

20 June 2019

Property | REITS

## Suntec REIT (SUN SP)

**Neutral** (Maintained)

### Awaiting Australian Acquisition; NEUTRAL

|                              |               |
|------------------------------|---------------|
| Target Price (Return)        | SGD1.90 (-1%) |
| Price:                       | SGD1.92       |
| Market Cap:                  | USD3,923m     |
| Avg Daily Turnover (SGD/USD) | 13.1m/9.6m    |

- **Maintain NEUTRAL, SGD1.90 TP**, 1% downside with 5.3% FY19F yield. Suntec REIT's (Suntec) recent placement exercise gears up its balance sheet for potential acquisitions, but is dilutive to unitholders in the near term. While operational weakness is expected to persist in the near term, a turnaround is expected in 2H20 post-completion of its development projects. Valuations are reasonable, at 0.9x P/BV with a FY19F dividend yield of 5.3%. We maintain our call pending deployment of proceeds.

- **Placement proceeds of SGD200m to further build its Australian presence.** In May, Suntec completed a private placement of 111.1m new units, raising gross proceeds of SGD200m. The proceeds will mainly be used to fund potential acquisitions of properties in Australia, which are currently undergoing due diligence. Suntec currently has three assets (including one under development) in Melbourne and Sydney, which account for ~15% of total NPI. Management previously noted that it will look for opportunities to acquire good-quality assets in the suburban markets of Sydney and Melbourne, and the core-CBD market for other key cities in Australia. With the transaction yield of Australian commercial assets ranging 4.5-6.5%, we expect the acquisition – if completed – to be yield-accretive to unit holders.

- **UBS leasing of 9 Penang Road a positive development.** In April, Suntec announced that its upcoming development 9 Penang Road's office space (NLA: 381,000 sqf) has been fully pre-leased to UBS for the long term. Suntec has a 30% stake in the development, and is in advanced discussions for leasing the remaining 15,000 sqf of retail space. We estimate average committed rental rates to be in high single digits (~SGD9 psf) which translates to a yield-on-cost of around 4%. The project, now 81% complete, is on track to be done by the year-end, with targeted occupation by 2H20.

- **Operational turnaround expected in 2H20.** With two of its seven assets currently under development and Suntec City Offices undergoing asset enhancements, we expect operational weakness (which will impact DPU) to persist until 1H20. Leasing progress in Olderfleet, Australia has been healthy, with 76% pre-committed, and heads of agreement signed for an additional 13%. The building is on track to be completed by mid-2020. The extensive refurbishment works on Suntec City Offices (done in phases) should be finished by 2021. We expect positive contributions to DPU upon completion of the above, which should help in organic DPU growth from 2021 onwards.

- **DPU adjustments.** We adjust FY19-21F DPU by -1 to +2%, factoring in recent placement exercises and contributions from development assets.

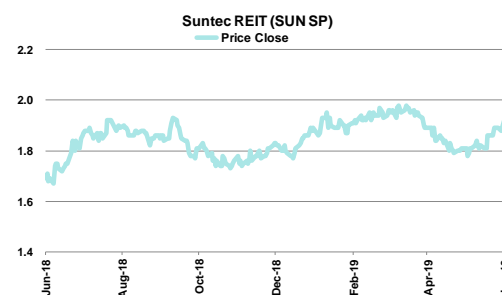
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#### Share Performance (%)

|                            | YTD         | 1m  | 3m    | 6m    | 12m  |
|----------------------------|-------------|-----|-------|-------|------|
| Absolute                   | 7.9         | 6.1 | (2.0) | 4.9   | 13.6 |
| Relative                   | 0.8         | 3.6 | (4.0) | (2.5) | 14.1 |
| 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  | 369.6   | 377.2   | 385.9   |
| Net property income (SGDm)   | 244.5  | 241.0  | 253.4   | 258.6   | 264.6   |
| Reported net profit (SGDm)   | 229.0  | 318.2  | 319.5   | 404.5   | 319.9   |
| Distributable income (SGDm)  | 263.0  | 266.8  | 280.0   | 292.7   | 304.4   |
| DPS (SGD - cents)            | 10.0   | 10.0   | 10.1    | 10.3    | 10.7    |
| DPS growth (%)               | 0.0    | (0.2)  | 1.4     | 2.1     | 3.2     |
| P/BV (x)                     | 0.9    | 0.9    | 0.9     | 0.9     | 0.9     |
| Dividend Yield (%)           | 5.2    | 5.2    | 5.3     | 5.4     | 5.6     |
| Return on average equity (%) | 4.1    | 5.6    | 5.4     | 6.7     | 0.0     |
| Return on average assets (%) | 2.5    | 3.3    | 3.3     | 4.1     | 0.0     |
| Interest coverage (x)        | 3.6    | 4.1    | 3.7     | 4.0     | 4.1     |

