Singapore Industry Focus

Singapore Retail

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DBS Group Research . Equity

18 Feb 2021

Where to shop in Orchard?

- Although lagging, shopper metrics should narrow in the coming months from higher local spending
- LREIT is best leveraged to deliver stronger metrics given its higher concentration in retail segments with greater upside potential
- Prefer LREIT and SGREIT for their attractive implied retail valuation psf and lower earnings risks
- Top pick LREIT; prefer SGREIT to SPH REIT for Orchard Road recovery play

Picking the most fruitful "Orchard Road" play. The return of tourist arrivals this year remains a question mark for now, but we believe that domestic consumer trends may surprise in the near term. We note that Orchard malls' shopper traffic and tenant sales lag against the broader retail index where sales have narrowed to pre-COVID levels in December 2020 (-0.9% y-o-y). However, we believe that the trend will narrow driven by various festivities in 1Q21. We see greater upside potential for the F&B, luxury, health & beauty and IT & electronics trade sectors in declining order of preference. Among the Orchard Road-focused malls, LREIT remains our top pick, given that the REIT has the largest exposure to the above sectors and is best positioned to deliver stronger performance.

Implied valuation favours LREIT and SGREIT given lower earnings risks. We estimate a more attractive implied valuation psf for Lendlease REIT (LREIT) (c.S$3,800 psf) and Starhill Global REIT (SGREIT) (c.S$2,400 psf). While SGREIT's valuation appears to be low, it is justified by a shorter lease term remaining of c.45 years as opposed to its peers' 84-91 years. On the same note, recovery looks to be priced in at c.S$4,450 psf for Paragon mall. We cast an eye on the potential downside earnings from the potential non-renewal at Metro Department store in the coming few years, which accounts for c.9% to Paragon mall, in our estimates.

Maintain LREIT (TP S$0.90) as top pick; prefer SGREIT (TP S$0.55) over SPH REIT (TP S$0.80) for an Orchard recovery play. Valuations for our Orchard mall REITs remain undemanding and at a discount to sector average at 0.97x P/NAV and at a current yield premium of 30-80bps above the sector's. Forward yields of between 6.6% and 7.7% are projected based on the assumption that FY22 DPU lags behind FY19 levels despite other incremental contributors such as acquisitions (SPH REIT and LREIT) and upside from Starhill Gallery's reopening. We continue to like LREIT as our top pick on an attractive risk-to-reward perspective and prefer SGREIT over SPH REIT due to the former's discounted valuation (0.63x P/NAV at -2 SD levels) and higher income visibility from master and anchor leases.

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STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
SPH REIT	0.83	1,738	0.80	3.8	(21.7)	HOLD
Starhill Global REIT	0.51	847	0.55	11.8	(26.2)	HOLD
LendLease Global Commercial REIT	0.81	719	0.90	20.2	(11.5)	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 17 Feb 2021

Legend:
SPH REIT : SPH REIT
Starhill Global REIT : SGREIT
LendLease Global Commercial REIT : LREIT

Where are shoppers returning to in Orchard?

Footfall and tenant sales are still feeling the COVID fever. Dubbed as a shopping paradise, Orchard malls were the first few to be hit by the pandemic when the nation closed its borders, causing tourist footfall to trickle to a halt. Shopper footfall plunged to a low of 20% of normalised levels during the Circuit Breaker period. Almost one year in, the aftermath of a COVID fever still reverberates with the Orchard malls, albeit to a lesser extent, in terms of shopper traffic and tenant sales that are currently still hovering below pre-COVID levels.

Will tourists return in 2021? Tourists typically contribute c.20% of central Orchard malls' sales and their numbers remain primarily lacklustre. Broader optimism on the reopening of domestic borders have soured with recent developments. Countries with large domestic travel components such as Japan and Europe saw a sharp spike in COVID cases, prompting Singapore to temporarily suspend the reciprocal green lanes (RGL) with South Korea, Malaysia and Germany for three months. This latest suspension comes on the back of the suspension of RGL with Indonesia and Japan in December.

