

Malaysia Company Guide

Sunway REIT

Version 6 | Bloomberg: SREIT MK | Reuters: SUNW.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

15 Feb 2017

BUY

Last Traded Price (14 Feb 2017): RM1.77 (KLCI : 1,708.90)

Price Target 12-mth: RM1.90 (7% upside) (Prev RM1.95)

Potential Catalyst: Yield-accretive acquisitions, higher reversions

Where we differ: In line with consensus

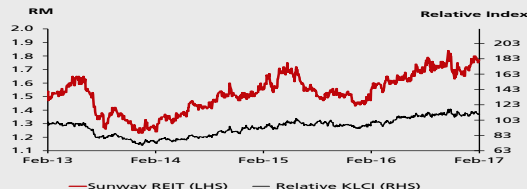
Analyst

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What's New

- 2QFY17 earnings below expectations
- Earnings dragged by poor performance of hotel and office segments
- Retaining positive outlook on rising Sunway Putra contributions, asset-enhancement initiatives and asset-injection opportunities
- DPU of 2.28 sen was declared with ex-date of 27 Feb

Price Relative



Forecasts and Valuation

FY Jun (RMm)	2016A	2017F	2018F	2019F
Gross Revenue	507	523	546	567
Net Property Inc	374	395	410	423
Total Return	324	269	292	301
Distribution Inc	270	269	292	301
EPU (sen)	8.93	9.15	9.93	10.2
EPU Gth (%)	(52)	3	9	3
DPU (sen)	9.18	9.15	9.93	10.2
DPU Gth (%)	5	0	9	3
NAV per shr (sen)	138	138	138	138
PE (X)	19.8	19.3	17.8	17.3
Distribution Yield (%)	5.2	5.2	5.6	5.8
P/NAV (x)	1.3	1.3	1.3	1.3
Aggregate Leverage (%)	33.3	35.9	36.2	36.4
ROAE (%)	6.5	6.6	7.2	7.4

Distn. Inc Chng (%)	(12)	(13)	(15)
Consensus DPU (sen)	9.15	9.90	10.2
Other Broker Recs:	B: 5	S: 1	H: 7

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P.

Still positive

Still positive about its prospects. We cut our FY17/FY18/FY19 figures by 12%/13%/15% to take into account the weak performance of its hotel and office segments due to the weak market conditions. Most notably, in 2QFY17 Sunway Pyramid Hotel & Spa NPI plunged by 31% y-o-y to RM7.7m. Moreover, reversions from the retail segment were positive but lower than its historical figures. However, we remain positive on Sunway REIT (SunREIT) given its attractive distribution yield and growth potential from the asset-enhancement work done on Sunway Pyramid Hotel, slated to be fully completed by 4QFY17.

Asset enhancement underway. Sunway Pyramid Hotel was closed for refurbishment in April 2016 but has been progressively opened from 2QFY17. In 2QFY17, the average occupancy rate for the hotel stood at 78.2% based on total refurbished rooms of 316 rooms. The occupancy level before closure was at 55% with total inventory of 564 rooms. The hotel is expected to fully re-open in 4QFY17. The NPI foregone at full available room inventory (FY15: RM18m) will be offset by the recent inclusion of new assets.

Visible sponsor asset pipeline. Sunway REIT's sponsor and major 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. This underpins an attractive growth pipeline for SunREIT. We are optimistic about potential injections from sponsor Sunway Bhd to meet SunREIT's RM7bn asset target.

Valuation:

Our DDM-derived TP declines to RM1.90, with 7% cost of equity and 1% TG, as we adjust our forecast and roll forward our valuation.

Key Risks to Our View:

Pace of acquisitions. Sunway REIT's yields are on par with its larger M-REIT peers. The draw is the potential to secure steady acquisitions. On this note, any significant delay in acquisitions could hamper its share price appreciation, especially as its peers are also looking at asset growth.

