

Singapore Company Guide

CapitaLand Retail China Trust

Version 13 | Bloomberg: CRCT SP | Reuters: CRCT.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Feb 2018

BUY

Last Traded Price (31 Jan 2018): S\$1.69 (STI : 3,533.99)

Price Target 12-mth: S\$1.80 (6% upside and 6% yield) (Prev S\$1.75)

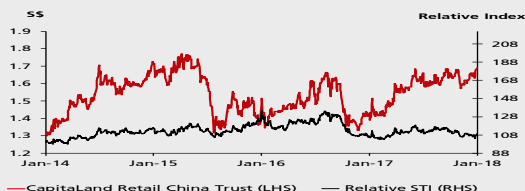
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What's New

- FY17 top line up 7% in SGD terms, as contribution from Xinnan offsets vacuum from Anzhen divestment
- FY17 DPU was 10.1 Scts, up 0.5% only as a result of larger unit base from share placement
- Raised TP to S\$1.80 after assuming more positive rental growth prospects for Rock Square; Maintain BUY

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2016A	2017A	2018F	2019F
Gross Revenue	214	229	261	277
Net Property Inc	140	149	167	180
Total Return	107	145	98.1	99.7
Distribution Inc	86.7	91.1	106	108
EPU (S cts)	7.64	11.2	10.0	9.97
EPU Gth (%)	(8)	47	(11)	(1)
DPU (S cts)	9.97	10.1	10.7	10.8
DPU Gth (%)	(6)	1	6	1
NAV per shr (S cts)	165	160	162	158
PE (X)	22.1	15.0	16.8	17.0
Distribution Yield (%)	5.9	6.0	6.3	6.4
P/NAV (x)	1.0	1.1	1.0	1.1
Aggregate Leverage (%)	35.1	28.0	35.6	35.9
ROAE (%)	4.5	6.9	6.2	6.2

Distn. Inc Chng (%):		1	1
Consensus DPU (S cts):		10.6	10.8
Other Broker Recs:	B: 4	S: 1	H: 2

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

On growth trajectory

Acquisition of Rock Square; good growth potential. After the divestment of CapitaMall Anzhen, CapitaLand Retail China Trust (CRCT) has acquired a much younger asset, Rock Square, in the first-tier city of Guangzhou. Although the initial yield is lower in comparison, we believe the asset has greater growth potential and is also an indication of CRCT embarking on a growth path.

Where we differ: Our TP is 6.5% higher than consensus as we believe new acquisitions have higher growth potential. We have priced in another acquisition of S\$250m to kick in from 2Q18 with 4.5% initial yield and 2.5% p.a. NPI growth. We have also booked rental reversion in the mid-10% for the new acquisition Rock Square for the next few years. As such, our revised TP of S\$1.80 is 6.5% higher than the consensus average.

Potential Catalyst: more acquisitions in the near term. CRCT's gearing is around 34% after the Rock Square acquisition. This translates into a debt headroom of over S\$550m, which provides flexibility for further acquisitions. We have booked in an additional S\$250m acquisition in FY18. We believe management's move to divest Anzhen and acquire Rock Square signals its shift in focus from stability from master leases to growth generated from more actively managed assets. More of such acquisitions would confirm such a move.

Valuation:

Raised DCF-based TP from S\$1.75 to S\$1.80 after assuming higher rental growth from Rock Square. DPUs in the next few years should grow steadily given the flexibility of distribution of disposal gains from Anzhen. Maintain BUY.

Key Risks to Our View:

A significant depreciation of the RMB versus SGD, and a downturn in Chinese consumption.

