



AmInvestment Bank

Company Report

SUNWAY REIT

(SREIT MK EQUITY, SUNW.KL)

17 November 2023

Newly acquired assets to contribute to earnings next year

BUY

(Maintained)

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Rationale for Report: Company Results

Price RM1.55
Fair Value RM1.84
52-week High/Low RM1.66/RM1.39

Key Changes

Fair value ⇄
EPS ⇄

YE to Dec	FY22	FY23F	FY24F	FY25F
Gross Revenue (RM mil)	651.4	675.2	747.6	764.5
Distributable Income (RM mil)	311.8	313.0	340.6	359.6
Consensus Net Income (RM mil)	-	336.5	370.0	382.9
EPU (sen)	9.1	9.1	9.9	10.5
DPU (sen)	9.2	9.1	9.9	10.5
DPU Growth (%)	51.1	-0.9	8.8	5.6
Adj. Distribution Yield (%)	5.9	5.9	6.4	6.8
PE (x)	16.8	17.0	15.6	14.8
EV/EBITDA	20.1	19.6	17.6	17.0
ROE (%)	5.6	5.8	6.3	6.6
Debt-to-Asset Ratio (%)	39.4	41.1	41.1	40.9

Stock and Financial Data

Shares Outstanding (million) 3,424.8
Market Cap (RM mil) 5,308.5
Book Value (RM/Share) 1.67
P/BV (x) 0.9
ROE (%) 5.6
Debt-to-Asset Ratio (%) 39.4

Major Shareholders
Sunway Bhd (40.9%)
Employees Provident Fund Board (15.6%)
Kumpulan Wang Persaraan Diperbadankan (5.9%)

Free Float 37.6
Avg Daily Value (RM mil) 4.9

Price performance	3mth	6mth	12mth
Absolute (%)	2.0	(4.4)	8.5
Relative (%)	1.5	(7.6)	7.3



— SREIT MK — FBMKLCI Index

Investment Highlights

- We maintain **BUY** on Sunway REIT (SREIT) with an unchanged fair value (FV) of RM1.84/unit based on our dividend discount model (DDM), which incorporates a 4-star ESG rating (Exhibits 12 & 13). The FV implies a FY24F distribution yield of 6%, at parity to its 5-year median.
- We make no changes to earnings forecasts as SREIT's 9MFY23 distributable income of RM246mil came in within expectations. It accounted for 78% of our FY23F earnings and 73% of the consensus estimate.
- In 9MFY23, SREIT's gross revenue grew 13% YoY while net property income (NPI) improved 11% YoY. This was mainly driven by the improved performance of its retail and hotel segments, particularly Sunway Pyramid, Sunway Carnival, Sunway Pyramid Hotel and Sunway Resort Hotel.
- On QoQ comparison, SREIT's 3QFY23 gross revenue rose 6% while NPI expanded 18%. This was mainly attributed to reduced marketing expenses from its retail segment, coupled with higher revenue from Sunway Resort Hotel driven by the completion of its refurbishment and full opening of its 460 rooms in July 2023.
- QoQ, average occupancy rate for overall segments rose slightly to 81% in 3QFY23 from 80% in 2QFY23 (Exhibits 4, 5 & 7).
- No income distribution has been declared in 3QFY23 due to its semi-annual distribution policy.
- For its retail malls, we foresee a positive rental reversion of 5% in FY24F. SREIT's tenant sales in 3QFY23 were 10% higher than pre-pandemic level (3Q2019) on the back of a sustained growth momentum in retail sales (Exhibit 10). Stronger tenant sales are anticipated to provide the group with the opportunity to negotiate for higher rentals in the subsequent years.
- Meanwhile, we expect turnover rent derived from tenant sales to remain resilient in 2HFY23, supported by robust footfall traffic from domestic shoppers and an uptick in retail sales. Our projection of stronger retail sales is underpinned by our in-house economic team's forecast of a stronger retail sales growth rate of 6.4% YoY in 2HFY23 vs. 5.2% YoY in 1HFY23. This is backed by the consumer sentiment to remain positive amidst expectations of no further interest rate hikes and a stable labour market.

