

SPH REIT (SPHREIT SP)

HOLD

Acquisition potential priced in

Share Price	SGD 1.00
12m Price Target	SGD 1.00 (+0%)
Previous Price Target	SGD 1.00

Results in line, HOLD

Our forecasts are unchanged for SPHREIT following in-line 2Q18 results (MKE and Consensus). SPHREIT remains a strong proxy to growth in tourist arrivals and a recovery in prime Orchard Road rents, and we expect its flagship Paragon mall to see catalysts from stronger shopper traffic and tenant sales. However, the shares are fairly valued having appreciated sharply the past year, likely pricing in potential acquisitions, the timing of which remain uncertain. Reiterate HOLD with DDM-based SGD1.00 TP (WACC: 6.9%, LTG: 1.5%). We prefer FCT (FCT SP, BUY, TP SGD2.55) for its suburban footprint and stronger growth profile.

Paragon's -7.1% rental reversion moderated QoQ

SPHREIT revenue/ NPI were down 0.8% YoY/ 1.1% YoY. While tenant sales improved, rental reversions at its two malls were negative, even as Paragon's rental reversion at -7.1% had moderated from -10.6% in 1Q18. Management explained that occupancy cost considerations drove its rental negotiations with tenants, with the leases typically committed a year earlier. These discussions also last occurred during the prolonged retail sales downturn since 2014, as Paragon's occupancy cost rose from 16.8% in FY13 to peak at 19.6% in FY17. SPHREIT has renewed the bulk of its leases expiring in FY18 and sees a stronger tenant sales outlook for its malls, in line with recovering retail sector fundamentals. These are backed by intensified efforts from its luxury brand tenants to roll-out experiential retail concepts at Paragon. We forecast rents to rise 3-5% in FY18-19.

How soon on acquisition-led growth?

Potential acquisition growth opportunities - Seletar Mall and third-party retail assets in Australia - remain in focus for management. We estimate a potential Seletar Mall acquisition adds 10-12% to FY18 DPU, assuming the purchase of a 100% stake that is fully debt-funded given its low gearing of 25.4%. However, we expect a lengthened process, given its sponsor's 70% stake, with the rest owned by United Engineers (UEM SP, SGD2.63, not-rated), now controlled by two distinct developer parties. SPHREIT is looking to firm up strong local partnerships in Australia as its focuses on overseas diversification.

FYE Aug (SGD m)	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	210	213	218	222	225
Net property income	161	168	173	175	178
Core net profit	140	136	143	143	145
Core EPU (cts)	5.0	6.3	8.4	6.9	6.8
Core EPU growth (%)	(17.7)	26.1	34.3	(18.8)	(1.0)
DPU (cts)	5.5	5.5	5.6	5.6	5.6
DPU growth (%)	0.5	0.5	1.3	(0.3)	0.6
P/NTA (x)	1.1	1.1	1.0	1.0	1.0
DPU yield (%)	5.5	5.5	5.6	5.6	5.6
ROAE (%)	5.3	6.7	8.7	6.9	6.7
ROAA (%)	4.2	4.1	4.2	4.1	4.1
Debt/Assets (x)	0.26	0.25	0.25	0.24	0.24
Consensus DPU	-	-	5.6	5.7	5.8
MKE vs. Consensus (%)	-	-	(0.0)	(2.2)	(3.0)

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Company Description

SPH REIT engages in the ownership and acquisition of commercial properties. It operates through the Paragon and The Clementi Mall segments.

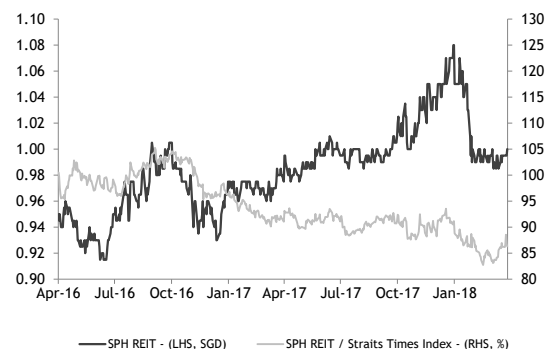
Statistics

52w high/low (SGD)	1.08/0.98
3m avg turnover (USDm)	1.5
Free float (%)	25.8
Issued shares (m)	2,566
Market capitalisation	SGD2.6B
	USD1.9B

