Singapore Company Guide

SPH REIT

Version 9 | Bloomberg: SPHREIT SP | Reuters: SPHR.SI

Refer to important disclosures at the end of this report

10 Oct 2017

BUY

Last Traded Price (9 Oct 2017): S$1.005 (**STI :** 3,291.56)
Price Target 12-mth: S$1.07 (6% upside,5.5% yield) (Prev S$1.04)

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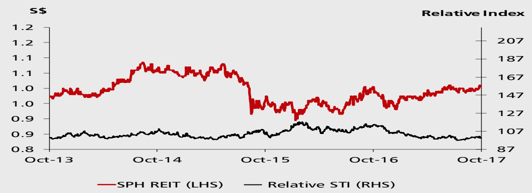
What's New

- 4Q17 results in line; renewal risk reduced as expiring leases have been renewed
- The Seletar Mall acquisition is on the horizon in our view
- Reduced fund raising of S$150m (S$200m previously) given under-geared balance sheet
- BUY call maintained, TP raised to S$1.07

Price Relative



Forecasts and Valuation

FY Aug (S$m)	2016A	2017A	2018F	2019F
Gross Revenue	210	213	223	264
Net Property Inc	161	168	169	196
Total Return	128	157	129	144
Distribution Inc	141	141	143	160
EPU (S cts)	5.02	6.15	5.03	5.43
EPU Gth (%)	(17)	22	(18)	8
DPU (S cts)	5.55	5.53	5.55	5.84
DPU Gth (%)	1	0	0	5
NAV per shr (S cts)	93.4	94.4	93.9	94.0
PE (X)	20.0	16.4	20.0	18.5
Distribution Yield (%)	5.5	5.5	5.5	5.8
P/NAV (x)	1.1	1.1	1.1	1.1
Aggregate Leverage (%)	25.5	25.3	25.7	31.6
ROAE (%)	5.3	6.5	5.3	5.8
Distn. Inc Chng (%):			(10)	(2)
Consensus DPU (S cts):			5.7	5.8
Other Broker Recs:		B: 4	S: 0	H: 2

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

The Seletar Mall acquisition is around the corner

Resilient performer. We believe that SPH REIT can continue to deliver resilience with sticky occupancies while its low gearing of c.26% empowers the Manager to undertake value accretive acquisitions. The 4Q17 results once again highlights the ability of SPH REIT to deliver steady distributions despite ongoing market uncertainties. Catalyst will come when the manager executes on the purchase of Seletar Mall. BUY!

Where we differ: The Seletar Mall acquisition is near. We believe timing of the acquisition of The Seletar Mall (c.S$500m) from its Sponsor is near and continue to price in the deal in our estimates. We expect the deal to complete in 2019 (2018 previously), leading us to raise our TP to S$1.07. We believe the Manager will utilise its significant debt-funded headroom, and now expect SPH REIT to raise S$150m (previously S$200m) via an equity fund raising exercise by the end of FY18F. This will push up gearing slightly from 26% to 32%, which is still conservative compared to the peer average of 34%. Under a more aggressive debt-raising scenario, gearing could rise to 36% with close to 10% increase in DPU (see detailed analysis 'Get Ready (before it's too late)' published on 16 March 2017).

Potential Catalyst: The Seletar Mall to drive higher growth. With The Seletar Mall, SPH REIT will derive a higher proportion of its income from suburban shopping (rising from 20% to 32%), which will enhance the portfolio's resilience.

Valuation:

Revised our DCF-backed TP to S$1.07 on lower new equity issuance assumptions. The stock offers a dividend yield of close to 5.5% and price upside potential of 6%. Maintain BUY.

Key Risks to Our View:

Timing and price of The Seletar Mall acquisition. We have factored in contributions from The Seletar Mall from FY19. Later-than-projected timeline or higher purchase price implies downside to our estimates.

