

Suntec REIT (SUN SP)

Battling higher rates

HOLD

Share Price	SGD 1.12
12m Price Target	SGD 1.15 (+8%)
Previous Price Target	SGD 1.30

Trimming price target on higher cost of equity

SUN reported 3Q DPU of SGD1.793c, +3.1% QoQ, -14% YoY. 9MYTD DPU of 5.269c fell 23.6% YoY and was 76.6% of our FY est. Top-line growth was anchored by accelerated recovery of the convention business. However, higher interest cost and lower margins moderated distribution. Unlike overseas assets, Singapore occupancy was steady while reversions strengthened for office and retail. Divestment continues albeit at a slow pace. With continued risk of lower asset values and higher funding cost, we maintain HOLD and lower our DDM-based TP to SGD1.15.

Convention centre shines; slow pace of divestment

3Q gross revenue of SGD123.4m rose 6.7% QoQ, 15% YoY. NPI of SGD84.6m rose 9.9% QoQ, 9.7% YoY. Recovery in the convention business along with steady growth in Singapore office and retail segments supported growth. This was partially offset by lower contribution from Australia and higher operating expenses. JV income of SGD23.8m was +1.7%QoQ but down 20.4% YoY due to higher interest expense, weaker AUD and rent-free incentives in Australia. Funding cost rose 14bps QoQ to 3.78% eroding operational gains and resulting in a 14% YoY decline in DPU. In the quarter, SUN divested three more strata units at c.SGD3000psf (SGD2500psf book value). Divestment target is SGD100m but at firm pricing. YTD, SUN has achieved 40% of the divestment target.

Funding cost guidance inches up

Operating metrics were relatively steady. Office occupancy slipped c.1% point to 97.4% mainly due to Australia. Retail occupancy firmed up to 97.9% vs. 97.5% in 2Q. Australia and UK assets are likely to witness lower occupancy over next 12 months due to non-renewals. Reversion strengthened in 3Q with Singapore office and retail witnessing 12.2% and 20.2% ytd positive reversions. This was partly aided by renewal of leases signed during the pandemic period. Interest cost guidance for FY24 inched up to 4.25% from c.4.0%. Management expects annual revaluation losses of overseas assets to raise leverage by c.100bps which amounts to a c.2.5% decline in NAV, by our estimates.

Maintain HOLD

We lower our TP to SGD1.15 factoring in a higher riskfree rate. While SUN's valuation (6.9% FY23E div. yield, 0.5x P/B) is attractive in a historical context, downside risk remains from elevated gearing, potentially lower asset values and continued repricing of interest costs.

FYE Dec (SGD m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	358	427	455	467	482
Net property income	255	316	318	329	335
Core net profit	174	265	158	173	177
Core EPU (cts)	6.1	9.3	5.5	5.9	6.0
Core EPU growth (%)	28.9	50.9	(40.8)	7.8	1.1
DPU (cts)	8.7	8.9	7.0	7.0	7.3
DPU growth (%)	48.8	2.4	(20.9)	(1.0)	5.6
P/NTA (x)	0.7	0.6	0.5	0.5	0.5
DPU yield (%)	5.7	6.4	6.3	6.2	6.6
ROAA (%)	1.5	2.3	1.3	1.5	1.5
Debt/Assets (x)	0.42	0.41	0.42	0.42	0.42
Consensus DPU	-	-	7.0	7.1	7.5
MIBG vs. Consensus (%)	-	-	0.4	(2.2)	(1.4)

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Company Description

SUN is a real estate investment trust that invests in income-producing properties used primarily for office and retail.

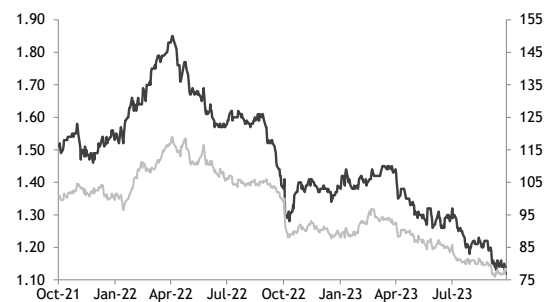
Statistics

52w high/low (SGD)	1.45/1.12
3m avg turnover (USDm)	4.7
Free float (%)	73.0
Issued shares (m)	2,825
Market capitalisation	SGD3.2B
	USD2.3B

