

29 July 2019

Property | REITS

## Suntec REIT (SUN SP)

**Buy** (from Neutral)

### Enhancing Earnings Quality; Upgrade To BUY

Target Price (Return)	SGD2.08 (+8%)
Price:	SGD1.92
Market Cap:	USD2,795m
Avg Daily Turnover (SGD/USD)	8.5m/6.2m

- **Upgrade to BUY from Neutral, with new SGD 2.08 TP from SGD1.90, 8% upside plus 5% yield**, as we expect earnings turnaround from flow through of positive rent reversions, completion of three development assets by 1H20, and higher income contribution from latest acquisitions. The recent placement exercise also removed an overhang of any imminent fund raising. Valuations are attractive with the stock trading at 0.9x P/BV (Office REITs: -1.1x P/BV) and dividend yield of 5.1%.
- **2Q operational DPU in line.** Operational DPU rose 1.4% YoY, while overall DPU declined 4.6% YoY, as Suntec REIT (Suntec) exercised prudence by lowering capital distribution by 35% YoY to maintain stable DPU ahead. It still has c.SGD60m of capital gains left from past divestments.
- **Suntec City office and retail rents to continue uptrend.** Office leasing picked up pace in 2Q19 with 180,000 sqf of leases signed (~3x more than 1Q19) with rent reversion of +7.9%. With 2H19-2020 expiring rents at <SGD9 psf, we expect rent reversions to be in the double digit level. Suntec City Mall registered healthy 1H19 performance – footfall (+3.9% YoY), tenant sales (+1.7% YoY), and positive rent reversion of +5.3%. Suntec expects rent reversions to be mid-single digits. Suntec Singapore Convention & Exhibition Centre's performance was impacted by fewer major events in 1H19, but we expect it to improve in 2020 on better biennial events calendar.
- **Accretive acquisition of two Australian assets.** Suntec recently announced the acquisition of 21 Harris Street (21HS) in Sydney (expected physical completion 1Q20, 5.5% initial NPI yield), and 55 Currie Street (55 CS) in Adelaide (8% NPI yield). Both assets are accretive to FY18 DPU assuming a 40:60 (debt:equity) mix. WALE is relatively long at 10.2 years and 4.4 years with built-in annual rent escalations of 3-4%. These acquisitions will be funded from recent private placement proceeds of SGD200m. We are positive on these acquisitions as they should provide much-needed earnings stability. Post acquisition, Australia will account for 23% of AUM. The REIT is expected to focus on overseas acquisitions in the medium term.
- **Development assets contributions to kick-in from 2H20.** One of the key drags in Suntec's earnings has been interest payments for its assets currently under development. The assets – 9 Penang Road (9PR), Olderfleet, and 21HS – are slated for completion by 1H20, and should start positively contributing to earnings, boosting organic DPU. The office component of 9PR has been 100% pre-committed to UBS on a long lease, while Olderfleet has secured commitment for 82.5% of its space with additional heads of agreement signed for 8.4%. This should contribute to healthy organic DPU growth from 2021, aided by built-in rental escalations for these assets.
- **DP and TP adjustments.** Our FY19F-21F DPU are lowered by 2-3%, mainly due to lower capital gains distribution assumed. With better earnings clarity, we cut our COE assumptions by 60bps, resulting in a higher TP.

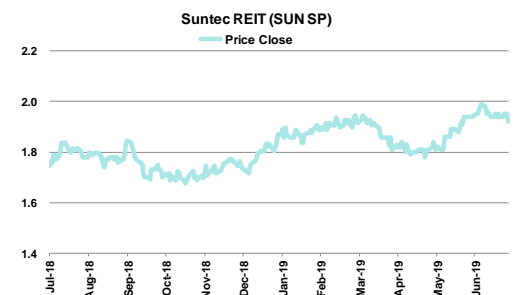
#### Analyst

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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	7.9	(1.0)	4.3	(0.5)	3.2
Relative	(1.5)	(2.7)	4.4	(5.3)	2.4
52-wk Price low/high (SGD)	1.66 - 2.00				