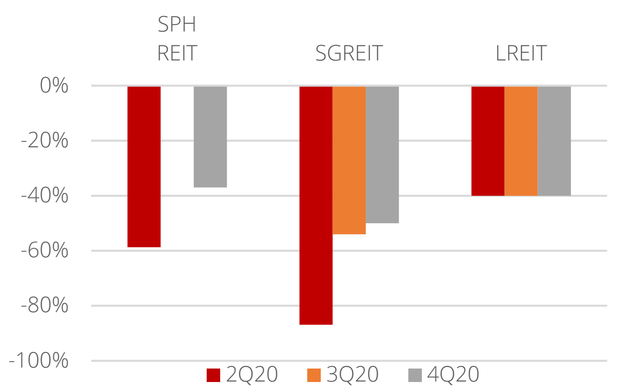
Corporate visitors likely to precede leisure travellers. Locally, Singapore started its vaccination programme in December 2020 and is aiming to inoculate the entire population by 3Q21. Should there be no further hiccups in the return of RGL arrangements and vaccination progress, the market expects MICE events to return in 2H21. These include the World Economic Forum which is scheduled to take place in Aug this year (albeit being postponed from May 2021). This will set the tone for future international MICE events to follow suit and benefit malls within the central precinct of Singapore, including our Orchard malls.

Greater upside for F&B, luxury, health & beauty and IT & electronics segments. While q-o-q normalisation had been on a steady rise, shopper traffic data reported in 4Q20 remained within a range of -50% to -37% of normalised levels, while tenant sales hovered within -25% to -33% of normalised levels.

We see greater upside potential relative to downside risks for trade sectors including food & beverage, luxury, health & beauty and IT & electronics, in descending order of preference. Trade sector data in the latest months shows that the F&B segment is seeing strong normalisation in this period of festivities as Singaporeans venture out to wine and dine. F&B retail sales growth improved from -23% y-o-y in November to -17% y-o-y in December. We see greater catalysts for F&B given the increased table capacity from five to eight people since the commencement of Phase 3 measures, which should support demand for group dining going into the Chinese New Year and hopefully, beyond. The luxury segment was also noticeably strong in comparison to other trade sectors, suggesting strong pent-up demand and increased retail appetite among the locals given the lack of travel ([Singapore Retail REITs: Defend and conquer]).

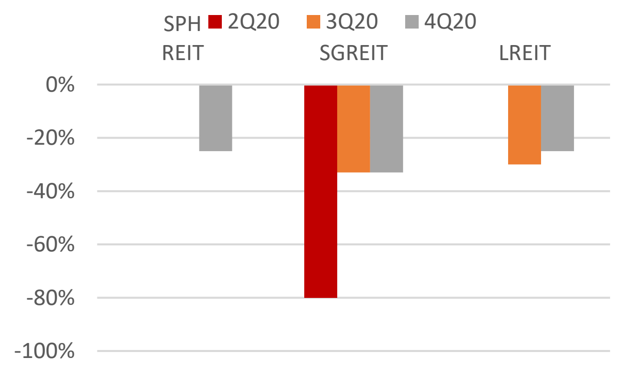
Based on tenant trade exposure and earnings buffer, we prefer LREIT and SGREIT to SPH REIT due to limited downside risks to SGREIT's 43% master lease exposure and LREIT's 39% exposure to the F&B segment.

Shopper traffic trend y-o-y (%)



Source: Manager (as at 30 September 2020)

Tenant sales trend y-o-y (%)



Source: Manager (as at 30 September 2020)

Trade mix exposure of Orchard malls Wisma Atria & Ngee Ann City (SGREIT), Paragon (SPH REIT) and 313@Somerset (LREIT)

