

1 April 2024

Property | REITS

## Suntec REIT (SUN SP)

**Buy** (Maintained)

### Can Internalisation Unlock Value? BUY

Target Price (Return): SGD1.35 (+25%)  
 Price (Market Cap): SGD1.08 (USD2,334m)  
 ESG score: 3.3 (out of 4)  
 Avg Daily Turnover (SGD/USD) 9.20m/4.38m

#### Analyst

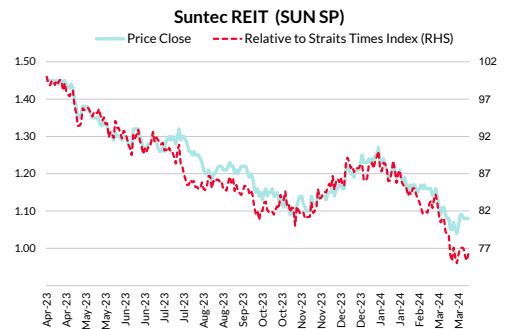
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- **Stay BUY and SGD1.35 TP, 25% upside and c.6% yield.** We see strong merits in internalising Suntec REIT's manager due to its unique positioning of differing asset class focus and strengths compared to its Sponsor, high free float and low sponsor stake, and its large size with high quality assets. As such, we believe that internalisation could be a win-win for all stakeholders and result in a healthy DPU uplift over the long run. This in turn should narrow the huge trading discount of ~50% to book value (-2SD level).
- **Why Suntec REIT fits the bill for internalisation?** Suntec REIT, with a sizeable portfolio AUM of SGD12bn, has historically had a limited reliance on its Sponsor for acquisition and fundraising. In addition, the REIT is different from other sponsor-led S-REITs as: i) The current sponsor, ESR Cayman, focuses on new economy assets compared to Suntec's office and retail portfolio, ii) High free float and limited shareholder concentration with the Sponsor holding a mere 10% stake, and iii) no visible sponsor growth pipeline.
- **Proposed internalisation structure.** In order for a successful internalisation, majority unitholder approval (>75%) and amendments to the trust deed are needed. We therefore believe it is important to align all stakeholders including the Sponsor and minorities. This, in our view, can be done by buying the REIT manager at a fair market value and also fully retaining the existing management team. Based on our initial analysis of past REIT manager transactions, the fair value range has been 7-9x of the historical management fees (Figure 1). Considering Suntec REIT's matured growth profile and size as well as limited embedded growth from the internalisation process, we believe a fair value estimate should be at a slight discount, or in the 5-7x range of FY23 management fees (base and performance fees) or c.SGD307-430m. This could be satisfied fully through shares or a combination of majority shares and cash, taking into account its high gearing while providing upside incentive for the Sponsor from share price appreciation.
- **Potential mid-single digit DPU accretion.** Based on Accounting and Corporate Regulatory Authority's (ACRA) filings, Suntec REIT manager (FY22) posted net profit of SGD 33m. We believe unitholders should be able to reap >SGD30m pa in additional distributable income (DI), even including the initial setup costs (c.SGD10-15m). Assuming a SGD30m increase in DI translates to a pro-forma (FY23) operational DPU accretion of 3-6%, based on our assumption of 100% consideration (SGD307-430m) paid in new Suntec REIT units @ SGD1.10/share. Gearing should also be lowered from equity issuance while there will be a slight NAV dilution. In addition, there will be future savings on acquisition fees (1% of value) and divestment fees (0.5%). We see limited impact to overall debt cost for the REIT due to its large and high quality asset base and potential lowering of its cost of equity.

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(12.2)	(6.1)	(13.6)	(6.1)	(24.0)
Relative	(11.7)	(8.8)	(13.9)	(6.6)	(23.0)
52-wk Price low/high (SGD)	1.04 - 1.45				



Source: Bloomberg

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (SGDm)	427	463	469	475	485
Net property income (SGDm)	316	313	316	317	327
Reported net profit (SGDm)	498	196	197	205	215
Total distributable income (SGDm)	256	208	188	195	204
DPS (SGD)	0.09	0.07	0.06	0.07	0.07
DPS growth (%)	3.0	(19.3)	(10.4)	3.2	3.5
P/B (x)	0.51	0.51	0.51	0.51	0.52
Dividend Yield (%)	8.2	6.6	5.9	6.1	6.3
Return on average equity (%)	8.2	3.2	3.2	3.3	3.5
Return on average assets (%)	4.3	1.7	1.8	1.8	1.9

Source: Company data, RHB

#### Overall ESG Score: 3.3 (out of 4)

##### E: EXCELLENT

All SUN's buildings are rated highly by respective green mark standards in respective countries. Has set net-zero carbon status by 2030 for assets with full ownership control and by 2050 for all assets across portfolio. Achieved 19.8%,13.6% reduction in energy and water intensity in FY22 from FY19 levels.

