Singapore Industry Focus

CapitaLand Group

Refer to important disclosures at the end of this report

DBS Group Research . Equity

6 Sep 2019

Born to fly

- Making waves in Bangkok
- CapitaLand and family of REITs are well positioned to weather market uncertainties
- Be ready to pounce on opportunities; its REITs remain on an acquisition path

Showcasing the best of CapitaLand and its family of REITs in Bangkok. In August, we hosted the third instalment of our annual investor outreach conference in Bangkok for the enlarged CapitaLand (CAPL) Group. Post consolidation with Ascendas-Singbridge (ASB), CAPL has eight managed REITs under its umbrella. Apart from the ongoing merger between Ascott Residence Trust (ART) and Ascendas Hospitality Trust (AHT), discussions were generally focused on current market uncertainties, M&A opportunities, and scope for further portfolio reconstitutions.

Ability to capitalise on market opportunities. The merger between ASB and CAPL drives value manifold. Apart from a 25% increase in AUM, CAPL benefits from gaining a portfolio that has lower cyclicality to business cycles. These enhanced characteristics should drive returns higher. Catalysts for re-rating include delivery of ROE of 10% on the back of (i) improved and expanded earnings base, (ii) revaluation gains on stronger cashflows for its investment properties, and (iii) gains following divestments of up to S$3.0bn p.a.

REITs with resilience to hedge against market uncertainties. While investors' sentiment has remained soft given the subdued macro outlook, we believe that CAPL-managed REITs are well positioned to overcome these macro headwinds. The group's retail-focused REITs (CMT, CMMT, CRCT) offer resilience in the midst of regional uncertainties given their positioning mainly in the resilient suburban sector, while A-REIT and AIT continue to ride on the robust fundamentals in the business parks and IT parks sector in Singapore and India.

Portfolio renewals to drive income sustainability. Ongoing repositioning and enhancement initiatives has enabled CCT to gain a competitive edge to ride the next office cycle, as well as offer sustainable earnings. Investors can look forward to the proposed bigger ART-AHT combination which in our view should drive increased flows into the stock while potential indexation could drive further upside.

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STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
Ascendas Hospitality Trust	1.07	879	1.21	17.6	33.8	BUY
Ascendas India Trust	1.48	1,115	1.55	14.7	28.7	BUY
Ascendas REIT	3.21	7,221	3.40	9.6	17.6	BUY
Ascott Residence Trust	1.30	2,043	1.45	3.2	18.2	BUY
CapitaLand	3.51	12,778	4.00	9.4	2.6	BUY
CapitaLand Commercial Trust	2.19	6,101	2.30	9.0	24.4	BUY
CapitaLand Malaysia Mall Trust	1.03	502	1.15	(5.5)	(10.4)	HOLD
CapitaLand Mall Trust	2.70	7,197	2.95	5.1	25.6	BUY
CapitaLand Retail China Trust	1.57	1,133	1.80	2.1	8.4	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 5 Sep 2019

Legend:
CapitaLand Limited (CAPL)
Ascendas REIT (A-REIT)
Ascendas India Trust (AIT)
Ascends Hospitality Trust (AHT)
Ascott Residence Trust (ART)
CapitaLand Mall Trust (CMT)
CapitaLand Retail China Trust (CRCT)
CapitaLand Commercial Trust (CCT)
CapitaLand Malaysia Mall Trust (CMMT)

CapitaLand Limited (CAPL)

Gaining access to a more diversified platform with more scale. The merger with Ascendas-Singbridge (ASB) has brought a complimentary portfolio to CAPL. CAPL has gained from a 25% increase in real estate assets under management (AUM) to S$129.1bn as of 1H19. More importantly, we see increased stability from ASB's portfolio of warehouses and business parks which have on average longer weighted average lease expiry (WALE), thus improving the income stability for the group. The group's earnings profile now has less volatility to business cycles, which in our view will drive share prices higher.

Hitting its ROE target of 10%. A key strategy of the group is to achieve a sustainable ROE target of close to 10% and efficiently allocate its capital to its funds/REITs. The group has been quick to execute on its strategy to deleverage its balance sheet and in 1H19, divested or in the process of divesting S$3.4bn (100% basis) of assets, ahead of its annual target of S$3.0bn. There is still a myriad of opportunities for the group to realise value through its REITs and private funds which, in the meantime, will continue to drive inorganic growth and will be accretive to both.