Major shareholders:

TANG GORDON	9.1%
CHEN HUAI DAN	7.6%
YANG CHAN ZHEN	6.8%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(8)	(13)	(21)
Relative to index (%)	(3)	(8)	(23)

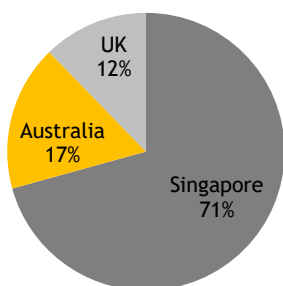
Source: FactSet

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 Tear Sheet Insert

Value Proposition

- Owns a portfolio of office and retail properties in Singapore and Australia valued at SGD12.1b, with its most prominent asset being Suntec City, comprising four office towers, a mall and a convention centre.
- Sponsor ESR manages a SGD140b AUM across 14 REITs, private funds and logistics assets, and is the largest REIT manager in APAC with USD45b in total AUM.
- Gearing at c.43% is high relative to peers, with acquisitions likely to be timed with divestments and/or an EFR, given strong share price appreciation.

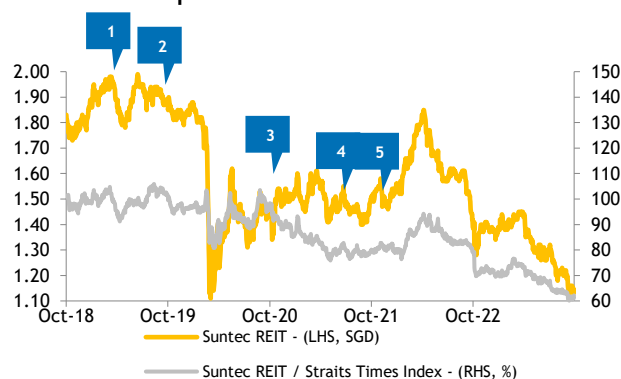
AUM breakdown



Source: Company

Price Drivers

Historical share price trend



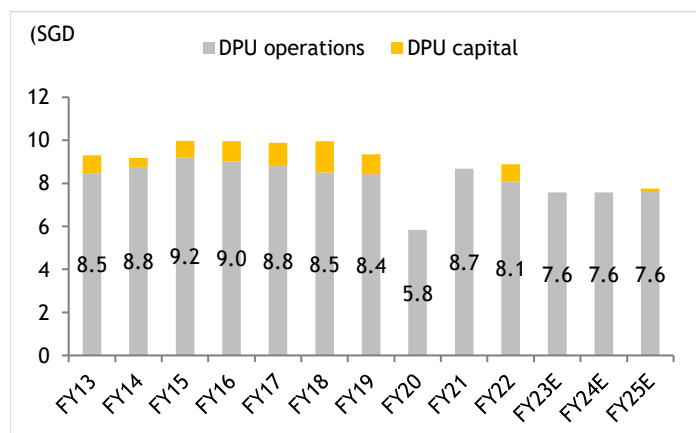
Source: Company, Maybank IBG Research

- Apr-19: Raises SGD200.0m in gross proceeds from private placement for potential Australian acquisition.
- Jul-19: Acquires two Australian properties - 21 Harris in Sydney for AUD297.0m at 5.5% NPI yield, and 55 Currie in Adelaide for AUD148.3m at 8.0% NPI yield.
- Oct-20: Acquires first London property - a 50% interest in Nova development for GBP430.6m at 4.6% NPI yield at a +4.6% DPU accretion (fully debt-funded).
- Jun-21: Divests 9 Penang Road for SGD295.5m achieving 305% Rol
- Jun-21: Divests Suntec office strata units at 3.1% yield and acquires Minster Building in London for GBP353.0m at 4.5% yield.

Financial Metrics

- DPUs rebounding from FY21 with the completions and contributions from acquisitions and reopening.
- Suntec City mall occupancy to trend toward 95%, with +7% rent reversion for the retail business in 2023.
- Office vacancies may rise and rent reversion moderate on back of tech rightsizing and ample shadow space. DPU may be impacted by higher borrowing cost and absence of capital tops ups.