Trade mix exposure	SGREIT	SPH REIT	LREIT	SG retail Nov (y-o-y)	SG retail Dec (y-o-y)	
Master Lease	43%	-	-	Flat	Flat	Toshin master lease at Ngee Ann City fixed with next rental review in 2022 and will add stability to the SGREIT's retail portfolio given the c.43% income contribution.
F&B	13%	12%	39%	-22.5%	-16.5%	Phase 3 post-Circuit Breaker measures to fuel demand for the F&B segment which currently lags the broader retail index, supported by big group gatherings for Chinese New Year.
Fashion, shoes & accessories	22%	10%	33%	-22.3%	-22.8%	Expect demand from a smaller subsector including (i) lounge wear, and (ii) recreational and sports-related apparels and shoes.
Luxury / Jewellery & watches	7%	34%	-	-8.6%	-10.2%	Appetite for 'big-ticket consumer goods' seems to be on an uptrend with travel restrictions, and before the onset of GST hike between 2022 and 2025.
Health & beauty	10%	14%	6%	-27.5%	-35.4%	Seasonal uplift to health & beauty segment from Chinese New Year demand.
Medical	-	19%	-			
Department store & supermarkets	-	9%	-	-24.5% department store +22.6% supermarkets	-28.7% department store +25.3% supermarkets	Going concern woes continue to plague traditional department stores with Metro being the latest to mull over a potential exit from the business.
IT & telecomms	-	-	5%	+29.0%	+24.8%	Demand from corporate-led upgrading and individual consumption from the "work from home" trend is likely to persist and grow at double-digit levels in 2021. Software demand will likely flow down to hardware demand alike.
General trade / Services / Others	5%	2%	16%	n.a.	n.a.	
Total retail contribution to portfolio	64%	79%	65%			

Source: DBS Bank, Companies

Earnings visibility and downside risks

Stability from Toshin master lease at Ngee Ann City and office / medical component at Paragon. Of the 255k sqft of retail space owned by SGREIT at Ngee Ann City, approximately 89% is master leased to Toshin. The Toshin master lease contributes c.43% of SGREIT's total retail exposure in Singapore and 22% of SGREIT's overall portfolio. The current master lease structure in place ensures stability to the REIT as the next rental review (every three years) will only be in mid-2022. This would allow SGREIT to sharpen its focus on Wisma Atria amidst the current headwinds and provide earnings stability to the REIT.

Paragon consists largely of retail NLA that contributes c.69% of the asset's total NLA, while the remaining non-retail NLA (comprising medical suites/offices at Paragon Medical) delivers relatively more stable earnings. The medical/office component at Paragon contributes c.19% of Paragon mall's and c.12% of SPH REIT's enlarged portfolio by gross rental income.

Potential exit of Paragon's anchor tenant – Metro. Metro announced that it is mulling over the potential closure of its existing two outlets in Singapore shortly after that of Robinsons (Singapore Retail S-REITs: Metro mulls exit from department store business). The trade sector had suffered one of the steepest drops in sales this year at -28.7% y-o-y (December 2020). One of its two outlets is at Paragon where it stands as the anchor tenant. We understand that there are several years left on the lease and the group might or might not extend those leases.

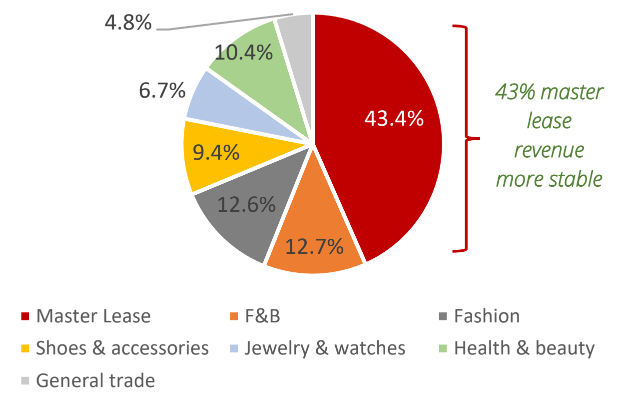
Metro is one of the top 10 tenants by GRI for SPH REIT as the department store contributes c.9% to the mall's gross rental income. Metro has been at the mall for many years and in our view, occupy a "cold corner" within the mall where there is less traffic. This might constitute downside risk to earnings should the tenancy not be renewed.

Repositioning amidst higher tenant turnover. Leasing momentum was robust for the period given the high tenant turnover and lower market rental rates. 313@Somerset saw the addition of several F&B and fashion tenants that complement the mall's current offerings. New tenants such as By Invite Only and Sunday Staples are up-and-coming local brands that have a strong omnichannel within the Singapore market, and earnings resilience by virtue of their high percentage of online revenue.

