.0
P/BV (x)	1.3	1.2	1.2	1.2	1.2

Source: Company, KAF

### Impact of the office segment is not bad as it seems

Sunway REIT's (SunREIT) office segment has performed poorly in the past few quarters, as there were significant vacancies particularly in Sunway Putra Tower and Sunway Tower. Given the weak market environment, we believe it will be challenging for the management to fill up these vacancies in the near term. However, the office segment only makes up 12% of total gross floor area (Chart 3) and contributed ~6% to overall 1HFY16 revenues (8% between FY14-15). The REIT still derives the bulk of its income from the retail and hotel segments which continues to do well. The retail segment, in particular, looks set to continue benefiting from the reopening of Sunway Putra Mall (SPM) which appears to be gaining good traction and Sunway Pyramid's resilient track record of constant growth.

### Growth to sustain driven by the commissioning of new assets and retail segment

We did some minor housekeeping on our FY16 numbers and trim FY17 forecasts by 5.5%, after factoring in: 1) the loss of income from the full closure of Pyramid Tower East in FY17 for a yearlong refurbishment exercise, 2) lower occupancy rates from the office segment, and 3) higher contribution from SPM following its reopening last year. We also introduce FY18 forecasts. We project earnings to grow at a decent CAGR of 7% between FY15 and FY18, driven by incremental contributions from its two new properties, SPM and the reopening of Pyramid Tower East in FY18. In spite of the revisions, our DDM based target price remains unchanged at RM1.70 as we roll our valuation one year forward.

### Limited upside, downgrade to Hold

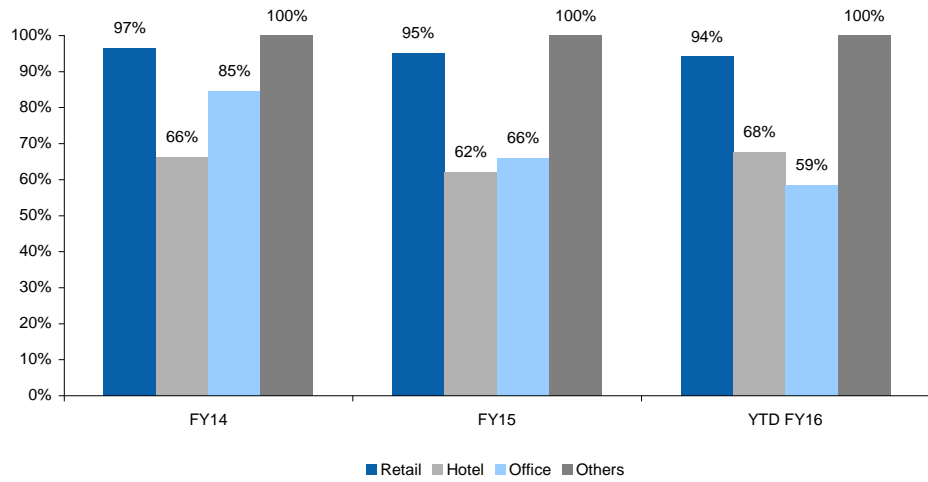
SunREIT's share price has performed well, climbing up 29% from its low in December 2013 (-9% for KLCI) and 9% YTD (+0.2% for KLCI), as investors sought defensive stocks amidst the uncertain market conditions. We remain positive on SunREIT's growth prospects as the retail segment continues to do well, and it has a pipeline of potential assets from its sponsor, Sunway (SWB MK, Buy, RM3.05). However, due to the limited upside to our target price, we downgrade SunREIT to a Hold. The current FY16 yield of 5.6% is also no longer as attractive, below the sector average of 6.0%. Downside risks are prolonged vacancies in existing assets and non-renewal of expiring leases, especially within the office segment.

