

26 August 2024

Property | REITS

Sunway REIT (SREIT MK)

Buy (Maintained)

Recalibrating TRANSCEND 2027; Maintain BUY

Target Price (Return): MYR1.92 (+16%)
 Price (Market Cap): MYR1.65 (USD1,292m)
 ESG score: 3.2 (out of 4)
 Avg Daily Turnover (MYR/USD) 2.54m/0.55m

- **Maintain BUY, with new DDM-derived MYR1.92 TP from MYR1.85, 16% upside and c.7% FY25F yield.** Our sector top pick Sunway REIT is recalibrating its strategic roadmap, TRANSCEND 2027, to refocus its efforts on its core strengths in retail, and foregoing its previous targets to strictly rebalance its portfolio with a higher mix of services, industrial, as well as adding foreign properties. We are positive on the strategic change as we think this affords the REIT more room to focus on yield-accretive acquisitions, via organic and inorganic fronts.
- **Key change.** Previously, one of the targets under the roadmap was to rebalance the REIT's portfolio such that services, industrial, and others would make up 20-30% of its property value, while diversifying into foreign properties would comprise 10-20% of assets under management. With the changes in market dynamics since it was initially introduced in 2021 such as the compressed yield for industrial properties, we think the earlier goal would have restricted the REIT's ability to find yield-accretive acquisitions. Instead, SREIT will now be open to strategic opportunities among the different sectors without imposing a specific target.
- **Entrenching its footprint in Malaysia's retail sector.** While not diversifying away from retail, management emphasised that there are multiple categories within the retail segment which the REIT wishes to invest in. The first is "regional malls", with a target market of the population within 50km and NLA >500k sqf. The highly successful Sunway Carnival Mall in Penang fits this category – Penang mainland was an underserved market as shoppers previously had to travel to Penang Island for more shopping options. We think that these regional malls outside the Klang Valley would do well given the more favourable supply-demand dynamics. Capitaland Malaysia Trust's (CLMT MK, NR) Gurney Plaza, Queensbay Mall, and East Coast Mall, which collectively enjoy close to full occupancy and recorded 10.2% rental reversion in 1H24, are good examples. Hence, we are confident with the upcoming Sunway City Ipoh Mall that is located next to Lost World Water Park and future medical centre. The mall will likely open in mid-2027, and should drive the future growth of SREIT upon injection from the Sponsor.
- **Neighbourhood malls to balance the retail portfolio.** Another category that SREIT plans to invest in is "neighbourhood malls", with a smaller target market and NLA. These properties are more resilient with their F&B and services offerings serving the local community. SREIT's ongoing acquisitions in this category such as 163 Mall and Kluang Mall, offer >90% occupancy rates and a healthy 6.5-6.8% NPI yield. Going forward, management expects the malls to deliver mid-single digit rental reversions.
- **ESG:** Our TP includes a 4% ESG premium. Key risks: Lower-than-expected occupancy and rental reversions, and longer-than-expected delays in acquisitions.

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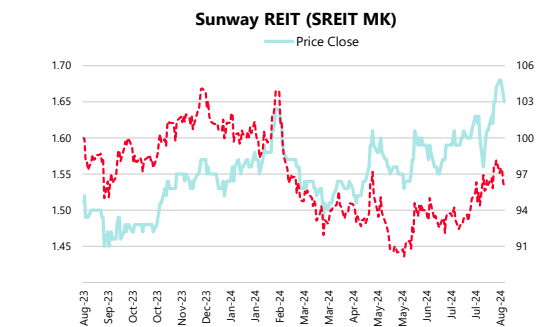


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	7.1	3.1	5.8	5.1	9.3
Relative	(5.3)	2.7	5.4	(0.5)	(4.3)
52-wk Price low/high (MYR)	1.45 – 1.68				