##### S: EXCELLENT

SUN has a well-diverse work profile with 68% of total employees being female. There were zero cases of reportable work-related injuries for employees in FY22. Average training hours was 35 hours per employee in FY22 – exceeding its target of 26 hours per employee.

##### G: EXCELLENT

SUN has a well drawn-out whistleblowing policy for its employees. It has an experienced board with a balanced mix of independent directors. Transparent and timely disclosures of market-sensitive information and updates.

## Financial Exhibits

Asia	Financial summary	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Singapore	Recurring EPS (SGD)	0.17	0.07	0.07	0.07	0.07
Property	EPS (SGD)	0.17	0.07	0.07	0.07	0.07
<b>Suntec REIT</b>	DPS (SGD)	0.09	0.07	0.06	0.07	0.07
SUN SP	BVPS (SGD)	2.12	2.11	2.11	2.10	2.09
Buy	Return on average equity (%)	8.2	3.2	3.2	3.3	3.5
	Weighted avg adjusted shares (m)	2,871.80	2,904.02	2,921.74	2,946.19	2,970.82
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
Dividend Discount Model	Recurring P/E (x)	6.23	15.98	16.00	15.54	14.90
	P/E (x)	6.23	15.98	16.00	15.54	14.90
	P/B (x)	0.5	0.5	0.5	0.5	0.5
	FCF Yield (%)	8.7	7.7	8.3	7.4	7.4
	Dividend Yield (%)	8.2	6.6	5.9	6.1	6.3
	EV/EBITDA (x)	- 14.39	- 14.55	- 14.65	- 14.60	- 14.08
	EV/EBIT (x)	- 14.41	- 14.55	- 14.65	- 14.60	- 14.08
<b>Key drivers</b>	<b>Income statement (SGDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
i. Continued recovery in Singapore office/retail demand;	Total turnover	427	463	469	475	485
ii. High quality office and retail assets offer resilience;	EBITDA	249	242	248	249	259
iii. Attractive valuation.	Depreciation and amortisation	(0)	(0)	0	0	0
	Operating profit	249	242	248	249	259
	Net interest	(112)	(154)	(158)	(152)	(150)
	Income from associates & JVs	145	36	120	117	117
	Pre-tax profit	514	204	216	224	235
	Taxation	(16)	(8)	(19)	(19)	(20)
	Recurring net profit	498	196	197	205	215
<b>Key risks</b>	<b>Cash flow (SGDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
i. Weaker performance from overseas assets and forex impact;	Change in working capital	(113)	(12)	(57)	(84)	(88)
ii. Low debt hedges and impact from continued increase in interest rates; and	Cash flow from operations	284	251	292	264	269
iii. Sharp reduction in demand from work-from home or WFH trends.	Capex	(14)	(10)	(30)	(30)	(30)
	Cash flow from investing activities	115	698	90	88	89
	Dividends paid	(263)	(210)	(188)	(195)	(204)
	Cash flow from financing activities	(384)	(1,001)	(366)	(361)	(367)
	Cash at beginning of period	268	270	218	234	226
	Net change in cash	15	(51)	16	(8)	(9)
	Ending balance cash	269	217	234	226	217
<b>Company Profile</b>	<b>Balance sheet (SGDm)</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
Suntec REIT is a REIT established with the objective of investing in income-producing real estate properties which are used primarily for retail and office purposes. It currently has a portfolio of commercial assets in Singapore, Australia and UK.	Total cash and equivalents	270	218	234	226	217
	Tangible fixed assets	1	2	2	2	2
	Total investments	11,413	10,819	10,829	10,827	10,825
	Total assets	11,711	11,129	11,103	11,094	11,084
	Short-term debt	646	400	500	600	600
	Total long-term debt	4,198	3,860	3,650	3,500	3,450
	Total liabilities	5,127	4,545	4,470	4,428	4,381
	Shareholders' equity	6,116	6,108	6,153	6,183	6,215
	Minority interests	120	128	132	136	140
	Total equity	6,584	6,584	6,633	6,667	6,703
	Net debt	4,574	4,042	3,916	3,874	3,833
	Total liabilities & equity	11,711	11,129	11,103	11,094	11,084
	<b>Key metrics</b>	<b>Dec-22</b>	<b>Dec-23</b>	<b>Dec-24F</b>	<b>Dec-25F</b>	<b>Dec-26F</b>
	Revenue growth (%)	19.3	8.3	1.3	1.3	2.2
	Recurrent EPS growth (%)	0.5	(61.0)	(0.2)	2.9	4.3
	Operating EBITDA margin (%)	58.3	52.4	52.8	52.4	53.3
	Net profit margin (%)	116.5	42.4	42.1	43.1	44.4
	Dividend payout ratio (%)	51.5	105.7	95.1	95.3	94.6
	Capex/sales (%)	3.3	2.1	6.4	6.3	6.2
	Interest cover (x)	2.22	1.58	1.57	1.64	1.73

