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News Flash

Sunway REIT — Neutral

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

Analyst
Ian Wan
ianwwk@alliancefg.com
+603 2604 3919

12-month upside potential

Target price	1.56
Current price (as at 3 July)	1.53
Capital upside (%)	2.0
Net distribution (%)	5.4
Total return (%)	7.4

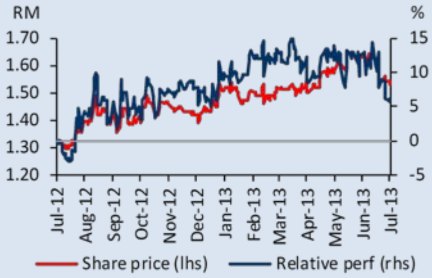
Key stock information

Syariah-compliant?	No
Market Cap (RM m)	4,466.7
Units outstanding (m)	2,919.4
Free float (%)	42.6
52-week high / low (RM)	1.65 / 1.30
3-mth avg volume ('000)	1,850.2
3-mth avg turnover (RM m)	2.9

Unit price performance

	1M	3M	6M
Absolute (%)	-6.1	2.0	0.8
Relative (%)	-6.3	-2.6	-3.6

Unit price chart



Source: Bloomberg

Guaranteed rent for Sunway Putra Hotel adjusted

Yesterday, Sunway REIT (SUNREIT) announced that the trustee, the manager and Sunway Putra Hotel Sdn Bhd (SPHSB) had on 5 January 2012 entered into a supplemental agreement to the Hotel Master Lease to document the agreement reached by the parties on the guaranteed rent payable (33.6% lower for FY14) by SPHSB, in light of a major refurbishment being carried out on the adjoining Sunway Putra Mall. We are not totally surprised by this news as we understand that the performance of Sunway Putra Hotel is likely to be adversely affected due to the major refurbishment. Nonetheless, given the net differential amount of the adjusted rent is only about 1% of SUNREIT's full year earnings for FY14, we leave our forecasts unchanged now, pending its 4QFY13 results. Hence, we keep our NEUTRAL recommendation unchanged with a DDM-based TP of RM1.56.

What's in the news

- Yesterday, SUNREIT announced that the trustee, the manager and Sunway Putra Hotel Sdn Bhd (SPHSB) had on 5 January 2012 entered into a supplemental agreement to the Hotel Master Lease (First Supplemental Agreement) to document the agreement reached by the parties on the guaranteed rent payable by SPHSB, in light of a major refurbishment being carried out on Sunway Putra Mall, a shopping mall situated on the adjoining property to the hotel commencing from 1 May 2013 for an estimated period of two years therefrom which will adversely affect the business of SPHSB.
- SPHSB has appealed to the manager and the trustee for a variation to the guaranteed rent. The manager and the trustee have agreed to enter into a second supplemental agreement to the Hotel Master Lease (Second Supplemental Agreement) to vary the guaranteed rent under the First Supplemental Agreement.
- Pursuant to the Second Supplemental Agreement, the parties agree to vary the guaranteed rent for 3rd fiscal year (FY14 for SUNREIT), with the total rent payable by SPHSB to the trustee shall be the amount calculated in accordance with the variable rent formula under the Hotel Master Lease.
- If the variable rent calculated is less than the amount of the guaranteed rent for the 3rd fiscal year, the difference (estimated at RM3.3m/ 33.6% of the guaranteed rent) between the guaranteed rent and the variable rent shall be adjusted in agreed proportions to the guaranteed rent from the 5th fiscal year until the 11th fiscal year, which shall be mutually agreed and documented by the parties in writing to supplement the Second Supplemental Agreement.
- The same variation to the total rent payable by SPHSB to the Trustee may apply to the 4th fiscal year (FY15 for SUNREIT) if requested in writing by SPHSB on the basis of continuing adverse operating conditions caused by the major refurbishment work at Sunway Putra Mall.

Our comments

- We are not totally surprised by this news as we understand that the performance of Sunway Putra Hotel is likely to be adversely affected by the major refurbishment of the adjoining Sunway Putra Mall.
- Nonetheless, given the net differential amount of the adjusted rent is only approximately 1% of SUNREIT's full year earnings for FY14, we leave our forecasts unchanged now, pending its 4QFY13 results.

Valuation and recommendation

- Hence, we keep our NEUTRAL recommendation unchanged with a DDM-based TP of RM1.56.
- Key risks include (1) rising interest rate which could result to higher cost of equity that undermine our DDM valuation model, and (2) sharp economic slowdown which affect domestic consumptions and investment activities.

Figure 1 : Key financial data

FYE 30 June	FY11	FY12	FY13F	FY14F	FY15F
Revenue (RM m)	327.4	406.4	419.4	427.0	453.5
EBITDA (RM m)	221.3	270.2	279.5	293.2	311.5
EBIT (RM m)	221.2	270.2	279.4	293.2	311.4
Pretax profit (RM m)	553.7	420.5	219.8	229.9	244.6
Reported net profit (RM m)	553.7	420.5	219.8	229.9	244.6
Core net profit (RM m)	168.1	190.3	219.8	229.9	244.6
EPU (sen)	20.6	15.6	7.8	7.9	8.3
Core EPU (sen)	6.3	7.1	7.8	7.9	8.3
Alliance / Consensus (%)			102.7	100.7	94.4
Core EPU growth (%)	N/A	12.8	10.7	0.4	6.1
P/E (x)	24.4	21.6	19.5	19.5	18.3
EV/EBITDA (x)	25.4	21.0	21.7	21.2	20.1
ROE (%)	6.0	6.3	6.6	6.9	7.3
Gearing (%)	35.1	33.4	32.0	33.8	34.3
Net DPU (sen)	6.6	7.5	8.3	8.3	8.8
Net distribution yield (%)	4.3	4.9	5.4	5.4	5.8
NAV/share (RM)	1.03	1.12	1.14	1.15	1.15
P/NAV (x)	1.5	1.4	1.3	1.3	1.3

Source: Alliance Research, Bloomberg

Figure 2 : DDM Valuation Model

Key Assumptions:	
Market Risk Premium (MRP)	7.1%
Beta (*B*)	0.50
Risk free rate (Rf)	3.5%
Constant DPU growth rate (g)	2.0%
Cost of equity (r) = Rf + (*B* x MRP)	7.1%

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

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

$$= 0.031 + \frac{0.083}{(1.071)^{1}} + \frac{0.088}{(1.071)^{2}} + \left[\frac{0.088 \times (1.02)}{(0.071 - 0.02)} \times \frac{1}{(1.071)^{2}}\right]$$

$$= 0.031 + 0.078 + 0.077 + 1.551$$

$$= 1.74$$

Target Price = DDM-derived fair value - 10% discounting factor due to its flattish EPU growth for FY14

= 1.74 - 10%

= 1.56

* 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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ALLIANCE RESEARCH SDN BHD (290395-D)
Level 19, Menara Multi-Purpose
Capital Square
8, Jalan Munshi Abdullah
50100 Kuala Lumpur, Malaysia
Tel: +60 (3) 2604 3333
Fax: +60 (3) 2604 3921
Email: allianceresearch@alliancefg.com

Bernard Ching
Executive Director / Head of Research