DPU Profile



Source: Company, Maybank IBG Research

Swing Factors

Upside

- Earlier-than-expected pick-up in leasing demand for office or retail 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 office and retail 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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Risk Rating & Score ¹	13 (Low)
Score Momentum ²	+1.0
Last Updated	02 Dec 2022
Controversy Score ³ (Updated: 02 Dec 2022)	0

Business Model & Industry Issues

- SUN draws on its available pool of funds to invest in commercial real estate, undertake asset enhancements, and redevelop properties to optimise value for its unit holders. It is susceptible to sustainability-focused investors with strong preference for investing in companies that meet specific ESG criteria, given its incessant need for additional capital.
- Its activities relating to permissible investments, leverage limits and annual reporting requirements are closely regulated by the MAS under Singapore's code on collective investment schemes. Independence, real estate and capital markets experience on its board is high, with strong representation by members with international experience, essential in our view, as its overseas portfolio is increasingly a growth platform.
- Has made efforts to improve the scope of reporting and formalisation of targets since its inaugural sustainability report in FY17, including engaging an independent external consultant in FY19 to help determine and finalise material ESG matters presented to and then approved by the board.
- Achieved the Global Real Estate Sustainability Benchmark's highest 5-star rating in its inaugural participation in FY20

Material E issues

- Four Singapore properties maintained their BCA Green Mark certifications in FY21; Suntec City Mall and Suntec Singapore both rated Gold, and ORQ and MBFC Platinum. Its Australian assets improved/maintained their environmental and energy ratings certifications.
- Had in FY21 adopted the market-based approach to account for Scope 2 emissions, to better articulate the impact of renewable energy consumption on its carbon emissions.
- The use of carbon credits to offset emissions due to energy consumption at the common areas was implemented at 177 Pacific Highway and 477 Collins in FY21.
- Maintained an explicit 2024 target to reduce energy intensity by 3.0% and to maintain water intensity, both from a 2019 baseline.
- Secured maiden AUD450m green loan facility in FY20 to finance or refinance eligible assets based on a green finance framework.

Material S issues

- Achieved average training per employee of 32 hours in FY21 (vs 55/35/36 hours in FY18/FY19/FY20), and ahead of its target of 26 hours, despite unavailability of large-scale in-person trainings during the pandemic.
- Gender diversity is high, with female representation at 70% for all employees in FY21 (vs 74%/65% in FY19/FY20), 60% at the management level (in FY19-21), and the Chairman's seat on the board.
- Set up end-of-trip facilities at 177 Pacific Highway to provide amenities for cyclists travelling to work.
- Suntec City has (since FY16) supported The Purple Parade, Singapore's largest movement for inclusion and people with disabilities.

Key G metrics and issues

- Externally managed by subsidiaries of ARA, since late 2021 a part of the ESR group, which supports its growth via a pipeline of property assets from its development activities, and access to capital markets.
- Board independence is fairly high - 4 of its 8 members are independent.
- Management fee structure, with the base fee at $\leq 0.3\%$ of its deposited property, performance fee at 4.5% pa of NPI, as well as acquisition and disposal fee at 1.0% and 0.5% deal value, is comparable to peers.
- Does not disclose the cumulative remuneration of its key management team including the CEO.
- Payout ratio for taxable income has been consistently maintained at above the minimum 90% threshold for tax transparency.
- Has scaled up via DPU-accretive acquisitions from its sponsor's pipeline. The deal process is rigorous; involving a review by the board's audit committee, and if valued $>5\%$ of NAV, unit holders' approval at an EGM.
- The Suntec City AEI at SGD410m over four phases from 2012-15 resulted in a 14% increase in NLA and SGD848m or 18% increase in valuation at end-2016.
- Diversified into the UK, a new geography, in FY20 with the acquisition of Nova properties, a quality well-sited asset at a favourable valuation of 4.6% NPI yield versus comparable yields of 4.0-4.2%, based on recent market transactions.
- Ranked 38 out of 44 S-REITs in the independent 2021 Governance Index For Trusts Index, with lower governance and business risks scores versus peers.
- Leverage averaged c.37% from FY06-21, but has risen to c.43% after the Nova acquisition, which is the highest among peers.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

1. Results summary

Fig 1:3QFY23 Result Highlights (SGDm.)