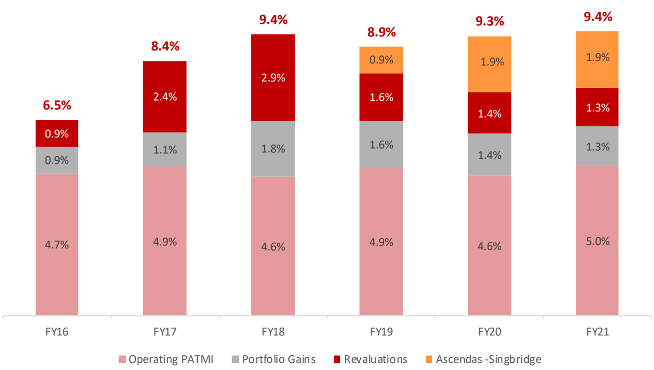
Its residential business segment (China, Malaysia and Vietnam) continues to see strong pre-sales during launches. Unrecognised revenues of RMB 18.3bn (S$3.8bn) in China and S$726m in Vietnam underpin earnings visibility in the next 18 months.

Retail in China is turning around. The group's retail properties in China continue to see improvement in tenant sales, thus driving yield improvements of 2.3% and 12.2% for malls in Tier 1 and Tier 2/other cities respectively. While concerns remain on the impact of e-commerce in China disrupting retail malls, we are seeing increased recent trend of online players taking up a physical presence in malls. This could imply that online players recognise the value of having an offline presence as well. That said, these online players have been selectively looking to set up and expand their presence in malls. Given the carefully curated tenant mix and with properties located at key residential districts or CBD locations mainly in Tier 1 and 2 cities across China, we believe that CAPL's portfolio stands tall to benefit from this trend going forward.

Private funds and REITs offer a scalable business. The funds management business is highly scalable and one of the key focus of AUM growth for CapitaLand Financial. We see CAPL, as Sponsor for its managed REITs, supporting its growth through seeding with new potential acquisition pipelines and, at the same time, launching a suite of new private equity funds to target third party capital. Over time, the higher AUM will generate recurring management and promotion fees which are highly ROE accretive in our view.

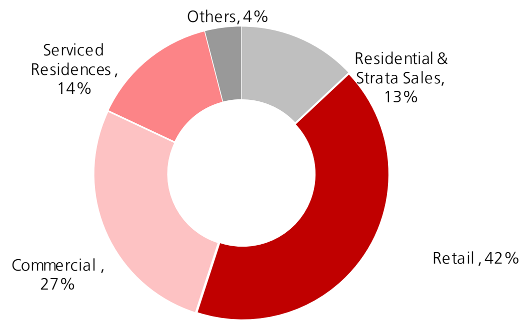
Scaling up in Vietnam and India. Building on the positive sales momentum at its residential projects in Vietnam, management remains positive and sees significant opportunities to scale up its business and targets for capital allocation to Vietnam over time. India is also a country where management sees the potential to scale up over time, riding on the robust fundamentals in the demand for outsource (IT parks) and logistics, driven by robust demand for warehousing space post the implementation of goods and services (GST) tax.

Projected ROE Growth (%)



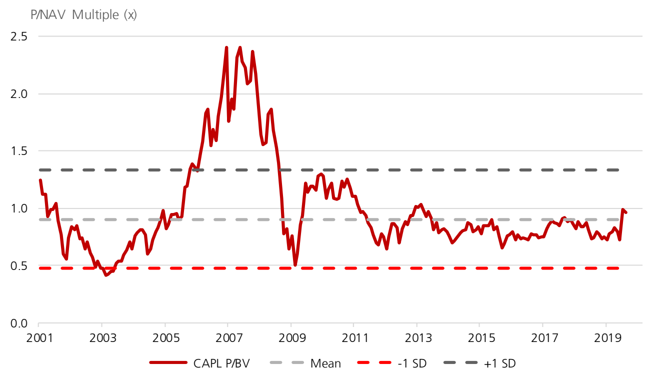
Source: DBS Bank

Asset breakdown (S$62.5bn)