At A Glance

Issued Capital (m shrs)	2,945
Mkt. Cap (RMm/US\$m)	5,213 / 1,171
Major Shareholders (%)	
Sunway Berhad	37.3
Employees Provident Fund	12.04
Skim Amanah Saham	9.88
Free Float (%)	39.7
3m Avg. Daily Val (US\$m)	1.2

ICB Industry : Real Estate / Real Estate Investment Trusts

WHAT'S NEW**Challenging quarter**

- 2QFY17 net distributable income of RM67m (-11% y-o-y) was below our expectation but met consensus forecast. The sharp decline in earnings was due to lower contributions from the hotel segment, namely Sunway Resort Hotel & Spa. Furthermore, the NPI growth for the retail segment was lower than the historical trends. Having said that, NPI margins remained stable at 74.1% due to lower operating expenses.
- A DPU of 2.28 sen was declared, implying a full payout.
- Management has received RM3.2m court award that is related to Sunway Putra which was recognised in 2QFY17, following confirmation of the legal case closure.

Resilient performance from retail segment

- The highest contributing retail segment recorded a 2QFY17 NPI of RM70.8m (+5% y-o-y). This is considerably lower compared to the historical growth (FY16: 14% y-o-y, 1QFY17: 17% y-o-y), no thanks to lower reversions due to the prevailing weak consumer sentiment.
- Sunway Pyramid registered NPI of RM55m (+5.9% y-o-y) with lower reversions mitigated by lower operating expenses due to reversal of allowance for doubtful debts. Occupancy rate was steady at c.98.2% in 2QFY17 (2QFY16: 97.7%).
- The percentage of lease expiring in Sunway Pyramid for FY17 is 19% of total portfolio NLA. Out of which, 59.6% of the leases expiring for the mall in FY17 were renewed at a single-digit rental reversion rate over the three-year tenancy term.
- The percentage of lease expiring in Sunway Carnival for FY17 is 28% of total portfolio NLA. Out of which, 23% of the leases expiring for the mall in FY17 were renewed at a single-digit rental reversion rate over the three-year tenancy term. The renewal has included the anchor tenant in the mall.
- It was disclosed that Sunway Putra Mall (SPM)'s occupancy reached 85.5% (from 72%), and tenants such as TGV Cinema, Padini and Uniqlo have opened to help draw footfall. However, contributions from SPM grew marginally by 5% y-o-y to RM12.4m due to rebates granted in the quarter.
- We expect SunREIT's retail assets to remain resilient throughout FY17.

Hotel segment improving with plans for asset enhancement.

- The hospitality segment registered NPI of RM14m (-33% y-o-y) due to lower contribution from Sunway Pyramid Hotel & Spa at RM7.7m (-31% y-o-y) and the closure of Sunway Pyramid Hotel (formerly known as Pyramid Tower East). Sunway Pyramid Hotel was closed for refurbishment but has been progressively opened from 2QFY17. The hotel is expected to be fully reopened in 4QFY17.
- Excluding the NPI contribution from Sunway Pyramid Hotel in 2QFY16, overall hotel portfolio's NPI declined by 33% y-o-y.
- Sunway Resort Hotel & Spa's average occupancy rate decreased to 80% in 2QFY17 (2QFY16: 82%) due to softer demand from both leisure and corporate customers. The reported NPI is considerably lower compared to the historical growth (FY16: 24% y-o-y, 1QFY17: 4% y-o-y). Revenue fell by 30% y-o-y to RM8m and NPI margins also fell to 95% in 2QFY17 compared to 96.9% in 2QFY16. The hotel is the second largest NPI contributor to the group at c.12% previously (2QFY17: 8%). We believe this trend will remain in the near term.
- The average occupancy rate for Sunway Putra Hotel has improved to 77.0% in 2QFY17 (2QFY16: 45%) as the hotel was still undergoing refurbishment during the same period last year. Post completion of refurbishment in 2QFY16, the hotel has embarked on active marketing activities and promotional rates to regain market shares across all segments.

Office segment struggles

- 2QFY17 NPI improved by 6% y-o-y to RM4m attributable to higher contribution from Sunway Putra Tower and Sunway Tower, but this was partially offset by Menara Sunway and Wisma Sunway's lower contribution.
- We expect the office segment to face challenges in filling up occupancies in the current oversupplied and weak market environment. Additionally, little headway was made in replenishing occupancies at Sunway Tower and Sunway Putra Tower after the departure of their anchor tenants.