	3Q22	2Q23	3Q23	3Q23, %QoQ	3Q23, % YoY	9M22	9M23	9M23, %YoY
Gross revenue	107.3	115.6	123.4	6.7	15.0	310.8	347.7	11.9
Property expenses	(30.2)	(38.6)	(38.8)	0.5	28.5	-80.8	-109.8	35.9
NPI	77.1	77.0	84.6	9.9	9.7	230.0	237.9	3.4
JV income	29.9	23.4	23.8	1.7	-20.4	91.2	70.0	-23.2
Distributable income from ops	54.2	44.5	46.2	3.8	-14.8	180.8	135.2	-25.2
Distributable income from capital	5.8	5.7	5.8	1.8		17.3	17.3	
Total distributable income	60.0	50.2	52.0	3.6	-13.3	198.1	152.5	-23.0
DPU (SGD cts)	2.084	1.739	1.793	3.1	-14.0	6.894	5.269	-23.6
NAV per unit (SGD)	2.10	2.12	2.09	-1.4	-0.3	2.10	2.09	-0.3
Aggregate leverage (%)	43.1	42.6	42.7	0.1	-0.9	43.10	42.7	-0.4
All-in financing cost (%)	2.76	3.64	3.78	0.14	37.0	2.76	3.78	1.0
SG Office occupancy (%)	99.4	99.3	99.5	0.2	0.1	99.4	99.5	0.1
AU Office occupancy (%)	95.2	96.6	95.4	-1.2	0.2	95.2	95.4	0.2
SG Retail occupancy (%)	96.5	98.2	98.6	0.4	2.2	96.5	98.6	2.1
NPI margin (%)	71.9	66.6	68.6	1.9	-4.6	74.0	68.4	-5.6
SG Office rent reversion (%)	5.9	10.3	14.0	3.7	137.3	5.7	12.2	6.5
Suntec City rent reversion (%)	5.6	18.2	25.3	7.1	351.8	3.6	20.2	16.6

Source: Maybank IBG Research, Company Data

Fig 2:3QFY23 Result Details

	3Q22	2Q23	3Q23	3Q23, %QoQ	3Q23, % YoY	9M22	9M23	9M23, %YoY
Gross revenue, SGDm.								
Singapore office	34.0	35.8	36.5	2.0	7.4	102.7	108.3	5.5
Australia Portfolio	24.3	24.3	23.7	-2.5	-2.5	73.4	71.9	-2.0
UK Portfolio	6.0	8.0	7.4	-7.5	23.3	18.7	21.8	16.6
Singapore retail	31.1	32.4	33.5	3.4	7.7	96.3	99.2	3.0
Suntec Convention	11.9	15.0	22.3	48.7	87.4	40.0	46.5	16.3
NPI, SGDm.								
Singapore office	27.1	26.3	27.5	4.6	1.5	81.8	81.1	-0.9
Australia Portfolio	19.3	18.5	17.8	-3.8	-7.8	57.7	55.4	-4.0
UK Portfolio	5.6	7.7	6.7	-13.0	19.6	17.5	20.5	17.1
Singapore retail	22.3	21.9	24.7	12.8	10.8	71.7	69.9	-2.5
Suntec Convention	2.8	2.6	7.8	200.0	178.6	11.2	10.9	-2.7
JV Income, SGDm.								
Singapore office	19.3	15.2	15.5	2.0	-19.7	56.5	45.8	-18.9
Australia Portfolio	2.1	0.8	0.0	-100.0	-100.0	7.9	2.7	-65.8
UK Portfolio	7.9	6.9	7.8	13.0	-1.3	21.0	20.1	-4.3
Singapore retail	0.6	0.5	0.5	0.0	-16.7	1.9	1.4	-26.3
NPI margins, %								
Singapore office	79.7	73.5	75.3	1.9	-5.5	79.6	74.9	-4.8
Australia Portfolio	79.4	76.1	75.1	-1.0	-5.4	78.6	77.1	-1.6
UK Portfolio	93.3	96.3	90.5	-5.7	-3.0	93.6	94.0	0.5
Singapore retail	71.7	67.6	73.7	6.1	2.8	74.5	70.5	-4.0
Suntec Convention	23.5	17.3	35.0	17.6	48.7	28.0	23.4	-4.6

Source: Maybank IBG Research, Company Data

2. Estimate changes

Fig 3: Estimate changes (SGDm.)

