2 January 2019

Strategy | Strategy - Singapore

Singapore Strategy 2019

Stay Defensive!

Stocks Covered	57
Ratings (Buy/Neutral/Sell):	34 / 22 / 1
Last 12m Earnings	Negative

- **Stay defensive amidst growth uncertainties.** The STI, down 12% (USD terms) in 2018, could remain under pressure in 2019 amidst slowing domestic GDP growth and an uncertain trade outlook amidst China-US tensions. While 12.6x forward P/E and 4.2% dividend yield make the STI's valuations look compelling, we recommend investors stay selective and focus on buying stocks offering stable earnings, strong balance sheets, and sustainable dividends. Consumer and industrial are our defensive sector picks. We stay overweight (OW) on banks given reasonable valuations, strong growth and high yield (see our ***2019 Singapore Strategy*** for details)
- **Market valuations are inexpensive…** Trading at 12.6x 1-year forward P/E, the STI's valuation sits at its -1SD band – tested only twice since the global financial crisis. Each time, the market witnessed a sharp rebound. 4.2% forward yield – 1SD above historical average – looks attractive as well. Compelling valuations, along with expectations of a moderate appreciation in the SGD, should bring long-term investors back into the market.
- **…but prefer to stay selective & defensive.** Amidst an uncertain economic outlook and elevated market volatility, we prefer defensive sectors like consumer and industrial, and to focus on a bottom-up stock picking strategy:
  i. **Sector rotation into defensives.** Our study of previous economic cycles reveals that industrial and consumer sectors tend to outperform the broader market after the peak of economic growth in Singapore. Sheng Siong and Wilmar are our top consumer picks, while we like STE amongst industrials on revival of its profit growth;
  ii. **Remain OW on banks.** Banks offer +10% growth and +5% dividend yields despite recent slower loan growth. We see limited downside risk after the recent price correction, and prefer UOB over DBS for reasonable valuations and the likelihood of higher dividends;
  iii. **Selective REITs.** Prefer REITs that are beneficiaries of improving economic activity, and/or have strong balance sheets. Prefer industrial and hospitality REITs, with Ascendas and CDL Hospitality as Top Picks.
  iv. **Opportunistic SMID cap ideas.** Amongst small and mid-cap stocks under our coverage, we expect Silverlake Axis, HRnetgroup, Fu Yu and Singapore Medical Group to deliver strong returns in 2019.

Company Name	Rating	TP (SGD)	% Upside (Downside)	P/E (x) Dec-19F	P/B (x) Dec-19F	Yield (%) Dec-19F
Ascendas REIT*	Buy	2.90	12.8	12.9	1.2	6.6
CapitaLand	Buy	4.00	28.6	12.5	0.7	4.2
CDL Hospitality	Buy	1.80	23.3	11.6	0.9	6.3
DBS Group	Buy	29.80	25.8	10.6	1.3	5.1
Delfi Ltd	Buy	1.59	20.5	24.2	2.7	2.1
Fu Yu Corp	Buy	0.23	21.1	13.3	0.9	8.4
Genting Singapore	Buy	1.23	26.2	14.0	1.5	3.6
HRnet Group	Buy	1.18	47.5	14.8	2.3	3.2
Manulife US REIT	Buy	^ 0.92	19.5	11.8	0.9	7.2
Sheng Siong	Buy	1.27	19.8	22.7	5.6	2.8
Silverlake Axis**	Buy	0.65	56.6	15.5	6.2	4.8
Singapore Medical	Buy	0.56	40.0	15.4	1.4	-
ST Engineering	Buy	3.97	13.8	20.0	4.8	4.3
Starhill Global**	Buy	0.80	17.6	10.2	0.7	7.1
UOB	Buy	30.80	25.4	9.8	1.2	4.7
Venture Corp	Buy	19.00	36.2	11.2	1.8	5.0
Wilmar	Buy	3.58	14.7	11.3	0.9	3.5

*Note: * FY19 (Mar); ** FY19 (Jun); ^ USD; Data: 31 Dec 2018. Source: Company data, RHB.*

Singapore sector ratings:

Overweight	Consumer, REITs, Banks
Neutral	Healthcare, Plantations Real Estate, Technology, Telecom
Not rated	Materials, Offshore & Marine

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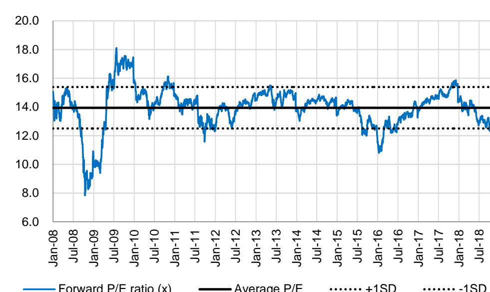
STI – forward P/E