Major shareholders:

Singapore Press Holdings Ltd.	68.2%
NTUC Enterprise Co-operative Ltd.	5.2%
SPH REIT Management Pte. Ltd.	1.3%

Price Performance



	-1M	-3M	-12M
Absolute (%)	1	(7)	2
Relative to index (%)	2	(5)	(6)

Source: FactSet

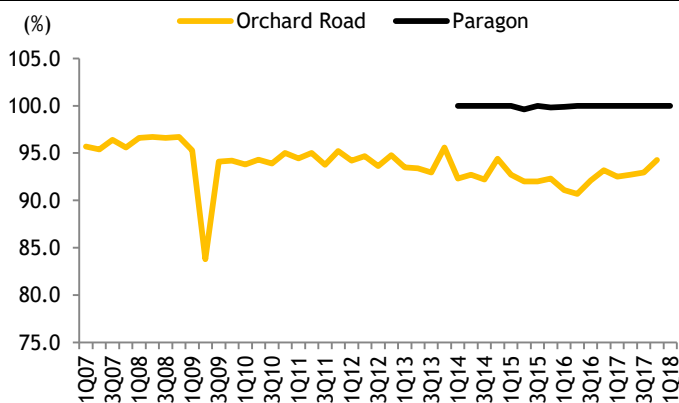
Fig 1: Summary financials 2Q18A comparison

FYE 31 Mar	2Q17 (SGD m)	1Q18 (SGD m)	2Q18 (SGD m)	Change (% YoY)	Change (% QoQ)	YTD18 (SGD m)	% of FYE	FY18E (SGD m)
Gross revenue	54.0	53.5	53.6	(0.8)	0.2	107.1	49.0	218.4
Property expenses	(11.3)	(11.3)	(11.3)	0.5	0.3	(22.6)	50.6	(44.7)
Net property income	42.7	42.2	42.3	(1.1)	0.2	84.5	50.2	168.1
Borrowing costs	(5.8)	(6.0)	(6.0)	2.6	(0.7)	(12.0)	53.9	(22.2)
Distributable income to unitholders	35.7	34.4	36.0	0.7	4.7	70.4	49.0	143.7
Distribution per unit (SGD cts)	1.40	1.34	1.40	0.0	4.5	2.74	48.9	5.60
NAV per unit (SGD)	0.94	0.95	0.94	0	(1)			
Aggregate leverage (%)^	25.7	25.4	25.4	(30)	0			
All-in financing cost (%)^	2.79	2.84	2.84	5	0			
Occupancy (%)^	100.0	100.0	100.0	0	0			
Rental reversion (%)	6.2	(10.6)	(7.1)					
NPI margin (%)^	79.1	78.9	78.9	(26)	(2)			

^Change in basis points

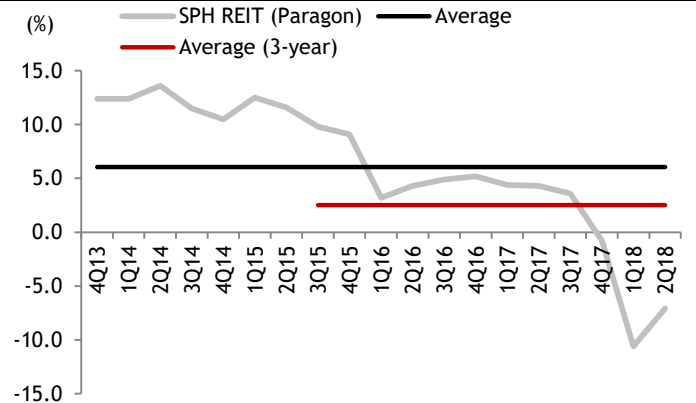
Source: Company data, Maybank Kim Eng

Fig 2: Occupancy (1Q07 to 1Q18) - calendarised



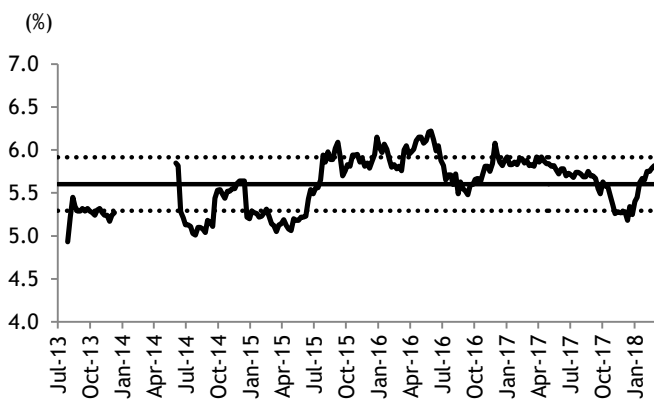
Source: Company data. *Paragon up till Feb 2018

