



AmInvestment Bank

Company report

SUNWAY REIT

(SREIT MK EQUITY, SUNW.KL)

21 Nov 2022

Gradual uptick in the occupancy rate for hotels

BUY

(Maintained)

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Rationale for report: Company results

Price	RM1.40
Fair Value	RM1.73
52-week High/Low	RM1.58/RM1.32

Key Changes

Fair value	⬇️
EPS	⬆️

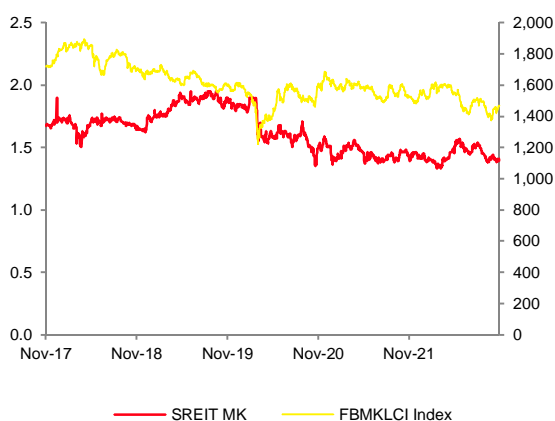
YE to Dec	18MFY21	FY22F	FY23F	FY24F
Gross Revenue (RM mil)	675.6	633.7	704.1	734.9
Distributable Income (RM mil)	221.9	310.8	326.8	336.1
Consensus Net Income (RM mil)	—	308.7	326.2	338.0
EPU (sen)	6.7	9.1	9.5	9.8
DPU (sen)	6.1	9.1	9.5	9.8
DPU Growth (%)	-16.8	48.8	5.2	2.8
PE (x)	23.0	15.4	14.7	14.3
EV/EBITDA	24.7	18.8	16.6	16.3
Adj. Distribution Yield (%)	4.4	6.5	6.8	7.0
ROE (%)	4.1	6.5	6.8	6.9
Debt-to-Asset Ratio (%)	40.2	39.9	39.3	38.8

Stock and Financial Data

Shares Outstanding (million)	3,424.8
Market Cap (RMmil)	4,794.7
Book Value (RM/share)	1.65
P/BV (x)	0.9
ROE (%)	4.1
Debt-to-Asset Ratio (%)	40.2

Major Shareholders	Sunway (40.9%) EPF (15.2%) KWAP (5.8%)
Free Float	38.1
Avg Daily Value (RMmil)	1.4

Price performance	3mth	6mth	12mth
Absolute (%)	(6.6)	(4.1)	(2.1)
Relative (%)	(3.9)	1.2	2.4



Investment Highlights

- We maintain BUY on Sunway REIT (SREIT) with a lower fair value (FV) of RM1.73/unit (from RM1.79/unit) based on our revised dividend discount model (DDM) (Exhibit 9).
- The decrease in our FV is mainly attributed to higher risk-free rate due to the surge in 10-year Malaysian Government Securities (MGS) to 4.3% from 3.9%. No change to our 4-star ESG rating (Exhibit 10).
- SREIT's distributable income of RM240mil (+2.5x YoY) in 9MFY22 (Exhibit 1) came in slightly above our expectations, but within consensus. It accounted for 81% of our FY22F distributable income and 78% of street's.
- The variance was mainly due to better-than-expected occupancy rate in its hospitality properties and lower-than-expected interest expense.
- We raise FY22F/FY23F/FY24F distributable income by 5%/3%/3%, after taking into account higher occupancy rate in its hospitality properties, particularly Sunway Lagoon Hotel to 55%/60% from 50%/55% in FY23F/FY24F.
- In 3QFY22, SREIT's gross revenue accelerated 56% YoY, supported by a revenue surge of 56% YoY from Sunway Pyramid mall and 3x YoY from Sunway Carnival mall. The increase in revenue from the malls were driven by higher retail footfalls and tenant sales, as well as lower rental support provided in 3QFY22.
- 3QFY22 net property income (NPI) surged 82% YoY to RM128mil. This was mainly attributed to higher revenue, coupled with recovery of doubtful debts following continued improvement in rental collections from the retail segment. As a result, distributable income jumped 2.4x YoY to RM87mil.
- On a QoQ comparison, SREIT's 3QFY22 gross revenue improved 15% while NPI rose 20%. This was mainly attributed to new contribution from the new wing of Sunway Carnival Mall, which opened in June 2022, as well as stronger contribution from the hotel segment following a phased opening of Sunway Resort Hotel from May 2022.

