10 December 2018

Property | REITS

**Overweight** (Maintained)

# REITS

## Thai Investor Meetings Feedback; Keep OVERWEIGHT

| | |
|---|---|
| Stocks Covered: | 12 |
| Ratings (Buy/Neutral/Sell): | 6 / 6 / 0 |
| Last 12m Earnings Revision Trend: | Neutral |

| Top Picks | Target Price |
|---|---|
| Ascendas REIT (AREIT SP) – BUY | SGD2.90 |
| CDL Hospitality Trust (CDREIT SP) – BUY | SGD1.80 |
| Starhill Global REIT (SGREIT SP) – BUY | SGD0.80 |
| Manulife US REIT (MUST SP) – BUY | USD0.92 |

**Keep OVERWEIGHT, sector Top Call. We recently met with fund managers in Bangkok as we marketed S-REITs. Investor sentiment was generally positive, with most positioning on a neutral to slightly overweight stance on the sector moving into 2019. The recent dovish statements by the US Fed also seem to have given added confidence that interest rates are unlikely to spike sharply, consequently benefiting REITs. Most questions were on the office and industrial sectors, which also seemed the most favoured sub-segments. On the hospitality sector, investors are still waiting for more clarity on RevPAR growth. The retail segment is seen as a defensive play, but most believe the sector in general has outperformed market expectations.**

**Key discussion points** from the investor meetings are summarised below:

### Valuations:

i. Investors in general agreed that the current S-REIT valuation does not look expensive, with the sector offering average yield and yield spread of 6.2% and 4% – both the highest in the world. Investors also believe the recent dovish statements by the US Federal Reserve (US Fed) and trade tension uncertainties are likely to lend support to S-REIT demand in 2019;

ii. We also note that, while the US Fed has hiked interest rates 75bps since the start of the year, Singapore 10-year bond yields have inched up 20bps during the same time period. Historically, REIT yields exhibit a closer co-relation to bond yields rather than interest rate hikes (Figure 1).

### Industrial sector:

i. Investor queries were mainly centred on supply outlook and weaker operational data posted by some industrial REITs during the latest quarter. We note that industrial segment supply in general peaked in 2017, except the logistics sector – it is still adjusting to the huge influx of supply that hit the market at end-2017. c.2.9m sqf or 1m sqf pa of industrial supply is expected to come on-stream over the next three years, ie only half of the industrial supply that came on-stream over the last three years;

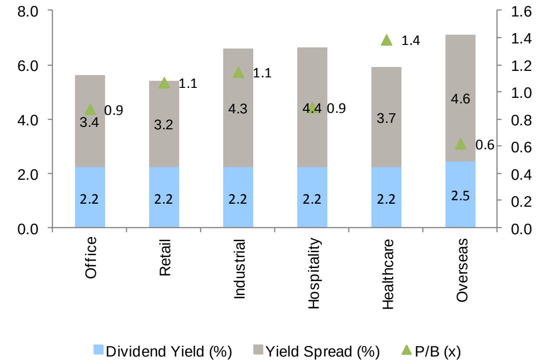
ii. On the industrial demand impact from recent trade tensions, we noted that tenants are taking a longer time to firm up on leases. There has also been some downsizing due to current uncertainties. Our base case view is that demand uncertainty is a short-term phenomenon and we expect the demand situation to stabilise and pick-up in 2019, in line with GDP growth. We also highlight the possibility of some high-end industrial demand from the region being shifted to Singapore if trade tensions prolong.

**Our sector preference is industrial and hospitality REITs** on favourable demand-supply dynamics and attractive valuations. While office sector rent has been on a steady uptrend, the positive effects are likely to be seen in DPU in late 2019 only. As such, we believe the sub-sector will be more of a 2H19 play. The retail segment still remains challenging, with many key shopping malls adding to supply in 2019 and rental rates likely to stay flattish. We recommend investors to buy on dips for retail and office REITs.