Source: Company data, RHB

20 June 2019

Property | REITs

## Financial Exhibits

|   |                                     |               |               |                 |                 |                 |
|---|-------------------------------------|---------------|---------------|-----------------|-----------------|-----------------|
| <b>Asia</b>   | <b>Financial summary</b>            | <b>Dec-17</b> | <b>Dec 18</b> | <b>Dec 19 F</b> | <b>Dec 20 F</b> | <b>Dec 21 F</b> |
| Singapore   | Recurring EPS (SGD)                 | 0.08          | 0.12          | 0.11            | 0.14            | 0.10            |
| Property  | EPS (SGD)                           | 0.08          | 0.12          | 0.11            | 0.14            | 0.10            |
| <b>Suntec REIT</b>  | DPS (SGD)                           | 0.10          | 0.10          | 0.10            | 0.10            | 0.11            |
| Bloomberg SUN SP  | BVPS (SGD)                          | 2.15          | 2.10          | 2.14            | 2.14            | 2.15            |
|   | Weighted avg adjusted shares (m)    | 2661          | 2671          | 2764            | 2831            | 2852            |
| <b>Valuation basis</b>  | <b>Valuation metrics</b>            | <b>Dec-17</b> | <b>Dec 18</b> | <b>Dec 19 F</b> | <b>Dec 20 F</b> | <b>Dec 21 F</b> |
| We have the following assumptions for our DDM valuation:  | Recurring P/E (x)                   | 22.7          | 16.7          | 17.8            | 14.2            | 18.4            |
| i. COE of 7.4%;   | P/E (x)                             | 22.7          | 16.7          | 17.8            | 14.2            | 18.4            |
| ii. Risk-free rate of 3.0%; and   | P/B (x)                             | 0.9           | 0.9           | 0.9             | 0.9             | 0.9             |
| iii. 2% terminal growth.  | FCF Yield (%)                       | 3.2           | 4.0           | 3.5             | 4.0             | 4.1             |
|   | Dividend Yield (%)                  | 5.2           | 5.2           | 5.3             | 5.4             | 5.6             |
| <b>Key drivers</b>  | EV/EBITDA (x)                       | 30.7          | 29.3          | 27.9            | 26.5            | 25.6            |
| i. Strong uptick in office rental rates;  | EV/EBIT (x)                         | 30.7          | 29.3          | 27.9            | 26.5            | 25.6            |
| ii. Positive contributions from development assets;   |                                     |               |               |                 |                 |                 |
| iii. Better-than-expected performance from Suntec City's retail component.  |                                     |               |               |                 |                 |                 |
| <b>Key risks</b>  | <b>Income statement (SGDm)</b>      | <b>Dec-17</b> | <b>Dec 18</b> | <b>Dec 19 F</b> | <b>Dec 20 F</b> | <b>Dec 21 F</b> |
| i. Unexpected slowdown in retail and office demand;   | Total turnover                      | 354           | 364           | 370             | 377             | 386             |
| ii. Delays in potential acquisitions.   | Gross profit                        | 244           | 241           | 253             | 259             | 265             |
|   | EBITDA                              | 274           | 298           | 304             | 322             | 335             |
|   | Depreciation and amortisation       | 0             | 0             | 0               | 0               | 0               |
|   | Operating profit                    | 274           | 298           | 304             | 322             | 335             |
|   | Net interest                        | (76)          | (72)          | (81)            | (81)            | (82)            |
|   | Income from associates & JVs        | 0             | 0             | 0               | 0               | 0               |
|   | Exceptional income - net            | 0             | 0             | 0               | 0               | 0               |
|   | Pre-tax profit                      | 247           | 331           | 320             | 405             | 320             |
|   | Taxation                            | (18)          | (13)          | 0               | 0               | 0               |
|   | Minority interests                  | 9             | 11            | 21              | 22              | 22              |
|   | Recurring net profit (adj)          | 229           | 318           | 320             | 405             | 320             |
