Singapore Industry Focus

Singapore Property

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DBS Group Research . Equity

11 Jun 2019

Double Prosperity

- CRCT proposed the acquisition of three fast-growing retail assets in China from CAPL-managed funds
- Move is mutually beneficial, leading to improved financial metrics for both, in our opinion
- CRCT to benefit from immediate yield and DPU accretion; a larger market cap also awaits
- CAPL on track to meet divestment and ROE targets while demonstrating in-house recycling capabilities

Proposed acquisition of three dominant retail malls in China. CapitaLand Retail China Trust (CRCT) has proposed the purchase of companies holding retail assets, CapitaMall Xuefu, CapitaMall Aidemengdun and CapitaMall Yuhuating, from the Sponsor, CapitaLand Limited's (CAPL) China Funds I and II. The agreed portfolio value of RMB2,960m (S$589.2m) represents a slight discount to latest independent valuations, which is c.13% higher compared to end-Dec 2018 valuations. We reckon that this could be mainly driven by the properties' strong cash flow generation capability and fundamentals. This implies an NPI yield of c.6%, compared to c.5.7% for CRCT's existing portfolio (excluding Wuhu).

Mega win for CRCT. We are positive on CRCT's diversification from Beijing/Shanghai to Tier 2 cities Harbin and Changsha – a strategic move that allows the REIT to tap the strong organic and economic growth prospects in these markets, which have generally outpaced the national average. Based on its current gearing of c.35.5%, the acquisition would likely entail partial equity funding. A 50%/50% debt/equity funding mix, which we assume to meet target gearing of c.38%, is projected to boost FY20F DPU by 2-3%.

The enlarged market cap will also improve liquidity and, over time, should enhance the visibility of CRCT as an attractive proxy to SGX-listed China-focused REITs among investors.

And another for CAPL. The proposed deal will net investment gains of c.S$37.6m for CAPL, which can be redeployed towards higher-yielding projects and importantly, demonstrates its ability to recycle capital in China via its listed platforms.

This allows CAPL to continue participating in the assets' longer-term growth potential (which is captured under its enlarged AUM) through its stake in CRCT, while delivering on its double-digit ROE targets over the medium term.

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STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
CapitaLand	3.31	10,113	4.00	(3.8)	(5.4)	BUY
CapitaLand Retail China Trust	1.56	1,140	1.65	2.6	(1.3)	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 10 Jun 2019

Live more, Bank less

A mutually beneficial and transformative transaction

CRCT proposes strategic diversification into high-growth cities in Harbin and Changsha. CapitaLand Retail China Trust (CRCT) has proposed the acquisition of companies holding retail assets, CapitaMall Xuefu, CapitaMall Aidemengdun, and CapitaMall Yuhuating, which have a combined NLA of 141,157 sqm (+ 27.1%) from entities related to the Sponsor, CapitaLand Limited (CAPL).

CapitaMall Xuefu and CapitaMall Aidemengdun are located in Harbin (Heilongjiang Province) and CapitaMall Yuhuating in Changsha (Hunan Province) – Tier 2 cities, in our opinion.

Acquisition consideration of approximately S$505.4m. The purchase price is based on the agreed market value of RMB2,960m (S$589.2m) for the portfolio – or RMB1,745m, RMB469m and RMB746m for CapitaMall Xuefu, CapitaMall Aidemengdun and CapitaMall Yuhuating, respectively. This represents slight discounts of 0.2%-1.3% to independent valuations by C&W and JLL. We also observe that current valuations represent c.13% premium over its last valuation on 31 Dec 2018, which is likely to be driven by higher cashflows for two of the three properties, in our opinion.

Attractive property attributes, with longer-term organic growth opportunities in store. All three incoming properties are characteristic of CapitaLand's malls in China – offering exposure to markets with strong economic fundamentals, good transport connectivity and access to strong captive populations within high-density zones.

CapitaMall Xuefu, which is set to rank among the top 3 in CRCT's enlarged portfolio by GRI post acquisition, enjoys direct connectivity to Xuefu Road Station on Metro Line 1 and is poised to benefit from its sizeable, affluent catchment and tertiary student population from eight universities in the vicinity, as on-going efforts to further inject experiential elements continue to take shape.

It is also of close proximity to CapitaMall Aidemengdun, which offers complementary retail offerings and synergies from leasing and operational perspective. On the other hand, both CapitaMall Aidemengdun and CapitaMall Yuhuating, which cater mainly to necessity shopping, are defensive and bode well for the stability of DPU, with longer-term growth opportunities from AEI and tenant reconfiguration.