| Company Name | Rating | Target (SGD) | % Upside (Downside) | P/E (x) Dec-19F | P/BV (x) Dec-19F | Yield (%) Dec-19F |
|---|---|---|---|---|---|---|
| Ascendas REIT** | Buy | SGD2.90 | 12.8 | 12.4 | 1.2 | 6.6 |
| Cache Logisitcs Trust | Buy | SGD0.84 | 18.3 | 9.9 | 1.0 | 8.6 |
| CDL Hospitality Trusts | Buy | SGD1.80 | 19.2 | 11.2 | 1.0 | 6.6 |
| Manulife US REIT | Buy | USD0.92 | 20.3 | 10.9 | 0.9 | 8.1 |
| Starhill Global REIT | Buy | SGD0.80 | 17.7 | 10.2 | 0.7 | 7.1 |
| OUE Hospitality Trust | Buy | SGD0.77 | 13.2 | 13.3 | 0.9 | 7.8 |
| CapitaLand Commercial Trust | Neutral | SGD1.80 | 17 | 21.1 | 1.0 | 5.1 |
| CapitaLand Malls Trust | Neutral | SGD2.14 | (5.7) | 15.4 | 1.1 | 5.2 |
| Frasers Centrepoint Trust* | Neutral | SGD2.19 | 0.5 | 14.5 | 1.0 | 6.0 |
| Frasers Commercial Trust* | Neutral | SGD1.43 | 2.9 | 11.4 | 0.9 | 6.8 |
| Suntec REIT | Neutral | SGD1.90 | 7.3 | 18.6 | 0.8 | 5.8 |
| Keppel REIT | Neutral | SGD1.06 | (9.4) | 17.7 | 0.8 | 4.7 |

*Source: Company Data, RHB; * Year End Sep; ** Year End Mar;*

**S-REITs sector yield spreads**




*Source: Bloomberg, RHB*

**Sector rental at a glance**

| 3Q18 | SGD psf/mth | % YoY | % QoQ |
|---|---|---|---|
| Office (Grade A) | 10.45 | 14.8 | 3.5 |
| Office (Grade B) | 7.45 | 8.8 | 2.8 |
| Retail (Orchard) | 31.70 | 1.3 | 0.8 |
| Retail (Suburban) | 29.15 | 1.2 | 0.2 |
| Factory (Ground Floor) | 1.57 | (2.5) | 0.0 |
| Warehouse (Ground Floor) | 1.58 | (1.9) | 0.0 |
| Business Park (Islandwide) | 3.80 | 2.7 | 1.8 |
| Hotel - YTD Sep RevPAR (SGD) | 190 | 3.3 | n.m |

*Source: CBRE, Singapore Tourism Board, RHB*

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# Thai Investor Meetings Feedback

### Industrial sector (continued)

Demand in the electronics sector has been showing some weakness of late, with a slowdown in tech demand. Other industrial sectors, such as precision engineering, transport engineering, and biomedical manufacturing, are still seeing good positive YoY growth. Among the sub-segments, we are most bullish on business & science parks, as well as high-tech manufacturing demand – with the logistics segment seen as a recovery play in the latter half of 2019.

### Office sector

On the office sector, we highlighted the steady pick-up in Grade-A office rent, which has helped narrow down the rental gap between expiring and new leases signed – there has been a mix of positive and negative rent reversions seen in office REITs' latest quarter results.

We believe the effect of positive rent reversions is likely to be seen in office REITs only from 2H19. Consequently, early 2Q19 might be an opportune time to re-enter the sector.

Aside from slowdown in supply, we also highlighted to the investors that a few office assets will be taken off the market for upgradation in 2019 – this includes Chevron House and Shaw Building. Investors also queried on CapitaLand Commercial Trust's (CCT) HSBC Building, with the sole tenant's – HSBC – lease expiring in 2020. CCT is currently evaluating potential options and a redevelopment of the asset seems to be the most likely option, in our view, considering the asset's prime location.

Investors also queried on the growing trend of co-working spaces and their impact on office demand. In our observation, co-working spaces has been one of the fastest-growing sectors in terms of office demand over the last 1-2 years. A report in July by Edmund Tie & Co pointed out that there were c.110 co-working spaces in Singapore, amounting to 1.1m sqf of office space or c.2% of inventory as at May. Edmund Tie & Co also expect demand to see a stellar 42%YoY increase in occupied space to 1.4m sqf by end-2018.

Our take on this is that, while this segment has indeed been a boon to office sector demand, there are also potential risks from co-working operators' aggressive expansions – this might eventually lead to lower effective rent, as they pose a head-on competition for smaller-sized tenants that generally tend to pay higher rent on a psf basis.

### Hospitality sector

Investors noted that, while the demand-supply dynamic has turned favourable, hospitality REITs have yet to see clear revenue per available room (RevPAR) growth. Based on our discussions, we sense that investors were still waiting on the sidelines to gain more clarity on the sustainability of RevPAR growth for hospitality REITs moving into 2019. Investors also opined that most hospitality REITs are now well-diversified across other markets, which – in general – have seen a muted performance.