- The rental reversion for its retail malls is expected to remain at a mid-single digit level in FY22F. We foresee a positive rental reversion in FY23F/FY24F of 5% with the expectation of stronger tenant sales as compared to pandemic levels, which will provide opportunity for the group to negotiate for higher rentals in subsequent years.
- SREIT's debt-to-asset ratio stayed at 37%, well below REITs' statutory limit of 50% (after 31 December 2022).
- There was no income distribution declared in 3QFY22. The REIT's distribution in 3QFY22 will be paid together with that of 4QFY22 due to its semi-annual distribution policy.
- QoQ, the average occupancy rate rose slightly to 76% in 3QFY22 from 75% in 2QFY22. This was mainly contributed by the stronger occupancy rates of most hotels. In 3QFY22, the retail segment's occupancy rate declined 1% while the office segment remained stable at 81%.
- China has recently begun to show some signs of early reopening of its borders, including shortening quarantines for inbound travellers and close contacts of infected individuals by 2 days, as well as removing the penalties for airlines that brought in many Covid cases. Notably, China has been Malaysia's third biggest tourist country after Singapore and Indonesia since 2012.
- Hence, we expect a gradual recovery in average occupancy rates for the hotel properties to 53% in FY22F and 63% in FY23F from 44% in 9MFY22. The hotel's average occupancy rate was 27.2% in FY2021 and 71.5% in FY2019 (pre-pandemic levels) (Exhibit 5). However, we do not expect a significant near-term recovery in the occupancy rate as rising interest rates and inflationary pressures could weaken consumer spending for leisure travels.
- The recent aggressive policy rate hikes in the United States (US) has caused US treasury yields to rise and this in turn has spilled over and resulted in an increase in 10-year MGS yield. However, we anticipate that the uptrend in 10-year UST yield to be tapering off with the expectation that the Federal Reserve may ease off aggressive rate hikes after the end of 2022 as a result of weaker economic data.
- Meanwhile, we anticipate the yield spread to be widening from FY22F onwards with the gradual recovery of retail footfalls and hotel occupancy rates, which will translate into higher distribution yields of 7% in FY22F-24F vs. 4% in FY21. We expect SREIT to be appealing to yield-seeking investors with its higher yield spread against 10-year MGS (Exhibit 8).
- We like SREIT underpinned by its well-diversified income base which could cushion potential downside risks. Its portfolio encompasses retail malls, offices, hotels, universities, hospitals and an industrial property 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 sustainable financial considerations into its capital management strategies.
- SREIT currently trades at a compelling FY23F PE of 15x vs. its 4-year average PE of 19x. Meanwhile, distribution yield for FY23F of 7% is attractive vs. 10-year MGS yield of 4%.
- The downside risks are:
 - (i) a lower-than-expected tenancy renewal and occupancy rate; and
 - (ii) further contraction in yield spread against the 10-year MGS amid higher-than-expected increase in interest rates.

EXHIBIT 1: RESULT SUMMARY

FY 31 Dec (RMmil)	3QCY21	2QCY22	3QCY22	QoQ (%)	YoY (%)	9MCY21	9MCY22	YoY (%)
Gross Revenue	106.9	144.5	166.2	15.0	55.5	314.5	464.7	47.7
Property Operating Expenses	(36.4)	(37.6)	(38.0)	1.0	4.5	(114.7)	(110.7)	(3.5)
Net Property Income	70.5	106.9	128.2	20.0	81.9	199.9	354.1	77.1
Net investment income	70.5	106.9	128.3	20.0	81.8	200.0	372.4	86.2
Manager's fee	(9.1)	(10.1)	(10.8)	7.6	19.5	(26.6)	(31.3)	17.7
Trustee's fee	(0.2)	(0.2)	(0.2)	1.5	(16.2)	(0.6)	(0.6)	(5.7)
Other trust expenses	(0.6)	(0.4)	(0.4)	(1.7)	(35.7)	(1.6)	(1.5)	(7.3)
EBIT	60.6	96.2	116.8	21.4	92.7	171.1	339.0	98.1
Net interest income/expenses	(19.6)	(21.7)	(24.9)	14.7	27.4	(59.7)	(66.2)	10.9
Profit Before Taxation	41.1	74.5	91.9	23.4	>100	111.4	272.7	>100
Taxation	0.0	0.0	0.0	n.a.	n.a.	0.0	0.0	n.a.
Net Income	41.1	74.5	91.9	23.4	>100	111.4	272.7	>100
Adjustment	(5.0)	(5.0)	(5.0)	0.8	0.4	(14.9)	(33.2)	>100
Distributable Income	36.0	69.5	86.9	25.0	>100	96.4	239.5	>100
<u>Distribution:</u>								
EPU (sen)	1.1	2.0	2.5	25.1	>100	2.8	7.0	>100
Declared DPU (sen)	0.0	4.2	0.0	n.a.	n.a.	1.6	4.2	>100
NAV/unit	1.5	1.5	1.5	(0.0)	(0.5)	1.5	1.5	(0.5)
Weighted average units in issue('mil)	3,424.8	3,424.8	3,424.8	0.0	0.0	3,424.8	3,424.8	0.0
<u>Margin:</u>								
Net Property Income Margin (%)	66.0	74.0	77.1	3.2	11.2	63.5	76.2	12.6
EBIT margin (%)	38.4	51.6	55.3	3.7	16.9	35.4	58.7	23.3
Net Interest Coverage (x)	3.1	4.4	4.7	5.8	51.2	2.9	5.1	78.6
Debt/Asset Ratio (%)	36.9	36.8	37.3	0.5	0.5	36.9	37.3	0.5