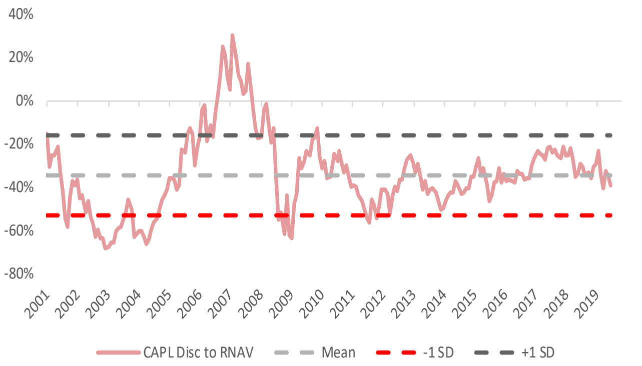
Source: DBS Bank

P/NAV Range



Source: DBS Bank

Discount to RNAV



Source: DBS Bank

Selected properties that could be divested to REITs/funds over time

Key Assets	Asset Class	Country	Potential Entity	CUR	Stake	LC$'m	S$'m	Est Yield
U.S. Office Portfolio	Commercial	U.S.	IPO / AREIT	US$	100%	950	1,283	6.0%
U.S. Multi-Family Portfolio	Lodging	U.S.	IPO / ART	US$	100%	845	1,141	6.3%
Raffles City Beijing	Retail	China	CRCT	RMB	55%	3,263	544	5.0%
Raffles City Shanghai	Retail	China	CRCT	RMB	30%	3,986	664	5.0%
Ion Orchard	Retail	Singapore	CMT	S$	50%	1,690	1,690	4.0%
Star Vista	Retail	Singapore	CMT	S$	100%	262	262	4.0%
The Cavendish London	Lodging	U.K.	ART	GBP	100%	158	269	5.0%
Retail Portfolio	Commercial	Japan	CMT	JPY	100%	53,220	663	4.8%
Commercial Portfolio	Commercial	Japan	CCT	JPY	100%	138,160	1,630	4.5%
Ascendas Business Parks	Business Parks	Singapore	A-REIT	S$	100%	1,000	1,000	5.5%-6.0%

Source: CAPL, DBS Bank

Ascendas REIT (A-REIT)

Portfolio metrics remain resilient despite slowdown. While the Manager is seeing tenants taking a more cautious stance in recent quarters, we believe that the REIT's diverse exposure puts it in a good position to deliver earnings resilience despite an expected slowdown. Forward guidance is for rental reversions to remain flattish. That said, A-REIT continued to deliver respectable rental reversion of c.1.8% for the quarter ended June-19. Business parks/science parks and hi-specifications properties delivered the highest rental reversions. We believe that demand would remain stable going forward as these properties target tenants in the higher-end manufacturing sectors like IoT, advanced manufacturing firms, biomedical companies where there is still good expansionary demand.

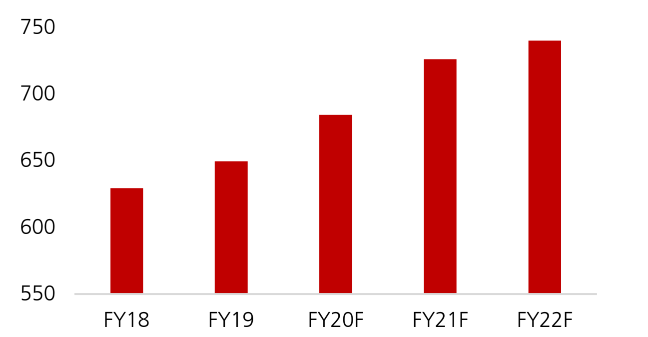
At this point, A-REIT has yet to see any substantial increase in demand coming from firms looking to relocate operations out of China into ASEAN (specifically Singapore). Over time, we believe higher end manufacturing firms (regional HQ, R&D firms, advanced manufacturing lines etc) could be attracted to relocate to Singapore given its highly qualified workforce, in-place infrastructure and eco-systems to attract them.