Source: Company data, RHB

**Sponsor benefits** would include freeing up management efforts, focus as well as capital that can be channelled into its key focus of growing new economy asset base. In addition, the value unlocking could result in a higher value for its stake which can be potentially divested in the future along with better return from higher dividends.

**No changes to estimates or ESG score.** Our TP includes a 4% ESG premium. Suntec REIT is currently trading at slightly below the -2SD level (to historic levels since Jun 2016) with P/BV of 0.5x, which we believe is mainly due investor concerns over its high gearing and low debt hedge position amidst a high interest rate environment and limited sponsor growth pipeline.

**Figure 1: Comparable manager transactions**

S.No	Transaction	Seller	Purchaser	Annual fees paid for prior year (SGD m)	Acquisition Price (SGD m)	Acquisition Price based on 100% stake	Acquisition multiple over Fees (x) based on 100% stake
1	CapitaLand Acquisition of Ascendas Singbridge fund management*	Ascendas-Singbridge	CapitaLand	159.1	1108.0	1108.0	7.0
2	Acquisition of 50% stake in IREIT Global Group**	Tikehau Capital	City Developments	3.9	18.4	36.7	9.4
3	Acquisition of 51% stake on Sabana Investment Partners	Vibrant Group	ESR Group	4.6	21.8	42.6	9.3
4	OUE and OUE Lippo Healthcare acquisition of First REIT manager	Lippo Karawaci	OUE (60%) and OUE Lippo Healthcare (40%)	10.9	98.9	98.9	9.1
5	ESR-REIT acquisition of Viva Industrial Trust manager	Viva Investment Management	ESR-REIT	8.7	62.0	62.0	7.1
6	Croesus Retail Trust***	Croesus Retail Asset Management	Croesus Retail Trust Unitholders	6.8	50.0	50.0	7.4

Note: \*Based on purchase price discount to average independent Sum of The Parts valuation

Note 2: \*\* Assuming EUR:SGD of 1:1.55 for conversion of management fees

Note 3: \*\*\* Croesus Retail Trust is a business trust. Based on JPY:SGD of 82:1.

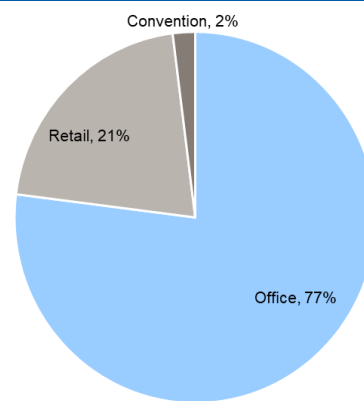
Source: Company announcements, RHB

**Figure 2: Trading at -2SD P/BV to historic levels**



Source: Bloomberg, RHB

**Figure 3: AUM breakdown by sector – SGD12.2bn (FY23)**



Source: Company data

## Emissions And ESG

### Trend analysis

In FY22, Suntec REIT's total energy consumption was 157,376 MWh and the average energy intensity was 220.0 kWh/sqm. Comparing the energy consumption with FY21, its energy consumption increased by 9.8%, which was due to the inclusion of The Minster Building in the United Kingdom, and increasing activities for offices, retail and meetings, incentives, conferences and exhibitions ("MICE") events. However, when comparing the FY22 energy intensity with Suntec REIT's baseline FY19, Suntec REIT's intensity has decreased by 19.8%, above its target of achieving 3% improvement on energy intensity values from FY19 levels.

