Singapore Company Guide
Suntec REIT

Edition 1 Version 1 | Bloomberg: SUN SP | Reuters: SUNT.SI

DBS Group Research . Equity

23 Oct 2015

HOLD

Last Traded Price: S$1.64 (STI : 3,038.11)
Price Target : 12-Month S$ 1.58 ((4)% downside)

Potential Catalyst: Acquisitions
Where we differ: We are more conservative on our retail rent assumptions

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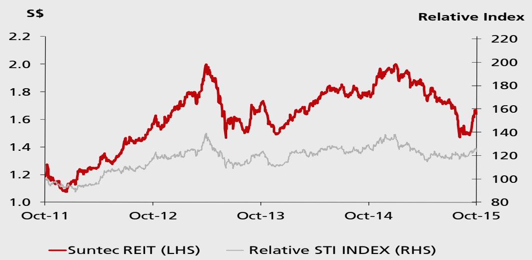
Price Relative



Forecasts and Valuation

FY Dec (S$ m)	2014A	2015F	2016F	2017F
Gross Revenue	282	335	351	369
Net Property Inc	192	233	249	264
Total Return	317	200	206	220
Distribution Inc	230	251	257	271
EPU (S cts)	9.2	7.9	8.1	8.5
EPU Gth (%)	(8)	(14)	2	6
DPU (S cts)	9.4	9.9	10.0	10.5
DPU Gth (%)	1	5	2	5
NAV per shr (S cts)	216.4	206.6	202.7	198.9
PE (X)	17.9	20.7	20.3	19.2
Distribution Yield (%)	5.7	6.0	6.1	6.4
P/NAV (x)	0.8	0.8	0.8	0.8
Aggregate Leverage (%)	35.3	35.4	35.7	36.3
ROAE (%)	4.3	3.8	3.9	4.2
Distn. Inc Chng (%):		3	0	(1)
Consensus DPU (S cts):		9.8	10.1	10.4
Other Broker Recs:		B: 2	S: 7	H: 13

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

HEADWINDS ABOUND

Hemmed in by double headwinds

In the year ahead, the REIT's earnings will be driven by new contribution from recently completed Suntec City Mall redevelopment. Due to headwinds in the retail sector however, we believe that earnings upside is capped as the mall's rents have underperformed the Manager's initial target. In addition, there could be downside risk for the REIT's office assets, which are expected to see some volatility in rents and occupancies when new office supply enters the CBD from 2016 onwards.

Weak retail outlook to cap upside from Suntec AEI

Phase 3 of AEI works at Suntec City Mall was completed in Feb-15, bringing the Mall's nearly three-year, S$410m redevelopment to completion. While the Manager has achieved healthy committed occupancy rates of 96.4%, we note that average rents of S$12.03 psf pm have fallen short of the Manager's initial target of S$12.59 in light of a difficult leasing environment.

Vacancy and rental pressures at MBFC and ORQ. Over the quarter, contribution from One Raffles Quay (ORQ(fell 21% y-o-y due to higher leasing commissions attributable to a significant lease renewal. Marina Bay Financial Centre Tower 1 & 2 (MBFC's) earnings also declined by 11% as occupancy fell 2.3ppts to 97.7%. Looking ahead, we believe that (a) the lack of obvious demand drivers for use of office space in the CBD, and (b) large incoming supply of office in 2016, will put pressure on rents and occupancies at these two assets, resulting in some earnings decline.

Valuation:

Maintain HOLD, TP S$1.58

We have a HOLD recommendation on Suntec REIT, with a TP of S$1.58, after factoring in the divestment of Park Mall and slightly lower rental assumptions for Phase 3 of Suntec Mall AEI works. While dividend yield of 6.1% for FY16 is fairly attractive, total returns to our TP is insufficient at <10%.

Key Risks to Our View:

Upside risk stemming from distributions from capital

The Manager has indicated a willingness to use proceeds to mitigate the decline in DPU after the divestment of Park Mall. Additional capital distributions to support dividend to shareholders will present upside to our estimates.

At A Glance

Issued Capital (m shrs)	2,516
Mkt. Cap (Sm/USm)	4,126 / 2,958
Major Shareholders	
Raffles Investments (%)	9.1
Blackrock (%)	6.0
Free Float (%)	93.8
3m Avg. Daily Val (US$m)	6.4
ICB Industry : Real Estate / Real Estate Investment Trust	

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

Completed Suntec Mall AEI to drive earnings in FY15/16. Suntec REIT's 3Q15 income available for distribution grew 3.1% y-o-y to S$59m, as earnings growth from the completed Suntec City retail redevelopment was eroded by higher interest expenses and weaker contribution from associates (ORQ and MBFC). Notwithstanding the weaker than expected earnings growth, the Manager has announced DPU of 2.52Scts (+8.3% y-o-y), with an additional S$4.6m to be distributed using proceeds from the sale of CHIJMES. Excluding distribution of capital, DPU was 2.34Scts.