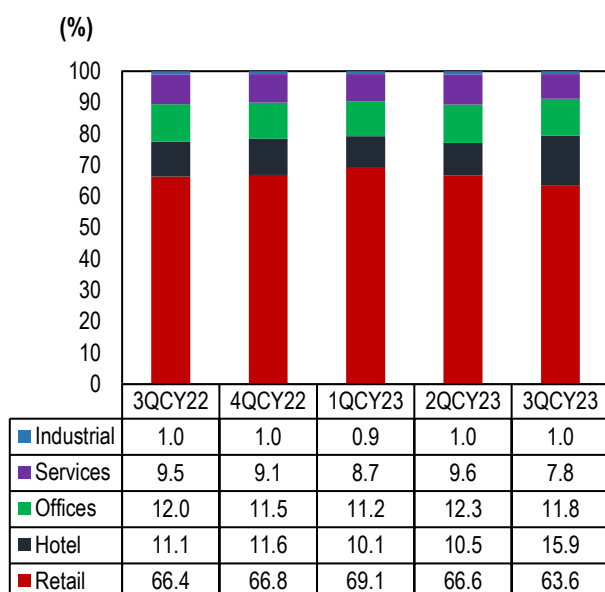
- With the gradual recovery of Malaysia's domestic travelling and influx of foreign tourists, we expect the average occupancy rate of the group's hotel properties to gradually improve in FY23F/24F and fully recover to pre-Covid levels in FY25F (Exhibit 6).
- Here are the key takeaways from the analyst briefing:
 - i. The acquisition of 6 freehold hypermarkets from Kwasa Properties has been postponed pending approval from the Economic Planning Unit. Barring any unforeseen circumstances, the approval is anticipated to be granted by November 2023, with the initial contribution expected to commence in January 2024.
 - ii. For its newly acquired industrial property in Sungei Way, SREIT has successfully secured 1 tenant to occupy 22% of the property's total NLA. Meanwhile, SREIT is still in the midst of negotiation with 2 prospective tenants to lease out the remaining spaces in the industrial property. We expect the maiden contribution from the first tenant of the industrial property to kick in in 1QFY24.
 - iii. 78% of the floor space or NLA occupied by tenancies in Wisma Sunway is scheduled to expire in FY2023. As of now, SREIT has successfully renewed all the tenancies set to expire in FY23 (Exhibits 8, 9). To recap, 97% of SREIT's tenants are government agencies, offering a resilient tenant base for SREIT.
- Our in-house economist anticipates the Fed fund rate to peak between 5.5%-5.75% by 4QCY23 from current levels of 5.25%-5.5%. We expect the uptrend in 10-year US Treasury yield to taper off after a pause in the Federal Reserve's rate hikes in 4QCY23. Our in-house economist also expects the Federal Reserve to start cutting interest rate in mid-2024 by 75 to 100bp. This would eventually bring the Fed fund rate to 4.5%-4.75% by the end of 2024.
- 10-year MGS yield is projected by our economics team to be at 3.95% in 4QCY23 with a gradual decline to 3.8% by 4Q2024. However, we do not rule out the possibility that the 10-year MGS yield could be lower than our projection of 3.95% in 2023 should there be an earlier than expected Fed pivot on US interest rates.
- From FY23F onwards, we anticipate SREIT's distribution yield spread against 10-year MGS to widen to 2.6% vs. 5-year median of 1%. Hence, we expect SREIT to be appealing to yield-seeking investors with its higher distribution spread against the 10-year MGS (Exhibit 11).
- We like SREIT for its well-diversified income base which could cushion potential downside risks from macro headwinds. Its portfolio encompasses retail malls, offices, hotels, universities and industrial properties across Malaysia. Also, the group is recognised for its environmental, social and governance (ESG) practices. Specifically, SREIT is the first amongst its local peers to incorporate sustainability financial considerations into its capital management strategies.
- SREIT currently trades at a compelling FY24F PE of 16x vs. its 4-year average PE of 20x. Meanwhile, distribution yield for FY24F of 6.4% is attractive vs. current 10-year MGS yield of 3.85%.

EXHIBIT 1: RESULT SUMMARY

FY 31 Dec (RMmil)	3QFY22	2QFY23	3QFY23	QoQ (%)	YoY (%)	9MCY22	9MCY23	YoY (%)
Gross Revenue	166.2	166.5	175.8	5.6	5.8	464.7	525.2	13.0
Property Operating Expenses	(38.0)	(50.3)	(39.1)	(22.4)	2.9	(110.7)	(133.9)	21.0
Net Property Income	128.2	116.2	136.8	17.7	6.6	354.1	391.2	10.5
Manager's fee	(10.8)	(10.5)	(11.2)	5.9	2.9	(31.3)	(32.8)	4.9
Trustee's fee	(0.2)	(0.2)	(0.2)	3.1	1.5	(0.6)	(0.6)	0.5
Other trust expenses	(0.4)	(0.7)	(0.5)	(34.5)	24.1	(1.5)	(2.0)	30.6
EBIT	116.8	105.0	124.9	19.0	6.9	339.0	356.2	5.1
Net interest income/expenses	(24.9)	(32.8)	(33.0)	0.6	32.3	(66.2)	(95.5)	44.2
Profit Before Taxation	91.9	72.2	92.0	27.4	0.1	272.7	260.6	(4.4)
Taxation	0.0	0.0	0.0	n.a.	n.a.	0.0	0.0	n.a.
Minority Interest (MI)	0.0	0.0	0.0	n.a.	n.a.	0.0	0.0	n.a.
Net Income	91.9	72.2	92.0	27.4	0.1	272.7	260.6	(4.4)
Adjustment	(8.3)	(5.0)	(5.0)	0.4	(39.6)	(36.5)	(14.9)	(59.0)
Adjusted Distributable Income	83.6	67.2	87.0	29.4	4.0	236.3	245.7	4.0
<u>Distribution:</u>								
EPU (sen)	2.4	2.0	2.5	29.4	4.0	6.9	7.2	4.0
Declared DPU (sen)	0.0	4.6	0.0	(>100)	n.a.	4.2	4.6	9.5
NAV/unit	1.5	1.5	1.5	(0.0)	(0.7)	1.5	1.5	(0.7)
<u>Margin:</u>								
Net Property Income Margin (%)	77.1	78.3	77.8	(0.5)	0.6	76.2	74.5	(1.7)
EBIT margin (%)	55.3	32.2	52.3	20.1	(3.0)	72.9	67.8	(5.1)
Net Interest Coverage (x)	4.7	3.1	3.8	0.7	(0.9)	5.1	3.7	(1.4)
Debt/Asset Ratio (%)	37.3	37.6	37.4	(0.2)	0.0	37.3	0.0	(37.3)