Quarterly / Interim Income Statement (RMm)

FY Jun	2Q2016	1Q2017	2Q2017	% chg yoy	% chg qoq
Gross revenue	132	129	127	(3.8)	(1.6)
Property expenses	(34.8)	(32.8)	(32.8)	(5.7)	0.0
Net Property Income	97.1	96.1	94.1	(3.1)	(2.1)
Other Operating expenses	(3.9)	(10.2)	(0.8)	(78.7)	(91.8)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	N/A	N/A
Net Interest (Exp)/Inc	(21.6)	(21.8)	(22.1)	(2.1)	(1.5)
Exceptional Gain/(Loss)	2.06	2.59	(4.0)	N/A	N/A
Net Income	73.6	66.7	67.1	(8.8)	0.6
Tax	0.0	0.0	0.0	N/A	N/A
Minority Interest	0.0	0.0	0.0	N/A	N/A
Net Income after Tax	73.6	66.7	67.1	(8.8)	0.6
Total Return	73.6	66.7	67.1	(8.8)	0.6
Non-tax deductible Items	0.0	4.50	0.0	nm	nm
Net Inc available for Dist.	75.6	71.7	67.2	(11.2)	(6.4)
Ratio (%)					
Net Prop Inc Margin	73.6	74.5	74.1		
Dist. Payout Ratio	99.3	106.7	99.4		

Source of all data: Company, AllianceDBS

Sunway REIT

CRITICAL DATA POINTS TO WATCH

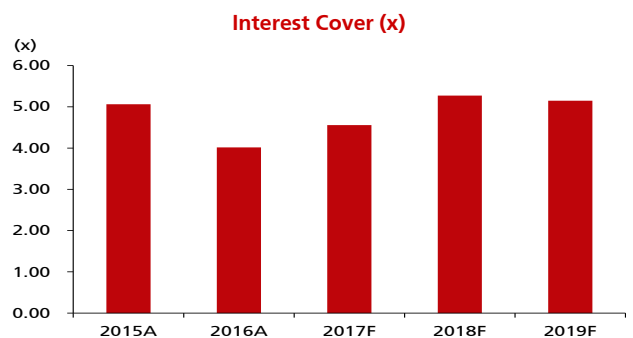
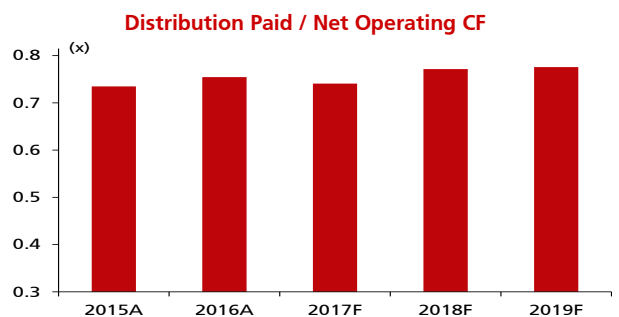
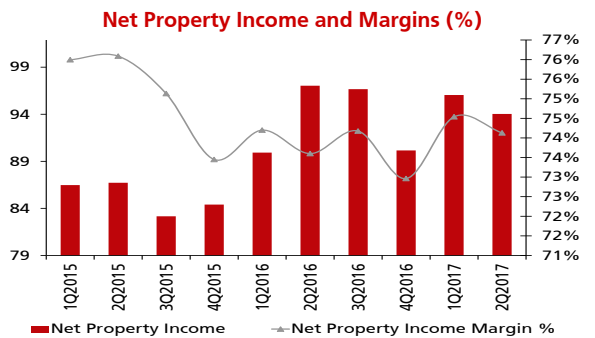
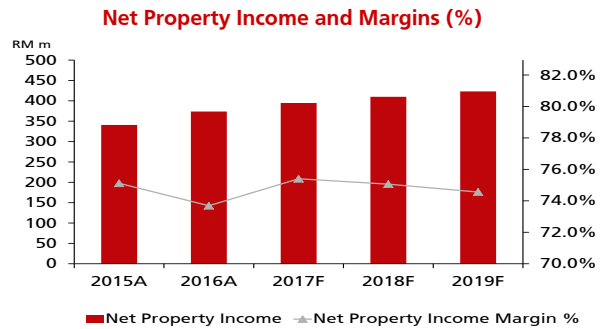
Earnings Drivers:

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. Sunway Pyramid Hotel (formerly known as Sunway Pyramid Hotel East) was closed for refurbishment in April 2016 but has been progressively opened from 2QFY17. In 2QFY17, the average occupancy rate for the hotel stood at 78.2% based on total refurbished rooms of 316 rooms. The occupancy level before closure was at 55% with total inventory of 564 rooms. The hotel is expected to fully re-open in 4QFY17. The NPI foregone at full available room inventory (FY15: RM18m) will be offset by the recent inclusion of new assets.