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

Source: Company, AmlInvestment Bank Bhd

EXHIBIT 2: REVENUE BREAKDOWN (%)

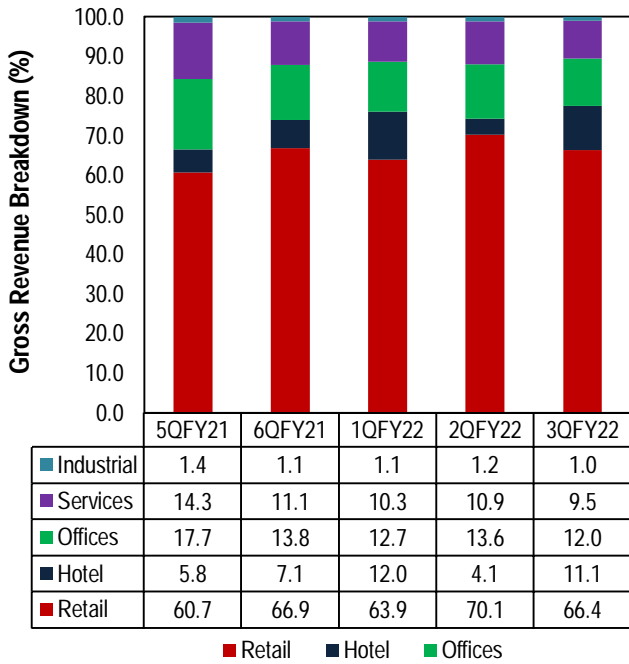
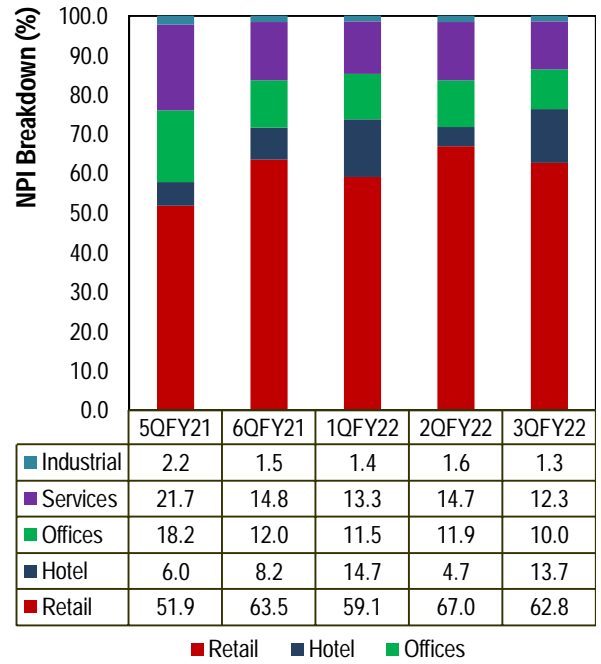