Produced by KAF-Seagroatt &amp; Campbell Securities Sdn Bhd

Important disclosures can be found in the Disclosure Appendix

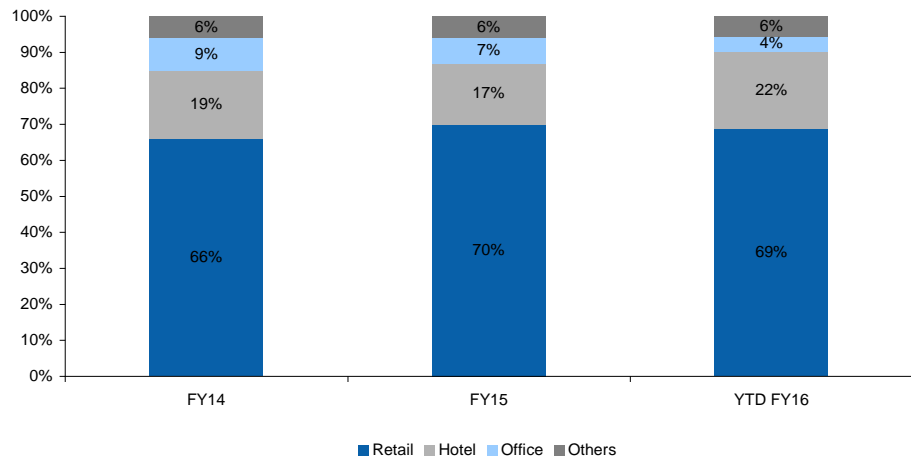
# Relevant charts and tables

**Chart 1 : Occupancy rate breakdown by segment**



Source: Company

**Chart 2 : NPI contribution by segment**



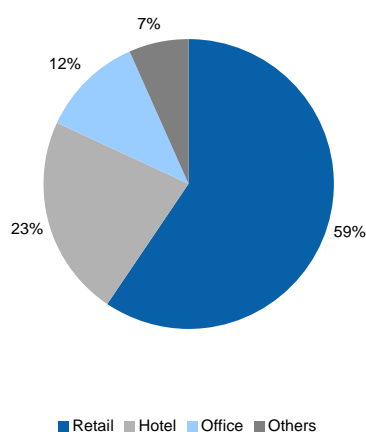
Source: Company

**Table 1 : Earnings revisions**

RMm	Original		Revised		Change	
	FY16	FY17F	FY16	FY17F	FY16	FY17F
Revenue	500.8	522.0	511.1	508.5	2.1%	-2.6%
NPI	376.4	392.3	381.6	379.6	1.4%	-3.2%
Pretax profit	262.4	277.6	262.4	262.4	0.0%	-5.5%
Net profit	262.4	277.6	262.4	262.4	0.0%	-5.5%