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (SGDm)	354.2	363.5	373.9	381.6	385.2
Net property income (SGDm)	244.5	241.0	239.3	244.2	246.5
Reported net profit (SGDm)	229.0	318.2	351.0	361.3	309.0
Distributable income (SGDm)	263.0	266.8	268.5	272.6	280.8
DPS (SGD - cents)	10.0	10.0	9.7	9.6	9.8
DPS growth (%)	0.0	(0.2)	(2.7)	(0.9)	2.2
P/BV (x)	0.9	0.9	0.9	0.9	0.9
Dividend Yield (%)	5.2	5.2	5.1	5.0	5.1
Return on average equity (%)	4.1	5.6	5.9	5.9	5.0
Return on average assets (%)	2.5	3.3	3.5	3.5	3.0
Interest coverage (x)	3.6	4.1	3.5	3.2	3.3

Source: Company data, RHB

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## Financial Exhibits

Asia	Financial summary	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
Singapore	Recurring EPS (SGD)	0.08	0.12	0.12	0.12	0.10
Property	EPS (SGD)	0.08	0.12	0.12	0.12	0.10
Suntec REIT	DPS (SGD)	0.10	0.10	0.10	0.10	0.10
Bloomberg SUN SP	BVPS (SGD)	2.15	2.10	2.15	2.15	2.16
	Weighted avg adjusted shares (m)	2661	2671	2764	2831	2853
Valuation basis	Valuation metrics	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
We use DDM:	Recurring P/E (x)	22.7	16.7	15.6	15.5	18.5
i. COE of 6.7%;	P/E (x)	22.7	16.7	15.6	15.5	18.5
ii. Risk free rate of 2.75%; and	P/B (x)	0.9	0.9	0.9	0.9	0.9
iii. 2% terminal growth.	FCF Yield (%)	3.2	4.0	3.3	3.4	3.4
Key drivers	Dividend Yield (%)	5.2	5.2	5.1	5.0	5.1
i. Strong uptick in office rents;	EV/EBITDA (x)	30.7	29.3	28.6	28.8	27.5
ii. Positive contribution from development assets;	EV/EBIT (x)	30.7	29.3	28.6	28.8	27.5
iii. Better-than-expected performance from Suntec City retail component.						
Key risks	Income statement (SGDm)	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
i. Unexpected slowdown in retail and office demand;	Total turnover	354	364	374	382	385
ii. Delays in potential acquisition.	Gross profit	244	241	239	244	247
	EBITDA	274	298	311	324	342
	Depreciation and amortisation	0	0	0	0	0
	Operating profit	274	298	311	324	342
	Net interest	(76)	(72)	(89)	(100)	(104)
	Income from associates & JVs	0	0	0	0	0
	Exceptional income - net	0	0	0	0	0
	Pre-tax profit	247	331	351	361	309
	Taxation	(18)	(13)	0	0	0
	Minority interests	9	11	11	11	12
	Recurring net profit (adj)	229	318	351	361	309
Company Profile	Cash flow (SGDm)	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
Suntec REIT is a Singapore based REIT established with the objective of investing in income-producing real estate properties which are used primarily for retail and office purposes.	Change in working capital	(5)	(17)	36	3	1
	Cash flow from operations	227	210	248	217	219
	Capex	(8)	(6)	(70)	(30)	(30)
	Cash flow from investing activities	6	(137)	(334)	(190)	121
	Dividends paid	(257)	(267)	(269)	(273)	(281)
	Cash flow from financing activities	(242)	(108)	139	(358)	(343)
	Cash at beginning of period	182	173	137	189	(141)
	Net change in cash	(10)	(34)	53	(330)	(3)
	Ending balance cash	173	137	189	(141)	(144)
	Balance sheet (SGDm)	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
	Total cash and equivalents	173	137	189	(141)	(144)
	Tangible fixed assets	6389	6496	6871	7154	7225
	Intangible assets	0	0	0	0	0
	Total investments	6389	6496	6871	7154	7225
	Total other assets	2680	2880	2976	3306	3340
	Total assets	9242	9512	10036	10319	10421
	Short-term debt	237	514	300	300	300
	Total long-term debt	2994	2978	3381	3531	3561
	Other liabilities	244	252	270	273	275
	Total liabilities	3475	3744	3951	4103	4136
	Shareholders' equity	5639	5637	5954	6084	6154
	Minority interests	128	132	132	132	132
	Total equity	5767	5768	6086	6215	6285
	Net debt	3058	3355	3492	3972	4005
	Total liabilities & equity	9242	9512	10036	10319	10421
	Key metrics	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
	Revenue growth (%)	7.8	2.6	2.9	2.0	1.0
	Recurrent EPS growth (%)	15.3	(26.7)	(6.3)	(0.6)	18.9
	Gross margin (%)	69.0	66.3	64.0	64.0	64.0
	Operating EBITDA margin (%)	77.3	81.9	83.1	85.0	88.7
	Net profit margin (%)	64.7	87.5	93.9	94.7	80.2
	Dividend payout ratio (%)	112.4	117.1	110.3	108.3	105.6
	Capex/sales (%)	2.4	1.6	18.7	7.9	7.8
	Interest cover (x)	3.6	4.1	3.5	3.2	3.3