Fig 3: Rental reversion (1Q13 to 2Q18)



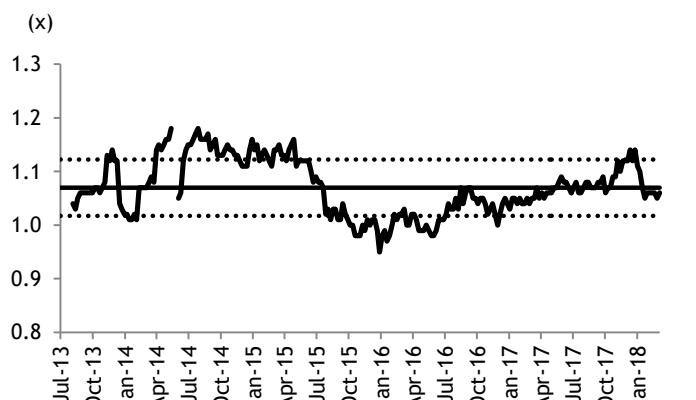
Source: Company data. *Paragon up till Feb 2018

Fig 4: SPH REIT's DPU yield at 1SD above the mean



Source: Company data, Bloomberg, Maybank Kim Eng

Fig 5: P/B is now at the historical mean

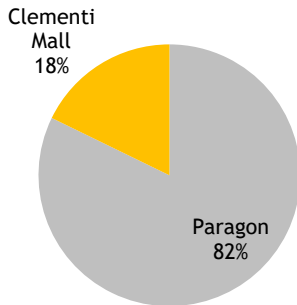


Source: Company data, Bloomberg, Maybank Kim Eng

Value Proposition

- Owns two well-located malls - Paragon (82% of its AUM) in Orchard Road's shopping belt and Clementi Mall (18% of AUM) in the west, linked directly to the Clementi MRT.
- Sponsor SPH is S'pore's oldest and most prominent media company, as well as active real estate developer. SPH REIT has a right of first refusal to Seletar Mall, which opened in Nov 2014, with book value of SGD490m at end-Aug 2017.
- Strongest balance sheet amongst peers, following its Jul 2013 IPO, with leverage at 25.4% at end-Feb 2018, and about SGD820m in debt headroom at 40% gearing.

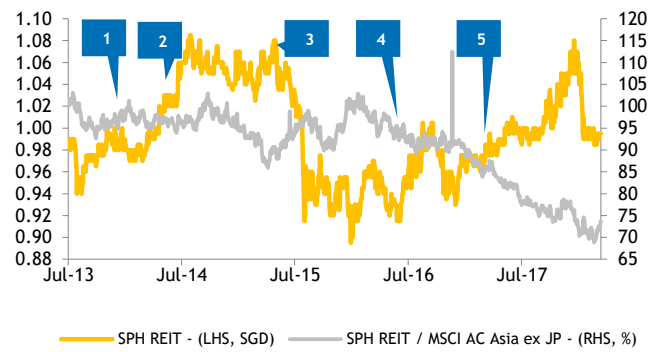
AUM breakdown (as of end-Feb 2018)