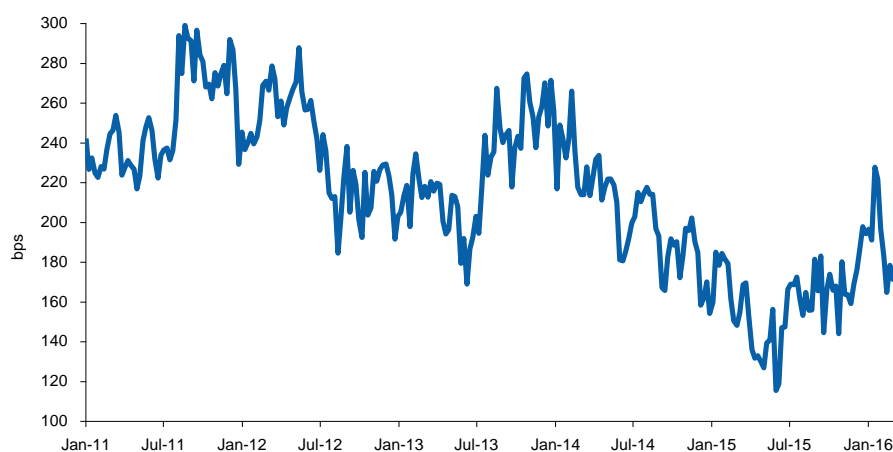
Source: Company, KAF

**Chart 3 : Segmental breakdown by gross floor area (GFA)**



Source: Company

**Chart 4 : Spread between SunREIT's dividend yield vs 10-year MGS bond yield**



Source: Bloomberg

**Table 2 : Peer comparison**

Company	Rec	Mkt Cap (RMm)	Price (RM)	TP (RM)	PER (x)		PBV (x)		ROE (%)		Yield (%)	
					2016F	2017F	2016F	2017F	2016F	2017F	2016F	2017F
Al-Aqar Healthcare REIT	BUY	1,092	1.50	1.80	17.0	16.8	1.2	1.2	7.2	7.3	5.9	6.0
Amanahraya REIT	BUY	504	0.88	1.36	12.4	12.2	0.8	0.8	6.1	6.2	7.6	7.8
AmFirst REIT	BUY	508	0.74	1.18	11.4	11.2	0.6	0.6	5.2	5.3	8.8	8.9
Atrium REIT	BUY	130	1.07	1.79	11.4	11.2	0.8	0.8	7.6	7.9	9.2	9.5
Axis REIT	HOLD	1,661	1.51	1.70	18.1	18.0	1.2	1.2	6.8	6.8	5.5	5.6
Hektar REIT	BUY	609	1.52	1.91	12.2	11.8	1.0	1.0	8.0	8.2	7.6	7.8
IGB REIT	BUY	5,321	1.53	1.55	19.0	18.2	1.4	1.4	7.6	8.0	5.9	6.2
Pavilion REIT	BUY	5,405	1.79	1.90	20.4	19.0	1.4	1.4	6.9	7.4	4.9	5.3
MRCB-Quill REIT	BUY	754	1.14	1.44	11.7	11.4	0.8	0.8	7.0	7.2	8.1	8.3
YTL Hospitality REIT	BUY	1,404	1.06	1.21	14.1	14.0	0.8	0.9	6.1	6.2	6.4	7.1
<b>Sunway REIT</b>	<b>HOLD</b>	<b>4,676</b>	<b>1.58</b>	<b>1.70</b>	<b>17.8</b>	<b>16.8</b>	<b>1.2</b>	<b>1.2</b>	<b>6.6</b>	<b>7.0</b>	<b>5.6</b>	<b>5.9</b>
Tower REIT	BUY	334	1.19	1.87	9.8	9.7	0.6	0.6	6.6	6.7	10.2	10.3
UOA REIT	BUY	677	1.60	1.64	13.8	13.7	1.1	1.1	7.7	7.8	7.2	7.3
<b>REITs</b>	<b>Overweight</b>	<b>23,030</b>			<b>16.5</b>	<b>15.8</b>	<b>1.2</b>	<b>1.2</b>	<b>7.0</b>	<b>7.3</b>	<b>6.1</b>	<b>6.3</b>

Source: Company, KAF, Bloomberg

## Income statement

FYE June (RM m)	2014	2015	2016F	2017F	2018F
Revenue	427.8	453.5	511.1	508.5	554.5
Property operating expenses	(106.8)	(112.6)	(129.5)	(128.9)	(140.5)
<b>Net property income</b>	<b>321.0</b>	<b>340.8</b>	<b>381.6</b>	<b>379.6</b>	<b>414.0</b>
Non-property operating expenses	(28.2)	(32.9)	(34.9)	(34.7)	(37.9)
<b>EBIT</b>	<b>292.8</b>	<b>307.9</b>	<b>346.7</b>	<b>344.9</b>	<b>376.1</b>
Interest income	2.3	3.4	4.0	5.7	5.6
Interest expense	(63.0)	(70.8)	(88.2)	(88.2)	(88.2)
Exceptional items	179.1	306.8	-	-	-
<b>Pretax profit</b>	<b>411.1</b>	<b>547.3</b>	<b>262.4</b>	<b>262.4</b>	<b>293.5</b>
Taxation	-	(5.9)	-	-	-
<b>Net profit</b>	<b>411.1</b>	<b>541.4</b>	<b>262.4</b>	<b>262.4</b>	<b>293.5</b>
<b>Normalised net profit</b>	<b>232.0</b>	<b>242.0</b>	<b>262.4</b>	<b>262.4</b>	<b>293.5</b>