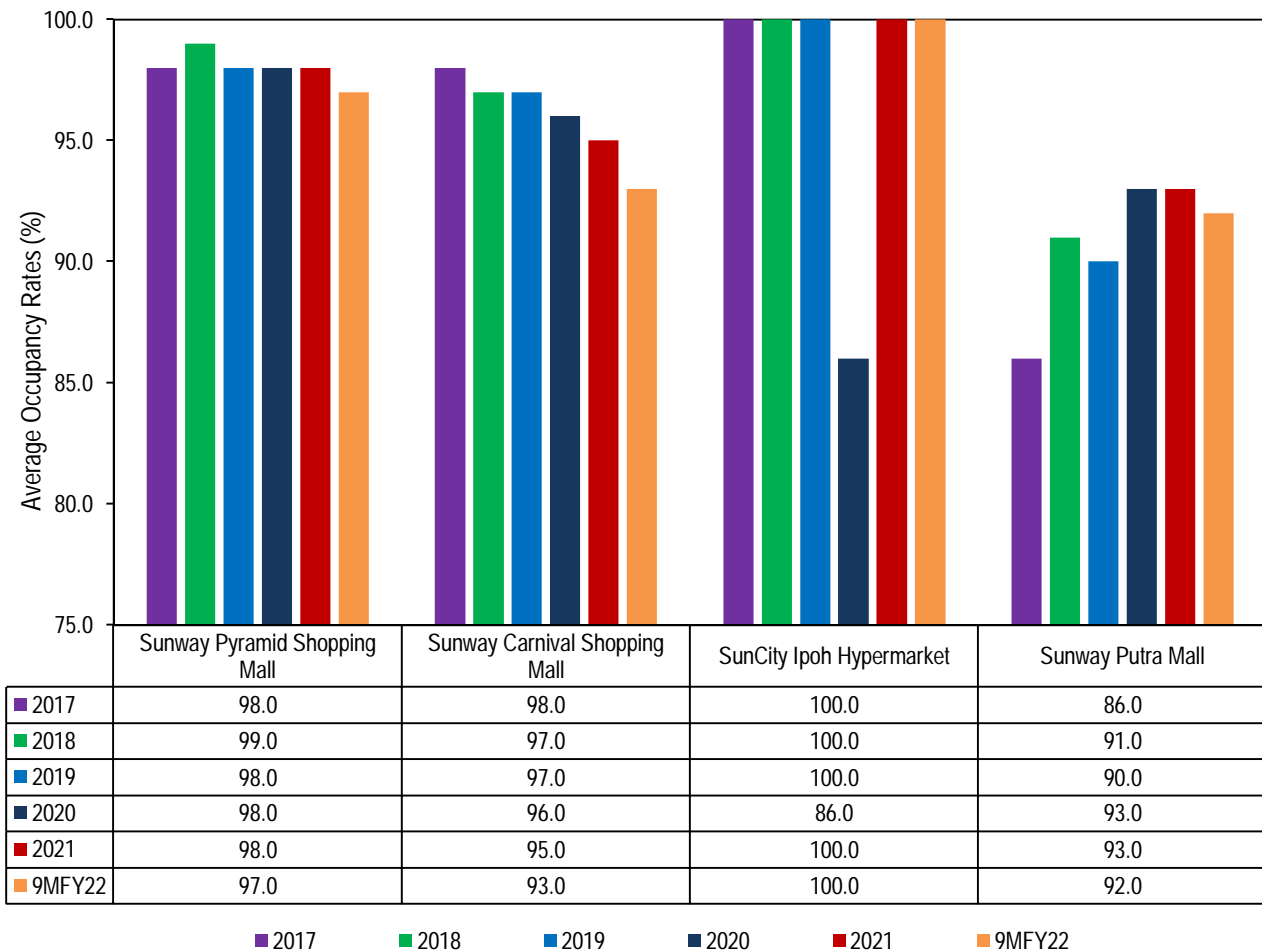
EXHIBIT 3: NET PROPERTY INCOME BREAKDOWN (%)