At A Glance

Issued Capital (m shrs)	966
Mkt. Cap (S\$m/US\$m)	1,633 / 1,245
Major Shareholders (%)	
CapitaLand Limited	24.1
CapitaMall Trust	12.7
Matthews Int'l Capital Management	5.6
Free Float (%)	57.6
3m Avg. Daily Val (US\$m)	1.5
ICB Industry : Financials / Real Estate Investment Trust	

WHAT'S NEW

4Q/FY17 DPU in line; higher contribution from Xinnan offset by larger unit base due to private placement to partially fund Rock Square

(-) Lower top line in 4Q17 due to divestment of Anzhen. In RMB terms, gross revenue in 4Q17 decreased by 3.9% or RMB10.6m y-o-y, mainly due to the divestment of CapitaMall Anzhen with effect from 1 July 2017, and lower revenue at CapitaMall Grand Canyon due to disruption to trading activities arising from an operational review by the authorities leading up to the 19th National Congress. This was partially offset by revenue growth from other multi-tenanted malls. In SGD terms, gross revenue for 4Q17 was down by 4.6% y-o-y to S\$54,107, while NPI declined 5.2% to S\$32,987.

(+) Higher full year revenue as contribution from Xinnan more than offset vacuum from Anzhen. For the full-year, gross revenue for FY17 in RMB terms increased by RMB 96.7m or 9.2%, mainly due to the contribution from CapitaMall Xinnan and rental growth from core multi-tenanted malls, and this had more than offset the lower revenue from CapitaMall Qibao, and CapitaMall Anzhen following its divestment in July 2017. In SGD terms, gross revenue increased 6.9% to S\$229.2m, and NPI increased 6.8% to S\$149.2m. The percentage of increase is lower than that in RMB terms due to stronger SGD against RMB.

(+) DPU up 0.5% y-o-y, in line. Distributable income for FY17 was 5.1% higher y-o-y after the inclusion of disposal gains from Anzhen. DPU for FY17 summed to 10.10 Scts (+0.5%) after adjusting for the private placement relating to the acquisition of Rock Square in November 2017. The full year DPU represents 100.1% of our forecasted DPU of 10.09 Scts, in line with our expectations.

Maintained high occupancy of 95.4%. All malls have occupancies above 98%, except Qibao (94.6% due to new competition nearby), MZLY (78.0%) and Wuhu (69.7%) – the latter two are still undergoing stabilisation after structural repositioning. The portfolio achieved positive rental reversion of 5.6% in FY2017, led by Xizhimen (7.7%), Wangjing (6.5%) and Saihan (10.2%). MZLY saw a positive reversion rate of 22.5% for 14% of its mall space renewed over the year. Growth in shopper traffic and tenant sales was 4.7% and 0.8% respectively.

(+) Gearing expected to move above 35%. The aggregate leverage has fallen to 28.4% as at end-Dec 2017, from 35.4% the previous quarter after the repayment of S\$175m term loan using proceeds from the divestment of Anzhen and the private placement to partially fund the acquisition of Rock

Square. Gearing is expected to go up to 34% after the loan portion of the funding of Rock Square acquisition is taken in full next quarter. Additionally, we expect gearing to go up further to 37% after our assumption of more acquisitions of S\$250m in FY18. Average cost of debt inched up slightly from 2.42% to 2.48% over the quarter. CRCT has completed all its refinancing in 2017, with no refinancing requirements until 2019.