Source: Bloomberg

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (MYRm)	639	705	765	857	899
Net property income (MYRm)	488	516	566	634	665
Reported net profit (MYRm)	324	338	355	390	414
Total distributable income (MYRm)	328	319	335	370	394
DPS (MYR)	0.10	0.09	0.10	0.11	0.11
DPS growth (%)	122.5	(2.8)	5.0	10.4	6.4
P/B (x)	1.02	1.02	1.02	1.02	1.02
Dividend Yield (%)	5.8	5.6	5.9	6.5	7.0
Return on average equity (%)	5.9	6.1	6.4	7.1	7.5
Return on average assets (%)	3.5	3.6	3.6	3.7	3.9

Source: Company data, RHB

Overall ESG Score: 3.2 (out of 4)

E: EXCELLENT

Sunway REIT's buildings strive for green certification standards through sustainable refurbishment practices, and supports clean energy use by providing charging bay facilities for electric vehicles – effectively reducing almost 50,000 tonnes of CO2 emission, with water consumption gradually decreasing over the years.

S: GOOD

In addition to the many benefits (care for nursing mothers, childcare subsidy) for employees of the Manager, training and engagement are also prioritised. Safety of employees is also ensured by the proper hazard identification, risk assessment and incident investigation. Community enrichment is also of utmost importance.

G: GOOD

A diverse and skilled board comprising 57% independent directors - 43% of whom are female. The tenure of an Independent Director is capped at 9 years, and the details of remuneration in the Annual Report are on a named basis.

Financial Exhibits

Asia	Financial summary	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Malaysia	Recurring EPS (MYR)	0.09	0.10	0.10	0.11	0.12
Property	EPS (MYR)	0.09	0.10	0.10	0.11	0.12
Sunway REIT	DPS (MYR)	0.10	0.09	0.10	0.11	0.11
SREIT MK	BVPS (MYR)	1.61	1.61	1.61	1.61	1.61
Buy	Return on average equity (%)	5.9	6.1	6.4	7.1	7.5
	Weighted avg adjusted shares (m)	3,424.81	3,424.81	3,424.81	3,424.81	3,424.81
Valuation basis						
Dividend discount model	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Recurring P/E (x)	17.46	16.71	15.93	14.50	13.66
	P/E (x)	17.46	16.71	15.93	14.50	13.66
	P/B (x)	1.0	1.0	1.0	1.0	1.0
	FCF Yield (%)	6.1	5.3	5.5	5.7	6.1
	Dividend Yield (%)	5.8	5.6	5.9	6.5	7.0
	EV/EBITDA (x)	0.13	(0.74)	(0.85)	(0.78)	(0.74)
	EV/EBIT (x)	0.13	(0.74)	(0.85)	(0.78)	(0.74)
Key drivers						
Improvement in domestic consumer sentiment leading to strong consumer spending.						
Key risks						
Lower-than-expected occupancy and rental reversions, and longer-than-expected delays in acquisitions.						
Company Profile						
Sunway REIT is a large-cap diversified M-REIT, with exposure in the retail, commercial, hospitality and healthcare segments.						
	Income statement (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total turnover	639	705	765	857	899
	EBITDA	441	468	505	565	593
	Operating profit	441	468	505	565	593
	Net interest	(95)	(129)	(152)	(178)	(182)
	Pre-tax profit	333	340	353	388	412
	Taxation	(9)	(1)	1	2	2
	Recurring net profit	324	338	355	390	414
	Cash flow (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Change in working capital	19	49	(80)	6	0
	Cash flow from operations	347	299	308	323	346
	Cash flow from investing activities	(383)	125	(802)	(158)	0
	Dividends paid	(348)	(339)	(355)	(390)	(414)
	Cash flow from financing activities	(109)	(268)	215	(464)	(645)
	Cash at beginning of period	291	251	425	487	599
	Net change in cash	(145)	156	(279)	(299)	(300)
	Ending balance cash	145	408	147	188	300
	Balance sheet (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total cash and equivalents	251	425	487	599	705
	Tangible fixed assets	0	0	1	2	3
	Total investments	8,688	8,990	9,792	9,950	9,950
	Total assets	9,413	9,539	10,314	10,589	10,696
	Short-term debt	1,637	1,637	1,637	1,637	1,637
	Total long-term debt	1,900	2,000	2,802	3,066	3,171
	Total liabilities	3,885	4,023	4,798	5,073	5,180
	Shareholders' equity	5,528	5,516	5,516	5,516	5,516
	Total equity	5,528	5,516	5,516	5,516	5,516
	Net debt	3,286	3,212	3,952	4,103	4,104
	Total liabilities & equity	9,413	9,539	10,314	10,589	10,696
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	42.4	10.2	8.5	12.0	4.9
	Recurrent EPS growth (%)	131.5	4.5	4.9	9.9	6.1
	Operating EBITDA margin (%)	69.0	66.4	66.0	66.0	66.0
	Net profit margin (%)	50.6	48.0	46.4	45.5	46.0
	Dividend payout ratio (%)	101.4	94.3	94.4	94.9	95.2
	Interest cover (x)	4.41	3.37	3.11	3.01	3.08

