

# Singapore Company Guide

## SPH REIT

Edition 1 Version 1 | Bloomberg: SPHREIT SP | Reuters: SPHR.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

13 Oct 2015

### HOLD

Last Traded Price: S\$0.97 (STI : 3,032.11)

Price Target : 12-Month S\$ 0.99 (3% upside) (Prev. S\$1.03)

Potential Catalyst: Acquisitions

Where we differ: We are more bullish on Orchard Road rentals

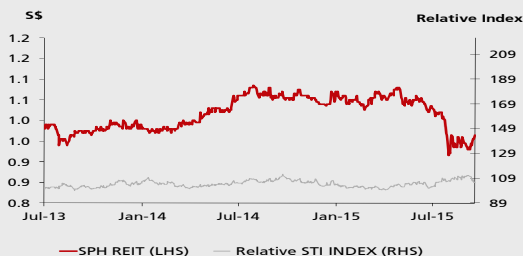
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#### Price Relative



#### Forecasts and Valuation

FY Aug (\$ m)	2014A	2015A	2016F	2017F
Gross Revenue	202	205	218	226
Net Property Inc	151	156	158	164
Total Return	217	154	122	127
Distribution Inc	136	139	141	145
EPU (S cts)	4.5	4.6	4.8	5.0
EPU Gth (%)	(3)	2	4	4
DPU (S cts)	5.4	5.5	5.5	5.7
DPU Gth (%)	(4)	1	1	2
NAV per shr (S cts)	93.0	94.3	93.6	93.0
PE (X)	21.3	20.8	20.1	19.4
Distribution Yield (%)	5.6	5.7	5.7	5.9
P/NAV (x)	1.0	1.0	1.0	1.0
Aggregate Leverage (%)	25.8	25.5	25.9	26.2
ROAE (%)	5.0	4.9	5.1	5.3

Distn. Inc Chng (%):			1	1
Consensus DPU (S cts):			5.6	5.7
Other Broker Recs:	B: 0	S: 0	H: 6	

Source of all data: Company, DBS Bank, Bloomberg Finance L.P

### THE PARAGON OF ORCHARD ROAD

#### Stock is fairly priced

We currently have a HOLD recommendation, with TP of S\$0.99. SPH REIT's dividend yield of 5.7% reflects the strength of its assets and stability of earnings. However, at this point we believe that comparable retail S-REITs offer more attractive yields.

#### Paragon to continue to drive earnings growth

We believe that Paragon will continue to outperform the rest of Orchard Road for both retail and office assets, due to the property's (a) location and frontage in the prime Orchard Road shopping district, as well as (b) proximity to the Mount Elizabeth medical cluster. As such, we assume reversions of 3.5-4% for Paragon. At Clementi Mall, while income is supported by the Sponsor's income support, upside to rents in the near term appears limited due to minimal lease expiries until 2017.

#### Strong rebound in tenant sales at Clementi Mall

Paragon achieved healthy reversions of 9.6% despite a 3.2% drop in tenant sales, and occupancy costs were 19.0%. Meanwhile at Clementi Mall, full year reversions were down 5.6% (albeit for only 5% of NLA). More encouragingly, tenant sales at Clementi Mall rebounded 3.6% to S\$242m, translating to healthy occupancy costs of 14.6%.

#### Valuation:

We currently have a DCF-backed target price of S\$0.99, implying a dividend yield of 5.7% for FY16. The stock has outperformed other retail REITs in recent months, as we believe investors have been drawn to the REIT's resilient earnings profile and conservative balance sheet. With limited upside to our TP, we maintain our HOLD call.

#### Key Risks to Our View:

**Rise in interest costs.** SPH REIT's all-in cost of debt stands at 2.55%, with c.85% of borrowings in fixed rates. In a rising interest rate environment, we see higher-than-expected interest costs when the Trust refinances its next floating-rate tranche of S\$250m (c.30% of total debt) in 2016.