| <b>Company Profile</b>  | <b>Cash flow (SGDm)</b>             | <b>Dec-17</b> | <b>Dec 18</b> | <b>Dec 19 F</b> | <b>Dec 20 F</b> | <b>Dec 21 F</b> |
| Suntec REIT is a Singapore-based REIT established with the objective of investing in income-producing real estate properties used primarily for retail and office purposes. | Change in working capital           | (5)           | (17)          | 18              | 2               | 3               |
|   | Cash flow from operations           | 227           | 210           | 258             | 247             | 254             |
|   | Capex                               | (8)           | (6)           | (70)            | (30)            | (30)            |
|   | Cash flow from investing activities | 6             | (137)         | 34              | 86              | 99              |
|   | Dividends paid                      | (257)         | (267)         | (280)           | (293)           | (304)           |
|   | Cash flow from financing activities | (242)         | (108)         | (309)           | (322)           | (360)           |
|   | Cash at beginning of period         | 182           | 173           | 137             | 119             | 131             |
|   | Net change in cash                  | (10)          | (34)          | (17)            | 12              | (7)             |
|   | Ending balance cash                 | 173           | 137           | 119             | 131             | 124             |
|   | <b>Balance sheet (SGDm)</b>         | <b>Dec-17</b> | <b>Dec 18</b> | <b>Dec 19 F</b> | <b>Dec 20 F</b> | <b>Dec 21 F</b> |
|   | Total cash and equivalents          | 173           | 137           | 119             | 131             | 124             |
|   | Tangible fixed assets               | 6389          | 6496          | 6550            | 6714            | 6781            |
|   | Intangible assets                   | 0             | 0             | 0               | 0               | 0               |
|   | Total investments                   | 6389          | 6496          | 6550            | 6714            | 6781            |
|   | Total other assets                  | 2680          | 2880          | 2876            | 2905            | 2935            |
|   | Total assets                        | 9242          | 9512          | 9546            | 9750            | 9840            |
|   | Short-term debt                     | 237           | 514           | 300             | 300             | 300             |
|   | Total long-term debt                | 2994          | 2978          | 2951            | 3001            | 3031            |
|   | Other liabilities                   | 244           | 252           | 252             | 254             | 258             |
|   | Total liabilities                   | 3475          | 3744          | 3502            | 3555            | 3589            |
|   | Shareholders' equity                | 5639          | 5637          | 5912            | 6063            | 6119            |
|   | Minority interests                  | 128           | 132           | 132             | 132             | 132             |
|   | Total equity                        | 5767          | 5768          | 6043            | 6195            | 6251            |
|   | Net debt                            | 3058          | 3355          | 3131            | 3170            | 3207            |
|   | Total liabilities & equity          | 9242          | 9512          | 9546            | 9750            | 9840            |
|   | <b>Key metrics</b>                  | <b>Dec-17</b> | <b>Dec 18</b> | <b>Dec 19 F</b> | <b>Dec 20 F</b> | <b>Dec 21 F</b> |
|   | Revenue growth (%)                  | 7.8           | 2.6           | 1.7             | 2.0             | 2.3             |
|   | Recurrent EPS growth (%)            | 15.3          | (26.7)        | 6.8             | (20.3)          | 29.4            |
|   | Gross margin (%)                    | 69.0          | 66.3          | 68.6            | 68.6            | 68.6            |
|   | Operating EBITDA margin (%)         | 77.3          | 81.9          | 82.2            | 85.3            | 86.8            |
|   | Net profit margin (%)               | 64.7          | 87.5          | 86.5            | 107.2           | 82.9            |
|   | Dividend payout ratio (%)           | 112.4         | 117.1         | 107.7           | 105.4           | 102.7           |
|   | Capex/sales (%)                     | 2.4           | 1.6           | 18.9            | 8.0             | 7.8             |
|   | Interest cover (x)                  | 3.6           | 4.1           | 3.7             | 4.0             | 4.1             |