Source: Company data, RHB

Solid assets to back elevated gearing. Gearing was at 43.7% as at Jun 2023, higher than most M-REITs under our coverage, and close to the 50% gearing limit. Management shared that moving forward, it would be comfortable with gearing being in the low 40% range due to the REIT's asset size. Management also cited the stable asset values during the pandemic as another reason for comfort with this level. In the medium term, while interest rates are stable, we think the higher-than-average gearing ratio provides limited downside risks, but future acquisitions should reasonably be funded partially via equity to pare down its gearing. As part of TRANSCEND 2027, SREIT aims to grow its property value to MYR14-15bn from the current MYR9.6bn.

High ROIs from strategic AEIs over the last two years. Since mid-2023, SREIT has allocated MYR920m on asset enhancement initiatives (AEIs). Sunway Carnival Mall has been a notable success story for the REIT following the opening of its new wing in 2022. Currently, the mall's existing wing is being refreshed (capex: MYR360m) to match the aesthetics of the new wing, allowing it to attract new key tenants. The AEI has already bore fruit with sales/sqf improving by approximately 50%, equalling Sunway Pyramid's level in the month of April.

Sunway Pyramid's ongoing AEI for the reconfiguration of a space previously occupied by an anchor tenant (named Oasis precinct) is on track to be completed by November. The NLA for the space will be reduced from 320k sqf to 260k sqf due to the addition of hallways, but with a refreshed tenancy mix (committed occupancy >90%), the rental rate for the space is expected to increase to MYR10-15 psf from the previous MYR3-8 psf.

Revising up earnings estimate. We raise our FY25-26 forecasts by 1% and 2% after increasing our rental rate assumptions. Our TP includes a 4% ESG premium based on our in-house methodology, and would result in a 5.6% yield at our 10.8 sen FY25F DPU. We think this is fair at slightly above the average yield spread with the 10-year Malaysian bond yield (c.140bps). Key risks include: Lower-than-expected occupancy and rental reversions, and longer-than-expected delays in acquisitions.

Figure 1: Recalibrated TRANSCEND 2027



Source: Company data

Figure 2: Building a diversified retail portfolio

	Super-Regional Malls	Regional Malls	Neighbourhood Malls	Big-Box Retail
Target market and NLA	Local and international tourists NLA >1m sqf	Population within 50km NLA > 500k sqf	Population within 20km NLA > 250k sqf	Population within 10km NLA > 250k sqf
Asset	Sunway Pyramid Mall	Sunway Carnival Mall	Sunway Putra Mall Sunway Pier Sunway 163 Mall* Sunway Kluang Mall*	Hypermarkets: SunCity Ipoh, Kinrara, USJ, Putra Heights, Ulu Kelang, Klang, Plentong
Geographic footprint	Sunway City KL	Penang	Kuala Lumpur, Klang	Ipoh, Selangor, Kuala Lumpur, Johor
Sunway REIT's strengths	Unique, iconic location. Strong management and leasing team	Focus on identifying underserved markets	Resilience from convenience and tenant profile (F&B, services)	Serving everyday needs of everyday people
WALE	1-3 years	1-3 years	1-3 years	5-10 years

Note: *proposed acquisition

Source: Company data, RHB

Emissions And ESG

Trend analysis

Sunway REIT targets to reduce emissions by 45% (2010 baseline) by 2030, and net zero by 2050. YoY emissions increased by 3% due to increased footfall as tenants resumed operations following the upliftment of movement control order. This also led to higher emissions intensity.