#### At A Glance

Issued Capital (m shrs)	2,529
Mkt. Cap (S\$m/US\$m)	2,441 / 1,750
Major Shareholders	
Singapore Press Holdings (%)	69.2
Free Float (%)	30.8
3m Avg. Daily Val (US\$m)	0.8

ICB Industry : Real Estate / Real Estate Investment Trusts

**CRITICAL DATA POINTS TO WATCH**

**Earnings Drivers:**

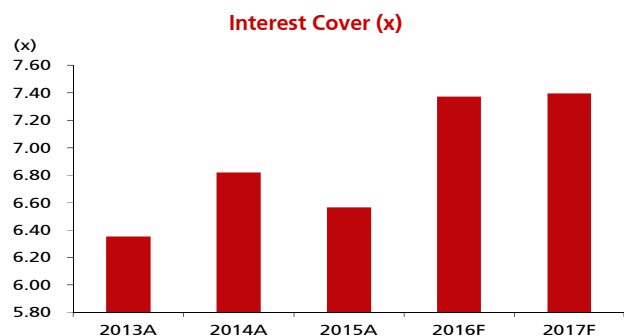
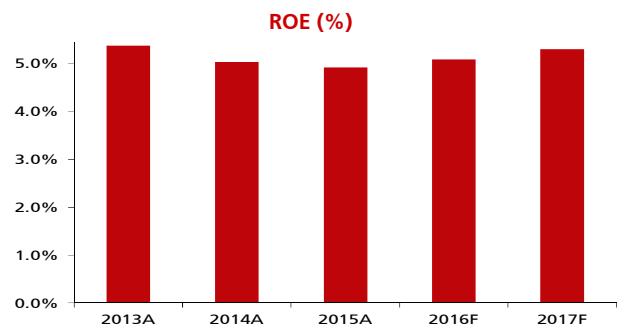
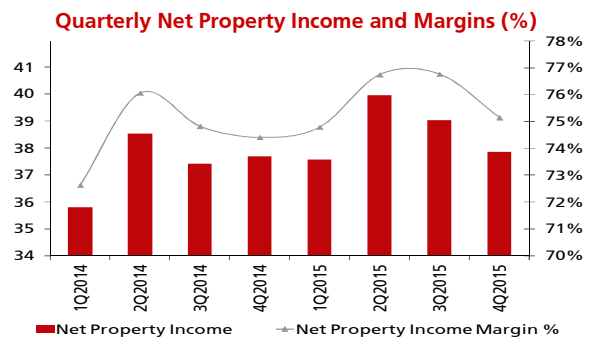
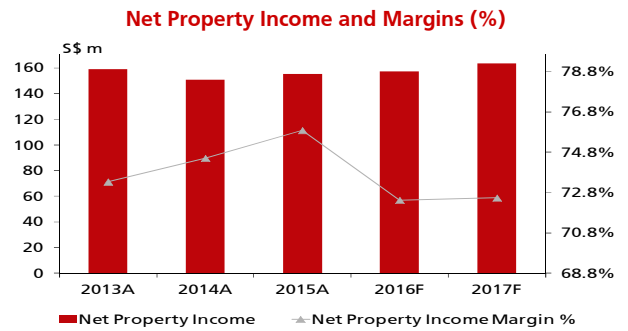
**Maximising mall efficiency to generate higher yields.**

In Paragon, the additional 7k sqft of NLA generated by the chiller decanting project has completed and fully committed, generating a ROI of >7%. With all tenants having commenced operations by August 2015, the space is expected to generate additional revenue of c.\$1m p.a. In addition, the Manager plans to convert some 7k sqft of space currently occupied by the Air Handling Units (AHU) into additional retail NLA. This project will be spread over three years from Sep-15 to Mar-18, in order to coincide with the various lease expiries of tenants in the area. When completed, the additional NLA is expected to contribute to incremental revenue for the REIT.

**Stable earnings profile over FY16 and FY17.** SPH REIT secured rental reversions 8.6% for FY15 (+9.1% for Paragon; -5.6% for Clementi Mall) while maintaining a track record of 100% occupancy. The REIT’s portfolio has a weighted average lease expiry (WALE) of 2.3 years and 2.4 years by net lettable area (NLA) and gross rental income respectively. We expect earnings to be stable over the next two years, with <30% of leases (by gross rental income) due to expire in FY16 and FY17. The next largest leasing tranche will be in FY18, when c.86% of Clementi Mall’s leases come up for renewal.