Weakness in office segment will moderate growth potential. We expect the office segment to face challenges in filling up occupancies 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.



Source: Company, AllianceDBS

Balance Sheet:

Sensible gearing levels. 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 conservative gearing levels. At present, of its RM2.1bn borrowings, RM1.4bn is from a commercial paper facility that will expire in four tranches between Oct 2017 and Apr 2018. The rest are on a monthly rollover basis. We also note that about half of SunREIT's manager fees are paid in units.

Share Price Drivers:

Acquisition newsflow. SunREIT's appeal mainly lies with the availability of asset-acquisition pipeline of completed investment properties from sponsor Sunway Bhd. Confirmation of injections at accretive yields will be key re-rating signals 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% level.

Key Risks:

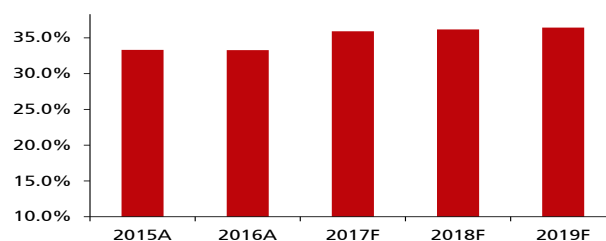
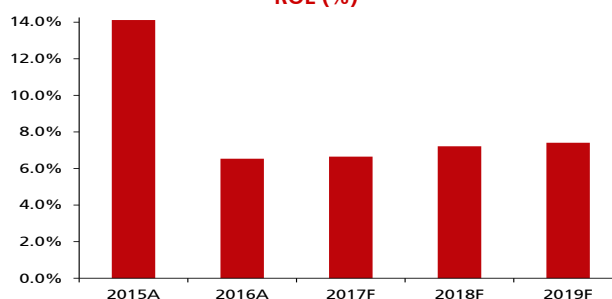
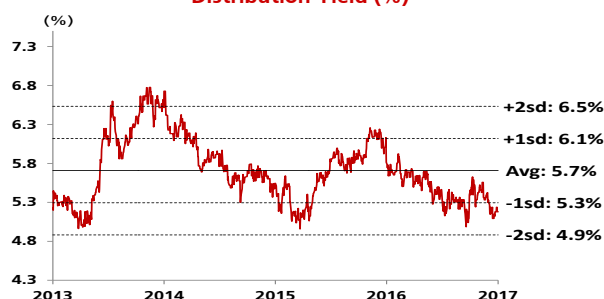
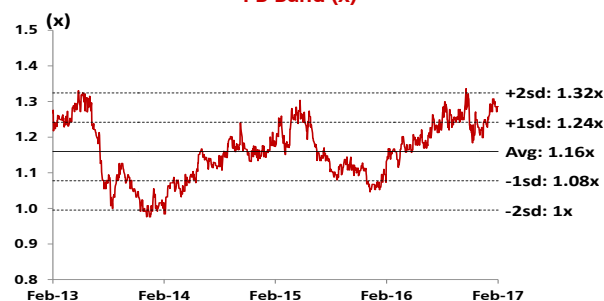
Pace of acquisitions. SunREIT's yields are on par with its larger M-REIT peers, so the draw is the potential to secure a steady stream of acquisitions. On this note, any significant delay in acquisitions could cap its share price appreciation, especially as its peers are also looking at asset growth.

Weak general sentiment. A dampened consumer sentiment may have a negative effect 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

Sunway REIT

Key Assumptions

FY Jun	2015A	2016A	2017F	2018F	2019F
Lease Expiry Profile (%) of NLA	26.2	6.91	11.4	27.8	20.8
SP Rental Gth (%)	11.0	8.00	6.00	6.00	6.00
SP Annual Step Up Gth (%)	3.00	3.00	3.00	3.00	3.00