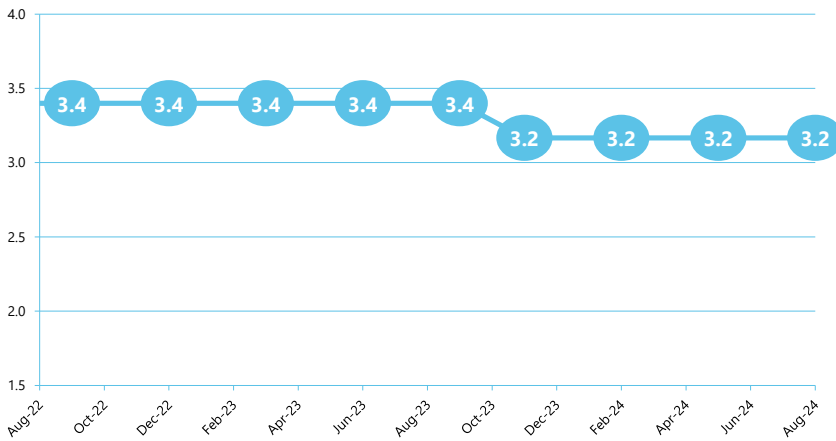
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	38	74	14
Scope 2	28,053	56,827	51,264
Scope 3	296,510	652,730	722,814
Total emissions	324,601	709,631	774,092

Source: Company data, RHB

Latest ESG-Related Developments

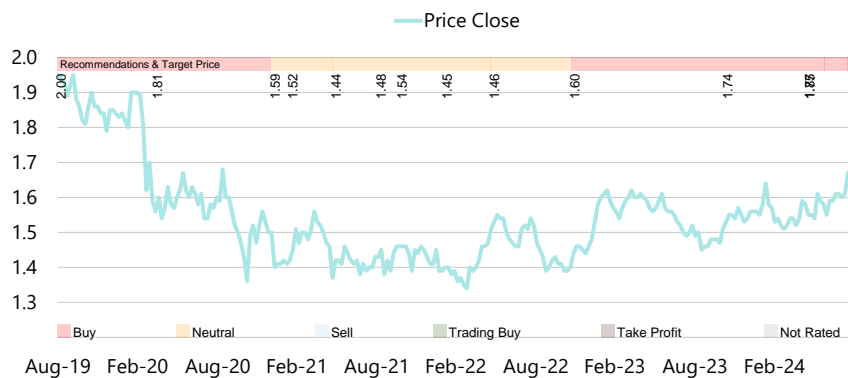
- Has an internal carbon pricing framework at MYR15 per tonne of CO2 emitted.
- The first M-REIT to implement a Green Lease Partnership programme.
- Was excluded from FTSE Indexes including FTSE4Good because of low liquidity trading volume.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-08-16	Buy	1.85	1.67
2024-06-23	Buy	1.77	1.58
2023-11-17	Buy	1.74	1.55
2023-11-06	Buy	1.74	1.53
2022-11-20	Buy	1.60	1.40
2022-08-19	Neutral	1.46	1.54
2022-05-19	Neutral	1.46	1.52
2022-01-31	Neutral	1.45	1.39
2021-10-20	Neutral	1.54	1.46
2021-09-01	Neutral	1.48	1.43
2021-05-20	Neutral	1.44	1.40
2021-02-10	Neutral	1.52	1.42
2020-12-31	Neutral	1.59	1.50
2020-04-06	Buy	1.81	1.58
2020-02-14	Buy	2.00	1.90

Source: RHB, Bloomberg

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