**Healthy occupancy costs ensure a vibrant medium term outlook for the malls.** While Paragon’s occupancy costs rose to 19% on the back of a 3.2% decline in tenant sales, we note that this is still within the healthy range for a mall in Orchard Road, where tenants are typically willing to count higher rents as part of marketing costs. In addition, we are heartened to note that occupancy costs at Clementi Mall have fallen to 14.6% as tenant sales (+3.6%) bounced back to FY13 levels. Low occupancy costs, coupled with minimal rental expiries at the mall until 2018, should ensure that tenants continue to trade well over the next few years. Higher sales growth in subsequent years will allow the REIT to generate higher rental revenue in a sustainable manner.

**Revitalise tenant mix.** The REIT’s strategy is to continuously restructure the tenant mix to keep its investment properties relevant to the respective target shoppers. The aim is to enable the REIT to reap better tenant synergies to improve traffic going forward and potentially boost the attractiveness of its mall properties which can be converted into higher rental reversions and renewals.



Source: Company, DBS Bank

**Balance Sheet:**

**Gearing.** SPH REIT has maintained a healthy gearing ratio at 25.7% that is well within the Manager’s comfortable range of up to 40%. This provides the REIT with significantly larger headroom for debt financing should it decide to gear up on acquisitions.

**Net Asset Value (NAV) per unit.** NAV of S\$0.95 is underpinned by stable asset valuations.

**Share Price Drivers:**

**Potential acquisitions.** With a healthy gearing at 26% and cost of debt of 2.55%, SPH REIT is well poised for debt-funded acquisition activities, given the opportunity in the medium term. The next growth catalyst for the REIT will be the acquisition of the Sponsor’s 70% stake in Seletar Mall, which was completed in Dec-14, and is valued at S\$495m. However, this acquisition is likely to be a more medium term prospect, as the mall is still in its first leasing cycle and has yet to stabilise.

**Key Risks:**

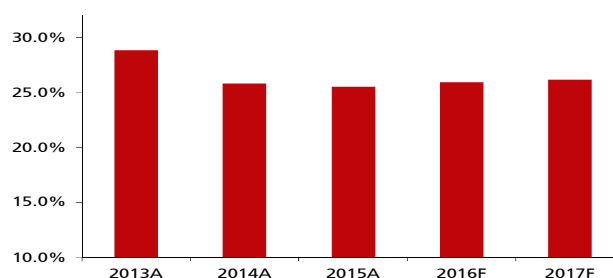
**Interest rate risk.** SPH REIT’s all-in cost of debt stands at 2.55%, with c.85% of borrowings in fixed rates. In a rising interest rate environment, we see higher-than-expected interest costs when the REIT refinances its next floating-rate tranche of S\$250m (c.30% of total debt) in 2016.

**Deterioration in retail sales of watches & jewellery.** Rental reversions at Paragon have been supported by an improvement in tenant sales of watches & jewellery products (as measured by the RSI), which accounts for c.30% of gross rentals. While deterioration in sales for this particular trade category is unlikely to result in any tenant exit, it could impact the level of reversions achieved going forward.

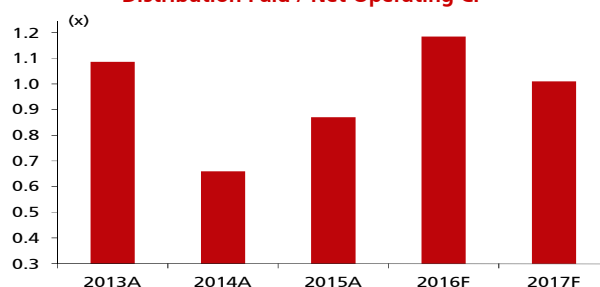
**COMPANY BACKGROUND**

SPH REIT is a real estate investment trust that invests in income-producing retail malls in Singapore. It currently owns the Paragon Mall within the Orchard Road district, as well as Clementi Mall, located in the west of Singapore.