Source: Company

Price Drivers

Historical share price trend



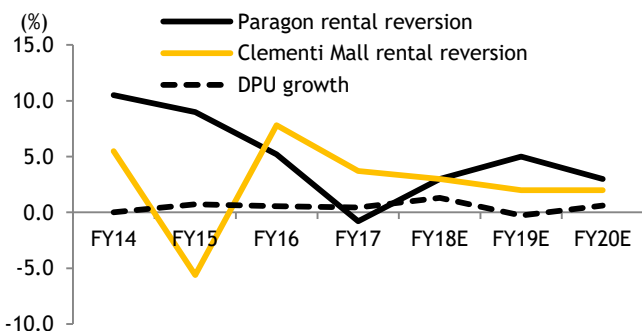
Source: Company, Maybank Kim Eng

- Jan-14: Reports maiden DPU 2.2% ahead of forecast with 100% occupancies at its two malls and +12.4% rental reversions at Paragon for the Jul-Nov-13 period.
- Jul-14: May-14 quarter results saw rental reversions for the portfolio and Paragon at +8.4% and +11.5%.
- Apr-15: Reports Feb-15 quarter results with -8.8% in rental reversions at Clementi Mall (which opened in May-11) during its first renewal cycle.
- Apr-16: Rental reversions at Clementi Mall returned to a positive at +5.4% in Feb-16 following three consecutive quarters in negative territory.
- Dec-16: Chairman affirms SPHREIT's interest in acquiring Seletar Mall from its sponsor subject to price and timing, during the AGM.

Financial Metrics

- DPU growth at 0-1% over FY18-20E, as the five-year rental support from Clementi Mall expires in Jul 2018.
- Paragon gains from an earlier recovery from Orchard Road rents, and Clementi Mall should stay at a single-digit growth trajectory over FY18-20E.

Rental reversion and DPU growth



Source: Company

Swing Factors

Upside

- Earlier-than-expected pick-up in leasing demand for retail, office space driving improvement in occupancy.
- Better-than-anticipated rental reversions.
- Accretive acquisitions or redevelopment projects.

Downside

- Prolonged slowdown in economic activity could reduce demand for retail, office space, resulting in lower occupancy and rental rates.
- Termination of long-term leases contributing to weaker portfolio tenant retention rate.
- Sharper-than-expected rise in interest rates could increase cost of debt and negatively impact earnings, with higher cost of capital lowering valuations.

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FYE 31 Aug	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
Price/DPU(x)	18.2	18.1	17.9	17.9	17.8
P/BV (x)	1.1	1.1	1.0	1.0	1.0
P/NTA (x)	1.1	1.1	1.0	1.0	1.0
DPU yield (%)	5.5	5.5	5.6	5.6	5.6
FCF yield (%)	6.3	6.5	6.8	6.4	6.5

INCOME STATEMENT (SGD m)

Revenue	209.6	212.8	218.4	221.6	224.7
Net property income	160.9	168.1	172.7	175.2	177.6
Management and trustee fees	(16.8)	(17.2)	(17.7)	(17.8)	(18.1)
Net financing costs	(24.0)	(23.9)	(22.2)	(22.4)	(23.2)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	7.7	34.9	82.6	42.5	40.1
Other pretax income/expenses	2.4	1.2	2.0	0.0	0.0
Pretax profit	126.7	160.7	216.3	176.3	175.3
Income tax	0.0	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Total return avail to unitholders	126.7	160.7	216.3	176.3	175.3
Preferred Dividends	0.0	0.0	0.0	0.0	0.0
Distributable inc to unitholders	139.0	141.2	143.7	143.9	145.4

BALANCE SHEET (SGD m)

Cash & Short Term Investments	67.4	63.0	77.5	81.1	84.9
Accounts receivable	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	1.0	0.8	0.8	0.8	0.8
Investment properties	3,230.0	3,278.0	3,367.6	3,417.1	3,464.2
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	12.9	4.9	4.9	4.9	4.9
Total assets	3,311.3	3,346.7	3,450.8	3,503.9	3,554.8
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	34.2	40.1	40.1	40.1	40.1
LT interest bearing debt	845.9	847.4	850.0	850.0	850.0
Other liabilities	42.7	38.1	38.1	38.1	38.1
Total Liabilities	922.7	925.6	928.2	928.2	928.2
Shareholders Equity	2,388.5	2,421.1	2,522.6	2,575.7	2,626.6
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	2,388.5	2,421.1	2,522.6	2,575.7	2,626.6
Total liabilities and equity	3,311.3	3,346.7	3,450.8	3,503.9	3,554.8

CASH FLOW (SGD m)