There were also queries on the Chinese visitor growth for the Singapore market. While visitor numbers from China are still seeing healthy growth – YTD-October YoY: +8.3% vs overall YTD visitor growth: +7.1% – the recent rise in Chinese arrivals seem mainly driven by an increase in visitors from the country's tier-2 cities vis-à-vis tier-1 urban centres. In general, the former have lower spending power when compared to the latter.

## Retail sector

On retail REITs, we highlighted to the investors that, despite the challenging environment, such REITs have managed to perform well – booking stable occupancies and flattish rent reversions. However, the retail sector supply still remains high at 1.5m sqf for 2019, with three big malls – Jewel Changi Airport, Funan, and Paya Lebar Quarter – expected to open.

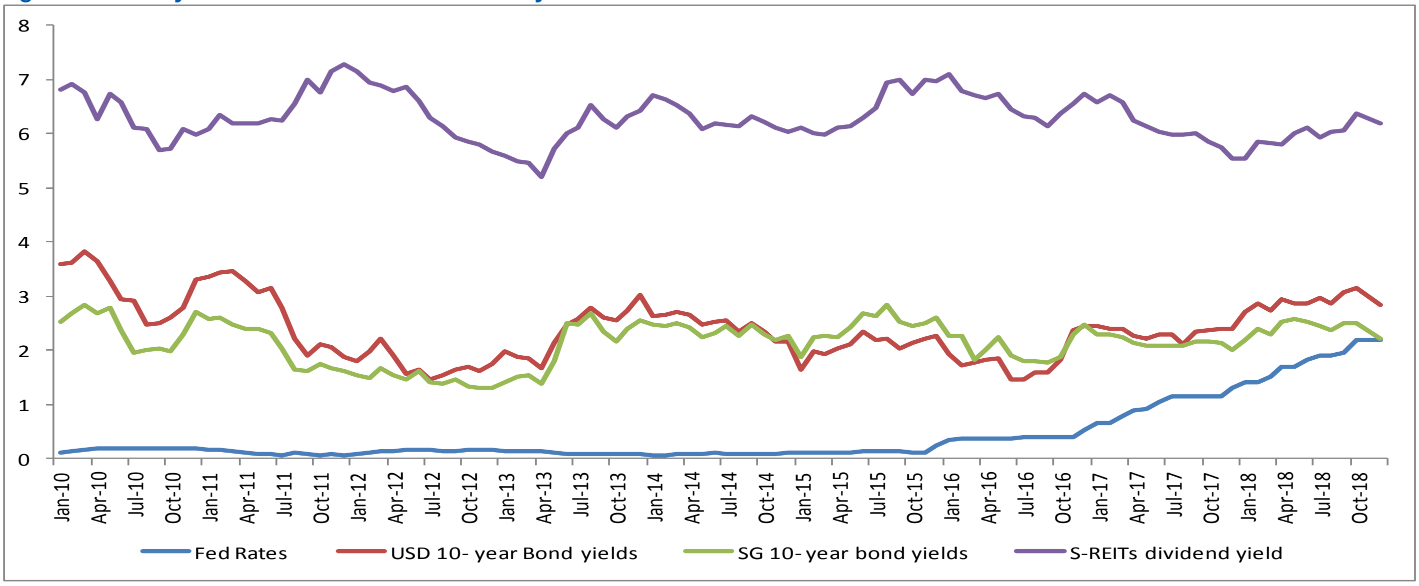
## Overseas REITs

Investors queried on our view over speculations surrounding tax reforms impacting US-based REITs. We believe the probability of any drastic change is low, as the existing structure is used by a large number of private funds and will have a broader impact on foreign investments in the US.

Additionally, we are of the view that the recent mid-term election results have made it harder for the current US Government to make drastic changes in tax regulations.

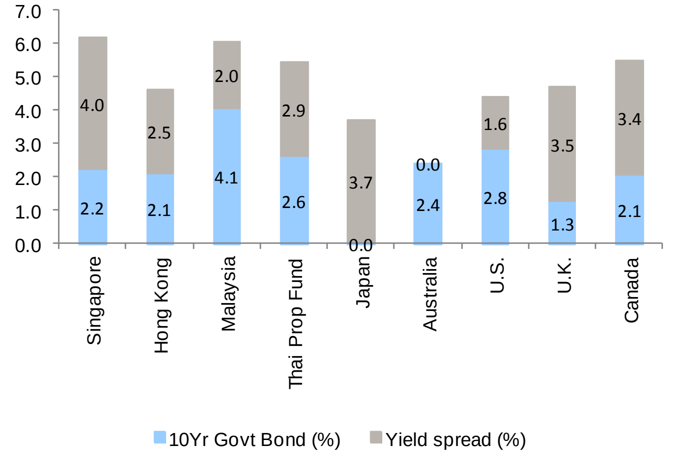
On China-based REITs, investors' main concerns were mainly on the falling CNY and its impact on distributions, as well as the ramifications of the US-China trade War. For REITs with a major exposure towards the Australian market, investors noted that growth seemed to have peaked and had been slowing down.