Aggregate Leverage (%)



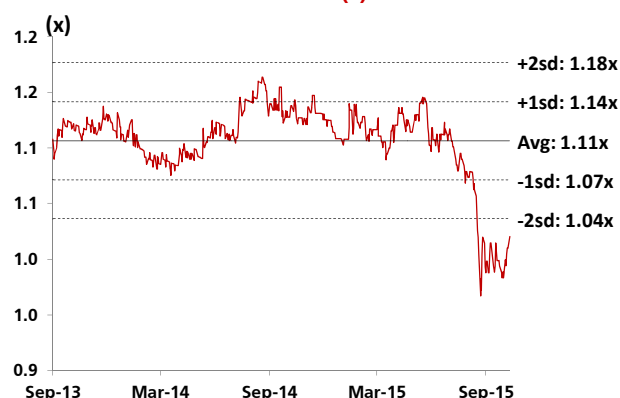
Distribution Paid / Net Operating CF



Distribution Yield (%)



P/Bk NAV (x)



Source: Company, DBS Bank

## SPH REIT

## Income Statement (\$\$ m)

FY Aug	2013A	2014A	2015A	2016F	2017F
Gross revenue	217	202	205	218	226
Property expenses	(58)	(52)	(49)	(60)	(62)
<b>Net Property Income</b>	<b>159</b>	<b>151</b>	<b>156</b>	<b>158</b>	<b>164</b>
Other Operating expenses	(19)	(17)	(18)	(17)	(17)
Other Non Opg (Exp)/Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(22)	(20)	(21)	(19)	(20)
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Net Income</b>	<b>118</b>	<b>114</b>	<b>117</b>	<b>122</b>	<b>127</b>
Tax	(1)	0	0	0	0
Minority Interest	0	0	0	0	0
Preference Dividend	0	0	0	0	0
<b>Net Income After Tax</b>	<b>117</b>	<b>114</b>	<b>117</b>	<b>122</b>	<b>127</b>
Total Return	117	217	154	122	127
Non-tax deductible Items	25	22	22	19	18
Net Inc available for Dist.	142	136	139	141	145
<b>Growth &amp; Ratio</b>					
Revenue Gth (%)	N/A	(6.7)	1.4	6.1	3.7
N Property Inc Gth (%)	nm	(5.2)	3.3	1.3	3.9
Net Inc Gth (%)	nm	(2.7)	2.7	4.3	4.2
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	73.3	74.5	75.9	72.4	72.5
Net Income Margins (%)	54.0	56.3	57.0	56.0	56.2
Dist to revenue (%)	65.6	67.4	67.5	64.8	64.3
Operating expenses (%)	9.0	8.5	8.6	7.6	7.5
ROAE (%)	5.4	5.0	4.9	5.1	5.3
ROA (%)	3.8	3.6	3.6	3.7	3.8
ROCE (%)	4.5	4.2	4.2	4.3	4.5
Int. Cover (x)	6.4	6.8	6.6	7.4	7.4

Earnings to be largely driven by Paragon, which accounts for c.80% of the REIT's NPI

Source: Company, DBS Bank

**Quarterly / Interim Income Statement (\$\$ m)**

FY Aug	4Q2014	1Q2015	2Q2015	3Q2015	4Q2015
Gross revenue	51	51	52	51	51
Property expenses	(13)	(13)	(12)	(12)	(13)
Net Property Income	38	38	40	39	38
Other Operating expenses	(4)	(4)	(5)	(4)	(4)
Other Non Opg (Exp)/Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(5)	(5)	(5)	(6)	(6)
Exceptional Gain/(Loss)	103	0	0	0	37
<b>Net Income</b>	<b>132</b>	<b>29</b>	<b>31</b>	<b>29</b>	<b>65</b>
Tax	0	0	0	0	0
Minority Interest	0	0	0	0	0
<b>Net Income after Tax</b>	<b>132</b>	<b>29</b>	<b>31</b>	<b>29</b>	<b>65</b>
Total Return	26	27	30	28	132
Non-tax deductible Items	(97)	5	5	5	5
Net Inc available for Dist.	35	34	36	35	34
<b>Growth &amp; Ratio</b>					
Revenue Gth (%)	1	(1)	4	(2)	(1)
N Property Inc Gth (%)	1	0	6	(2)	(3)
Net Inc Gth (%)	364	(78)	7	(4)	121
Net Prop Inc Margin (%)	74.4	74.8	76.7	76.8	75.1
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