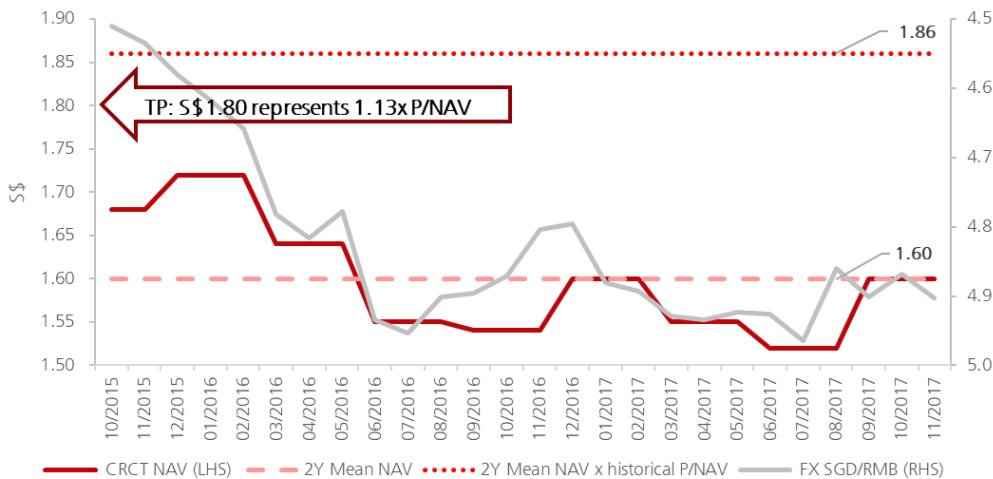
OUR VIEW

(-) Trimmed FY18F DPU as we book in contribution of Rock Square and other acquisitions only from 2Q18 (vs full year previously). We have trimmed our FY18F DPU after assuming contribution from Rock Square and new acquisitions only from 2Q18, as opposed to previously assuming full year contribution in FY18. The revised FY18F DPU represents a y-o-y DPU growth of 5.9%. The actual timing of new acquisitions is uncertain but we believe CRCT will manage the distribution to achieve DPU at around this level as it has the flexibility to distribute its gains from the disposal of Anzhen – it has about S\$28m available after making a S\$3.7m distribution in 4Q17.

(+) Increased TP to S\$1.80 to account for more positive view on rental growth of Rock Square. Even though Rock Square was only acquired at an initial NPI yield of 4%, management is confident about its rental growth in the near future because 1) more than 50% of the gross rental income of the mall is due to be renewed in the next three years, and 2) the passing rent is below market peers. Based on the management's confidence of double-digit rental reversion at Rock Square, we lifted our rental growth assumptions at the property. As a result, TP is raised from S\$1.75 to S\$1.80. We believe the acquisition strategy going forward is to continue to buy assets with greater growth potential, even if not immediately yield accretive. Maintain BUY.

CRCT deserves to trade at a higher premium to NAV. From a valuation perspective, CRCT has historically traded at an average of more than 10% premium to its net asset value (NAV). We noticed that the exchange rate of SGD/RMB has stabilised in the last two years. As a cross-check, applying the historical mean P/NAV multiple of 1.16x to CRCT's historical 2-year mean NAV of S\$1.60, we would derive a potential price of S\$1.86 (chart on the next page). Hence, we believe our TP of S\$1.80 is achievable.

Chart: CRCT's Price should trade at a higher premium to NAV



Source: Thomas Reuters, Corporate, DBS Bank

Quarterly / Interim Income Statement (\$m)

FY Dec	4Q2016	3Q2017	4Q2017	% chg yoy	% chg qoq
Gross revenue	56.7	56.0	54.1	(4.6)	(3.4)
Property expenses	(21.9)	(20.0)	(21.1)	(3.6)	5.4
Net Property Income	34.8	36.0	33.0	(5.2)	(8.2)
Other Operating expenses	(4.0)	(3.2)	(4.0)	1.5	25.9
Other Non Opg (Exp)/Inc	(0.4)	1.24	(1.4)	(231.6)	N/A
Net Interest (Exp)/Inc	(5.2)	(5.2)	(4.5)	14.0	13.3
Exceptional Gain/(Loss)	0.0	52.2	0.0	-	-
Net Income	25.2	81.1	23.1	(8.2)	(71.5)
Tax	(15.6)	(24.9)	(15.9)	1.9	(36.1)
Minority Interest	1.52	0.0	0.48	(68.6)	-
Net Income after Tax	11.1	56.2	7.70	(30.7)	(86.3)
Total Return	34.0	56.2	36.1	6.3	(35.7)
Non-tax deductible Items	(13.3)	(34.8)	(17.8)	33.3	(48.9)
Net Inc available for Dist.	20.6	21.4	18.3	(11.1)	(14.4)
Ratio (%)					
Net Prop Inc Margin	61.3	64.2	61.0		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Price driven by both Singapore and China markets. CRCT's share price movements are reflected in both the S-REIT Index and the Shanghai Composite Index. In 2H2011 (Chart 1), CRCT shares were sold off – together with S-REIT Index and Shanghai Composite – amid the Eurozone crisis (event 1). Its share price soon recovered along with the S-REIT despite the Shanghai Composite recovering at a much later stage. A similar pattern was seen during the taper tantrum (event 2) and fears over China's slowdown (event 3); during the latter event, the degree of sell-off in CRCT was between that of S-REIT Index and Shanghai Composite. In short, CRCT's share price has been impacted by macro events and performance in both markets and these should be monitored simultaneously.