Introducing flexible workspaces in Industrial. The Manager has started an innovative project called Workshop at Techplace II in Singapore and looks to replicate this to selected industrial properties in its portfolio. Catering mainly to start-ups and smaller firms in the industrial sector, take-up has been encouraging with occupancy rates >80%. We like this innovative concept as it helps to address "sticky vacancies" at selected properties, in our view. Longer term, this a scalable strategy to introduce flexible workspaces across its portfolio over time.

Acquisitions to drive material growth in AUM. A-REIT continues to remain on the hunt for assets and is looking at deepening its exposure in the UK and Australia. The uncertainty of Brexit has not materially impacted demand yet but the Manager has noted that decision making from existing tenants to renew/expand is taking more time to firm up. Looking at the Sponsor's pipeline, we believe that A-REIT may look to acquire either (i) portfolio of business parks in Singapore; or (ii) suburban office properties currently on CAPL's books. The combined pipeline amounts to over S$2.0bn, according to our estimates.

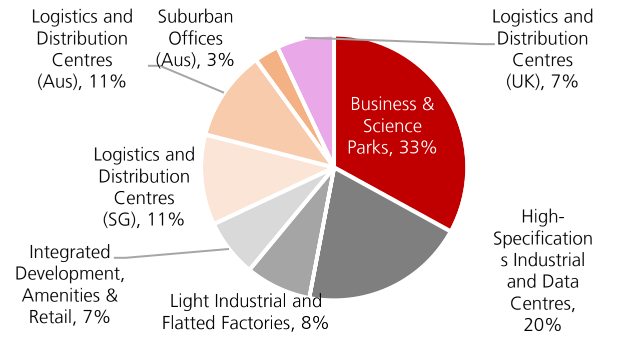
Cost of funds. Given its strong credit rating and active capital markets management, A-REIT has managed to keep cost of funds stable at c.3.0% over the past few years despite the rising interest rate environment and terming out its debt expiry profile to 3.5 years.

Net Property Income Growth (S$ m)



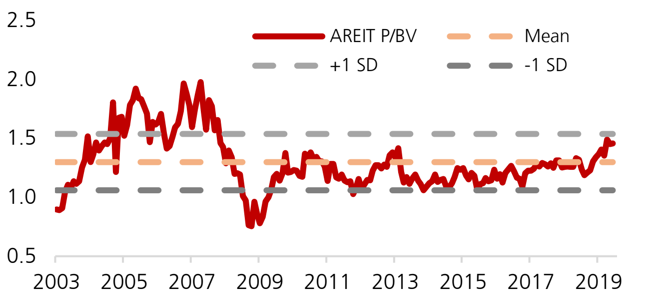
Source: DBS Bank

Breakdown of Investment Property Value (S$11.1bn)



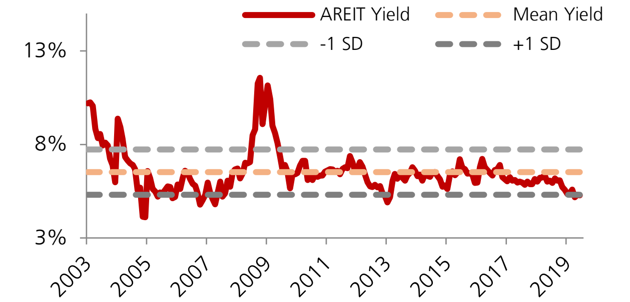
Source: DBS Bank

P/NAV Range



Source: DBS Bank

Yield Trading Range



Source: DBS Bank

Ascendas India Trust (AIT)

India – the global offshoring hub. Ascendas India Trust (AIT) offers investors a unique exposure to the robust demand growth for office / IT Parks and logistics properties across key cities in India. We continue to see strong demand from firms in the IoT, and technology sectors as they grow their operational footprint in India. One of the key drivers for this offshoring trend is underpinned by the country's low-cost environment coupled with talent, especially in the IT sector. According to PayScale, the average salary for IT/software developers or programmers in India stands at US$6,000 p.a. which is below that of other competing and/or developed countries such as the US (c.US$74,000), Hong Kong (c.US$28,000), and Malaysia (US$11,000).