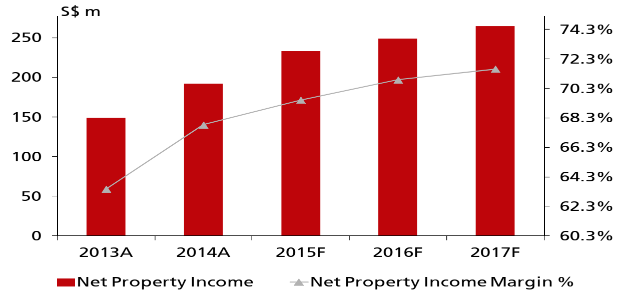
Office portfolio faces some earnings risk. Suntec REIT currently owns three office assets in Singapore's CBD – Suntec Office, One Raffles Quay (33%), and MBFC Towers 1 and 2 (33%). Suntec Office, which accounts for nearly 30% of gross revenue, once again demonstrated its resilience, with signing rents holding steady at S$9.21 psf pm, and occupancies bouncing back to 99.5% after a slight dip in 2Q15. However earnings risks remain for ORQ and MBFC, which saw weaker contributions y-o-y. Looking ahead, we believe that ORQ and MBFC Tower 2 could face some earnings risk, as anticipated office supply coming in 2016 and stiff competition for quality tenants could put rents and occupancies under pressure.

Risk to reversions from Phase 1 AEI at Suntec. In FY16, 28% of retail leases will be due for renewal, with majority coming from Phase 1 of Suntec AEI works. Given that average passing rents of c.S$13 psf pm for Phase 1 are higher than the S$12 achieved for the whole mall, we believe that rental reversions will be flat with a downside bias, as the Manager opts to retain tenants rather than drive rents.

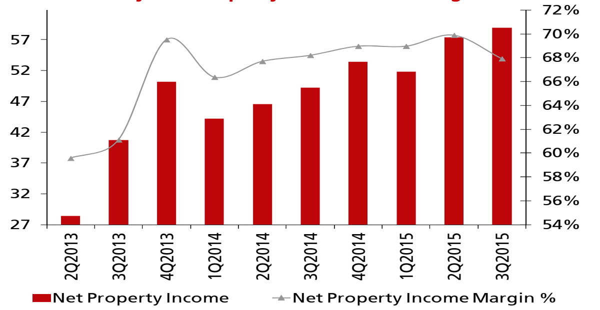
Secure income contribution from Australian asset from FY16 onwards. Suntec's recent acquisition of 177 Pacific Highway for A$413m located in North Sydney will provide geographic diversification to its portfolio. Upon completion of the office property in early 2016, Leighton Holdings will take up 76% of NLA for an approximate lease period of 10 years, and has stipulated a rental guarantee of 4 years for vacant space. The office is expected to complete in early-2016, and this will help to diversify and improve the REIT's income stream.

30% stake in redevelopment of Park Mall offers development upside. Suntec REIT has announced the sale of Park Mall for S$412m (expected to complete in 4Q15), and will take a 30% stake in the JV co which will completely redevelop Park Mall into a commercial development comprising two office towers with an ancillary retail podium. Suntec REIT will subsequently have the option to acquire one of the two office towers. While details of this redevelopment project have yet to be finalised, acquisition of the office tower will be a long term growth driver for the REIT.

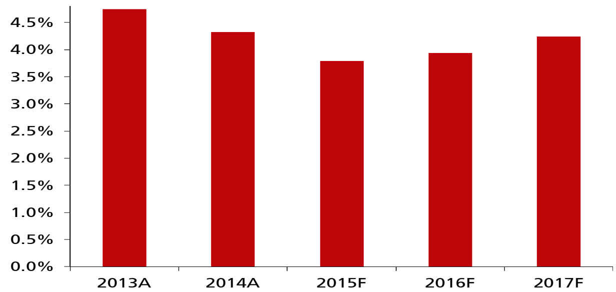
Net Property Income and Margins (%)



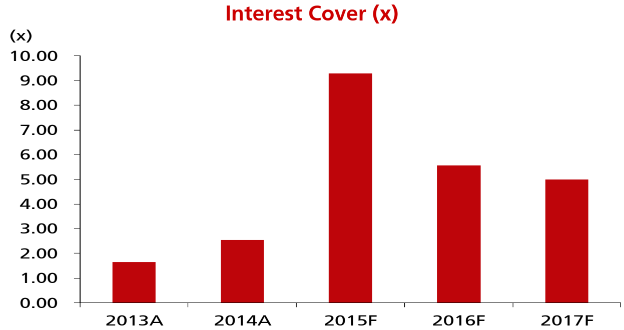
Quarterly Net Property Income and Margins (%)



ROE (%)



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Gearing within range Suntec REIT's gearing as of 3Q15 stands at 35.8%. We expect gearing to remain stable going forward, as the Manager is able to fund the remainder of development at 177 Pacific Highway with proceeds from the divestment of Park Mall.