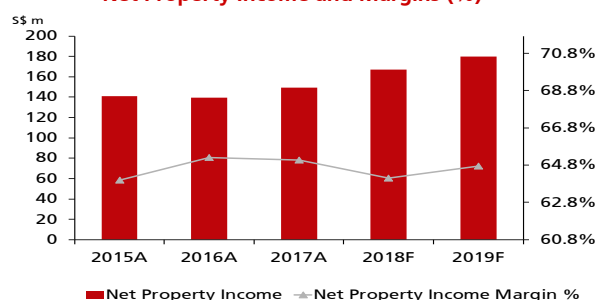
REIT-specific factor: sensitive to policy, pay attention to Beijing.

CRCT's share price is sensitive to changes in property-related policies in China. These policies differ from city to city – close attention should be paid to Beijing as c.75% of the portfolio's NPI is derived from properties in Beijing. For example, during 2H2016, the sell-off in CRCT was caused by the change in property tax in Beijing (event 4, Chart 1)

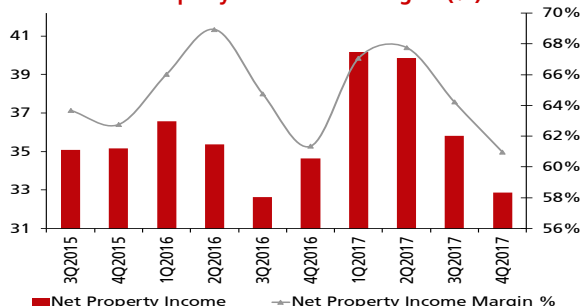
Deserves to trade at premium to NAV. The historical mean multiple for CRCT's P/NAV was 1.16x. We believe the premium is justified as the potential of several malls in the portfolio are yet to be maximised, including Grand Canyon, Minzhongleyuan, and Xinnan. Also, as observed in the four incidents when CRCT was sold off (Chart 1), a sharp recovery usually followed when the P/NAV fell to around 0.80x. The recent divestment of CapitaMall Anzhen at 13% premium over its latest valuation again demonstrated that CRCT deserves to trade at a premium to its NAV. Based on the two-year average NAV of S\$1.60, the stock is currently trading at P/NAV of 1.05x vs the historical mean of 1.16x.

DPU growth in tandem with China retail sales and has a long-term correlation coefficient of 0.69 (Chart 2). The short-term relationship, however, has been disrupted by forex fluctuations as China's retail data is reported in CNY whereas CRCT's DPU is distributed in SGD. We believe China's retail sales data is a good leading indicator of DPU growth.

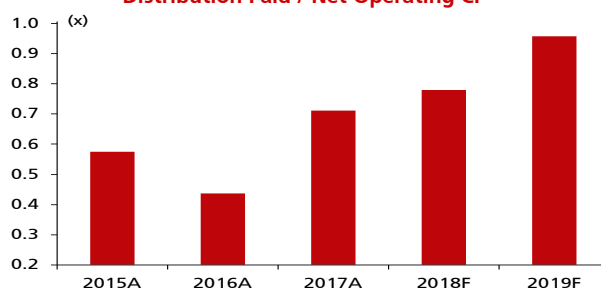
Net Property Income and Margins (%)



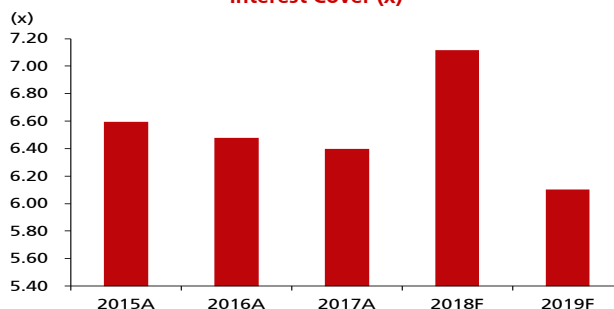
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Appendix 1: Critical Factors to CRCT's price movements