Source: Company data, RHB

Figure 1: Suntec – fair value based on dividend discount model

DDM	FY19F	FY20F	FY21F	FY22F	FY23F	Terminal Value
DPU (SGD cts)	9.72	9.63	9.84	10.22	10.62	230.09
<b>Fair value (SGD)</b>	<b>2.08</b>					
Current price (SGD)	1.92					
Price upside (%)	8.3					
Distribution yield (%)	5.1					
<b>Total return (%)</b>	<b>13.4</b>					
<b>Assumptions</b>						
Risk-free rate (%)	2.8					
Beta	0.6					
Cost of equity (%)	6.7					
Terminal growth (%)	2.0					

Source: Company data, RHB

Figure 2: 21 Harris Street, Pyrmont, Sydney



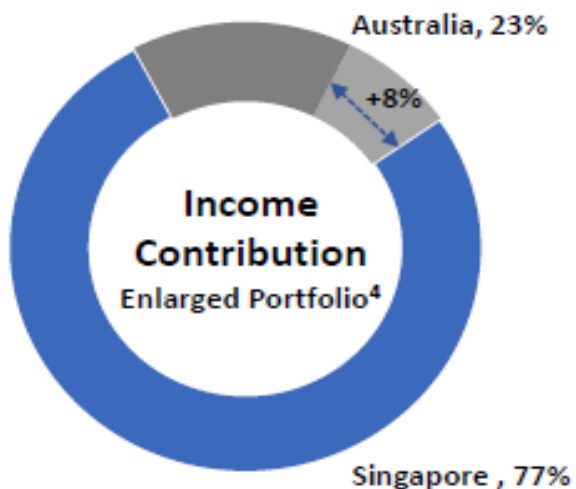
Source: Company

Figure 3: 55 Currie Street, Adelaide



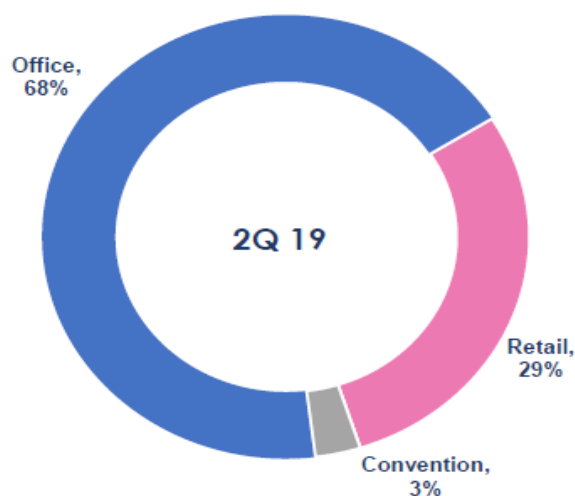
Source: Company

Figure 4: Income by geography - post acquisitions



Source: Company data

Figure 5: NPI by segment (2Q19)



Source: Company data

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