At A Glance

Issued Capital (m shrs)	2,556
Mkt. Cap (Sm/USm)	2,569 / 1,884
Major Shareholders (%)	
Singapore Press Holdings Ltd	68.5%
National Trades Union Congress	5.3%
Free Float (%)	26.2%
3m Avg. Daily Val (US$m)	1.2
ICB Industry : Real Estate / Real Estate Investment Trusts	

WHAT'S NEW

Acquisition of The Seletar Mall should boost earnings

Steady 4Q17 results: SPH REIT reported 1.3% y-o-y and 3.9% increase in revenues and net property income to S$52.9m and S$41.8m respectively. This was mainly driven by higher rents achieved at Paragon and The Clementi Mall. The Manager continues to keep a tight rein on expenses (utilities and maintenance), reporting a 7.6% y-o-y decline to S$11.1m but flat q-o-q. Distributable income dipped 7.3% y-o-y , but due to payment of formerly retained income, distribution to unitholders rose by 1.1% y-o-y to S$36.3m. This translates to a DPU of 1.42 Scts for this quarter. For FY17, SPH REIT reported a DPU of 5.53 Scts.

Portfolio value stable. This was mainly due to a c.15bps-25bps tightening in cap rates from the retail (ranging 4.50%-4.80% from 4.85%-5.0%) and medical suites (3.75% from 4.0%). NAV increased marginally to 0.95 Scts. Gearing remains a conservative 25.4%.

Stable reversions; but under pressure. While rental reversions for FY17 were positive at 1.3%, performance seemed to be weak in 4Q17, especially when cumulative rental reversions for 9M17 remained stable at 3.7%. While foot traffic held steady at both malls, tenant sales was up 2.1% in Paragon while The Clementi Mall recorded a drop of 5.8%.

The weakness in 4Q17 came from Paragon, where the Manager acknowledged that they have been more flexible in their leasing strategy as the ongoing uncertainties in the retail sector are starting to bite. Occupancy costs for Paragon and The Clementi Mall remained stable at 19.6% and 15.8% respectively.

Working with tenants to create a "win-win" eco-system: Looking forward, the Manager has renewed a majority of the leases expiring in The Clementi Mall and will be focusing on leases expiring in FY18 at the Paragon, representing c. 24% of gross rental income. While we believe that occupancy levels are likely to remain high given the high visibility accorded to tenants from being located there, rental reversions could remain under pressure given the still weak retail sentiment.

That said, the Manager is seeing improvements in certain retail trades (watches and jewelry) and believe that a nascent recovery in the retail sector could be underway in the medium term. The Manager remains keen to retain tenants and occupancy rates as a key strategy going forward.

Debt refinancing in FY18. The Manager is in advanced talks with banks on the refinancing of S$320m worth of loans expiring in FY18F, and rates offered by banks are competitive and should remain stable.

The Seletar Mall – a target acquisition: We believe that the possibility of the acquisition of The Seletar Mall is nearing (estimated valuation at S$500m) especially as the Mall is currently in its first renewal cycle (opened in Nov'14). The Manager is keen to acquire the property and believes that it is in unitholders' interest to consider acquiring the property as it has achieved a more stabilised tenant base and occupancy level.

Revising acquisition assumptions. We had initially forecasted an acquisition to take place by FY17 but this did not take place. We believe that a deal, when it materialises, will be in unitholders' interest, given the accretion to DPU and growth acceleration that The Seletar Mall offers. We have now imputed a lower fund-raising assumption in our estimates (S$150m instead of S$200m), implying that gearing will increase to a more optimal 32% level in FY18F. Our TP is raised to S$1.07 as a result. Maintain BUY.

Quarterly / Interim Income Statement (S$m)

FY Aug	4Q2016	3Q2017	4Q2017	% chg yoy	% chg qoq
Gross revenue	52.2	53.3	52.9	1.3	(0.9)
Property expenses	(12.0)	(11.1)	(11.1)	(7.6)	(0.5)
Net Property Income	40.2	42.2	41.8	3.9	(1.0)
Other Operating expenses	(4.3)	(4.6)	(4.4)	3.1	(4.9)
Other Non Opg (Exp)/Inc	0.0	0.0	(4.3)	-	-
Net Interest (Exp)/Inc	(5.7)	(5.9)	(5.9)	(2.7)	1.0
Exceptional Gain/(Loss)	7.69	0.0	34.9	-	-
Net Income	**37.9**	**31.6**	**62.0**	**63.8**	**96.3**
Tax	0.0	0.0	0.0	-	-
Minority Interest	0.0	0.0	0.0	-	-
Net Income after Tax	**37.9**	**31.6**	**62.0**	**63.8**	**96.3**
Total Return	28.1	29.6	30.2	7.3	1.9
Non-tax deductible Items	4.17	4.11	4.71	12.8	14.5
Net Inc available for Dist.	34.4	35.7	31.8	(7.3)	(10.9)
Ratio (%)					
Net Prop Inc Margin	77.0	79.1	79.0		
Dist. Payout Ratio	104.5	98.0	114.0		