Chart 1: Both Singapore and China markets need to be monitored

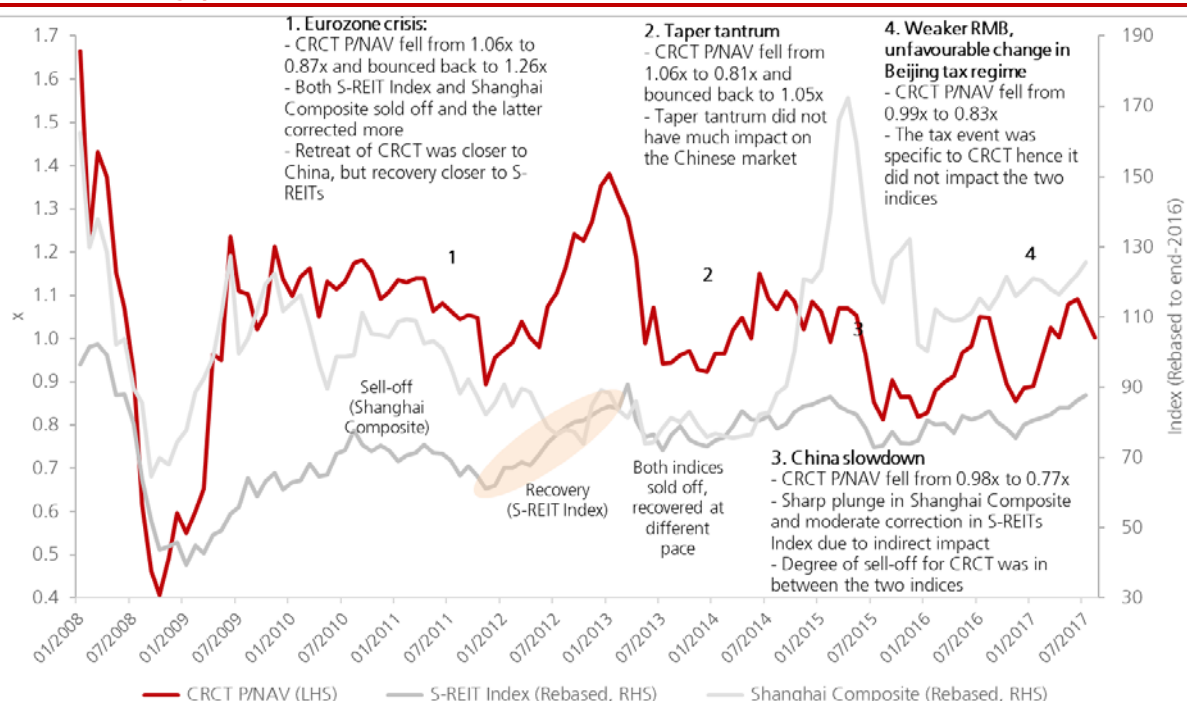
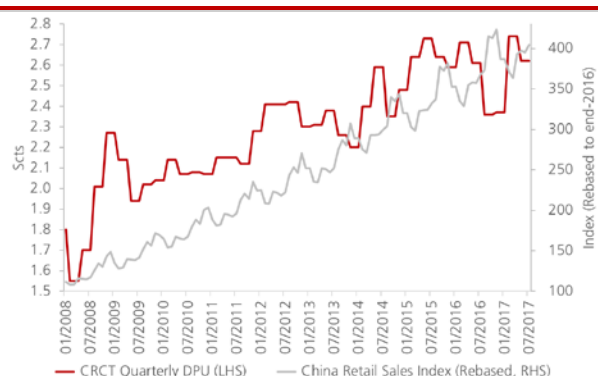