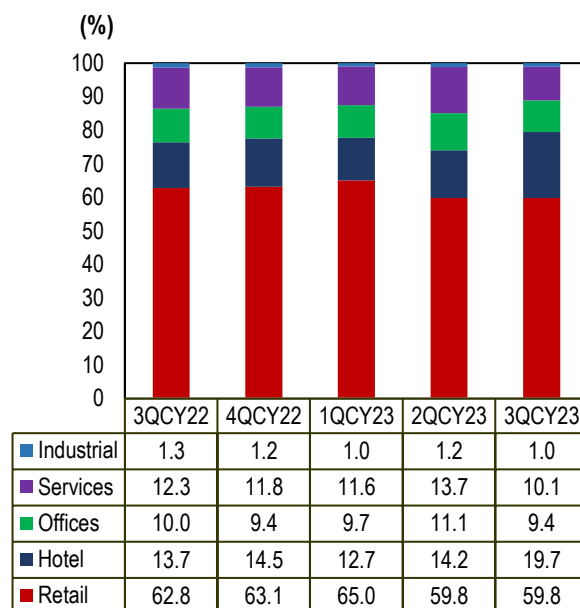
Source: Company, AmlInvestment Bank Bhd

EXHIBIT 2: REVENUE BREAKDOWN



Source: Company, AmlInvestment Bank Bhd

EXHIBIT 3: NET PROPERTY INCOME BREAKDOWN



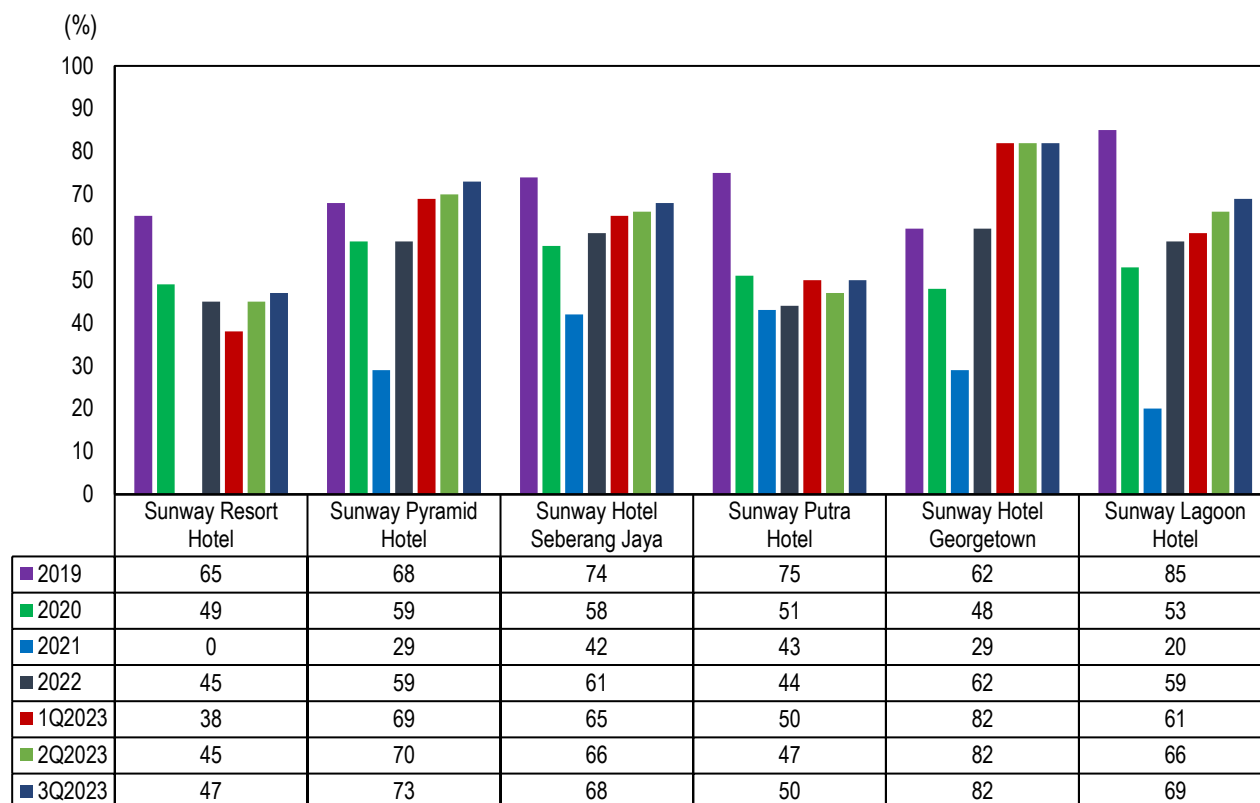
Source: Company, AmlInvestment Bank Bhd