Source of all data: Company, DBS Bank

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CRITICAL DATA POINTS TO WATCH

Critical Factors

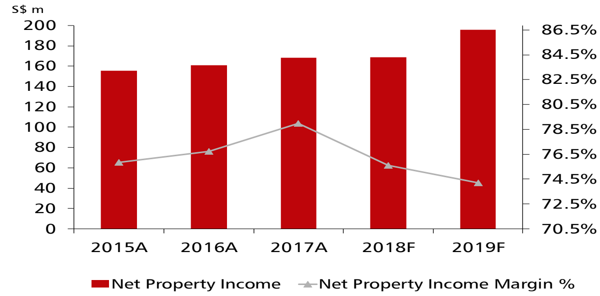
A retail proxy – price driven by rental reversion and Singapore retail sales*. As shown in Table 1, strong correlations were found between SPH REIT's price and Singapore retail sales* (coefficient 0.71) and with its rental reversion rates (coefficient 0.66). We believe the rental performance of the two properties - Paragon and The Clementi Mall - in the portfolio, predominantly the former, is a good representation of investor's perception and confidence in the direction of the Singapore retail market. Singapore Retail Sales and SPH REIT's rental reversion rates are in turn strongly correlated with a high coefficient of 0.80 which can be explained by the greater willingness for merchants to renew their tenancies at a higher rent once they have observed positive retail momentum in the previous rental cycle.

SPH REIT's first acquisition will likely be positive. The market's reaction to acquisitions by SPH REIT has not been tested as it has not acquired any properties since its IPO, but we believe that response will be positive. We believe the acquisition of The Seletar Mall, will be positive. Besides marking the REIT's first acquisition, it will also allow the REIT to improve liquidity as a result of the potential equity fund raising to part fund the deal. We have included the potential acquisition of The Seletar Mall in our estimates (from FY19F onwards), a non-consensus call at this moment, raising FY19F DPUs by 5% (based on S$150m fund raising assumption).

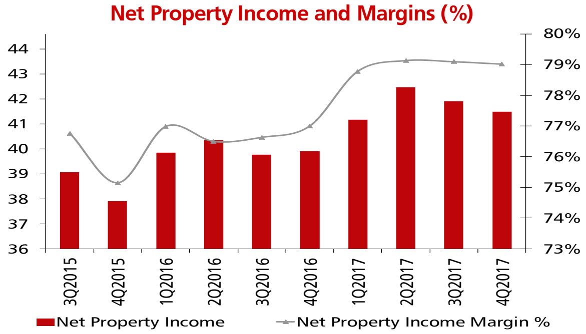
No meaningful connection with tourist arrivals. Despite the lack of official data, the REIT's management estimates that approximately 75% of the spending at Paragon is made by local shoppers, whereas overseas shoppers count for less than a quarter. We further attested this when we found no meaningful correlation between Singapore tourist arrivals and SPH REIT's share price or rental reversions (Table 1). Hence, we believe the principal target shoppers of Paragon and The Clementi Mall are Singapore residents.

Not correlated with interest rates. There is no correlation between SPH REIT's share price with interest rates (price correlation coefficient of -0.02 with Singapore 10Y government bond yield and yield coefficient of -0.08). We conclude that interest rate is not a critical factor for SPH REIT's price or yield performance. *Singapore retail sales index, ex-motor vehicle, inflation and seasonality adjusted

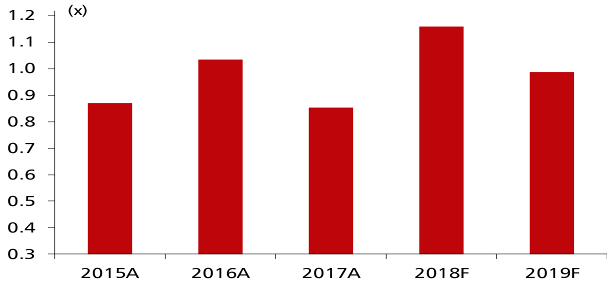
Net Property Income and Margins (%)