Chart 2: CRCT's DPU vs China Retail Sales



Remarks

- Generally, DPU growth is in tandem with China Retail Sales data
- Short-term relationship could be disrupted due to forex fluctuations as China retail sales data is reported in CNY whereas CRCT's DPU is distributed in SGD
- Long-term correlation coefficient is 0.69

Chart 3: CRCT's P/NAV vs Rental Reversion Rates



Remarks

- CRCT's P/NAV is somewhat correlated to rental reversion rate
- This was especially so during periods of sharp correction or recovery
- Short-term NAV could be volatile due to forex fluctuations
- Long-term correlation coefficient is 0.47

Source: Corporate, SGX, Thomas Reuters, Bloomberg Finance L.P., DBS Bank

Balance Sheet:

Aggregate leverage is low. Aggregate leverage after drawing the debt funding for Rock Square will be around 35% - a very comfortable level below MAS' 45% gearing limit. This provides CRCT with debt headroom of over S\$550m for acquisitions.

Share Price Drivers:

Acquisitions. With adequate debt headroom and the signal of a shift in focus to more actively managed assets – from the divestment of CapitaLand Anzhen to the acquisition of Rock Square – we believe more acquisitions are on the Manager's radar in the near term.

Positive rental revisions. Despite the concerns over China's economic outlook weighing on CRCT, we believe delivery of positive rental reversions and DPU growth should allay such concerns. Furthermore, high positive rental reversions from Rock Square should reassure market CRCT's strategy in investing in growth-oriented assets.

Key Risks:

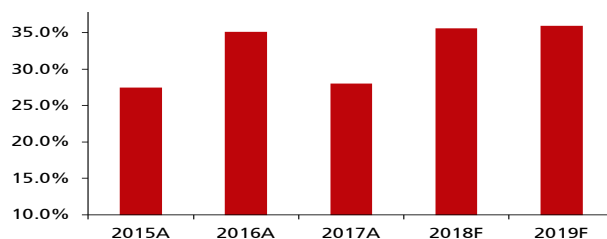
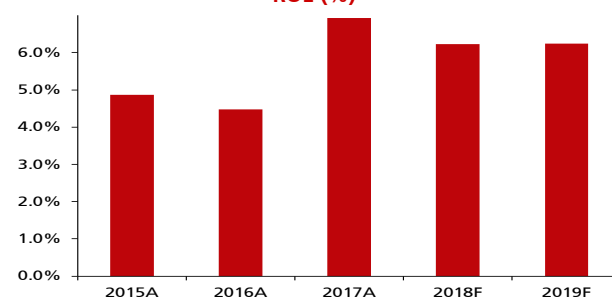
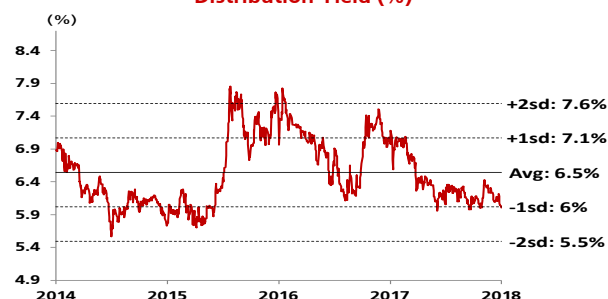
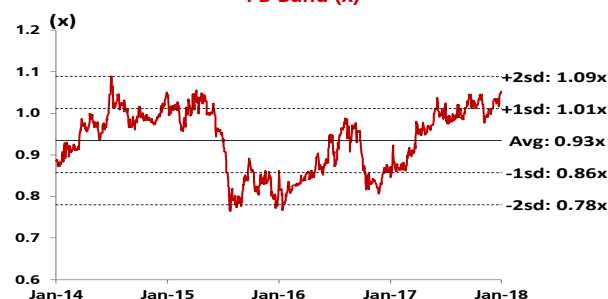
Currency risk. As 100% of CRCT's income is derived in RMB and it does not hedge its income, depreciation of the RMB against the SGD would result in a lower DPU to unitholders.