Source: Company, AmlInvestment Bank Bhd

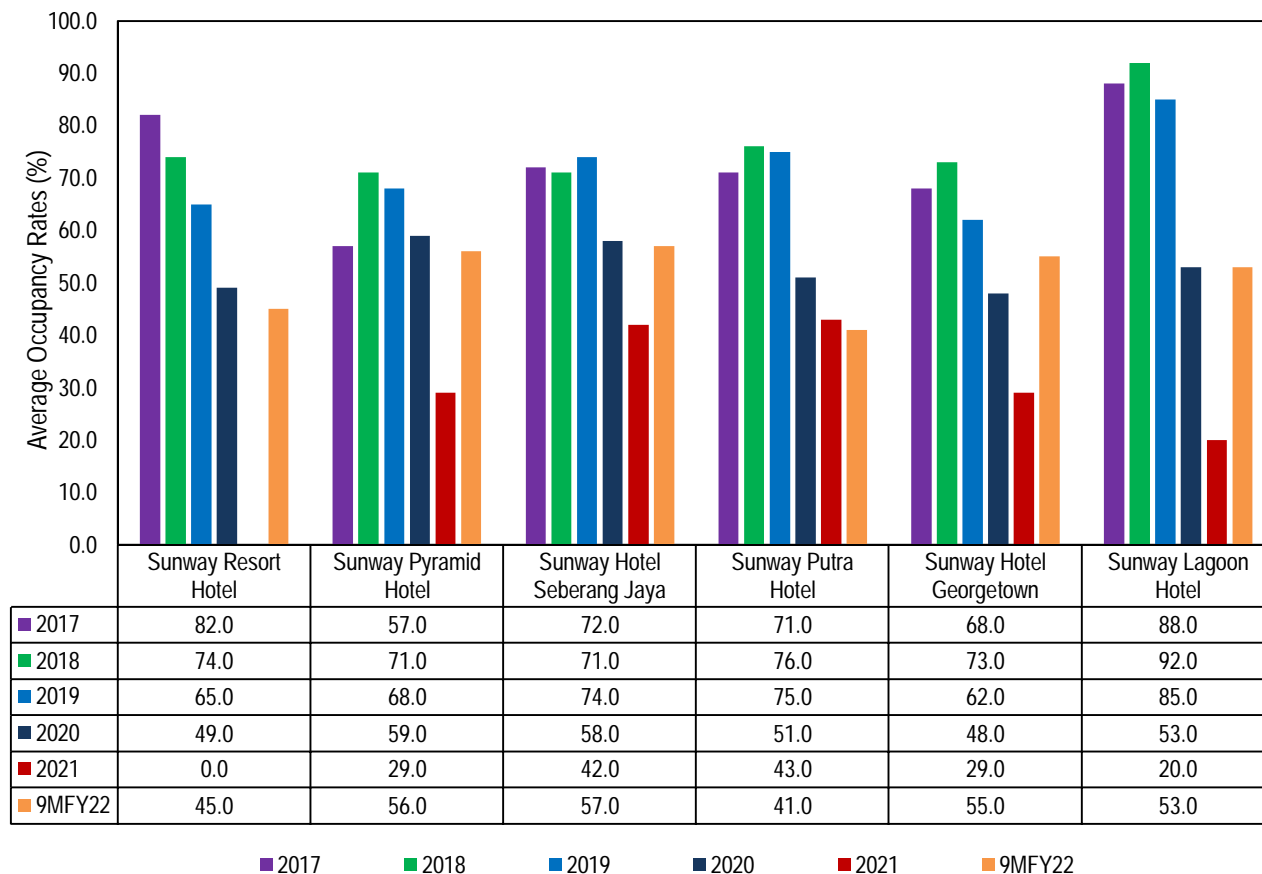
Source: Company, AmlInvestment Bank Bhd

EXHIBIT 4: OCCUPANCY RATE (RETAIL)



Source: Company, AmlInvestment Bank Bhd

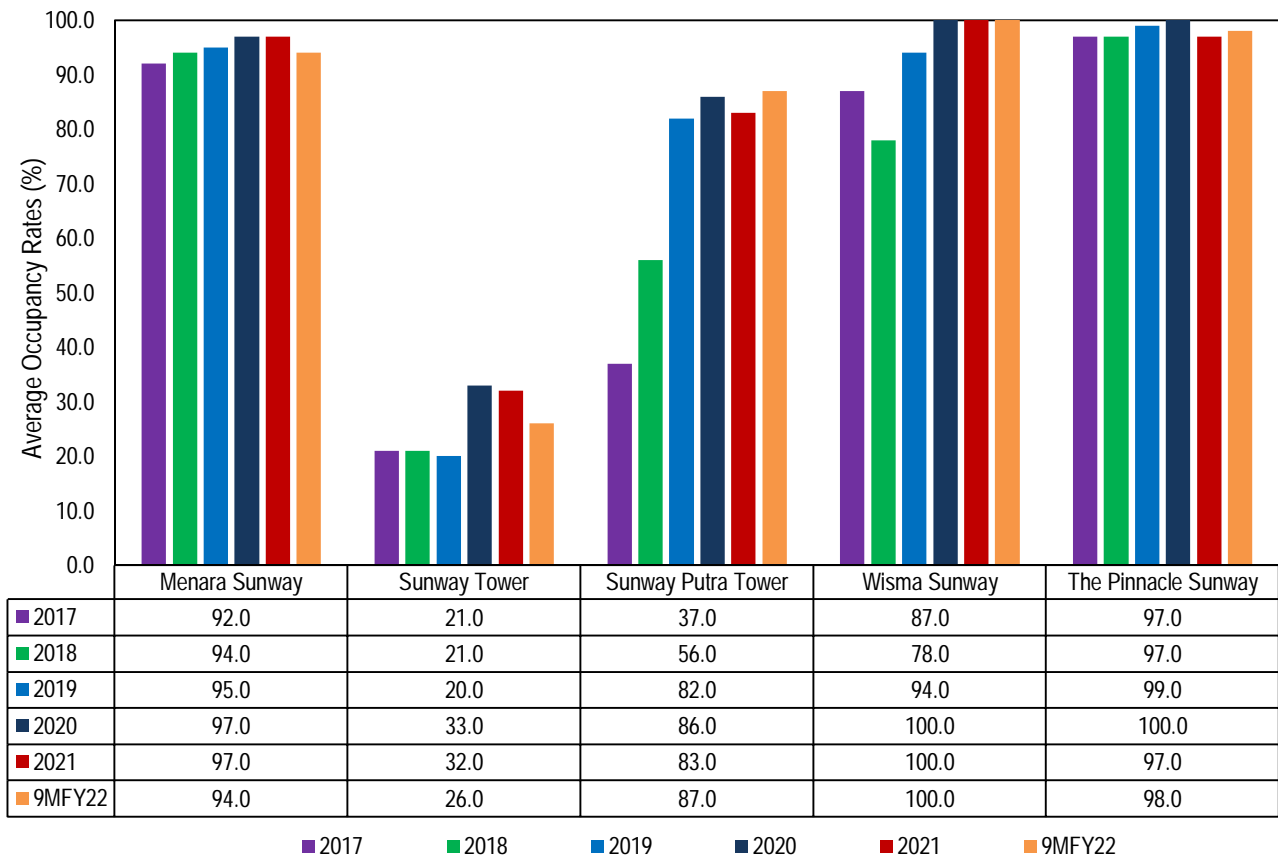
EXHIBIT 5: OCCUPANCY RATE (HOTEL)