Summary of the Properties

	CapitaMall Xuefu	CapitaMall Aidemengdun	CapitaMall Yuhuating
			
Address	No. 1 Xuefu Road, Nangang District, Harbin	No. 38 Aidemengdun Road, Daoli District, Harbin	No. 421 Shaoshan Middle Road, Yuhua District, Changsha
Property Description	Multi-tenanted mall comprising 5 above ground levels and 1 basement level of retail space and 1 basement level for car park use	Multi-tenanted mall comprising 4 above ground levels and 1 basement level for retail and car park use	Multi-tenanted mall comprising 4 above ground levels and 1 basement level for retail and car park use
Year of Opening	2012	2010	2005
Land Use Right Expiry	2045	2042	2044
Gross Rentable Area ("GRA") (sq m)	104,294	43,394	62,080
Committed Occupancy[1]	99.8%	98.6%	98.1%
No. of Leases[1]	419	189	221
Independent Valuations (RMB million)	C&W: 1,760 JLL: 1,748	C&W: 480 JLL: 470	C&W: 760 JLL: 749
Agreed Value (RMB million)	1,745	469	746
Agreed Value per sq m GRA (RMB)	16,732	10,808	12,017
NPI Yield on Agreed Value[2]	6.1%	5.6%	6.2%

Source: Company

Our thoughts

We believe this to be a **win-win strategy** for both the Sponsor and CRCT. Firstly, a sizeable deal for CRCT will enable the REIT to continue to bulk up and grow its market cap compared to its China-focused peers. We believe that such efforts will ultimately allow the REIT to stand out among investors as a proxy to yield plays in China. Meanwhile, such acquisitions will also enable Capitaland to continue deleveraging and recycling capital.

CRCT:

Raising visibility amongst investors as it bulks up in China. Similar to CRCT's Rock Square acquisition in 2017/2018, we believe that this acquisition could be transformative for the REIT. If successful, it is set to drive an 18.8% increase in portfolio value to approximately RMB18.7bn (~S$3.8bn) and a 22.8% jump in NPI to RMB959.3bn.

This would significant widen the AUM gap between CRCT and SGX-listed China-centric REIT peers, which are largely below the S$2bn mark. As this plays out, could significantly enhance the REIT's proposition to investors over time.

Implied NPI yield of 6% is accretive. Based on FY18 NPI of RMB178.1m, the implied NPI yield for the three assets to be acquired stands at 6%, which is 30bps above CRCT's ex-Wuhu portfolio of approximately 5.7%.

Funding structure likely to include some form of equity raising. Including c.S$16.4m in acquisition-related fees, the total outlay comes to approximately S$505.4m. Given its current gearing of 35.5% (as at 31 Mar 2019), the transaction is likely to be funded by a combination of equity and debt.

DPU accretion of 2-3%, according to our estimates. While the proposed acquisition represents a diversification away from its Beijing and Shanghai-focused malls, it is also a strategic move that allows the REIT to capitalise on the strong economic and organic growth prospects in these markets, which have generally outpaced the national average.

Assuming 50%/50% debt/equity funding to meet its target gearing of c.38%, we estimate pro-forma FY18 DPU accretion of c.2.5% and between 2% and 3% for FY20F. However, due to the impact of EFR against just four months' contributions from the acquired portfolio, we still expect a flattish FY19F DPU.

Maintain BUY. Overall, we are positive on CRCT's move as the target portfolio offers both DPU accretion and organic growth prospects, unlocking a longer-term growth runway for the REIT. We currently have a **BUY call with a TP of S$1.65**, and have yet to factor in positive contributions from the acquisition for CRCT.

CAPL:

On track to meet its AUM divestment target in FY19. The proposed sale of the three properties for close to RMB 3.0bn (S$589.2m) on a 100% basis, allows the group to realise the group's property investment value and unlock capital for reinvestment. The sale will generate proceeds of about S$239.9m and a net gain of about S$37.6m for CAPL. While marginal, the cumulative impact adds towards to the group's longer-term ROE of close to 10%.

The pro-forma impact of the transaction, if completed on 1 Jan 2019, will boost CAPL's 3Q19 EPS from 7.1 to 7.9 Scts.
The transaction, which is conditional upon CRCT unitholders' approval, is expected to be completed in 3Q19.

Keeping its AUM within the group. The properties will be divested from the CapitaLand Mall China Income Fund III (two Harbin properties) and CapitaLand Mall China Income Fund I (Changsha property), and with CRCT being the purchaser, this keeps the AUM within the group. Most importantly, CAPL through its stake in CRCT, will continue to benefit from the longer-term uplift in operational performance and capital values for the three properties.

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BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
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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 share price catalysts within this time frame)

**Share price appreciation + dividends*

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