Sizing up against neighbouring giants. The excellent connectivity at Wisma Atria has been losing steam in terms of its high-end positioning in comparison to neighbours Ion Mall and Nge Ann City. Instead, SGREIT is looking to reposition Wisma Atria as a premier lifestyle mall, with a specific focus on strengthening its food & beverage offerings.

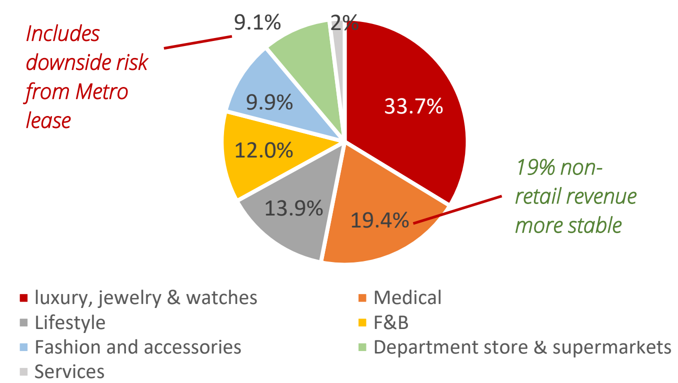
Hotpot giant HaiDiLao and beverage brand Yanmi Yoghurt are among the new tenants at Wisma Atria. We think that the mall will stand out better by focusing on mid-priced F&B tenants. This enables Wisma Atria to better differentiate itself against neighbouring malls which are all well-positioned within the luxury space.

Wisma Atria trade category exposure by GRI (%)



Source: DBS Bank, Companies

Paragon trade category exposure by GRI (%)



Source: DBS Bank, Companies

Operating Metrics and Implied Valuation

In good financial health. On a balance sheet perspective, all three REITs are at a comfortable gearing range of30-36%, despite downward pressure on retail valuations in 2020. In the latest round of revaluation, value appreciation of the Orchard malls was in the range of +0.5% (313@Somerset) to -4.6% (Wisma Atria) y-o-y.

SPH REIT has the highest acquisition potential. in terms of gearing and visible ROFR pipeline, we see the highest acquisition potential for SPH REIT, subjected to the capital-raising environment. SPH REIT may look to diversify exposure away from Paragon and acquire more resilient suburban retail assets such as Seletar Mall or the upcoming Woodleigh Mall. Woodleigh mall is positioned as a dominant retail mall within a mixed development project in the underserved Bidadari precinct. The mall is currently under construction and could come under consideration only five years later, i.e. after the first leasing cycle.

Implied valuation the highest for Paragon. The current share price performance of the three REITs implies a valuation of S$1,096m, S$1,482m and S$2,737m for 313@Somerset, Wisma Atria & Ngee Ann City and Paragon mall respectively. On a price psf basis, SPH REIT and SGREIT look to be at a discount by virtue of their office and medical NLA which we estimate to be valued lower at c.S$2,400 psf based on Orchard office rent rates in comparison to Orchard retail space.

Wisma Atria and Ngee Ann City have a shorter lease term of 40/51 years remaining in comparison to 313@Somerset (84 years) and Paragon (91 years). This was a factor that caused SGREIT to trade at a P/NAV discount relative to peers. Based on our calculations, retail price is estimated at S$2,382 psf and S$4,450 psf for SGREIT and SPH REIT respectively if we strip out the non-retail component. On a relative basis, SPH REIT's current trading level looks to be closer to the market value of the asset, with a faster pace of recovery priced in as compared to both LREIT and SGREIT.