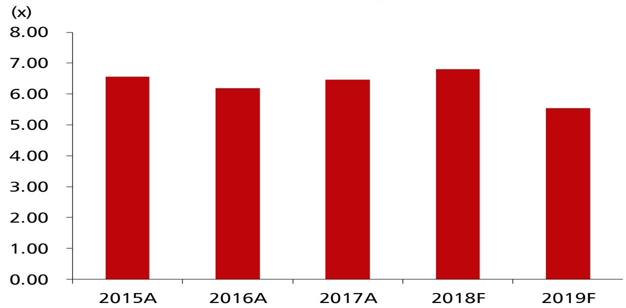
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



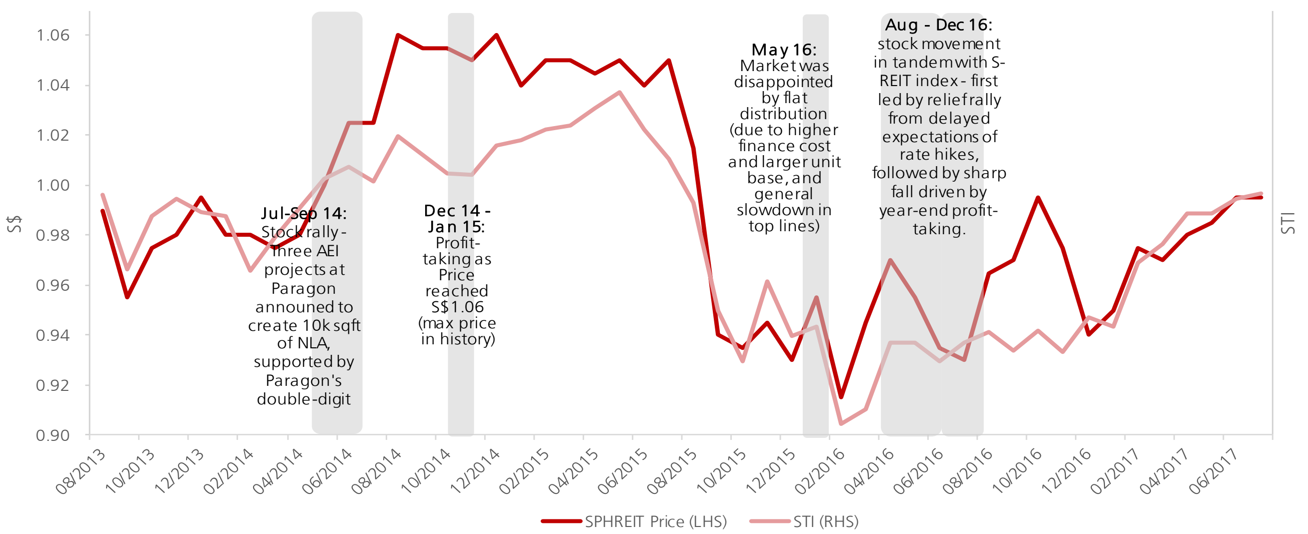
Interest Cover (x)



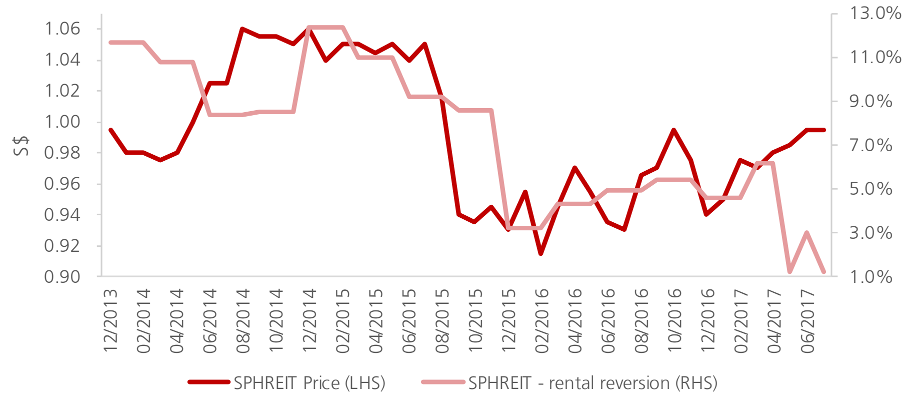
Source: Company, DBS Bank

Appendix 1:

Chart 1: SPH REIT Price vs STI (correlation coefficient 0.88): Anomaly Periods



SPH REIT vs Rental reversions

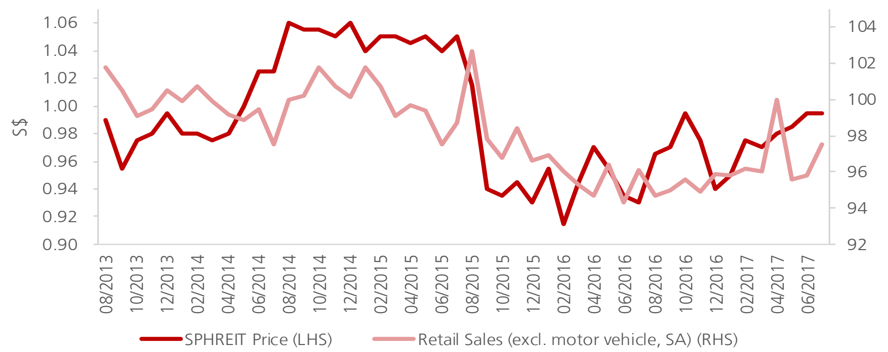


Remarks

High correlation of 0.66x between share price and rental reversions

Source: Bloomberg Finance L.P., company, DBS Bank

SPH REIT vs Retail Sales



Remarks

Close correlation between retail sales and SPH REIT's share price

Source: Bloomberg Finance L.P., company, DBS Bank

Balance Sheet:

Healthy gearing ratio empowers REIT to undertake significant acquisitions. SPH REIT has maintained a healthy gearing ratio of around 26% that is well within the Manager's comfortable range of up to 40%. This provides the REIT with a significantly larger headroom for debt financing should it decide to gear up on acquisitions. Net Asset Value (NAV) per unit of S$0.94 is underpinned by stable asset valuations.

Share Price Drivers:

Potential acquisitions. With a healthy gearing of below 30% and cost of debt of less than 3.0%, SPH REIT is well poised for debt-funded acquisitions. The next growth catalyst for the REIT will be the acquisition of the Sponsor's 70% stake in The Seletar Mall, which was completed in December 2014. We believe the transaction is likely to happen in the next 12 months.

Key Risks:

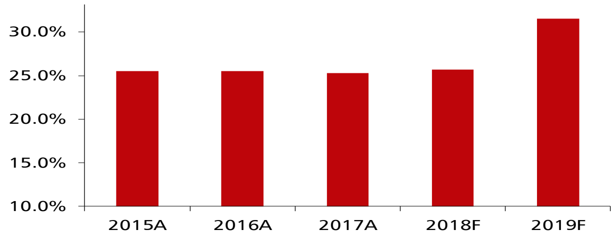
Timing and price of The Seletar Mall acquisition. While we believe it is very likely for the transaction to happen in the next 12 months at a price marginally higher than the current appraised value of S$495m, the exact timing and price are uncertain. Tenant sales while mixed in FY17 is a concern. Paragon's tenant sales registered a positive growth of 2.1%, and more traffic could be drawn from the opening of the link bridge in the medium term. The decline at The Clementi Mall was most likely from the unproductive traffic as a new MRT exit at Clementi station opened early in the year, providing an alternative route for the train passengers.

Management fees payable in units. After paying 100% of management fees in units since inception, the REIT paid c.85% of base management fees in cash in 3Q17 and we believe it is likely to continue doing so going forward. We believe this will strengthen the sustainability of DPU growth in the next few years.

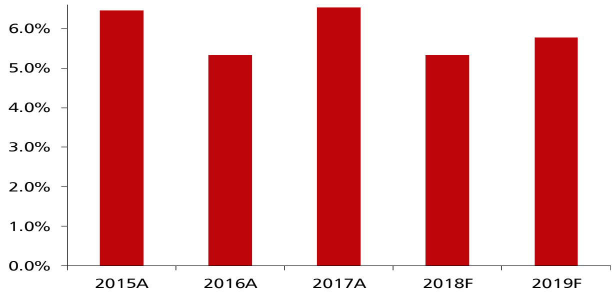
Company Background

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 The Clementi Mall, located in the west of Singapore.

