

21 March 2019

Property | REITs

Starhill Global REIT (SGREIT SP)

Buy (Maintained)

Long Leases Mitigate AEI Impact; Keep BUY

Target Price (Return)	SGD0.78 (+11%)
Price:	SGD0.70
Market Cap:	USD1,129m
Avg Daily Turnover (SGD/USD)	0.5m/0.4m

- **Still BUY with new TP of SGD0.78 from SGD0.80, 11% upside plus 7% yield.** Starhill Global REIT, a sector Top Pick, is among the cheapest S-REITs – yield 160bps higher than sector average and P/BV of 0.8x, vs sector's 1.1x. Its Malaysian master lease extensions of 9-19.5 years provide income certainty at the slight expense of upfront capex for AEI. We believe the new master lease is in the unit holders' best interest amidst the challenging retail market in KL.
- **New master lease comes with long-tenure mitigating upfront Asset Enhancement Initiatives (AEI) costs.** Starhill has two Malaysian assets – Starhill Gallery (SG) and Lot 10 Property (Lot 10) – with the current master lease expiring on Jun 2019. Management announced the signing of new master lease agreement with existing master tenant, YTL Corp (YTL MK, NR) (The REITs sponsor), which will have a long tenure of 19.5 years and nine years (including options) for SG and Lot 10. The initial rental income for the SG master lease is similar to the expiring rent with a built-in step-up of 4.75% after every three years. For Lot 10, the initial rent will be 5% higher than current with 6% rental step up after every three years (Figure 4). The transaction is subjected to unit holders' approval in the upcoming EGM.
- **Asset enhancement for SG.** To better position this mall amidst increasing competition and supply in vicinity, the manager will undertake upgradation works, which include conversion of top three floors into hotel as an extension of the adjoining JW Marriott, revamp mall entrance and refresh interior spaces. The asset enhancements to be undertaken by master tenant, with the REIT bearing estimated cost of MYR 175m (~SGD 58.1m) that should be fully funded by debt. The REIT would also provide a 6-month rent rebate of MYR26m for the first two years to offset AEI impact. The REIT manager plans to offset the impact to DPU by taking 57% of management fees in units (currently 100% in cash). Gearing, as a result, is expected to see a slight increase to 36.7% (from 35.5%), but still well below the threshold of 45%.
- **Rationale for master lease extensions is reasonable.** Management explained that it explored various options for the mall from direct undertaking of operations to sourcing for another master lessee with different concepts. However, it noted that the above option proved to be best, in terms of strengthening mall positioning and securing earnings sustainability. In the [MREITs sector update on 19 Mar](#), our Malaysian analyst highlighted the oversupply of retail malls plaguing KL. Thus, we believe the long master lease extensions help to mitigate uncertainties/challenges in the retail sector.
- **DPU adjustments.** We lower our FY20F-21F (Jun) DPU by 2-3%, factoring in rental rebates and assuming 60% of management fees in units. Key catalysts are expected turnaround in overseas and Singapore office portfolio.

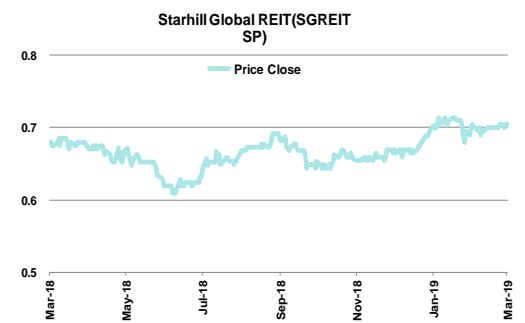
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	3.7	0.0	3.7	0.0	(2.8)
Relative	(0.8)	2.2	(1.4)	(0.8)	6.0
52-wk Price low/high (SGD)					0.64 - 0.78