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

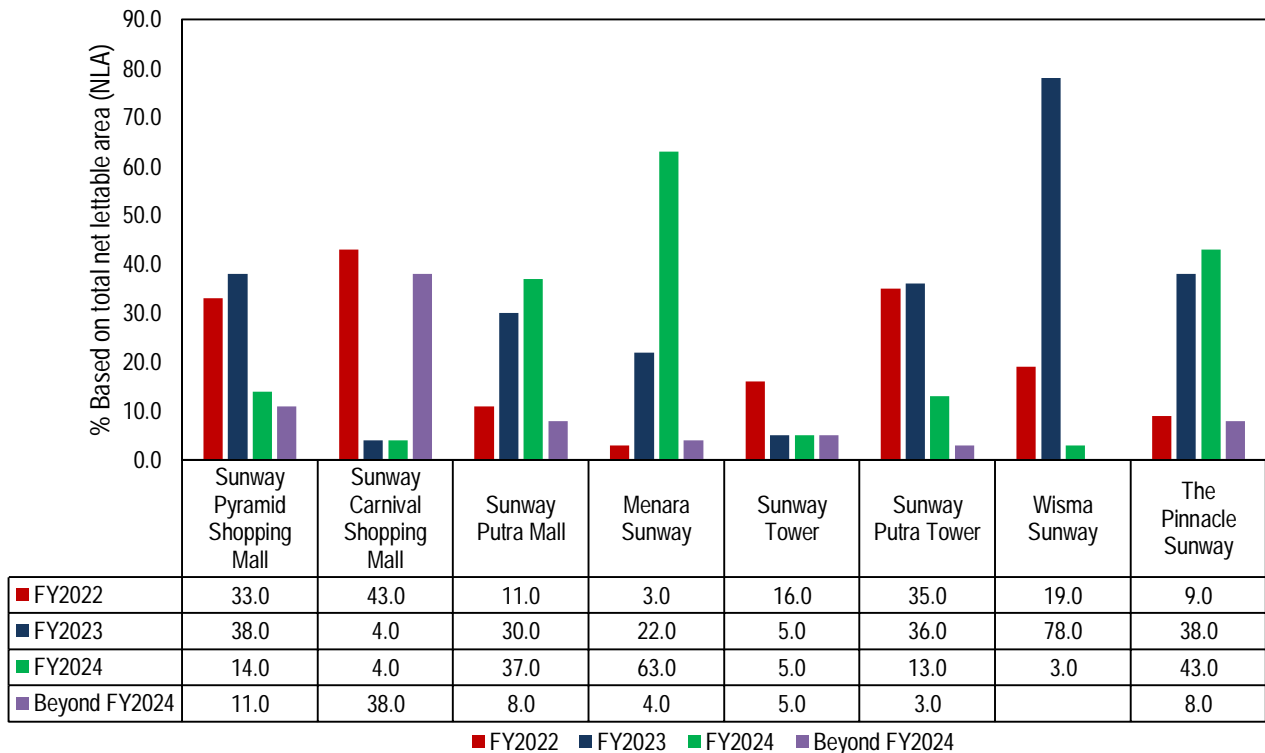
Source: Company, AmInvestment Bank Bhd

EXHIBIT 6: OCCUPANCY RATE (OFFICE)