Source: Bloomberg

Investment themes

Rotate into defensive sectors. While stocks could certainly move lower-to-sideways from here, we believe this is not a time for investors with long-term horizons to abandon risk assets. We view the current sell-off in the Singapore market as an opportunity to buy into defensive sectors – we define defensive stocks as ones with strong balance sheets, stable earnings growth, high but stable dividend yields, and low historical propensity for big price declines.

i. **Prefer consumer stocks with earnings visibility.** Singapore has seen a gradual improvement in its retail sales growth (excluding auto) since late 2016. Although at a slower pace amidst slowing economic growth, we expect the growth in retail sales to sustain into 2019. We have an OVERWEIGHT rating for the consumer sector and favour exposure to companies where we see more clear signs of earnings growth. Our preferred consumer sector picks are Sheng Siong (SSG SP, BUY, TP: SGD1.27), Wilmar International (WIL SP, BUY, TP: SGD3.58), Genting Singapore (GENS SP, BUY, TP: SGD1.23) and Delfi (DELFI SP, BUY, TP: SGD1.59).

♦ Sheng Siong and Wilmar are our preferred consumer sector picks

ii. **Defensive industrial stock:** ST Engineering. ST Engineering (STE SP, BUY, TP: SGD3.97) has been amongst the few STI stocks that has delivered positive share price returns in 2018. We expect STE's share price to do well in 2019, in line with the revival of its profit growth, which we believe will be aided by increased capacity and capabilities at its Aerospace division – the delivery of smart city-related contracts in and outside Singapore – and defence-related contracts.

♦ ST Engineering's share price should do well in 2019

BUY banks for steady earnings growth and consistent dividends. With an impending economic slowdown in 2019, investors are concerned about slowing loan growth, lower-than-expected NIM expansion, and likely escalation in NPLs for Singapore banks. However, we believe the recent price corrections have priced in negatives for banking stocks, and there exists limited downside to their share prices.

♦ Although both are BUY rated, we prefer UOB over DBS for its relatively lower valuations and industry leading capital adequacy ratio, which creates scope for higher dividend payouts in 2019

Valuations have moderated to more reasonable levels as UOB (UOB SP, BUY, TP: SGD30.80) and DBS (DBS SP, BUY, TP: SGD29.80) are now trading closer to historical average 1-year forward P/BVs.

While the outlook for 2019 loan growth has moderated since the beginning of 2018, it is still in positive territory. We expect loan growth for the three Singapore banks to moderate to 6.2% in 2019 from an estimated 8.2% in 2018.

On net interest margins, banks have witnessed gradual quarterly improvements in 2018. We expect this momentum to carry into 2019. With strong balance sheets and healthy ratios, we expect two banks under our coverage to deliver 8-12% earnings growth in 2019 and offer sustainable dividend yields of over 4.5%.

We prefer UOB over DBS for its relatively lower valuations and industry leading capital adequacy ratio, which creates scope for higher dividend payouts in 2019.

REITs that have visibility on DPU growth. While we do not expect a broad-based outperformance from the REIT sector, stock-specific catalysts should find favour with investors – especially for those REITs that are direct beneficiaries of improving economic activity, have strong balance sheets, and can undertake accretive acquisitions that could offer DPU growth.

♦ We prefer industrial and hospitality REITs mainly on favourable demand-supply dynamics and attractive valuations

We prefer industrial and hospitality REITs mainly on favourable demand-supply dynamics and attractive valuations. Both sectors offer one of the best yield spreads over 10-year bond yields. While growing tourist arrivals, moderating hotel room supply, and 3-7% expected growth in RevPAR should support growth for hospitality REITs, tapering of oversupply situation, gradual pick-up in demand, and 1-5% increase in rents should support DPU growth for industrial REITs. Our preferred industrial and hospitality REITs are Ascendas REIT (AREIT SP, BUY, TP: SGD2.90) and CDL Hospitality (CDREIT SP, BUY, TP: SGD1.80).

While office segment rental rates have been on a steady uptrend, the positive effects will likely only be seen in DPU in late 2019. As such, we believe the office sub-sector will be more of a 2H19 play. Starhill Global REIT (SGREIT SP, BUY, TP: SGD0.80) is our preferred office REIT exposure.

♦ Office REITs could be a 2H19 play

We like Manulife US REIT (MUST SP, BUY, TP: USD0.92) as a play on continuing improvement in the US office market. MUST should benefit from organic DPU growth via inbuilt rental rate escalation and a strong sponsor offers it the ability to grow via quality acquisitions.