	FY23E (old)	FY24E (old)	FY23E (New)	FY24E (New)	FY23E (%) change)	FY24E (%) change)
Revenue	444.1	459.4	455.4	467.1	2.6	1.7
NPI	303.8	323.0	318.0	328.8	4.7	1.8
JV income	88.3	109.3	78.8	104.1	-10.8	-4.7
Interest expenses	-169.9	-176.8	-174.2	-181.0	2.5	2.4
Distribution	199.8	208.6	204.3	204.5	2.2	-2.0
DPU (SGD cents)	6.87	7.10	7.03	6.96	2.3	-2.0

Source: Maybank IBG Research

We raise FY23 DPU by 2.3% and lower FY24 DPU by 2%. Reason for increase in FY23 DPU are: factoring higher contribution from Suntec Convention Centre and Suntec Retail mall. These are partially offset by higher interest cost at the group and JV level. FY24 has similar trends but higher interest cost outweighs the impact of top-line revenue growth.

3. Valuation

We value SUN using a 3-stage dividend discount model with a risk free rate of 3.3% and CoE of 7.7%. This is higher than our prior inputs of 2.8% and 7.2%, respectively. Coupled with changes in DPU forecasts, the higher discount rate results in a lower PT of SGD1.15 from SGD1.30.

4. Risks

Non-renewal of office leases, slowdown in retail sales, lower asset values, higher rates.

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
Price/DPU(x)	17.4	15.5	15.9	16.1	15.2
P/BV (x)	0.7	0.6	0.5	0.5	0.5
P/NTA (x)	0.7	0.6	0.5	0.5	0.5
DPU yield (%)	5.7	6.4	6.3	6.2	6.6
FCF yield (%)	6.3	8.8	8.6	9.7	9.4
INCOME STATEMENT (SGD m)					
Revenue	358.1	427.3	455.4	467.1	481.7
Net property income	254.6	315.8	318.0	328.8	334.7
Management and trustee fees	(64.1)	(67.1)	(69.8)	(71.0)	(71.4)
Net financing costs	(127.5)	(151.4)	(174.2)	(181.0)	(182.8)
Associates & JV	102.9	144.9	92.8	104.1	104.3
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income/expenses	0.0	0.0	0.0	0.0	0.0
Pretax profit	199.1	281.2	188.3	202.6	206.5
Income tax	(25.0)	(16.2)	(30.0)	(30.0)	(30.0)
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	174.0	265.0	158.3	172.6	176.5
Core net profit	174.0	265.0	158.3	172.6	176.5
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	268.3	269.6	233.4	179.5	113.4
Accounts receivable	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	1.3	0.0	0.0	0.0	0.0
Investment properties	7,913.1	7,906.8	7,906.8	7,906.8	7,906.8
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	3,444.8	3,424.1	3,424.1	3,424.1	3,423.1
Other assets	61.1	110.0	189.3	187.4	188.3
Total assets	11,688.7	11,710.5	11,753.6	11,697.8	11,631.7
ST interest bearing debt	499.8	645.6	645.6	604.4	563.1
Accounts payable	105.1	128.7	116.9	122.8	119.8
LT interest bearing debt	4,419.2	4,197.9	4,281.8	4,282.5	4,295.9
Other liabilities	165.8	154.2	154.2	154.2	153.2
Total Liabilities	5,189.9	5,126.3	5,198.4	5,163.8	5,132.0
Shareholders Equity	6,399.9	6,464.4	6,435.3	6,413.9	6,379.4
Minority Interest	98.9	119.7	119.7	119.7	119.7
Total shareholder equity	6,498.8	6,584.1	6,555.0	6,533.6	6,499.1
Total liabilities and equity	11,688.7	11,710.4	11,753.4	11,697.4	11,631.1
CASH FLOW (SGD m)					
Cash flow from operations	272.1	349.7	277.7	318.1	312.2
Capex	(0.5)	(0.2)	(0.2)	(0.2)	(0.2)
Acquisitions & investments	(82.2)	140.0	(23.5)	0.0	(5.0)
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	0.0	0.0	0.0	0.0	0.0
CF from investing activities	(82.7)	139.8	(23.7)	(0.2)	(5.2)
Dividends paid	(246.0)	(263.4)	(253.4)	(204.4)	(216.5)
Interest expense	(116.2)	(133.1)	(174.2)	(181.0)	(182.8)
Change in debt	257.0	26.9	83.9	(40.5)	(27.9)
Equity raised / (purchased)	0.0	0.0	31.9	32.4	32.5
Other financial activities	(11.7)	(250.5)	21.6	21.6	21.6
CF from financing activities	(116.9)	(620.1)	(290.2)	(371.8)	(373.0)
Effect of exchange rate changes	(3.3)	(14.1)	0.0	0.0	0.0
Net cash flow	69.2	(144.7)	(36.2)	(53.9)	(66.1)