EXHIBIT 4: OCCUPANCY RATE (RETAIL)



Source: Company, AmlInvestment Bank Bhd

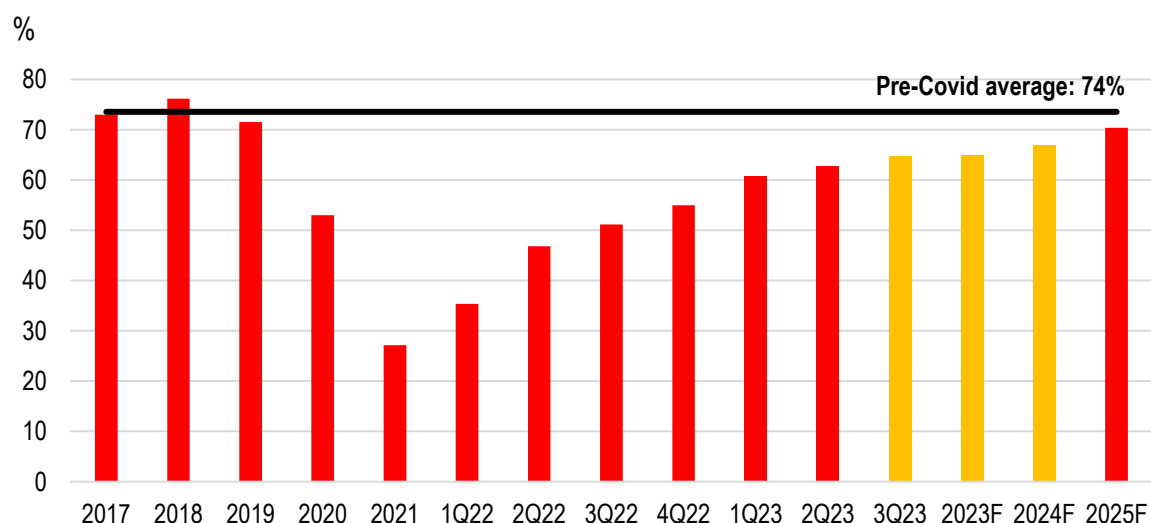
EXHIBIT 5: OCCUPANCY RATE (HOTEL)



*Sunway Resort Hotel is closed for refurbishment commencing July 2020 with phased reopening in May 2022.