Operating Metrics

Balance sheet metrics	LREIT	SGREIT	SPH REIT
Gearing (%)	35.5%	35.8%	30.5%
Average cost of debt (%)	1.80%*	3.28%	1.82%
% debt hedged on fixed rate	100%	92%	49%
debt duration (yrs)	3.1	2.3	2.7

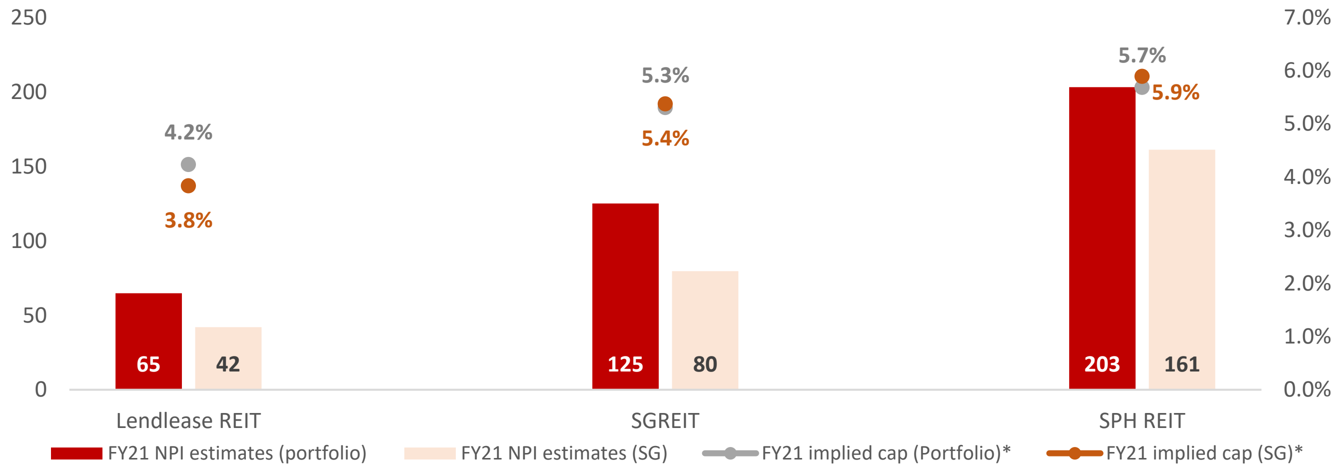
*Source: DBS Bank, Companies, *estimated*

Implied valuation of the Orchard malls based on current trading levels

	Lendlease REIT		SGREIT		SPH REIT	
Share price (S$)	0.81		0.52		0.82	
Market Cap (S$m)	985		1,139		2,277	
Debt (S$m)	545.3		1,221		1,299	
Enterprise Value (S$m)	1,531		2,360		3,576	
Less:						
Overseas	-434.6		-878		-839.2	
Implied valuation of Orchard malls (S$m)	1,096		1,482		2,737	
NLA (sqft)	288,277	313@Somerset	620,308	Wisma Atria + Ngee Ann City	717,847	Paragon retail + office + medical
Valuation (S$/sqft)	3,804		2,389		3,813	
Valuation - retail (S$/psf)	3,804		2,382		4,450	

Source: DBS Bank, Companies

Implied cap rate of the Orchard malls on current trading level



Source: DBS Bank, Companies
** Implied cap on an asset level which includes office components at Wisma Atria and Ngee Ann City and Medical / office component at Paragon mall*

Valuations

SGREIT is a laggard on three fronts – share price performance, P/NAV and dividend yield.

Share price performance. Since December 2019, Starhill Global REIT (-28%) has been lagging behind both SPH REIT (22%) and LREIT (17%) despite having almost half (49.5%) of its gross rents on a relatively stable basis, in comparison to SPH REIT (12.4% stable rents from medical / office leases) and LREIT (c.30.3% stable rents from Milan office asset Sky Complex) on a portfolio basis.

P/NAV. On a P/NAV basis, all three Orchard plays are trading below the sector average of 0.97x, and below book at 0.93x P/NAV for SPH REIT, 0.64x P/NAV for SGREIT and 0.91x P/NAV for LREIT. Both SGREIT and SPH REIT are trading within the range of -1 and -2 SD of historical range. We note that the comparably lower P/NAV for SGREIT factors in the shorter remaining lease term for Wisma Atria (40 years) and Ngee Ann City (51 years) in comparison to Paragon (91 years) and 313@Somerset (84 years).