Minimal refinancing in FY15-17. Suntec REIT has a debt tenure of 2.8 years and all-in interest cost of 2.74%. With 75% of borrowings hedged and zero refinancing requirements for FY15, the REIT is fairly well protected against near term interest rate volatility. In FY16, 12% of borrowings (S$370m) will be due for refinancing, while majority will only be due from FY18 onwards.

Share Price Drivers:

Better than expected performance at Suntec City retail. Higher occupancy rates at Suntec City retail, as well as better than expected rental reversions, would present upside to our earnings estimates.

Acquisitions. The Manager could redeploy net proceeds of c.S$290m from the divestment of Park Mall into yield accretive acquisitions, which would boost DPU growth and diversify the REIT's earning base.

Key Risks:

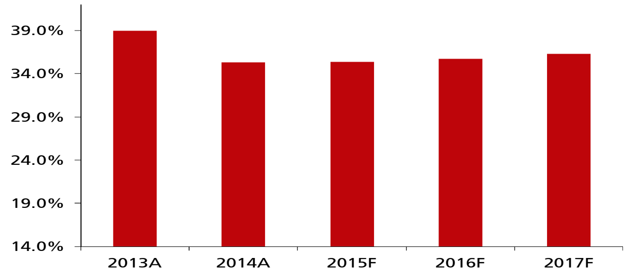
Retail **rental reversion risk**. In FY16, 28% of the Trust's retail NLA will be up for renewal, largely stemming from leases at Phase 1 of AEI works. With average Phase 1 rental of S$13.09 psf pm higher than the mall's blended average of S$12.03 psf pm, there could be risk of flat or mildly negative reversions.

Vacancies at Suntec office. While we have flagged out MBFC and ORQ as key earnings risks in the Trust's office portfolio, we believe that occupancy and rents will continue to remain stable at Suntec due to its more differentiated product offering. Due to Suntec office's staggered lease expiry profile, any decline in rents will not be felt immediately. However higher vacancies could present some downside risks to our earnings assumptions.

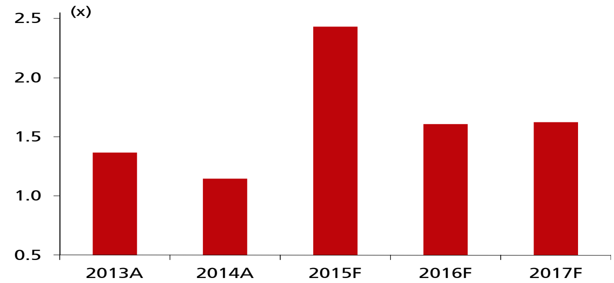
COMPANY BACKGROUND

Suntec REIT has a portfolio of office and retail properties in Singapore and Australia. Its most prominent asset is Suntec City, which comprises four office towers, a retail mall, and a convention centre, located close to the city area of Singapore.

Aggregate Leverage (%)



Distribution Paid / Net Operating CF



Distribution Yield (%)

P/Bk NAV (x)

Source: Company, DBS Bank

Income Statement (S$ m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Gross revenue	234	282	335	351	369
Property expenses	(85)	(91)	(102)	(102)	(105)
Net Property Income	**149**	**192**	**233**	**249**	**264**
Other Operating expenses	(58)	(77)	(47)	(45)	(45)
Other Non Opg (Exp)/Inc	20	19	0	0	0
Net Interest (Exp)/Inc	(55)	(45)	(20)	(37)	(44)
Exceptional Gain/(Loss)	11	(3)	0	0	0
Net Income	**239**	**225**	**216**	**224**	**239**
Tax	5	(7)	(9)	(10)	(12)
Minority Interest	(18)	2	(7)	(7)	(8)
Preference Dividend	0	0	0	0	0
Net Income After Tax	**226**	**219**	**200**	**206**	**220**
Total Return	364	317	200	206	220
Non-tax deductible Items	(172)	(98)	51	51	52
Net Inc available for Dist.	211	230	251	257	271
Growth & Ratio					
Revenue Gth (%)	(10.6)	20.6	18.5	5.0	5.1
N Property Inc Gth (%)	(9.0)	28.9	21.4	7.0	6.1
Net Inc Gth (%)	(6.7)	(2.8)	(8.8)	3.0	6.6
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	63.5	67.9	69.5	70.9	71.7
Net Income Margins (%)	96.4	77.7	59.8	58.7	59.5
Dist to revenue (%)	90.2	81.5	75.0	73.2	73.5
Operating expenses (%)	24.7	27.3	14.0	12.7	12.1
ROAE (%)	4.7	4.3	3.8	3.9	4.2
ROA (%)	2.8	2.6	2.3	2.4	2.6
ROCE (%)	1.1	1.3	2.1	2.3	2.5
Int. Cover (x)	1.6	2.6	9.3	5.6	5.0

Earnings to be driven by full year contribution from Suntec retail and 177 Pacific Highway.