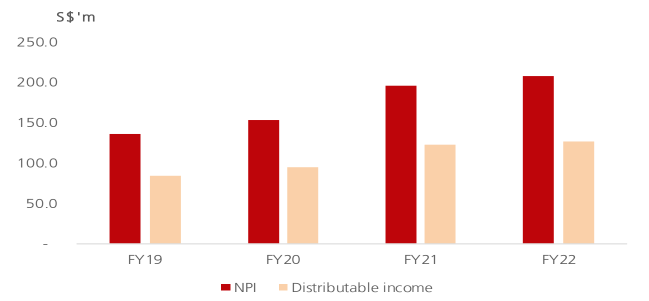
Steady operating metrics. AIT's portfolio in 1QFY20 has continued to improve on a q-o-q basis. We note that this was driven by higher physical occupancies at aVance Pune (formerly BlueRidge II; 98% versus 78% in 1Q19) and ITPB (99% versus 94%). Overall portfolio committed occupancy now stands at 99%.

Acquisitions and strong organic growth to power distributions forward. We remain excited on AIT's longer term growth potential. AIT recently announced a forward purchase agreement to acquire BlueRidge 3, and a seventh warehouse at the Arshiya Free Trade Warehousing Zone. Combined with previously announced forward purchases and redevelopment plans, total floor area should increase by 71% to 22.3m sqft by end-2023. In the near term, AIT has ample debt-funded capacity to fund its capital commitments but could tap the market for new equity in the future.

Furthermore, we see robust organic growth momentum based on recent transacted rents for AIT's various properties, which are 5-31% higher than current effective rents for similar properties. These factors should help AIT deliver robust 10% DPU CAGR over the next three years.

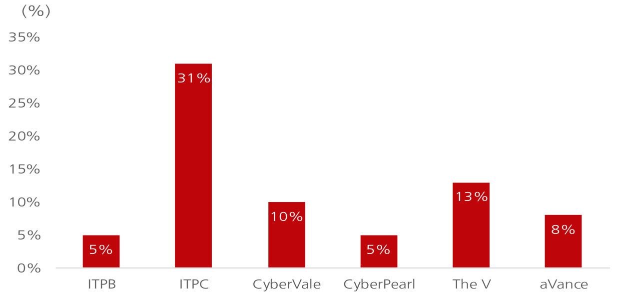
Competitive cost of funds. An advantage for AIT is that it has been able to tap overseas debt capital markets, keeping its all-in cost lower at c.6.2%. This competitive funding structure allows AIT to execute on its unique "land-banking" strategy, which allows to trust to gain access to quality development projects. Keeping 67% of its debt in INR, the trust has also been conservative in keeping an optimal natural hedge ratio.

Net property income and distribution growth



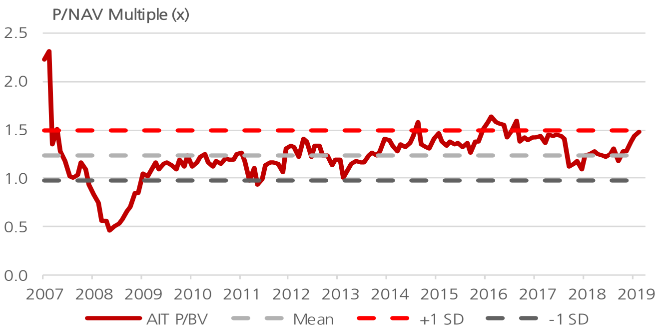
Source: DBS Bank

Transacted vs effective rents (%)



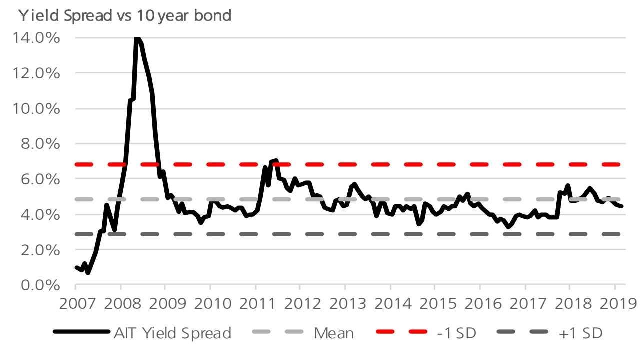
Source: DBS Bank

P/NAV



Source: DBS Bank

Yield Spread



Source: DBS Bank

Ascott Residence Trust (ART)