Threat from e-commerce. This threat is partially mitigated by the fact that c.48% of CRCT's Gross Rental Income (GRI) is sourced from tenants who are more resilient to competition from e-commerce, i.e. F&B (28% of GRI), supermarkets (5%), leisure & entertainment (3%), education (4%), and beauty & healthcare (8%).

New mall supply in Beijing and Shanghai. This risk is partially mitigated by the fact that c.80% of the new supply in Beijing is located outside core retail areas where CRCT's malls are situated. CapitaMall Qibao in Shanghai remains on the watch-out as it combats competition from nearby new supplies.

Company Background

CapitaLand Retail China Trust (CRCT) is a real estate investment trust which invests in income-producing retail properties located mainly in China, Hong Kong, and Macau.

Aggregate Leverage (%)**ROE (%)****Distribution Yield (%)****PB Band (x)**

Source: Company, DBS Bank

Income Statement (\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Gross revenue	220	214	229	261	277
Property expenses	(79.2)	(74.5)	(80.0)	(93.4)	(97.7)
Net Property Income	141	140	149	167	180
Other Operating expenses	(14.6)	(13.8)	(14.5)	(17.8)	(18.3)
Other Non Opg (Exp)/Inc	0.55	(2.0)	(0.1)	0.0	0.0
Net Interest (Exp)/Inc	(19.2)	(19.4)	(21.0)	(21.0)	(26.5)
Exceptional Gain/(Loss)	0.0	0.0	52.2	0.0	0.0
Net Income	108	104	166	128	135
Tax	(43.4)	(41.6)	(64.2)	(28.9)	(33.7)
Minority Interest	4.70	2.61	1.65	(1.4)	(1.5)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	69.2	65.5	103	98.1	99.7
Total Return	114	107	145	98.1	99.7
Non-tax deductible Items	20.1	(19.9)	(57.3)	7.69	8.19
Net Inc available for Dist.	89.2	86.7	91.1	106	108
Growth & Ratio					
Revenue Gth (%)	8.4	(2.8)	7.0	13.7	6.4
N Property Inc Gth (%)	6.6	(1.0)	6.8	12.0	7.5
Net Inc Gth (%)	73.9	(5.4)	57.7	(5.0)	1.7
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	64.0	65.2	65.1	64.1	64.8
Net Income Margins (%)	31.4	30.6	45.0	37.6	35.9
Dist to revenue (%)	40.5	40.5	39.8	40.6	38.9
Managers & Trustee's fees	6.6	6.5	6.3	6.8	6.6
ROAE (%)	4.9	4.5	6.9	6.2	6.2
ROA (%)	2.8	2.4	3.8	3.4	3.2
ROCE (%)	3.7	3.5	3.7	4.8	4.5
Int. Cover (x)	6.6	6.5	6.4	7.1	6.1

Source: Company, DBS Bank

Rock Square and assumed acquisitions to contribute from FY18.

Quarterly / Interim Income Statement (\$\$m)

FY Dec	4Q2016	1Q2017	2Q2017	3Q2017	4Q2017
Gross revenue	56.7	60.1	59.0	56.0	54.1
Property expenses	(21.9)	(19.8)	(19.0)	(20.0)	(21.1)
Net Property Income	34.8	40.3	40.0	36.0	33.0
Other Operating expenses	(4.0)	(4.1)	(3.2)	(3.2)	(4.0)
Other Non Opg (Exp)/Inc	(0.4)	0.0	0.0	1.24	(1.4)
Net Interest (Exp)/Inc	(5.2)	(6.0)	(5.4)	(5.2)	(4.5)
Exceptional Gain/(Loss)	0.0	0.13	0.0	52.2	0.0
Net Income	25.2	30.3	31.3	81.1	23.1
Tax	(15.6)	(9.5)	(14.0)	(24.9)	(15.9)
Minority Interest	1.52	0.21	0.98	0.0	0.48
Net Income after Tax	11.1	21.1	18.3	56.2	7.70
Total Return	34.0	21.1	31.3	56.2	36.1
Non-tax deductible Items	(13.3)	3.28	(8.0)	(34.8)	(17.8)
Net Inc available for Dist.	20.6	24.4	23.3	21.4	18.3
Growth & Ratio					
Revenue Gth (%)	12	6	(2)	(5)	(3)
N Property Inc Gth (%)	6	16	(1)	(10)	(8)
Net Inc Gth (%)	(39)	90	(13)	207	(86)
Net Prop Inc Margin (%)	61.3	67.1	67.8	64.2	61.0
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