♦ Manulife US REIT is our preferred overseas REIT play

Opportunistic SMID cap ideas. Although small and mid-cap (SMID cap) stocks in Singapore have underperformed large cap stocks, we believe selective opportunities exist for investing into SMID cap companies that offer either strong visibility on earnings growth, sustainable high dividends, and/or are trading at compelling valuations. In the SMID cap space, our preferred picks are Silverlake Axis (SILV SP, BUY, TP: SGD0.65), HRnetgroup (HRNET SP, BUY, TP: SGD1.18), Fu Yu (FUYU SP, BUY, TP: SGD0.23) and Singapore Medical Group (SMG SP, BUY, TP: SGD0.56).

- Amongst SMID caps, Silverlake Axis, HRnetgroup, FuYu and Singapore Medical Group could outperform in 2019

We like Silverlake for its strong earnings growth as it draws down on its existing orderbook; HRnetgroup, for its ability to offer earnings upside from earnings-accretive acquisitions; Fu Yu for its attractive +8% dividend yield; and Singapore Medical Group for its lowest valuation amongst healthcare players in Singapore.

Top Picks For 2019

Figure 1: Top Picks

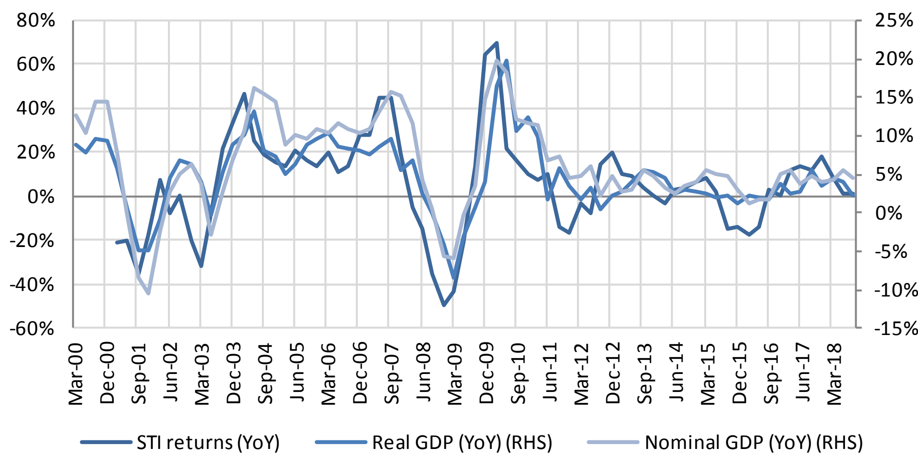
Company name	M Cap (USDm)	Rating	Target price	Upside/ down. (%)	1FY year	P/E (x) 1FY	P/E (x) 2FY	P/BV (x) 1FY	P/BV (x) 2FY	Yield (%) 1FY	Yield (%) 2FY	ROE (%) 1FY	ROE (%) 2FY
Large Cap													
Ascendas REIT	5,869	Buy	2.90	12.8	2019	12.9	12.9	1.2	1.2	6.6	6.6	9.1	9.3
CapitaLand	9,504	Buy	4.00	28.6	2018	12.5	11.4	0.7	0.7	4.2	4.2	6.0	6.3
DBS Group Holdings	44,375	Buy	29.80	25.8	2018	10.6	9.5	1.3	1.2	5.1	5.1	12.3	12.9
Genting Singapore	8,621	Buy	1.23	26.2	2018	14.0	13.7	1.5	1.4	3.6	3.6	11.0	10.7
ST Engineering	7,993	Buy	3.97	13.8	2018	20.0	17.2	4.8	4.5	4.3	4.4	23.6	26.1
United Overseas Bank Ltd	30,044	Buy	30.80	25.4	2018	9.8	9.3	1.2	1.1	4.7	5.1	11.9	12.2
Venture Corp Ltd	2,948	Buy	19.00	36.2	2018	11.2	10.3	1.8	1.6	5.0	5.0	15.3	15.4
Wilmar International	14,491	Buy	3.58	14.7	2018	11.3	12.0	0.9	0.8	3.5	3.5	7.6	6.9
SMID Cap													
CDL Hospitality	1,292	Buy	1.80	23.3	2018	11.6	10.9	0.9	0.9	6.3	6.7	8.1	8.4
Delfi Ltd	592	Buy	1.59	20.5	2018	24.2	23.1	2.7	2.6	2.1	2.6	10.1	11.3
Fu Yu Corp	105	Buy	0.23	21.1	2018	13.3	12.4	0.9	0.9	8.4	8.4	6.5	7.1
HRnet Group	591	Buy	1.18	47.5	2018	14.8	14.1	2.3	2.1	3.2	3.3	16.0	15.4
Manulife US REIT	984	Buy	0.92	19.5	2018	11.8	10.7	0.9	0.9	7.2	7.6	7.9	8.6
Starhill Global	1,089	Buy	0.80	17.6	2019	10.2	9.5	0.7	0.7	7.1	7.4	7.1	7.5
Silverlake Axis	807	Buy	0.65	56.6	2019	15.5	14.3	6.2	6.0	4.8	4.8	37.2	36.1
Singapore Medical Group	139	Buy	0.56	40.0	2018	15.4	14.2	1.4	1.3	-	1.4	8.9	9.0
Sheng Siong Group	1,170	Buy	1.27	19.8	2018	22.7	19.4	5.6	5.0	2.8	3.8	24.3	26.6