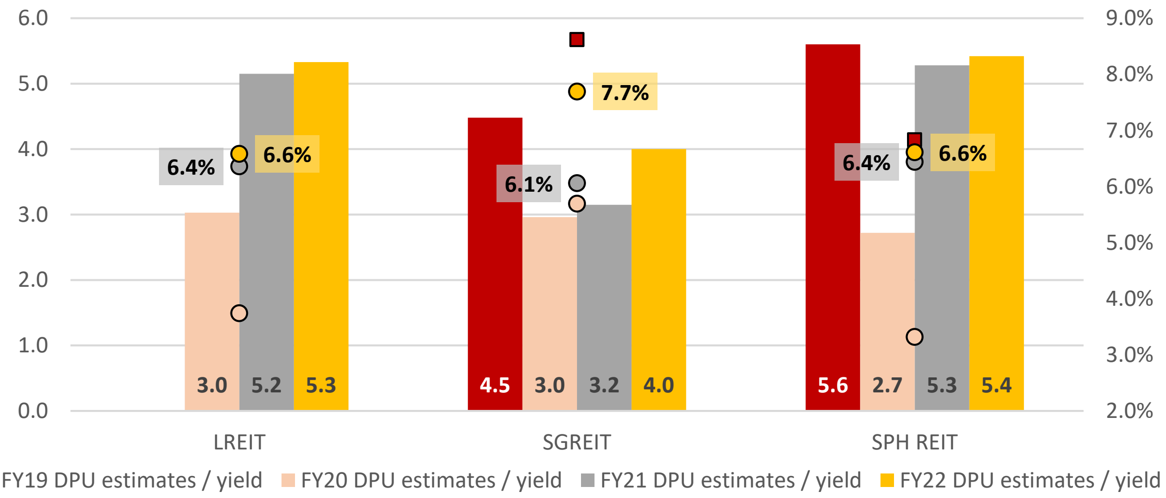
Dividend yield. On a yield perspective, we estimate SGREIT to deliver the highest FY22 forward yield at 7.7%, followed by LREIT (6.6%) and SPH REIT (6.6%). Our forward FY22 DPU estimates remain conservatively below FY19 levels on the assumption that tourist traffic will only normalise in FY24 or beyond. All three Orchard plays are trading at a current 30- to 80-bp yield premium to the sector average of 5.8%.

Top pick LREIT; prefer SGREIT over SPH REIT.
We remain overweight on LREIT as our top Orchard pick (TP S$0.90) and prefer SGREIT (TP S$0.55) over SPH REIT (S$0.80) for an Orchard recovery play.

LREIT is well-placed as our top Orchard pick given its (i) 39% exposure to the F&B sector where we see immediate upside to normalisation, (ii) future-positioned mall with a continuous effort to scale its omnichannel share a step ahead of SGREIT and SPH REIT, (iii) c.30% stable revenue contribution from office asset Sky Complex, and (iv) forward yield of c.6.6% that is attractive on a risk-to-reward perspective.