Earnings dip due to the divestment of Anzhen and new acquisition Rock Square yet to contribute

Balance Sheet (\$\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Investment Properties	2,413	2,628	2,441	2,673	2,682
Other LT Assets	5.91	4.03	2.99	360	360
Cash & ST Invt	126	136	187	24.3	39.1
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	12.8	12.8	37.1	14.5	15.5
Other Current Assets	12.6	2.11	0.44	0.44	0.44
Total Assets	2,570	2,783	2,668	3,072	3,096
ST Debt	0.0	0.0	0.0	0.0	0.0
Creditor	59.5	64.5	59.6	65.6	69.8
Other Current Liab	246	241	242	242	242
LT Debt	706	978	748	1,094	1,112
Other LT Liabilities	43.3	48.8	50.8	50.8	50.8
Unit holders' funds	1,491	1,432	1,549	1,599	1,599
Minority Interests	24.2	19.9	19.3	20.7	22.3
Total Funds & Liabilities	2,570	2,783	2,668	3,072	3,096
Non-Cash Wkg. Capital	(280)	(290)	(264)	(293)	(296)
Net Cash/(Debt)	(580)	(842)	(561)	(1,070)	(1,073)
Ratio					
Current Ratio (x)	0.5	0.5	0.7	0.1	0.2
Quick Ratio (x)	0.5	0.5	0.7	0.1	0.2
Aggregate Leverage (%)	27.5	35.1	28.0	35.6	35.9
Z-Score (X)	1.1	1.0	1.0	0.9	0.9

Assumed an additional acquisition of S\$250m in FY18.

Source: Company, DBS Bank

Cash Flow Statement (\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Pre-Tax Income	108	104	166	128	135
Dep. & Amort.	2.64	2.40	1.73	1.73	1.73
Tax Paid	(20.2)	(41.6)	(64.2)	(28.9)	(33.7)
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	2.50	12.7	(17.5)	28.6	3.29
Other Operating CF	22.3	42.0	30.5	5.96	6.46
Net Operating CF	115	120	116	136	113
Net Invnt in Properties	(16.1)	(313)	199	(258)	(8.3)
Other Invnts (net)	0.0	0.0	0.0	0.0	0.0
Invnts in Assoc. & JV	0.0	0.0	(25.5)	(331)	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.14	0.0	1.42	0.0	0.0
Net Investing CF	(16.0)	(313)	175	(589)	(8.3)
Distribution Paid	(66.1)	(52.5)	(82.6)	(106)	(108)
Chg in Gross Debt	30.0	277	(228)	347	18.3
New units issued	0.0	0.0	102	50.0	0.0
Other Financing CF	(25.9)	(13.5)	(30.4)	0.0	0.0
Net Financing CF	(62.0)	211	(239)	291	(89.6)
Currency Adjustments	(3.8)	(8.1)	(2.1)	0.0	0.0
Chg in Cash	33.3	9.78	50.4	(162)	14.8
Operating CFPS (\$ cts)	13.5	12.5	14.6	11.0	10.9
Free CFPS (\$ cts)	11.8	(22.5)	34.4	(12.5)	10.4

Source: Company, DBS Bank

Acquisition of 51% interest in Rock Square

Target Price & Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	24 Apr 17	1.50	1.68	BUY
2:	03 May 17	1.56	1.68	BUY
3:	28 Jul 17	1.65	1.70	BUY
4:	16 Aug 17	1.59	1.70	BUY
5:	24 Oct 17	1.66	1.80	BUY
6:	12 Dec 17	1.60	1.75	BUY

Source: DBS Bank

Analyst: Singapore Research Team

Derek TAN

DBS Bank recommendations are based on 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

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

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