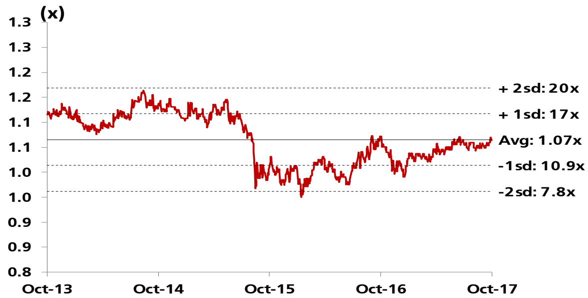
Aggregate Leverage (%)



ROE (%)



PB Band (x)



Source: Company, DBS Bank

Income Statement (S$m)

FY Aug	2015A	2016A	2017A	2018F	2019F
Gross revenue	205	210	213	223	264
Property expenses	(49.5)	(48.7)	(44.7)	(54.3)	(67.9)
Net Property Income	**156**	**161**	**168**	**169**	**196**
Other Operating expenses	(17.7)	(17.9)	(18.3)	(17.3)	(20.0)
Other Non Opg (Exp)/Inc	0.0	0.0	(4.3)	0.0	0.0
Net Interest (Exp)/Inc	(21.0)	(23.1)	(23.2)	(22.3)	(31.7)
Exceptional Gain/(Loss)	36.6	7.69	34.9	0.0	0.0
Net Income	**154**	**128**	**157**	**129**	**144**
Tax	0.0	0.0	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	**154**	**128**	**157**	**129**	**144**
Total Return	154	128	157	129	144
Non-tax deductible Items	21.6	21.2	19.0	13.6	15.5
Net Inc available for Dist.	139	141	141	143	160
Growth & Ratio					
Revenue Gth (%)	1.4	2.2	1.5	4.8	18.2
N Property Inc Gth (%)	3.3	3.4	4.5	0.4	16.1
Net Inc Gth (%)	(29.1)	(16.9)	23.2	(17.8)	11.5
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	75.9	76.8	79.0	75.6	74.3
Net Income Margins (%)	74.9	60.9	73.9	57.9	54.6
Dist to revenue (%)	67.5	67.3	66.4	64.0	60.5
Managers & Trustee's fees	8.6	8.6	8.6	7.8	7.6
ROAE (%)	6.5	5.3	6.5	5.3	5.8
ROA (%)	4.7	3.9	4.7	3.9	4.0
ROCE (%)	4.2	4.4	4.6	4.6	4.9
Int. Cover (x)	6.6	6.2	6.5	6.8	5.5

Source: Company, DBS Bank

Driven by the assumed acquisition of The Seletar Mall

Quarterly / Interim Income Statement (S$m)

FY Aug	4Q2016	1Q2017	2Q2017	3Q2017	4Q2017
Gross revenue	52.2	52.6	54.0	53.3	52.9
Property expenses	(12.0)	(11.2)	(11.3)	(11.1)	(11.1)
Net Property Income	40.2	41.4	42.7	42.2	41.8
Other Operating expenses	(4.3)	(4.6)	(4.6)	(4.6)	(4.4)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	(4.3)
Net Interest (Exp)/Inc	(5.7)	(5.8)	(5.7)	(5.9)	(5.9)
Exceptional Gain/(Loss)	7.69	0.0	0.0	0.0	34.9
Net Income	**37.9**	**31.1**	**32.4**	**31.6**	**62.0**
Tax	0.0	0.0	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	**37.9**	**31.1**	**32.4**	**31.6**	**62.0**
Total Return	28.1	29.8	30.2	29.6	30.2
Non-tax deductible Items	4.17	5.30	4.86	4.11	4.71
Net Inc available for Dist.	34.4	36.4	37.3	35.7	31.8
Growth & Ratio					
Revenue Gth (%)	0	1	3	(1)	(1)
N Property Inc Gth (%)	0	3	3	(1)	(1)
Net Inc Gth (%)	28	(18)	4	(3)	96
Net Prop Inc Margin (%)	77.0	78.8	79.1	79.1	79.0
Dist. Payout Ratio (%)	104.5	94.0	95.8	98.0	114.0

Balance Sheet (S$m)