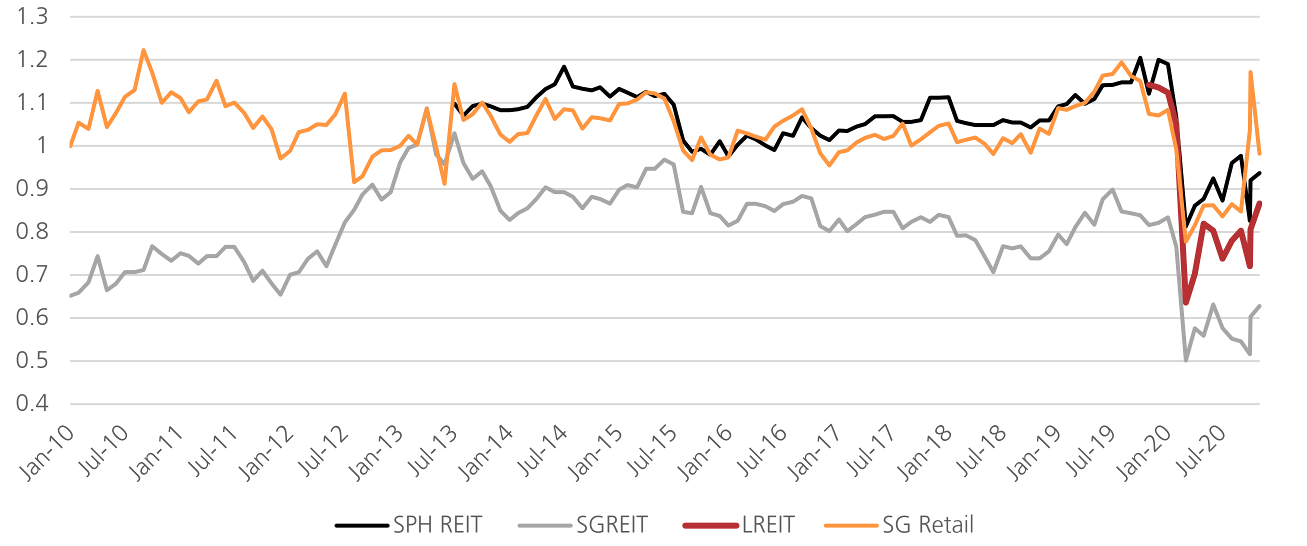
We expect near-term share price normalisation for SGREIT to trade closer to mean, supported by earnings visibility through a 50% revenue contribution from master lease and anchor leases.

Current and forward DPU estimates and yield at current levels



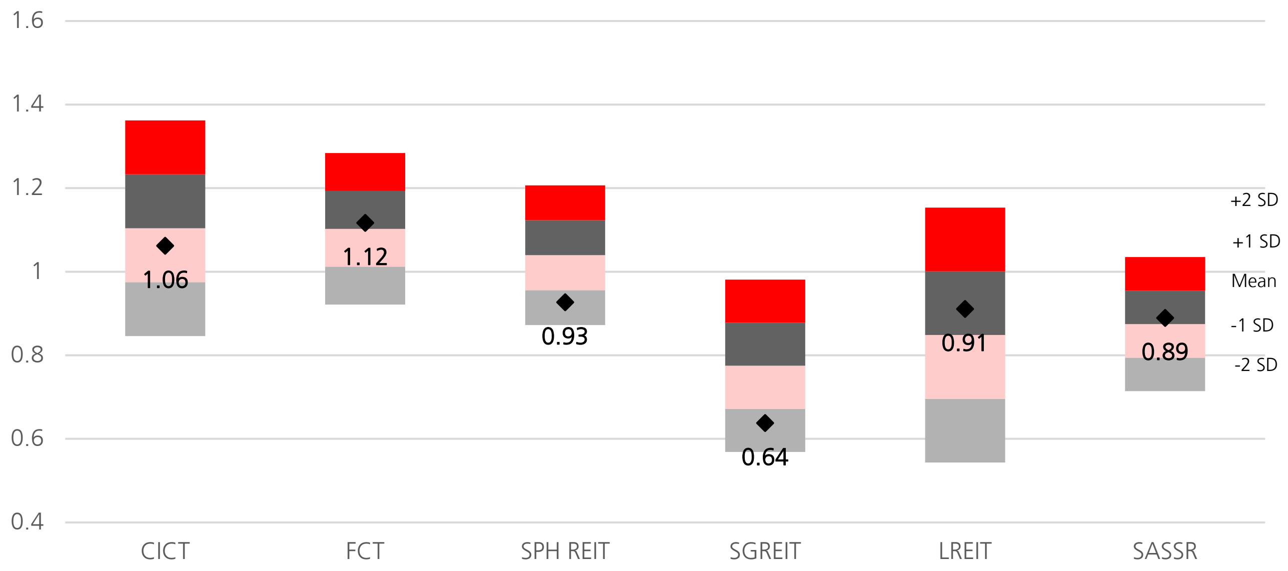
Source: DBS Bank

10-year historical P/NAV in comparison to the retail sector



Source: DBS Bank

5-year historical P/NAV trading band vs current P/NAV



Source: DBS Bank

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Share price appreciation + dividends

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