**Figure 1: REIT yields vs US Fed rates vs bond yields**



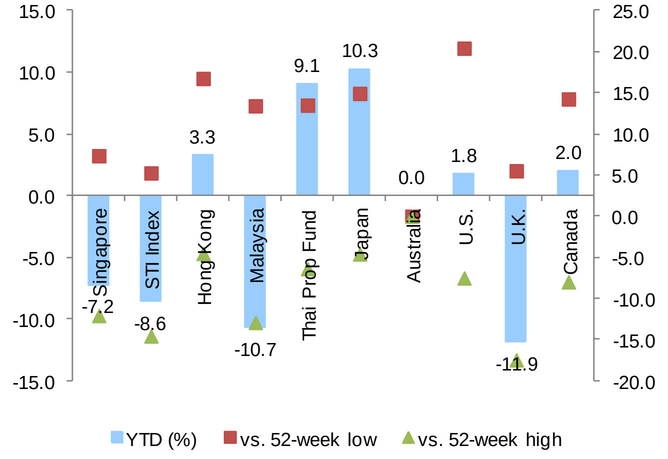

*Source: RHB, Bloomberg*

**Figure 2: Major global REITs comparison**



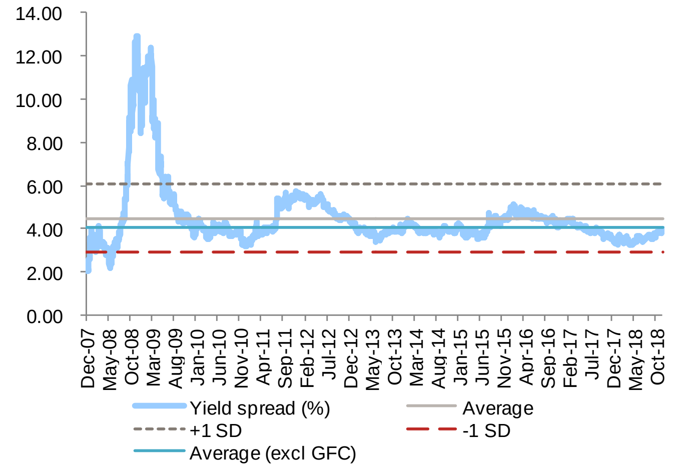

*Note: As at 5 Oct 2018*
*Source: RHB, Bloomberg*

**Figure 3: Global REITs YTD performance**



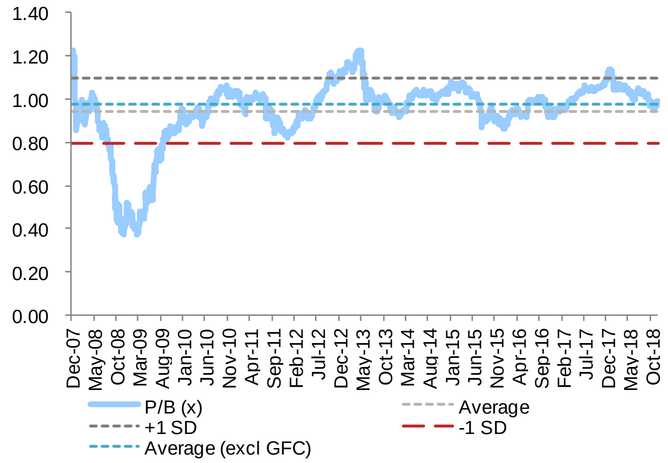

*Note: As at 5 Oct 2018*
*Source: RHB, Bloomberg*

**Figure 4: S-REITs Index (yield spreads)**




*Source: RHB, Bloomberg*

**Figure 5: S-REITs Index (P/BV)**




*Source: RHB, Bloomberg*

# Investment Thesis For S-REITs

## Figure 6: Investment thesis

| REITs | BBG ticker | Share price | Target price | Potential upside | FY-1 dividend yield (%) | Rec | Investment thesis |
|---|---|---|---|---|---|---|---|
| Ascendas REIT | AREIT SP | 2.57 | 2.90 | 0.13 | 6.6 | BUY | • High exposure to business parks and hi-tech industrial space, which will provide buffer to its overall portfolio.<br>• Geographical diversification from Australia and UK expansion.<br>• Potential organic growth as portfolio is currently under-rented.<br>• Risk: Sharp drop in global manufacturing growth. |
| Cache Logistic Trust | CACHE SP | 0.71 | 0.84 | 0.19 | 8.5 | BUY | • Expecting a turnaround in SG logistics sector in 2019<br>• New REIT manager offers vast experience and growth potential<br>• Tail-end of Single user to multi-tenancy conversion cycle |
| CapitaLand Commercial Trust | CCT SP | 1.77 | 1.80 | 0.02 | 5.1 | NEUTRAL | • Outpacing market in-terms of new rents signed and improving Asia Square performance •<br>Recent divestments likely to create near-term earnings vaccum<br>• Tail-end of negative rent reversion cycle<br>• Positive catalysts: Acquisitions at attractive price and Capitaspring redevelopment. |
| CapitaLand Mall Trust | CT SP | 2.27 | 2.14 | (0.06) | 4.8 | NEUTRAL | • Relatively high supply in retail space and exit of popular fashion retail brands<br>• Active capital recylcing efforts from divestment of mature assets and accreitive acquisitions<br>• Positive catalysts: Revamp of mall concepts, redevelopment of Funan and strong sponsor. |
| CDL Hospitality Trust | CDREIT SP | 1.51 | 1.80 | 0.19 | 6.0 | BUY | • Positive dynamics for Singapore Hospitality sector in 2018/19.<br>• Recent acquisitions to contribute positively.<br>• Most liquid proxy to recovery in visitor arrivals<br>• Risk: Lower-than-expected increase in tourist arrivals. |