FY Aug	2015A	2016A	2017A	2018F	2019F
Investment Properties	3,213	3,230	3,278	3,283	3,789
Other LT Assets	14.4	7.99	2.34	2.34	2.34
Cash & ST Invts	77.4	67.4	63.0	48.3	50.5
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	5.01	5.89	3.35	3.35	3.35
Other Current Assets	0.37	0.0	0.0	0.0	0.0
Total Assets	**3,310**	**3,311**	**3,347**	**3,337**	**3,845**
ST Debt	249	0.0	319	319	319
Creditor	30.2	34.2	40.1	22.3	26.4
Other Current Liab	0.0	0.0	0.62	0.62	0.62
LT Debt	596	846	528	538	894
Other LT Liabilities	36.7	42.7	37.5	37.5	37.5
Unit holders' funds	2,398	2,389	2,421	2,419	2,567
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**3,310**	**3,311**	**3,347**	**3,337**	**3,845**
Non-Cash Wkg. Capital	(24.9)	(28.3)	(37.3)	(19.6)	(23.6)
Net Cash/(Debt)	(768)	(779)	(784)	(809)	(1,163)
Ratio					
Current Ratio (x)	0.3	2.1	0.2	0.2	0.2
Quick Ratio (x)	0.3	2.1	0.2	0.2	0.2
Aggregate Leverage (%)	25.5	25.5	25.3	25.7	31.6
Z-Score (X)	3.5	3.6	3.6	3.0	3.0

Source: Company, DBS Bank

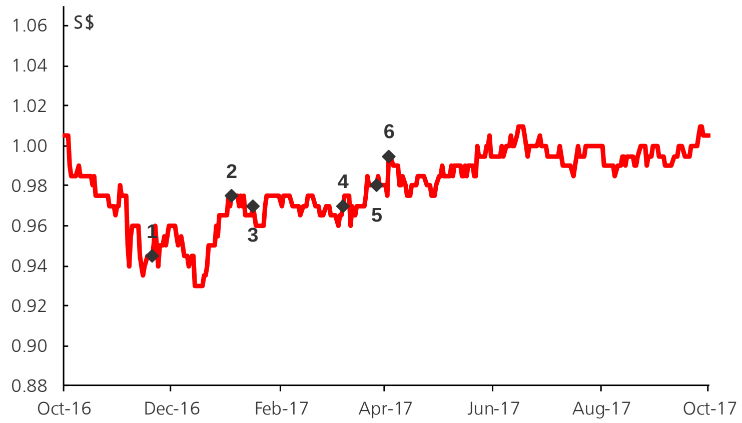
Gearing to increase but still stay at a sustainable level

Cash Flow Statement (S$m)

FY Aug	2015A	2016A	2017A	2018F	2019F
Pre-Tax Income	117	120	122	129	144
Dep. & Amort.	0.16	0.21	0.21	0.0	0.0
Tax Paid	0.0	0.0	0.0	0.0	0.0
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	1.28	(1.9)	(0.3)	(17.8)	4.07
Other Operating CF	40.0	16.1	43.0	11.7	13.6
Net Operating CF	**158**	**134**	**165**	**123**	**162**
Net Invt in Properties	(15.3)	(8.5)	(6.3)	(5.1)	(506)
Other Invts (net)	(0.1)	(0.1)	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.61	0.85	0.0	0.0	0.0
Net Investing CF	**(14.8)**	**(7.8)**	**(6.3)**	**(5.1)**	**(506)**
Distribution Paid	(138)	(139)	(141)	(143)	(160)
Chg in Gross Debt	(0.2)	(1.0)	0.0	10.0	356
New units issued	(18.8)	(22.3)	0.0	0.0	150
Other Financing CF	0.0	0.0	(22.5)	0.0	0.0
Net Financing CF	**(157)**	**(162)**	**(163)**	**(133)**	**346**
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	(13.3)	(35.6)	(4.4)	(14.7)	2.18
Operating CFPS (S cts)	6.22	5.36	6.47	5.49	5.94
Free CFPS (S cts)	5.66	4.95	6.22	4.60	(13.0)

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	28 Nov 16	0.95	1.00	HOLD
2:	12 Jan 17	0.98	1.00	HOLD
3:	24 Jan 17	0.97	1.00	HOLD
4:	16 Mar 17	0.97	1.03	BUY
5:	04 Apr 17	0.98	1.03	BUY
6:	11 Apr 17	1.00	1.04	BUY

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

Source: DBS Bank

Analyst: Derek TAN
Singapore Research Team
Mervin SONG CFA

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

Completed Date: 10 Oct 2017 07:53:55 (SGT)
Dissemination Date: 10 Oct 2017 09:13:31 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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