**Balance Sheet (\$\$ m)**

FY Aug	2013A	2014A	2015A	2016F	2017F
Investment Properties	3,059	3,159	3,213	3,217	3,222
Other LT Assets	15	13	14	13	13
Cash & ST Invt	34	91	77	62	66
Inventory	0	0	0	0	0
Debtors	1	6	5	5	5
Other Current Assets	0	0	0	0	0
<b>Total Assets</b>	<b>3,110</b>	<b>3,269</b>	<b>3,310</b>	<b>3,298</b>	<b>3,306</b>
ST Debt	0	0	249	249	249
Creditor	11	35	30	11	12
Other Current Liab	1	0	0	0	0
LT Debt	897	843	596	606	616
Other LT Liabilities	33	38	37	37	37
Unit holders' funds	2,169	2,353	2,398	2,395	2,393
Minority Interests	0	0	0	0	0
<b>Total Funds &amp; Liabilities</b>	<b>3,110</b>	<b>3,269</b>	<b>3,310</b>	<b>3,298</b>	<b>3,306</b>
Non-Cash Wkg. Capital	(11)	(29)	(25)	(6)	(6)
Net Cash/(Debt)	(863)	(752)	(768)	(793)	(799)
<b>Ratio</b>					
Current Ratio (x)	3.0	2.7	0.3	0.3	0.3
Quick Ratio (x)	3.0	2.7	0.3	0.3	0.3
Aggregate Leverage (%)	28.8	25.8	25.5	25.9	26.2
Z-Score (X)	3.6	3.6	3.6	3.6	3.6

Gearing to remain stable at c.26%, as acquisition prospects in the near term are limited

Source: Company, DBS Bank

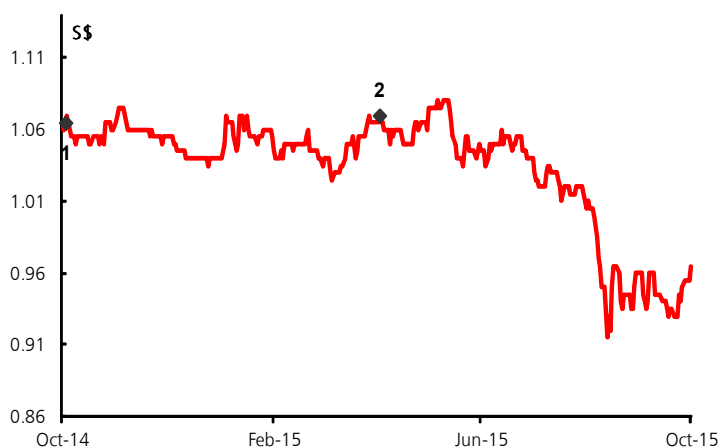
## Cash Flow Statement (\$\$ m)

FY Aug	2013A	2014A	2015A	2016F	2017F
Pre-Tax Income	118	114	117	122	127
Dep. & Amort.	0	0	0	0	0
Tax Paid	0	0	0	0	0
Associates & JV Inc/(Loss)	0	0	0	0	0
Chg in Wkg.Cap.	2	21	1	(19)	0
Other Operating CF	12	40	40	16	16
<b>Net Operating CF</b>	<b>131</b>	<b>175</b>	<b>158</b>	<b>119</b>	<b>144</b>
Net Invnt in Properties	(6)	(3)	(15)	(5)	(5)
Other Invnts (net)	3	0	0	2	0
Invnts in Assoc. & JV	0	0	0	0	0
Div from Assoc. & JVs	0	0	0	0	0
Other Investing CF	0	0	1	0	0
<b>Net Investing CF</b>	<b>(3)</b>	<b>(3)</b>	<b>(15)</b>	<b>(3)</b>	<b>(5)</b>
Distribution Paid	(142)	(115)	(138)	(141)	(145)
Chg in Gross Debt	6	0	0	10	10
New units issued	0	(9)	(19)	0	0
Other Financing CF	0	(18)	0	0	0
<b>Net Financing CF</b>	<b>(136)</b>	<b>(142)</b>	<b>(157)</b>	<b>(131)</b>	<b>(135)</b>
Currency Adjustments	0	0	0	0	0
Chg in Cash	(8)	30	(13)	(15)	4
Operating CFPS (S cts)	5.2	6.1	6.2	5.4	5.6
Free CFPS (S cts)	5.0	6.8	5.7	4.5	5.4

One-off cost to replace ageing chillers

Source: Company, DBS Bank

## Target Price &amp; Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date	Closing Price	Target Price	Rating
1:	14 Oct 14	1.07	1.03	HOLD
2:	14 Apr 15	1.07	1.03	HOLD

Source: DBS Bank

DBS Bank recommendations are based on Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return i.e. > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

*Share price appreciation + dividends*

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