Source: Company data, RHB

Figure 1: Suntec REIT's DDM valuation

| DDM                     | FY19F       | FY20F | FY21F | FY22F | FY23F | Terminal Value |
|-------------------------|-------------|-------|-------|-------|-------|----------------|
| DPU (SGD cts)           | 10.13       | 10.34 | 10.67 | 10.94 | 11.15 | 210.54         |
| <b>Fair value (SGD)</b> | <b>1.90</b> |       |       |       |       |                |
| Current price (SGD)     | 1.92        |       |       |       |       |                |
| Price upside (%)        | (1.0)       |       |       |       |       |                |
| Distribution yield (%)  | 5.3         |       |       |       |       |                |
| <b>Assumptions</b>      |             |       |       |       |       |                |
| Risk-free rate (%)      | 3.0         |       |       |       |       |                |
| Beta                    | 0.8         |       |       |       |       |                |
| Cost of equity (%)      | 7.4         |       |       |       |       |                |
| Terminal growth (%)     | 2.0         |       |       |       |       |                |

Source: Company data, RHB

Figure 2: 9 Penang Road's construction progress



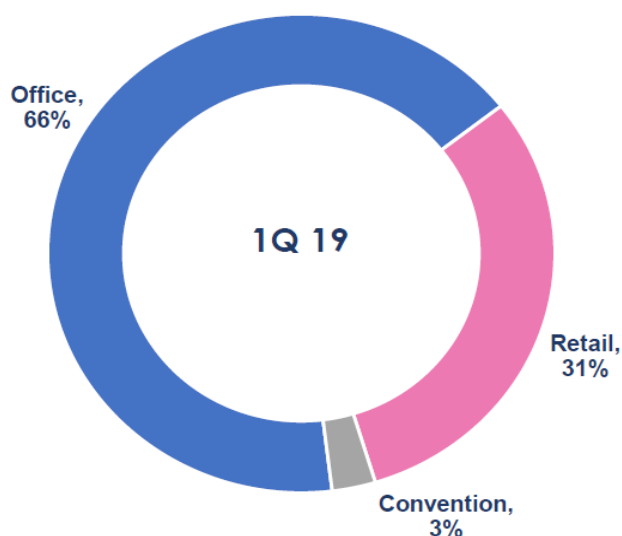
Source: Company

Figure 3: Construction progress at Olderfleet



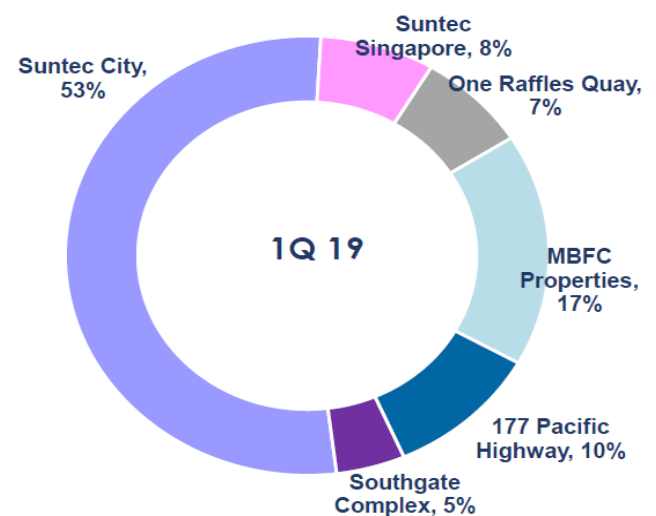
Source: Company

Figure 4: NPI by segment (1Q19)



Source: Company data

Figure 5: NPI by asset (1Q19)



Source: Company data

## RHB Guide to Investment Ratings

|                     |  |
|---------------------|--|
| <b>Buy:</b>         | Share price may exceed 10% over the next 12 months   |
| <b>Trading Buy:</b> | Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain |
| <b>Neutral:</b>     | Share price may fall within the range of +/- 10% over the next 12 months                         |
| <b>Take Profit:</b> | Target price has been attained. Look to accumulate at lower levels                               |
| <b>Sell:</b>        | Share price may fall by more than 10% over the next 12 months                                    |
| <b>Not Rated:</b>   | Stock is not within regular research coverage  |

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(a) -
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- d. an individual who within the last six months was a Person defined in letters a, b or c, above.

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