Source: Company, KAF

## Balance sheet

FYE June (RM m)	2014	2015	2016F	2017F	2018F
<b>Non-current assets</b>					
Investment properties	5,523.0	6,329.3	6,329.3	6,329.3	6,329.3
<b>Current assets</b>					
Receivables, deposits and prepayments	16.4	20.2	22.7	22.6	24.7
Deposits, cash and bank balances	54.6	66.2	94.5	93.2	115.9
Available-for-sale financial assets	12.5	14.4	14.4	14.4	14.4
<b>Total current assets</b>	<b>83.5</b>	<b>100.8</b>	<b>131.6</b>	<b>130.2</b>	<b>154.9</b>
<b>Total Assets</b>	<b>5,606.5</b>	<b>6,430.0</b>	<b>6,460.9</b>	<b>6,459.5</b>	<b>6,484.1</b>
<b>Current liabilities</b>					
Payables and accruals	116.1	242.8	273.7	272.3	296.9
Borrowings	742.0	743.4	743.4	743.4	743.4
<b>Total current liabilities</b>	<b>858.1</b>	<b>986.2</b>	<b>1,017.1</b>	<b>1,015.7</b>	<b>1,040.3</b>
<b>Shareholders' equity</b>					
Unit holder's capital	2,702.8	2,716.5	2,716.5	2,716.5	2,716.5
Undistributed income	985.3	1,265.8	1,265.8	1,265.8	1,265.8
Shareholders' funds	3,688.1	3,982.3	3,982.3	3,982.3	3,982.3
<b>Non-current liabilities</b>					
Borrowings	1,060.3	1,461.5	1,461.5	1,461.5	1,461.5
<b>Total Finances</b>	<b>5,606.5</b>	<b>6,430.0</b>	<b>6,460.9</b>	<b>6,459.5</b>	<b>6,484.1</b>

Source: Company, KAF

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**Cash flow statement**

<b>FYE June (RM m)</b>	<b>2014</b>	<b>2015</b>	<b>2016F</b>	<b>2017F</b>	<b>2018F</b>
<b>Cashflow from operations (CFO)</b>					
Pretax profit	411.1	547.3	262.4	262.4	293.5
Adjustment for non cash items:					
Interest income	-	(3.4)	(4.0)	(5.7)	(5.6)
Interest expense	-	70.8	88.2	88.2	88.2
Others	-	-	-	-	-
Net change in working capital	314.9	347.5	28.3	(1.3)	22.6
<b>CFO</b>	<b>314.9</b>	<b>347.5</b>	<b>375.0</b>	<b>343.6</b>	<b>398.8</b>
<b>Cashflow from investing (CFI)</b>					
Acquisitions & capital expenditure	(120.6)	(404.4)	-	-	-
Others	2.3	3.3	4.0	5.7	5.6
<b>CFI</b>	<b>(118.3)</b>	<b>(401.0)</b>	<b>4.0</b>	<b>5.7</b>	<b>5.6</b>
<b>Cashflow from financing (CFF)</b>					
Proceeds from term loans	(2,870.0)	392.5	-	-	-
Issue of new units	-	-	-	-	-
Dividends paid	(244.1)	(255.4)	(262.4)	(262.4)	(293.5)
Others	2,913.6	(72.0)	(88.2)	(88.2)	(88.2)
<b>CFF</b>	<b>(200.4)</b>	<b>65.1</b>	<b>(350.6)</b>	<b>(350.6)</b>	<b>(381.7)</b>
<b>Net change in cash and cash equivalents</b>	<b>(3.9)</b>	<b>11.6</b>	<b>28.3</b>	<b>(1.3)</b>	<b>22.6</b>

Source: Company, KAF

# Disclosure Appendix

## Recommendation structure

**Absolute performance, long term (fundamental) recommendation:** The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

**Performance parameters and horizon:** Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

**Market or sector view:** This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

**Target price:** The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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