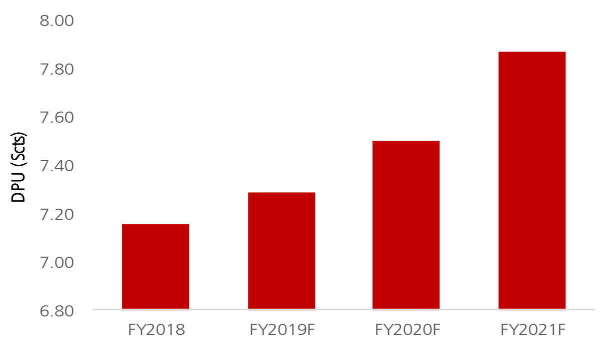
En route to be the largest hospitality Trust in Asia Pacific with total assets of S$7.6bn. In Jul-19, ART announced the proposed S$1.9bn merger between ART and Ascendas Hospitality Trust (AHT) with a gross exchange ratio of 0.836x. The merger will propel ART's position to be the largest hospitality trust in Asia Pacific with combined total assets of S$7.6bn, overtaking Regal Reit and Japan Hotel Reit. Both companies are expected to hold their EGMs in Oct-19 and target to complete the proposed merger by Dec-19.

The new combined ART will have 14 additional properties, giving the trust a total of 88 properties with more than 16k units from 11.7k units previously. As AHT's properties comprise largely freehold properties, the combined ART's freehold component will increase by 8% to 61%.

Next catalyst from potential inclusion into FTSE EPRA Nareit Developed Index in 1H2020. Upon the completion of the proposed merger, the new ART will meet the criteria for potential inclusion into FTSE EPRA Nareit Developed Index given that i) free float will increase by c.50% to S$2.4bn (vs threshold for index inclusion at S$1.7bn), and ii) EBITDA contributions from developed markets will increase from 75% to 82%. Indications are that it could likely be included in 1H2020. We remain positive that the possibility of indexation will likely keep ART within the investment horizon of many institutional investors, include index funds which will result in higher trading liquidity and yield compression in the REIT over time.

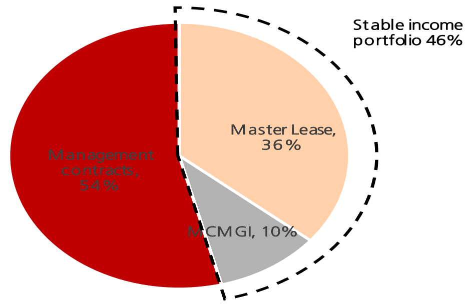
Potential headwinds with a larger Australian portfolio. While ART will benefit from a higher proportion of income stability with AHT's master leases (52% of AHT's NPI) which will increase the new ART's stable income component to 46% from 39%, ART will also triple its exposure to Australia to 18% from 3% of NPI. Given the heightened supply concerns (addition of 7k new rooms to be completed over the next 4 years) in the Australian market especially Melbourne and Sydney coupled with that AHT's Australian portfolio comprises of all management contracts, we believe ART may see potential headwinds as the Australia market continues to soften in the near-to-medium term.

DPU Growth profile



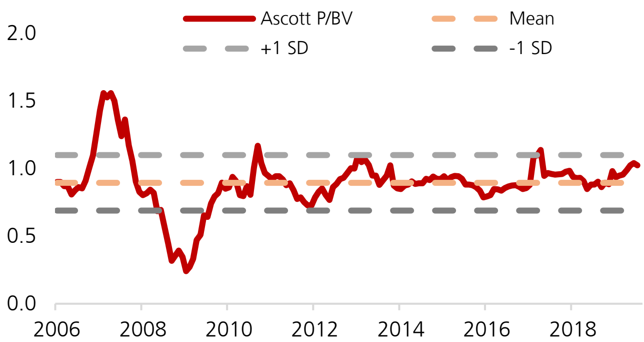
Source: DBS Bank

Income contribution by contract type (FY18/19 pro forma)