Note: Prices are as at 31 Dec 2018
Source: Bloomberg, RHB

Market valuation

Implications from slowing economic growth. The STI has declined by 12% in USD terms YTD in line with slowing economic growth, the weakening SGD against the USD, and cut in corporate earnings. As seen in Figure 2, Singapore's stock index returns follow the country's nominal and real GDP growth closely. We believe it will be tough for the STI to generate strong positive returns, as our economics team is forecasting a slowdown in GDP growth to extend into 2019 and 2020.

Figure 2: STI returns are highly correlated to the country's GDP growth

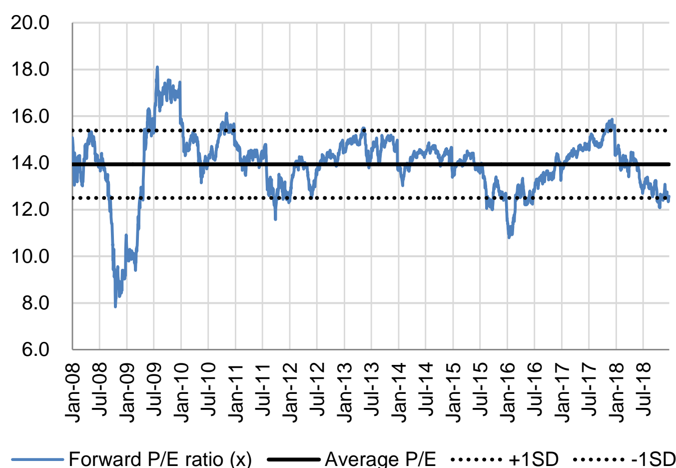


Source: Bloomberg

STI target of 3,300 for end-2019. We use a top-down method to derive our STI target, based on a P/E multiple on 2019 forecast EPS. The STI's 12.6x 1-year forward P/E sits at its -1SD band, which has only been breached twice since the global financial crisis – each time, the market witnessed a sharp rebound. With expectations of a slowdown in GDP growth, we believe a strong P/E multiple expansion will be difficult to pencil in.

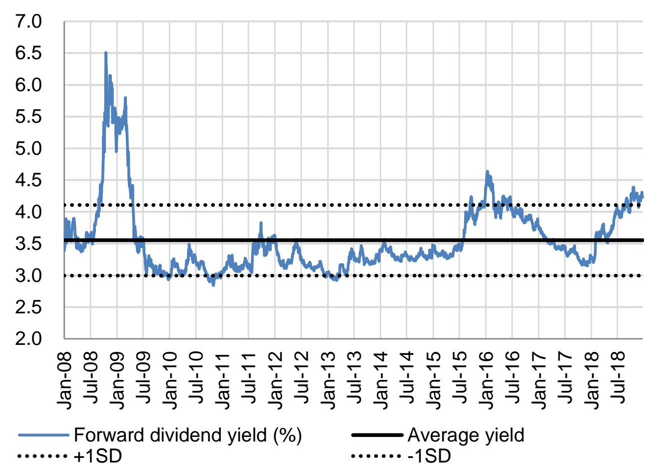
We value the STI based on average forward P/E of 13x, which is slightly above where the index is trading right now. Applying this to our 2019 EPS estimate, we derive an index target of 3,300 for end-2019 (+7.5% from 31 Dec 2018 closing price). Including a 4.2% dividend yield for the market, this implies a total shareholder return of 11.7% in 2019.

Figure 3: STI – forward P/E



Source: Bloomberg

Figure 4: STI – forward dividend yield



Source: Bloomberg

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

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