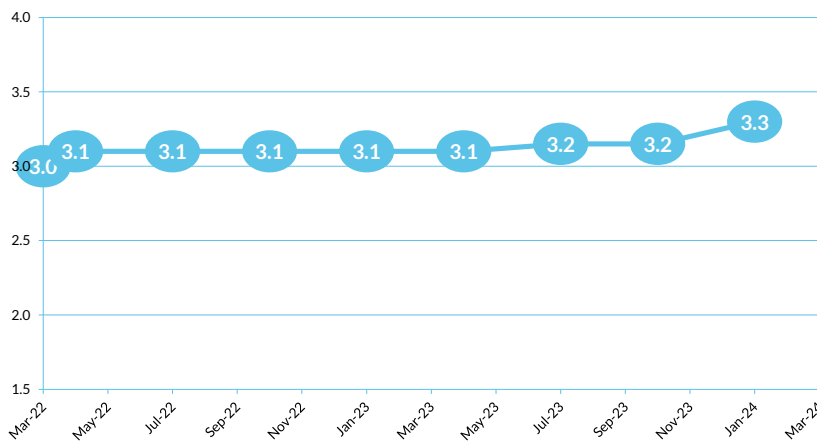
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	1,250	1,671	na
Scope 2	57,632	59,673	na
Scope 3	na	na	na
Total emissions	58,882	61,344	na

Source: Company data, RHB

## Latest ESG-Related Developments

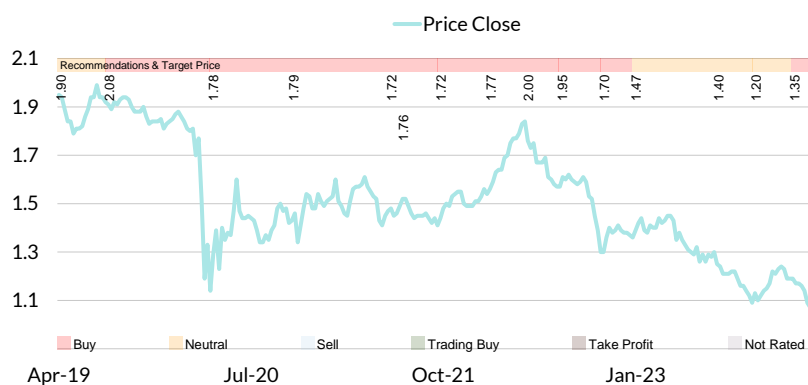
- In FY22, Suntec City launched a new campaign to educate both office and retail tenants on initiatives to reduce electricity consumption and cost: Some initiatives include configuring equipment such as computers and photocopiers to energy saving mode when not in use, replacing existing light fittings with LED energy efficient light bulbs and using air-conditioning systems at optimal settings to reduce over cooling of the spaces.
- Suntec REIT continued to roll out automated electricity meters and energy efficient LED lighting fixtures across its portfolio.

## ESG Rating History



Source: RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-01-24	Buy	1.35	1.23
2023-10-23	Neutral	1.20	1.11
2023-07-26	Neutral	1.40	1.29
2023-01-24	Neutral	1.47	1.39
2023-01-09	Neutral	1.47	1.37
2022-10-26	Buy	1.70	1.41
2022-07-17	Buy	1.95	1.57
2022-04-26	Buy	2.00	1.84
2022-01-27	Buy	1.77	1.55
2021-09-29	Buy	1.72	1.41
2021-07-01	Buy	1.76	1.47
2021-06-17	Buy	1.72	1.47
2021-06-02	Buy	1.72	1.46
2021-01-27	Buy	1.79	1.58
2020-10-11	Buy	1.79	1.42

Source: RHB, Bloomberg

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<b>Buy:</b>	Share price may exceed 10% over the next 12 months
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