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$ m)

FY Dec	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015
Gross revenue	71	77	74	81	86
Property expenses	(23)	(24)	(23)	(25)	(28)
Net Property Income	49	53	51	57	58
Other Operating expenses	(32)	(12)	(12)	(12)	(12)
Other Non Opg (Exp)/Inc	6	1	1	1	1
Net Interest (Exp)/Inc	(9)	(11)	(13)	(15)	(15)
Exceptional Gain/(Loss)	1	(3)	8	4	5
Net Income	28	122	50	49	51
Tax	(2)	(2)	(2)	(2)	(2)
Minority Interest	7	(2)	(2)	(3)	(2)
Net Income after Tax	33	118	47	44	47
Total Return	33	216	47	44	47
Non-tax deductible Items	0	0	0	0	0
Net Inc available for Dist.	58	65	65	63	64
Growth & Ratio					
Revenue Gth (%)	5	7	(3)	9	6
N Property Inc Gth (%)	6	9	(3)	11	3
Net Inc Gth (%)	2	260	(60)	(6)	6
Net Prop Inc Margin (%)	68.2	69.0	69.0	69.9	67.9
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

3Q15 distributions were supported by S$4.6m of distributions from capital

Balance Sheet (S$ m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Investment Properties	5,741	5,948	5,953	6,005	6,007
Other LT Assets	2,370	2,488	2,488	2,488	2,488
Cash & ST Invts	181	150	52	9	16
Inventory	0	0	0	0	0
Debtors	29	17	27	28	30
Other Current Assets	0	0	0	0	0
Total Assets	8,322	8,602	8,520	8,530	8,541
ST Debt	772	0	0	0	0
Creditor	91	107	56	59	61
Other Current Liab	21	23	30	32	33
LT Debt	2,389	2,981	2,986	3,036	3,086
Other LT Liabilities	64	73	73	73	73
Unit holders' funds	4,844	5,305	5,255	5,203	5,152
Minority Interests	141	113	120	127	135
Total Funds & Liabilities	8,322	8,602	8,520	8,530	8,541
Non-Cash Wkg. Capital	(83)	(113)	(59)	(62)	(65)
Net Cash/(Debt)	(2,980)	(2,831)	(2,934)	(3,027)	(3,070)
Ratio					
Current Ratio (x)	0.2	1.3	0.9	0.4	0.5
Quick Ratio (x)	0.2	1.3	0.9	0.4	0.5
Aggregate Leverage (%)	39.0	35.3	35.4	35.7	36.3
Z-Score (X)	0.8	0.9	1.0	1.0	1.0

Gearing expected to remain fairly stable as construction works at 177 Pacific Highway can be funded using proceeds from the divestment of Park Mall

Source: Company, DBS Bank

Cash Flow Statement (S$ m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Pre-Tax Income	239	225	216	224	239
Dep. & Amort.	0	0	0	0	0
Tax Paid	(4)	0	(2)	(9)	(10)
Associates &JV Inc/(Loss)	(172)	(139)	(50)	(56)	(64)
Chg in Wkg.Cap.	(1)	14	(61)	1	2
Other Operating CF	91	96	0	0	0
Net Operating CF	**153**	**196**	**103**	**160**	**167**
Net Invt in Properties	(189)	(96)	(5)	(52)	(2)
Other Invts (net)	0	0	0	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc. & JVs	0	0	50	56	64
Other Investing CF	(33)	31	0	0	0
Net Investing CF	**(222)**	**(66)**	**45**	**4**	**62**
Distribution Paid	(208)	(224)	(251)	(257)	(271)
Chg in Gross Debt	260	98	5	50	50
New units issued	0	342	0	0	0
Other Financing CF	(1)	(376)	0	0	0
Net Financing CF	**51**	**(160)**	**(245)**	**(207)**	**(221)**
Currency Adjustments	0	(2)	0	0	0
Chg in Cash	(19)	(32)	(98)	(43)	7
Operating CFPS (S cts)	6.8	7.6	6.5	6.2	6.4
Free CFPS (S cts)	(1.6)	4.2	3.9	4.2	6.4

Source: Company, DBS Bank

DBS Bank recommendations are based an 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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