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth ratios (%)					
Revenue growth	13.5	19.3	6.6	2.6	3.1
Net property income growth	27.4	24.0	0.7	3.4	1.8
Core net profit growth	30.1	52.3	(40.3)	9.0	2.3
Distributable income growth	na	na	na	na	na
Profitability ratios (%)					
Net property income margin	71.1	73.9	69.8	70.4	69.5
Core net profit margin	48.6	62.0	34.8	36.9	36.6
Payout ratio	141.6	96.0	128.3	117.9	123.1
DuPont analysis					
Total return margin (%)	48.6	62.0	34.8	36.9	36.6
Gross revenue/Assets (x)	0.0	0.0	0.0	0.0	0.0
Assets/Equity (x)	1.8	1.8	1.8	1.8	1.8
ROAE (%)	na	na	na	na	na
ROAA (%)	1.5	2.3	1.3	1.5	1.5
Leverage & Expense Analysis					
Asset/Liability (x)	2.3	2.3	2.3	2.3	2.3
Net gearing (%) (excl. perps)	71.6	69.5	71.6	72.0	73.0
Net interest cover (x)	1.8	1.9	1.5	1.5	1.6
Debt/EBITDA (x)	nm	16.8	18.3	17.5	17.1
Capex/revenue (%)	0.1	0.0	0.0	0.0	0.0
Net debt/ (net cash)	4,650.7	4,573.9	4,694.0	4,707.4	4,745.6
Debt/Assets (x)	0.42	0.41	0.42	0.42	0.42

Source: Company; Maybank IBG Research

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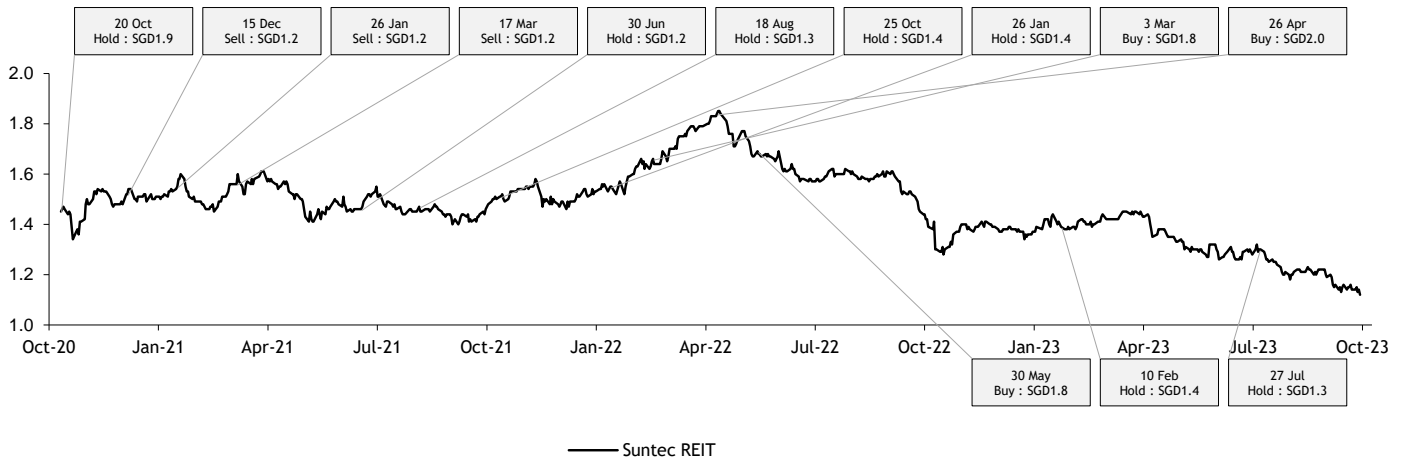
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