| Frasers Centrepoint Trust | FCT SP | 2.18 | 2.19 | 0.00 | 6.0 | NEUTRAL | • A stable and defensive suburban retail player.<br>• Potential acquisition from its parent company: Waterway Point.<br>• Increasing competition from new retail malss limits the upside.<br>• Risk: Rising e-commerce and online food delivery services such as Food Panda. |
| Frasers Commercial Trust | FCOT SP | 1.39 | 1.50 | 0.08 | 7.2 | NEUTRAL | • Near-term operating weakness from Alexandra Technopark (ATP) vacancies and asset repositioning<br>• Asset enhamncements and China square central redevelopment should contribute positively from 1H19<br>• Risk: Further weakening of AUD against SGD. |
| Keppel REIT | KREIT SP | 1.17 | 1.06 | (0.09) | 5.1 | NEUTRAL | • Expiry of rental supports to impact DPU.<br>• One of highest geared office REIT.<br>• Highly-exposed to financial sector tenant mix. Increasing competition from newer developments.<br>• Risk: Cap rate expansion. |
| Manulife US REIT | MUST SP | 0.77 | 0.92 | 0.20 | 7.8 | BUY | • Play on rebounding US economy and office market.<br>• Organic DPU growth via inbuilt rent escalation.<br>• Strong sponsor and ability to grow REIT via. quality acquisitions.<br>• Risk: Retaining tenants and changes in tax structure. |
| OUE Hospitality Trust | OUEHT SP | 0.68 | 0.77 | 0.13 | 7.4 | BUY | • Key beneficiary of opening of new airport terminal.<br>• RevPAR expected to rebound with hotel supply declining.<br>• Risk: Lower-than-expected increase in tourist arrivals. |
| Starhill Global REIT | SGREIT SP | 0.67 | 0.80 | 0.19 | 7.2 | BUY | • Office demand and rents picking up. Retail rents still stabilising.<br>• Tight retail supply within Orchard Shopping belt in the next two years limits downside<br>• Overseas portfolio AEI's nearing completion.<br>• Risk: Weaker than expected pick-up in retail market demand |
| Suntec REIT | SUN SP | 1.77 | 1.90 | 0.07 | 5.6 | NEUTRAL | • Near-term DPU to stay flat on the back of ongoing redevelopments and asset enhancements<br>• Suntec City redevelopment will benefit the REIT in the longer term<br>• Risk: Better-than-expected performance from its newly refurbished Suntec City AEI. |

*Note: Price close on 7 Dec 2018*
*Source: RHB, Bloomberg*

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