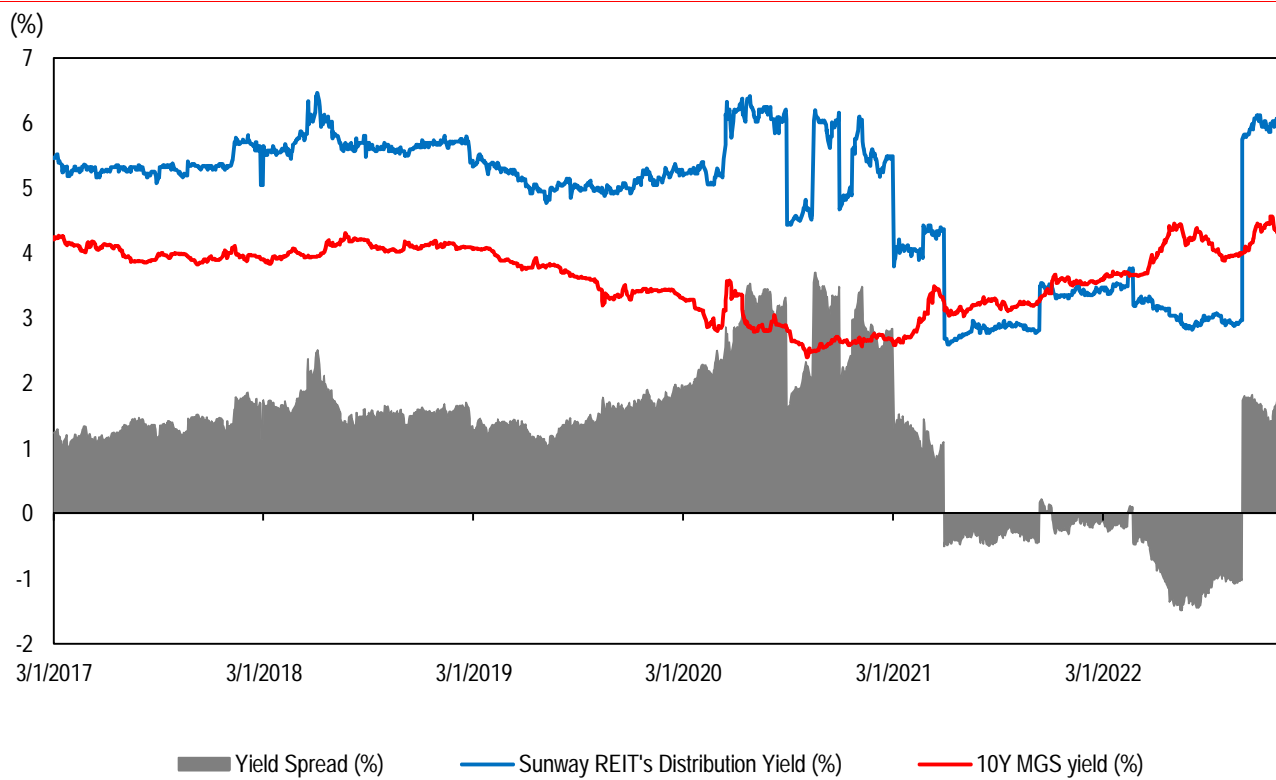
Source: Company, AmInvestment Bank Bhd

EXHIBIT 7: PROJECTED LEASE EXPIRY SCHEDULE



Source: Company, AmInvestment Bank Bhd

EXHIBIT 8: YIELD SPREAD AGAINST 10-YEAR MALAYSIAN GOVERNMENT SECURITIES (MGS)



Source: Company, AmInvestment Bank Bhd

EXHIBIT 9: DISCOUNT DIVIDEND MODEL

Assumption for Weighted Average Cost of Capital (WACC)

Risk Free Rate	4.3%
Beta	0.6
Market Return	14.4%

Cost of Equity (Ke)	10.4%
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Average Cost of Debt	5.0%
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Capital Structure: (RM Mil)

Market Cap	4,794.7	58.6%
Total Borrowing	3,394.1	41.4%
Total	8,188.8	100.0%

Weighted Average Cost of Capital (WACC):

	Weight	Cost	W X C
Cost of Equity (Ke)	58.6%	10.4%	6.1%
Average Cost of Debt	41.4%	5.0%	2.1%
WACC			8.1%

Multi-Stage DDM	2022	2023	2024	2025	2026	Terminal Value
Period	1	2	3	4	5	
Dividends (RM)	0.09	0.10	0.10	0.10	0.11	1.91
Present Value (RM)	0.08	0.08	0.08	0.07	0.07	1.29
Valuation	1.68					
(+3%) adjustment for 4-star ESG rating	0.05					
Fair Value/unit (RM)+ESG	1.73					
WACC (%)	8.1%					
Growth Rate (%)	2.5%					

Source: AmInvestment Bank Bhd

EXHIBIT 10: 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: AmInvestment Bank

