Asia Credit

Earnings Review: Suntec REIT ("SUN")

Recommendation

- Sustained retail improvements have mitigated transitional weakness at the Suntec City office. Performance to improve given high committed occupancy and rising office lease rates.
- Balance 25% stake in Southgate, Melbourne to be acquired in 2Q2018 as per our expectations. Aggregate leverage to drift higher to pro-forma ~38% based on our estimates, but still manageable within our Issuer Profile Rating of Neutral (4).
- In general, we find the SUNSP curve to be relatively rich. The exception would be the SUNSP'23s, which trades +70bps above swaps. Even then, it only looks fair value versus the FCTSP'22s (Neutral (3) Issuer Profile) and SGREIT'23s (Neutral (4) Issuer Profile).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread
SUNSP 2.85% '23s	02/09/2023	36.6%	3.10%	68bps
SGREIT 3.4% '23s	26/05/2023	35.3%	3.18%	78bps
FCTSP 2.645% '22s	06/06/2022	29.2%	2.99%	67bps

Indicative prices as at 3 May 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter

Issuer Profile: Neutral (4)

Ticker: **SUNSP**

Background

Suntec REIT ("SUN") has a portfolio which includes "Suntec City" (Suntec City Mall, units in Towers 1–3, and whole of Towers 4 & 5), a 60.8%-interest in Suntec Singapore Convention & Exhibition Centre ("Suntec Singapore"), a one-third interest in One Raffles Quay ("ORQ"), and a one-third interest in Marina Bay Financial Centre Towers 1 & 2 and Marina Bay Link Mall ("MBFC"). For Australia, SUN holds 177 Pacific Highway, an interest in the Southgate as well as 477 Collins Street in Melbourne.

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Key Considerations

- **Improvements at retail and convention cover patchy office performance**: SUN reported 1Q2018 results. Gross revenue was up 2.6% y/y to SGD90.7mn while NPI was up 1.9% y/y to SGD63.0mn. In general, revenue contribution for SUN's office assets was soft (-3.8% y/y to SGD42.9mn), mitigated by better performance at retail (+3.7% y/y to SGD31.1mn) and convention (+21.0% y/y to SGD16.7mn). Specifically, Suntec City revenue fell 1.5% y/y to SGD58.4mn on lower office contribution, 177 Pacific Highway revenue fell 2.0% y/y to SGD10.5mn on the weaker AUD, while Suntec Singapore revenue increased 18.2% y/y to SGD21.9mn due to stronger convention flows. When considering SUN's off balance sheet assets, contributions from JV declined by 6.5% y/y to SGD22.7mn, largely due to the 22.3% y/y decline in contributions from ORQ -to SGD6.9mn (SUN described this as due to ORQ benefitting from certain one-off items in 1Q2017). Comparatively, contributions from MBFC (+2.2% y/y) and Southgate (+5.8% y/y) have held up.

- **Suntec City office issues look transitional**: It should be noted that despite the weakness seen in office during the quarter, office portfolio committed occupancy remains strong at 99.1% (4Q2017: 99.2%) while tenant retention ratio remains healthy at 88%. Management had indicated that some office spaces committed at Suntec City are commencing progressively. The timing of these tenants ramping up (during the rent free fitting out period) had driven the decline in Suntec City's office contribution. That being said, a bright spot would be SUN's average office rents being secured at SGD9.02 psf/mth, higher than the SGD8.50 psf/mth seen in 4Q2017, and reversing the downward trend seen the last couple of quarters. Outstanding expiring office leases are manageable at 9.0% of NLA for the balance of 2018 and 15.1% of NLA for 2019, particularly given the decline in Singapore new office supply these two years. Office WALE stands at 3.62 years (2017: 3.8 years). SUN's Australian assets look to be performing as well with 177 Pacific Highway reporting 100% committed occupancy, Southgate seeing committed occupancy improve to 92.5% (end-2017: 91.7%) and pre-commitments for 477 Collins Street increased to 45.8%.

- **Retail statistics indicate sustainable recovery**: For retail, committed occupancy eased q/q to 98.4% (4Q2017: 98.8%) though it could be due to seasonal factors, as y/y occupancy increased from 98.0%. Retail lease expiries look heavy at 21.1% of NLA for the balance of 2018. Retail WALE stands at 2.22 years (end-2017: 2.35 years). Operational statistics were strong for Suntec City

Mall though (the largest retail asset) with footfall up 12.7% y/y, while tenant sales were up 5.2% y/y. This built on the 7.3% y/y increase in footfall and 5.2% y/y increase in tenant sales seen in 1Q2017. Management had indicated that the strong showing was in part driven by higher footfall from the Promenade MRT station entrance.

- **Credit profile to worsen with additional Southgate acquisition**: Aggregate leverage remained relatively stable q/q at 36.6% (4Q2017: 36.4%). Reported interest coverage worsened slightly to 3.8x (4Q2017: 3.9x) as all-in financing costs had increased to 2.73% (4Q2017: 2.62%). It should also be noted that fixed / hedged debt had declined to ~65% of total debt (end-2017: ~75%). This could have been driven by the SGD400mn 5-year loan facility which SUN obtained end-March 2018. Given the new facility, short-term debt of SGD237.0mn (SGD105mn in bonds due November, balance in partial drawdown of SGD500mn loan facility) looks manageable. As noted previously (refer to OCBC Asian Credit Daily (28 Feb 2018)), SUN will be acquiring a further 25% stake in the Southgate, Melbourne (~SGD160mn consideration with completion expected in 2Q2018). Assuming that the acquisition is funded via additional borrowings, it could drive aggregate leverage higher to ~38%. The acquisition would bring SUN's stake in Southgate to 50% (with the balance held by a fund managed by SUN's sponsor).

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Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.