Source: Bloomberg

Forecasts and Valuation	Jun-17	Jun-18	Jun-19F	Jun-20F	Jun-21F
Total turnover (SGDm)	216.4	208.8	214.6	207.9	212.5
Net property income (SGDm)	166.9	162.2	167.5	160.0	163.2
Reported net profit (SGDm)	100.3	84.2	144.2	144.0	161.8
Distributable income (SGDm)	110	103	108	109	111
DPS (SGD - cents)	4.9	4.5	4.8	4.9	4.9
DPS growth (%)	(5.0)	(7.5)	5.4	1.6	1.5
P/BV (x)	0.8	0.8	0.8	0.7	0.7
Dividend Yield (%)	7.0	6.5	6.9	7.0	7.1
Return on average equity (%)	5.0	4.2	7.1	6.9	7.5
Return on average assets (%)	3.1	2.6	4.5	4.4	4.8
Interest coverage (x)	3.8	3.7	3.7	3.5	3.5

Source: Company data, RHB

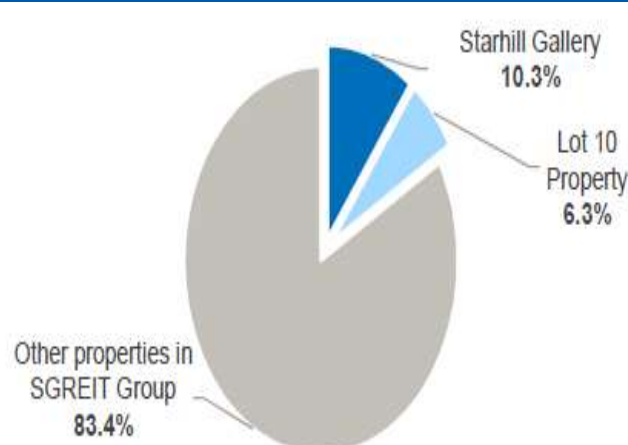
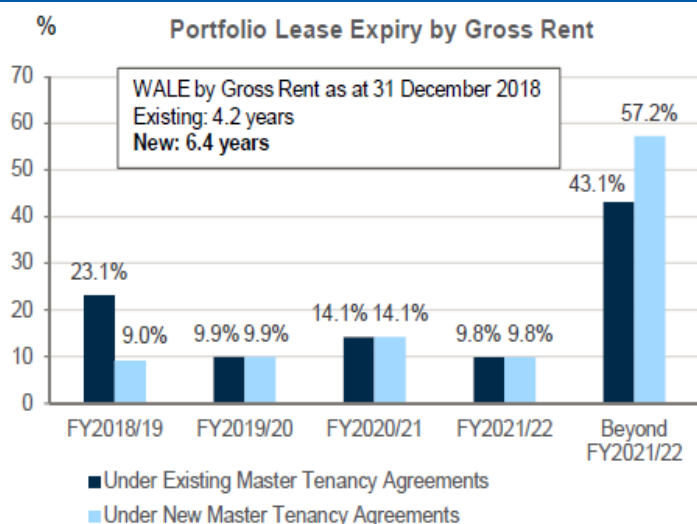
Figure 1: Starhill's DDM valuation

FYE Jun	FY19F	FY20F	FY21F	FY22F	FY23F	Terminal value
DPU (SGD cts)	4.80	4.87	4.95	5.11	5.31	83.30
Fair value (SGD)	0.78					
Current price (SGD)	0.70					
Price upside (%)	11.4					
Distribution yield (%)	6.9					
Assumptions						
Risk-free rate (%)	3.0					
Beta	0.6					
Cost of equity (%)	7.4					
Terminal growth (%)	1.0					

Source: RHB

Figure 2: Lease expiry profile post new master leases

Figure 3: NPI contribution of Malaysia properties – FY18



Source: URA, CBRE, RHB

Source: ?

Figure 4: New master tenancy agreement

Key Information of the New MTA	Starhill Gallery	Lot 10 Property
Annual rent	<ul style="list-style-type: none"> The initial annual rents after the AEW under the New MTA represent an increase of 1.5% or RM1.3 million compared to the expiring rents for the Malaysia Properties¹ The initial annual rents payable under the New MTA are comparable to the appraised rental values provided by the independent valuers² 	
Long tenures	19.5 years (to 31 December 2038)	9 years ³ (to 30 June 2028)
Rent step-ups every 3 years from 4 th year till lease expiry ¹	4.75%	6.0%
Asset enhancement works	<ul style="list-style-type: none"> Includes a condition for AEW to be performed on Starhill Gallery Upon lease expiry, master tenant to reinstate hotel component to retail at their cost, at SGREIT's option 	

Source: CBRE

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