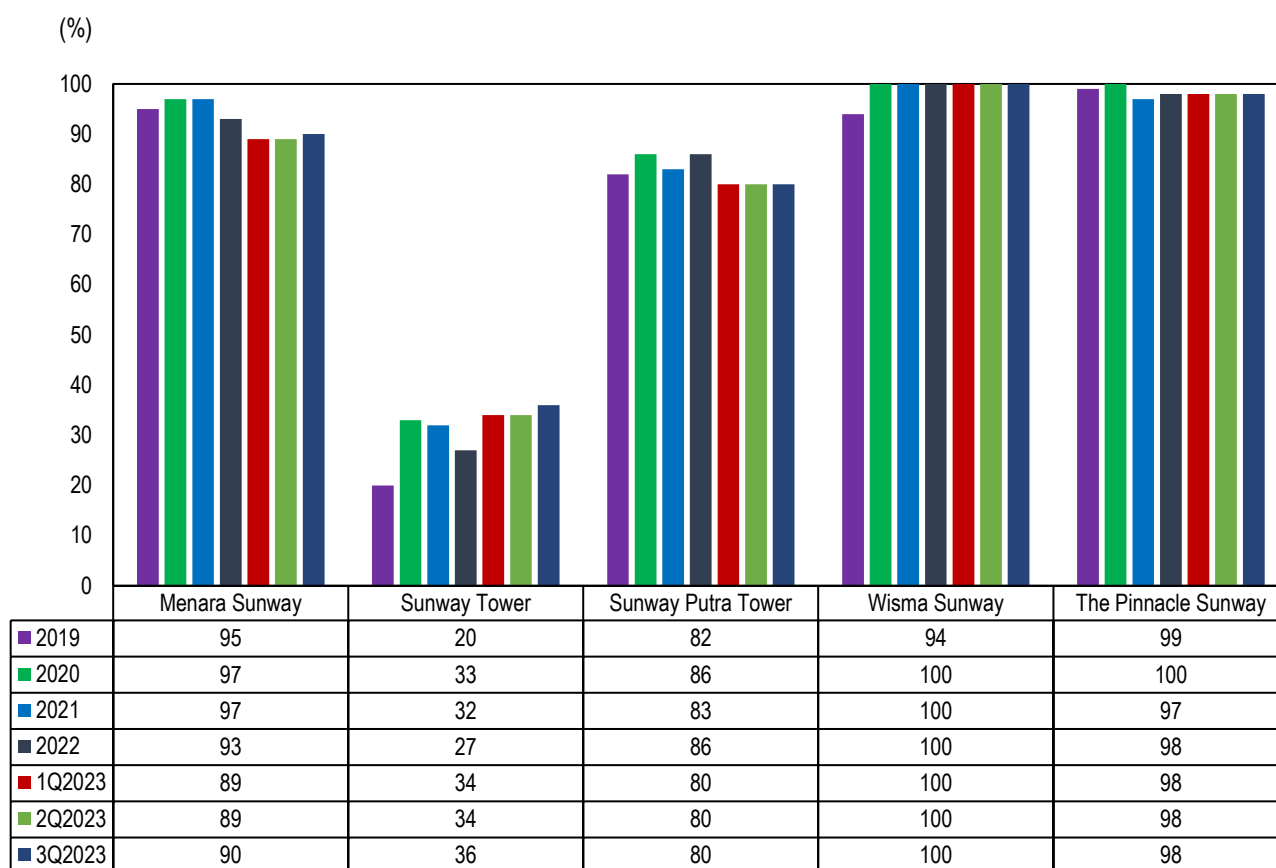
Source: Company, AmlInvestment Bank Bhd

EXHIBIT 6: AVERAGE OCCUPANCY RATE OF SUNWAY REIT'S HOTEL



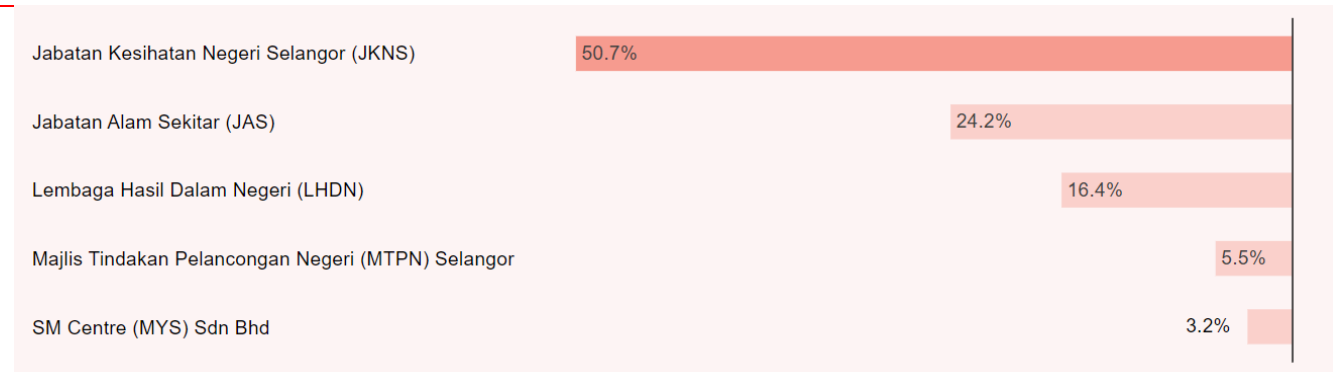
Source: Sunway REIT, AmlInvestment Bank Berhad

EXHIBIT 7: OCCUPANCY RATE (OFFICE)