Segmental Breakdown

FY Jun	2015A	2016A	2017F	2018F	2019F
Revenues (RMm)					
Retail	333	383	385	404	422
Hotel	61.3	72.8	59.7	61.3	62.8
Office	39.1	30.3	31.3	31.5	31.9
Others	20.4	21.1	47.5	49.1	50.7
Total	453	507	523	546	567
NPI (RMm)					
Retail	237	269	279	291	302
Hotel	58.7	68.8	54.8	56.1	57.5
Office	24.8	14.5	16.0	16.0	15.9
Others	20.4	21.1	45.0	46.5	48.0
Total	341	374	395	410	423
NPI Margins (%)					
Retail	71.2	70.4	72.5	72.1	71.5
Hotel	95.8	94.5	91.8	91.7	91.6
Office	63.5	47.9	51.2	50.7	50.1
Others	100.0	100.0	94.7	94.7	94.7
Total	75.2	73.7	75.4	75.1	74.6

Income Statement (RMm)

FY Jun	2015A	2016A	2017F	2018F	2019F
Gross revenue	453	507	523	546	567
Property expenses	(113)	(133)	(128)	(136)	(144)
Net Property Income	341	374	395	410	423
Other Operating expenses	0.0	(27.4)	0.0	0.0	0.0
Other Non Opg (Exp)/Inc	(32.9)	0.0	(38.7)	(39.8)	(40.4)
Net Interest (Exp)/Inc	(67.3)	(86.2)	(86.6)	(77.7)	(82.2)
Exceptional Gain/(Loss)	307	2.26	0.0	0.0	0.0
Net Income	547	262	269	292	301
Tax	(5.9)	0.0	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	541	262	269	292	301
Total Return	541	324	269	292	301
Non-tax deductible Items	14.1	7.70	0.10	0.0	0.0
Net Inc available for Dist.	256	270	269	292	301
Growth & Ratio					
Revenue Gth (%)	6.0	11.8	3.2	4.3	3.9
N Property Inc Gth (%)	6.2	9.7	5.6	3.9	3.2
Net Inc Gth (%)	31.7	(51.5)	2.6	8.6	2.8
Dist. Payout Ratio (%)	99.8	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	75.2	73.7	75.4	75.1	74.6
Net Income Margins (%)	119.4	51.8	51.5	53.6	53.0
Dist to revenue (%)	56.5	53.3	51.5	53.6	53.0
Managers & Trustee's fees	0.0	5.4	0.0	0.0	0.0
ROAE (%)	14.1	6.5	6.6	7.2	7.4
ROA (%)	9.0	4.0	4.0	4.3	4.4
ROCE (%)	5.8	5.5	6.1	6.2	6.4
Int. Cover (x)	5.1	4.0	4.6	5.3	5.1

Source: Company, AllianceDBS

Quarterly / Interim Income Statement (RMm)

FY Jun	2Q2016	3Q2016	4Q2016	1Q2017	2Q2017
Gross revenue	132	130	124	129	127
Property expenses	(34.8)	(33.7)	(33.4)	(32.8)	(32.8)
Net Property Income	97.1	96.7	90.2	96.1	94.1
Other Operating expenses	(3.9)	(10.3)	(9.2)	(10.2)	(0.8)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(21.6)	(21.6)	(21.5)	(21.8)	(22.1)
Exceptional Gain/(Loss)	2.06	2.95	1.20	2.59	(4.0)
Net Income	73.6	67.7	60.6	66.7	67.1
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	73.6	67.7	60.6	66.7	67.1
Total Return	73.6	67.7	60.6	66.7	67.1
Non-tax deductible Items	0.0	0.0	7.82	4.50	0.0
Net Inc available for Dist.	75.6	69.7	70.7	71.7	67.2
Growth & Ratio					
Revenue Gth (%)	9	(1)	(5)	4	(2)
N Property Inc Gth (%)	8	0	(7)	7	(2)
Net Inc Gth (%)	21	(8)	(10)	10	1
Net Prop Inc Margin (%)	73.6	74.2	73.0	74.5	74.1
Dist. Payout Ratio (%)	99.3	99.4	112.4	106.7	99.4

Balance Sheet (RMm)