EXHIBIT 11: PB BAND CHART



EXHIBIT 12: PE BAND CHART



EXHIBIT 13: FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	FY20	*18MFY21	FY22F	FY23F	FY24F
Gross Revenue	556.9	675.6	633.7	704.1	734.9
Property Operating Expenses	(140.1)	(218.5)	(169.8)	(183.7)	(205.9)
Net property income (NPI)	416.8	457.1	463.9	520.4	529.0
Net Investment Income	358.8	380.3	464.7	520.9	529.7
Net interest	(111.0)	(125.7)	(107.9)	(143.3)	(140.4)
Exceptional items	0.0	0.0	0.0	0.0	0.0
Pretax profit	207.3	194.6	309.0	325.0	334.2
Taxation	0.9	0.9	1.7	1.8	1.9
Minorities	0.0	0.0	0.0	0.0	0.0
Net income	208.2	195.5	310.8	326.8	336.1
Distributable Income	228.9	221.9	310.8	326.8	336.1
Balance Sheet (RMmil, YE 31 Dec)	FY20	*18MFY21	FY22F	FY23F	FY24F
Plant and Equipment	12.9	11.6	12.9	14.4	15.9
Investment Properties	8,020.2	8,020.2	8,020.2	8,020.2	8,020.2
Total non-current assets	8,050.1	8,069.2	8,033.2	8,034.7	8,036.1
Cash & equivalent	101.8	290.5	309.8	330.2	352.1
Trade receivables	53.3	39.8	29.8	35.3	39.2
Other current assets	255.1	69.5	69.5	69.5	69.5
Total current assets	410.2	399.8	409.1	435.0	460.7
Trade payables	1.7	5.2	3.4	3.3	3.7
Short-term borrowings	1,645.4	1,595.4	1,406.5	1,731.8	2,101.0
Other current liabilities	150.9	203.7	189.7	210.8	220.0
Total current liabilities	1,798.0	1,804.2	1,599.6	1,945.9	2,324.7
Long-term borrowings	1,800.0	1,810.0	1,961.3	1,598.8	1,192.8
Other long-term liabilities	92.5	71.0	92.8	101.6	105.4
Total long-term liabilities	1,892.5	1,881.0	2,054.1	1,700.4	1,298.2
Total Unitholders' funds	4,769.8	5,465.2	4,788.5	4,823.4	4,873.9
Minority interests	—	—	—	—	—
NAV per unit (RM)	1.5	1.5	1.4	1.4	1.4
Cash Flow (RMmil, YE 31 Dec)	FY20	*18MFY21	FY22F	FY23F	FY24F
Pretax profit	207.3	194.6	309.0	325.0	334.2
Depreciation/Amortisation	0.0	0.0	0.0	0.0	0.0
Net change in working capital	(102.9)	116.8	(5.7)	15.5	5.7
Others	240.5	121.1	175.2	190.6	198.8
Cash flow from operations	344.9	432.5	478.5	531.2	538.7
Capital expenditure	(2.3)	(2.2)	(3.0)	(3.3)	(3.4)
Net investments & sale of fixed assets	(117.4)	(713.4)	0.0	0.0	0.0
Others	(154.0)	140.6	13.3	16.6	17.7
Cash Flow (used in) / from Investing	(273.6)	(575.0)	10.4	13.3	14.3
Debt raised/(repaid)	331.4	(28.7)	(37.6)	(37.2)	(36.8)
Equity raised/(repaid)	0.0	710.0	0.0	0.0	0.0
Distribution paid to unitholders	(212.9)	(178.8)	(310.9)	(327.0)	(336.2)
Others	(135.2)	(171.2)	(121.2)	(159.9)	(158.1)
Cash flow (used in) / from Financing	(16.7)	331.3	(469.7)	(524.0)	(531.1)
Net cash flow	54.6	188.8	19.1	20.5	21.8
Net cash/(debt) b/f	47.3	101.8	290.6	309.8	330.2
Net cash/(debt) c/f	101.8	290.6	309.8	330.2	352.1
Key Ratios (YE 31 Dec)	FY20	*18MFY21	FY22F	FY23F	FY24F
Revenue growth (%)	-4.0	21.3	-6.2	11.1	4.4
NPI margin (%)	74.8	67.7	73.2	73.9	72.0
Pretax margin (%)	37.2	28.8	48.8	46.2	45.5
Net income margin (%)	37.4	28.9	49.0	46.4	45.7
Interest cover (x)	2.9	2.5	3.9	3.3	3.4
DPU payout (%)	94.3	92.2	100.0	100.0	100.0
Receivable turnover (days)	23.8	25.1	17.2	18.3	19.4
Payable turnover (days)	6.2	5.7	7.4	6.6	6.5

Source: Company, AmInvestment Bank Bhd estimates

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

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