Source: Company, AmlInvestment Bank Bhd

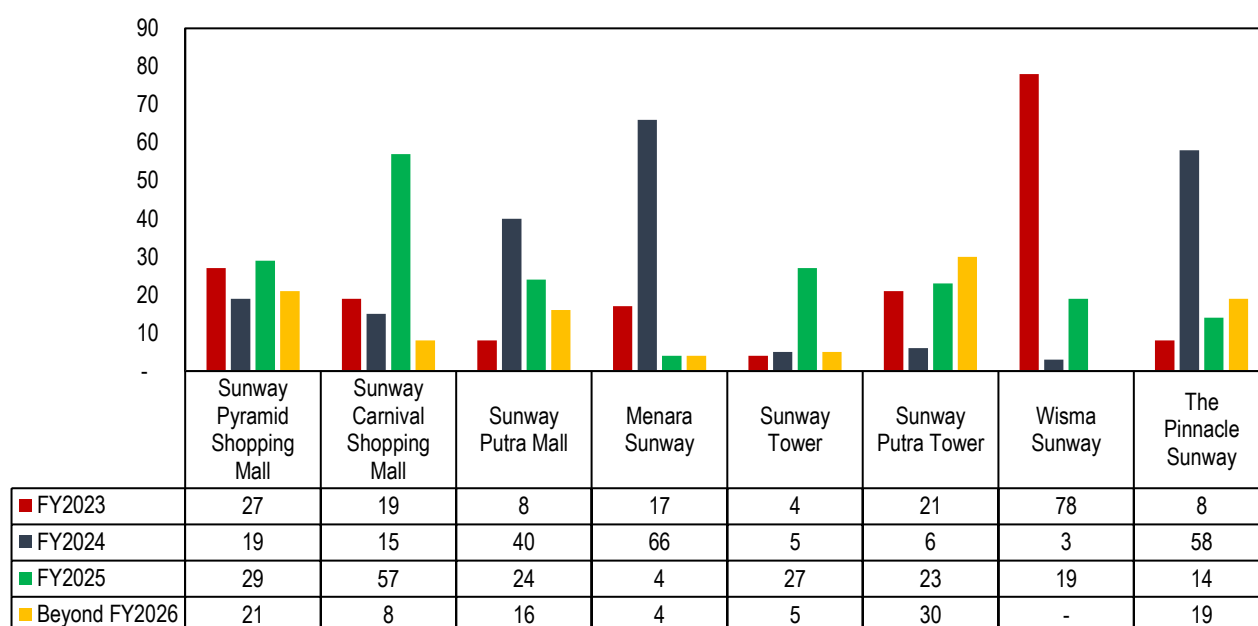
EXHIBIT 8: TOP TENANTS OF WISMA SUNWAY



Source: Sunway REIT

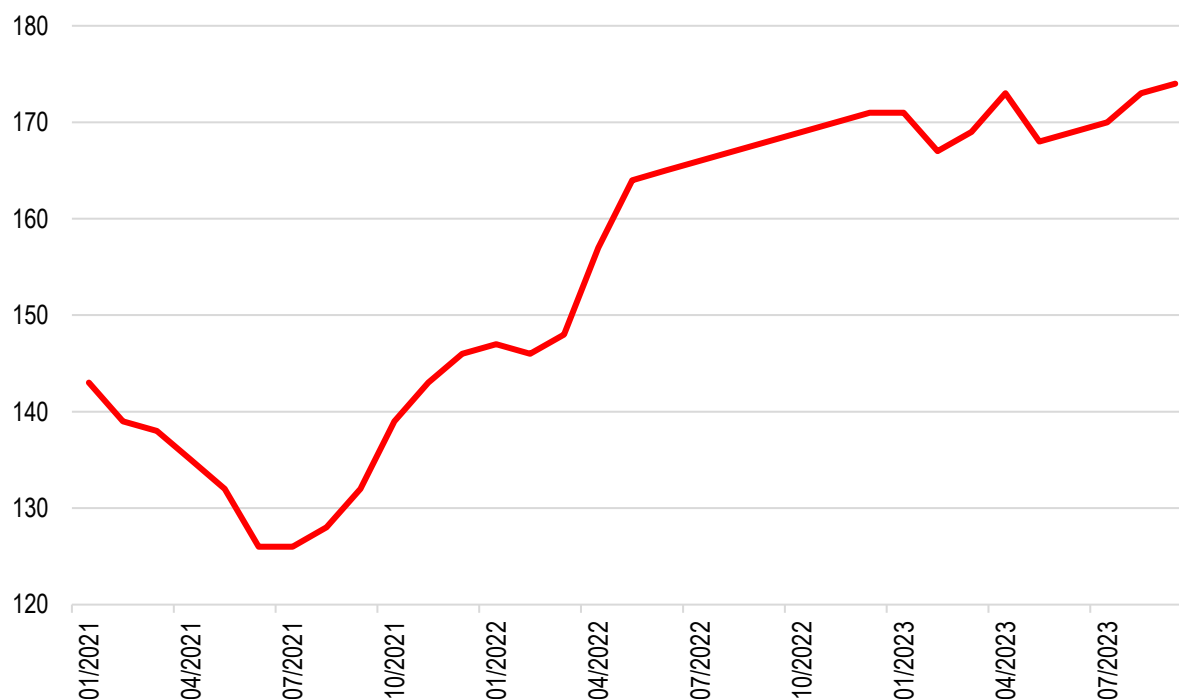
EXHIBIT 9: PROJECTED LEASE EXPIRY SCHEDULE