Cash flow from operations	160.0	165.2	173.6	165.5	167.8
Capex	(0.2)	(0.0)	0.0	0.0	0.0
Acquisitions & investments	(8.5)	(7.0)	(7.0)	(7.0)	(7.0)
Disposal of FA & investments	0.0	0.0	0.0	0.0	0.0
Dividend income from associates	0.0	0.0	0.0	0.0	0.0
Other investing cash flow	0.9	0.8	0.7	0.7	0.7
CF from investing activities	(7.9)	(6.3)	(6.3)	(6.3)	(6.3)
Dividends paid	(139.0)	(140.8)	(143.7)	(143.9)	(145.4)
Interest expense	(23.3)	(22.5)	(22.2)	(22.4)	(23.2)
Change in debt	0.0	0.0	2.6	0.0	0.0
Equity raised / (purchased)	0.0	0.0	10.6	10.6	10.8
Other financial activities	0.0	0.0	0.0	0.0	0.0
CF from financing activities	(162.2)	(163.3)	(152.8)	(155.7)	(157.8)
Effect of exchange rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	(10.1)	(4.4)	14.5	3.6	3.7

FYE 31 Aug	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth ratios (%)					
Revenue growth	2.2	1.5	2.7	1.5	1.4
Net property income growth	3.4	4.5	2.7	1.5	1.4
Core net profit growth	1.7	(3.0)	5.1	0.1	1.0
Distributable income growth	0.8	1.6	1.7	0.1	1.0
Profitability ratios (%)					
Net property income margin	76.8	79.0	79.1	79.1	79.1
Core net profit margin	66.9	63.9	65.4	64.6	64.4
Payout ratio	110.3	87.9	66.3	81.4	82.8
DuPont analysis					
Total return margin (%)	60.4	75.5	99.0	79.5	78.0
Gross revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.4	1.4	1.4	1.4	1.4
ROAE (%)	5.3	6.7	8.7	6.9	6.7
ROAA (%)	4.2	4.1	4.2	4.1	4.1
Leverage & Expense Analysis					
Asset/Liability (x)	3.6	3.6	3.7	3.8	3.8
Net gearing (%) (excl. perps)	32.6	32.4	30.6	29.9	29.1
Net interest cover (x)	5.9	6.2	6.9	7.0	6.8
Debt/EBITDA (x)	6.0	5.7	5.5	5.4	5.4
Capex/revenue (%)	0.1	0.0	0.0	0.0	0.0
Net debt/ (net cash)	778.5	784.4	772.5	768.9	765.1
Debt/Assets (x)	0.26	0.25	0.25	0.24	0.24

Source: Company; Maybank

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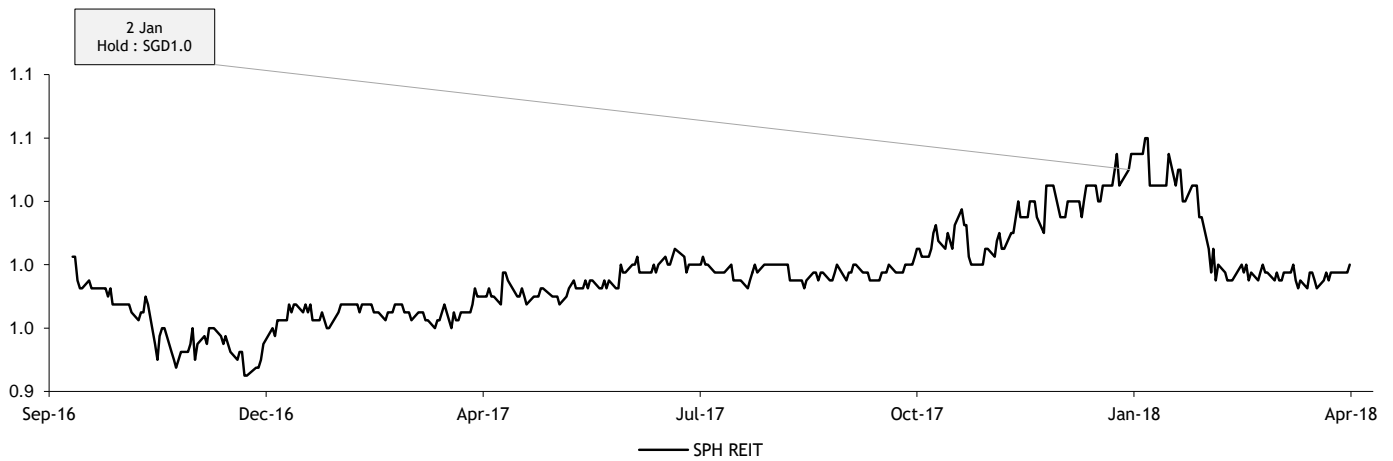
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