FY Jun	2015A	2016A	2017F	2018F	2019F
Investment Properties	6,324	6,433	6,461	6,489	6,516
Other LT Assets	5.27	8.70	13.5	18.4	23.2
Cash & ST Invts	80.6	69.7	314	316	316
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	20.2	25.8	23.3	24.3	25.2
Other Current Assets	0.0	0.0	0.0	0.0	0.0
Total Assets	6,430	6,537	6,812	6,848	6,880
ST Debt	763	772	823	853	853
Creditor	0.0	0.0	3.67	3.89	4.12
Other Current Liab	223	226	226	226	226
LT Debt	1,379	1,403	1,624	1,624	1,654
Other LT Liabilities	83.0	84.3	84.3	84.3	84.3
Unit holders' funds	3,982	4,051	4,051	4,057	4,059
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	6,430	6,537	6,812	6,848	6,880
Non-Cash Wkg. Capital	(203)	(200)	(207)	(206)	(205)
Net Cash/(Debt)	(2,061)	(2,106)	(2,133)	(2,161)	(2,191)
Ratio					
Current Ratio (x)	0.1	0.1	0.3	0.3	0.3
Quick Ratio (x)	0.1	0.1	0.3	0.3	0.3
Aggregate Leverage (%)	33.3	33.3	35.9	36.2	36.4
Z-Score (X)	1.6	1.5	1.5	1.5	1.5

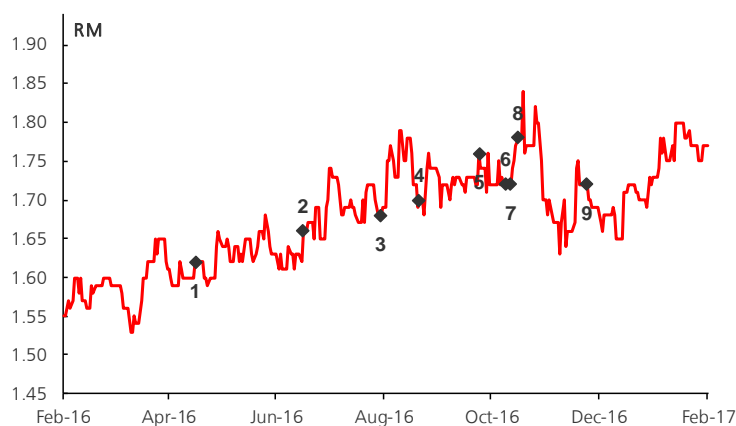
Source: Company, AllianceDBS

Cash Flow Statement (RMm)

FY Jun	2015A	2016A	2017F	2018F	2019F
Pre-Tax Income	547	324	269	292	301
Dep. & Amort.	0.68	1.38	1.63	2.21	2.79
Tax Paid	(5.9)	0.0	0.0	0.0	0.0
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	101	12.0	6.24	(0.8)	(0.7)
Other Operating CF	(296)	18.0	86.7	77.7	82.2
Net Operating CF	348	355	364	372	385
Net Invt in Properties	(404)	(72.0)	(34.8)	(34.8)	(34.8)
Other Invt (net)	0.0	0.0	0.0	0.0	0.0
Invt 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	3.34	3.55	2.61	11.8	12.7
Net Investing CF	(401)	(68.5)	(32.2)	(23.1)	(22.2)
Distribution Paid	(255)	(268)	(270)	(287)	(299)
Chg in Gross Debt	393	70.1	271	30.0	30.0
New units issued	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(72.0)	(85.3)	(89.2)	(89.5)	(94.9)
Net Financing CF	65.1	(283)	(87.5)	(346)	(363)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	11.6	3.50	244	2.31	(0.7)
Operating CFPS (sen)	8.40	11.7	12.2	12.6	13.1
Free CFPS (sen)	(1.9)	9.62	11.2	11.4	11.9

Source: Company, AllianceDBS

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	28 Apr 16	1.62	1.70	BUY
2:	28 Jun 16	1.66	1.80	BUY
3:	11 Aug 16	1.68	1.80	BUY
4:	02 Sep 16	1.70	1.80	BUY
5:	06 Oct 16	1.76	1.80	BUY
6:	21 Oct 16	1.72	1.80	BUY
7:	24 Oct 16	1.72	1.80	BUY
8:	28 Oct 16	1.78	1.95	BUY
9:	06 Dec 16	1.72	1.95	BUY

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

Source: AllianceDBS

Analyst: Inani ROZIDIN

AllianceDBS recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 14 Feb 2017 20:35:36 (MYT)

Dissemination Date: 15 Feb 2017 08:07:43 (MYT)

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