% Based on total NLA



Source: Company, AmlInvestment Bank Bhd

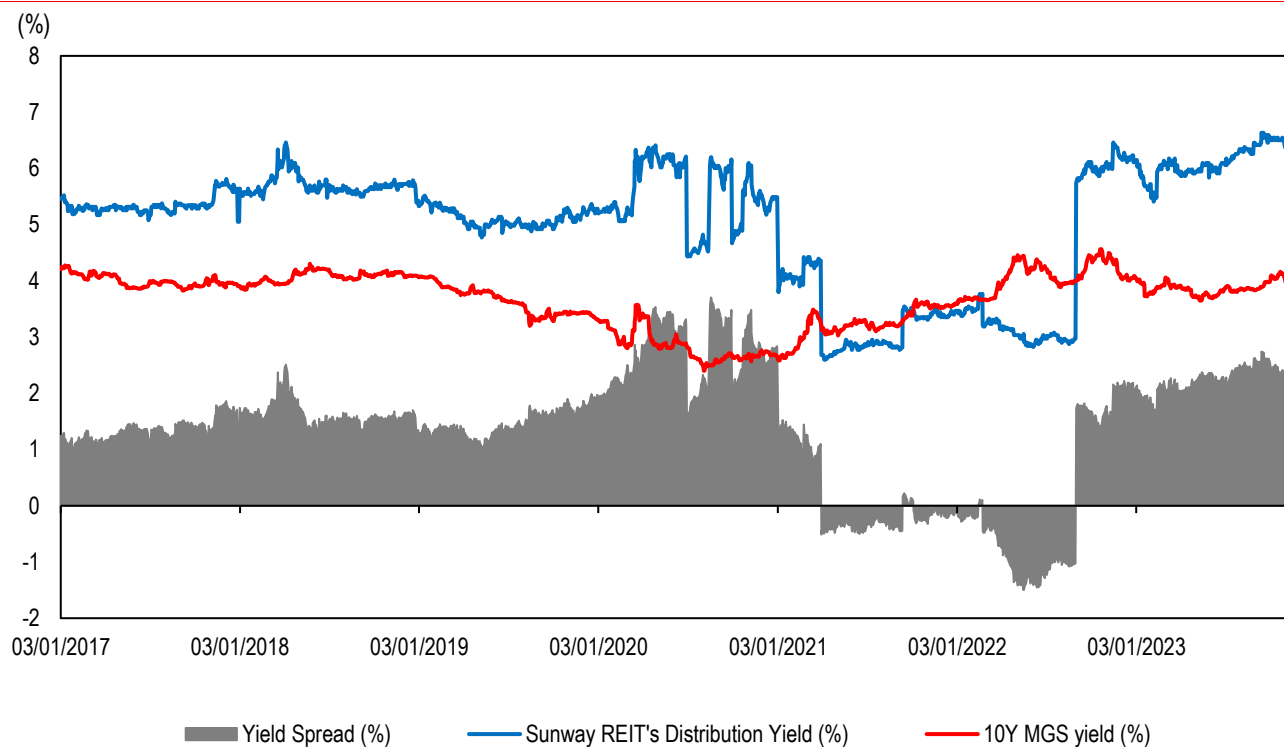
EXHIBIT 10: RETAIL SALES INDEX



*The retail sales index is an aggregated measure of the sales of retail goods over a stated period. Because retail sales are a measure of consumer demand for finished good. The retail sales index measures only the volume changes, i.e. price level changes are excluded.

Source: DOSM

EXHIBIT 11: YIELD SPREAD AGAINST 10-YEAR MALAYSIAN GOVERNMENT SECURITIES (MGS)



Source: Company, AmlInvestment Bank Bhd

EXHIBIT 12: DIVIDEND DISCOUNT MODEL

Assumption for Weighted Average Cost of Capital (WACC)

Risk Free Rate	3.9%
Beta	0.7
Market Return	13.9%
Cost of Equity (Ke)	10.6%

Average Cost of Debt	5.0%
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Capital Structure: (RM Mil)

Market Cap	5,137.2	56.2%
Total Borrowing	4,004.8	43.8%
Total	9,142.0	100.0%

Weighted Average Cost of Capital (WACC):

	Weight	Cost	W X C
Cost of Equity (Ke)	56.2%	10.6%	5.9%
Average Cost of Debt	43.8%	5.0%	2.2%
WACC			8.1%

Multi-Stage DDM	2023	2024	2025	2026	2026	Terminal Value
Period	1	2	3	4	5	
Dividends (RM/share)	0.09	0.10	0.10	0.11	0.11	2.05
Present Value (RM/share)	0.08	0.08	0.08	0.08	0.08	1.38
Valuation	1.79					
(+3%) adjustment for 4-star ESG rating	0.05					
Fair Value/unit (RM/share)+ESG	1.84					
WACC (%)	8.2%					
Growth Rate (%)	2.5%					

Source: AmlInvestment Bank Bhd

EXHIBIT 13: ESG RATING

Overall	★	★	★	★	
Zero-carbon initiatives	★	★	★	★	★
Waste management	★	★	★	★	★
Pollution control	★	★	★	★	
Sustainable industrialization	★	★	★	★	
Diversity and inclusion	★	★	★	★	
Employees' welfare	★	★	★	★	
Corporate social responsibilities	★	★	★	★	
Accessibility & transparency	★	★	★	★	

We accord a discount/premium of -6%, -3%, 0%, +3% and +6% on fundamental fair value based on the overall ESG rating as appraised by us, from 1-star to 5-star

Source: AmlInvestment Bank

EXHIBIT 14: PB BAND CHART



EXHIBIT 15: PE BAND CHART



EXHIBIT 16: FINANCIAL DATA

Income Statement (RM mil, YE 31 Dec) *18MFY21		FY22	FY23F	FY24F	FY25F
Gross Revenue	675.6	651.4	675.2	747.6	764.5
Property Operating Expenses	(218.5)	(151.2)	(183.7)	(205.9)	(205.6)
Net property income (NPI)	457.1	500.2	491.5	541.8	559.0
Net Investment Income	380.3	475.4	492.0	542.5	559.6
Net interest	(125.7)	(95.3)	(131.8)	(155.0)	(152.6)
Exceptional items	0.0	0.0	0.0	0.0	0.0
Pretax profit	194.6	332.9	304.5	331.4	349.8
Taxation	0.9	(9.3)	8.5	9.3	9.8
Minorities	0.0	0.0	0.0	0.0	0.0
Net income	195.5	323.6	313.0	340.6	359.6
Distributable Income	221.9	311.8	313.0	340.6	359.6
Balance Sheet (RM mil, YE 31 Dec) *18MFY21		FY22F	FY23F	FY24F	FY24F
Plant and Equipment	11.6	15.8	14.3	15.9	17.3
Investment Properties	8,738.3	8,671.0	8,871.0	8,871.0	8,871.0
Total non-current assets	8,750.7	8,687.6	8,885.3	8,886.9	8,888.3
Cash & equivalent	290.5	251.2	746.2	740.1	789.1
Trade receivables	39.8	25.2	33.7	39.8	43.5
Other current assets	69.5	19.4	69.5	69.5	69.5
Total current assets	399.8	295.8	849.4	849.4	902.1
Trade payables	5.2	2.3	3.3	3.7	3.7
Short-term borrowings	1,595.4	1,636.8	2,082.3	2,554.5	3,247.5
Other current liabilities	203.7	248.9	201.2	223.8	228.9
Total current liabilities	1,804.2	1,888.0	2,286.9	2,782.0	3,480.0
Long-term borrowings	1,810.0	1,900.0	1,922.4	1,450.2	757.3
Other long-term liabilities	71.0	97.4	97.6	107.0	109.1
Total long-term liabilities	1,881.0	1,997.4	2,020.0	1,557.2	866.3
Total Unitholders' funds	5,465.2	5,528.0	5,427.8	5,397.1	5,443.9
Minority interests	—	—	—	—	—
NAV per unit (RM)	1.5	1.6	1.6	1.6	1.6
Cash Flow (RM mil, YE 31 Dec) *18MFY21		FY22F	FY23F	FY24F	FY24F
Pretax profit	194.6	332.9	304.5	331.4	349.8
Depreciation/Amortisation	0.0	0.0	0.0	0.0	0.0
Net change in working capital	116.8	29.4	(27.6)	16.8	1.4
Others	121.1	72.7	346.0	196.9	213.5
Cash flow from operations	432.5	435.0	622.9	545.0	564.6
Capital expenditure	(2.2)	(6.9)	(3.1)	(3.5)	(3.6)
Net investments & sale of fixed assets	(713.4)	(313.1)	(200.0)	0.0	0.0
Others	140.6	54.6	34.9	37.2	39.7
Cash Flow (used in) / from Investing	(575.0)	(265.5)	(168.2)	33.7	36.1
Debt raised/(repaid)	(28.7)	147.7	468.0	(0.0)	0.0
Equity raised/(repaid)	710.0	0.0	0.0	0.0	0.0
Distribution paid to unitholders	(178.8)	(240.4)	(313.0)	(340.6)	(359.6)
Others	(171.2)	(116.0)	(166.7)	(192.2)	(192.2)
Cash flow (used in) / from Financing	331.3	(208.8)	(11.7)	(532.9)	(551.8)
Net cash flow	188.8	(39.3)	442.9	45.9	48.9
Net cash/(debt) b/f	101.8	290.6	251.3	694.2	740.1
Net cash/(debt) c/f	290.6	251.3	694.2	740.1	789.1
Key Ratios (YE 31 Dec) *18MFY21		FY22F	FY23F	FY24F	FY24F
Revenue growth (%)	21.3	-3.6	3.6	10.7	2.3
NPI margin (%)	67.7	76.8	72.8	72.5	73.1
Pretax margin (%)	28.8	51.1	45.1	44.3	45.7
Net income margin (%)	28.9	49.7	46.4	45.6	47.0
Interest cover (x)	2.5	4.5	3.3	3.1	3.3
DPU payout (%)	92.2	101.3	100.0	100.0	100.0
Receivable turnover (days)	25.1	17.2	18.3	19.4	20.8
Payable turnover (days)	5.7	7.4	6.6	6.5	6.5

SOURCE: COMPANY, AMINVESTMENT BANK BHD ESTIMATES

*18 months, FYE change from June to Dec from FY21 onwards

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