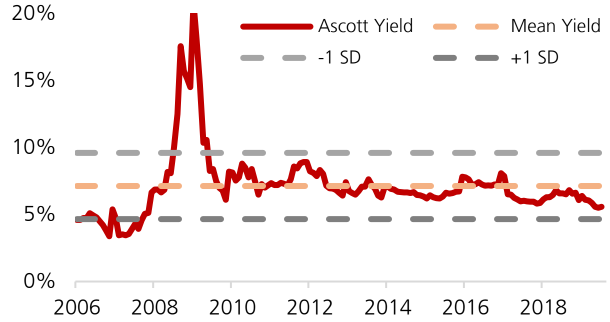
** MCMGI = Management Contracts with Min Guaranteed income*
Source: DBS Bank

P/NAV Range



Source: Bloomberg Finance L.P., DBS Bank

Yield Trading Range



Source: Bloomberg Finance L.P., DBS Bank

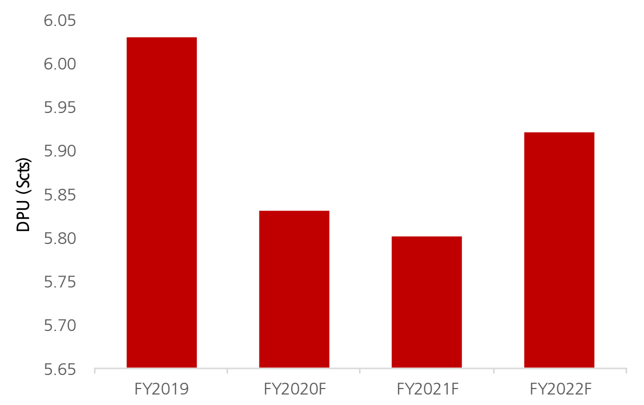
Ascendas Hospitality Trust (AHT)

Australia hotels continue to see supply headwinds. AHT's hotels in Sydney and Melbourne recorded RevPAR decline of 2.2% y-o-y in most recent quarter (1QFY20) on an aggregate basis. Supply headwinds would continue to impact both occupancy and ADR. Despite the challenges, the performance of Pullman Sydney Hyde Park improved on the back of stronger conference and events business in 1QFY20. Management expects Sydney and Melbourne markets to remain soft in the medium term but believes that Brisbane may be on a recovery trend given that the supply peak has passed.

Japan hotels to ride on major events in 2019 / 2020; Korea benefiting from strong inbound tourism. Despite some upcoming new supply in Tokyo and Osaka ranging from 2% to 5% p.a. up to FY2022, management remains optimistic of the Japan market riding on major events lined up in 2019 / 2020 including i) Rugby World Cup 2019, ii) Olympics 2020, iii) Nintendo World, a new them park opening in Universal Studios Japan in 2020. On the other hand, Korea is benefiting from strong inbound travel growth of 16.9% as demand from China recovers.

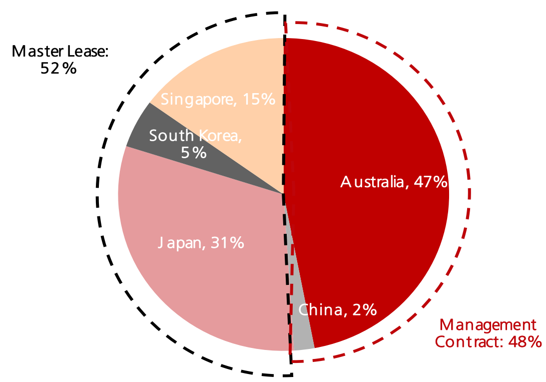
Bigger platform presents opportunities for economies of scale and portfolio repositioning for the future. With the proposed merger, unitholders of AHT will be able to leverage on a bigger hospitality platform under ART and its Sponsor, The Ascott Group. With management contracts of its Australian portfolio expiring in 3 years, AHT's Australia hotels could be rebranded into the Ascott group brand, presenting opportunity to benefit from economies of scale. In addition, with the current weak market in Australia, the new combined entity could take this opportunity to reposition its Australian properties for the future when the market turns more positive.

DPU Growth Profile



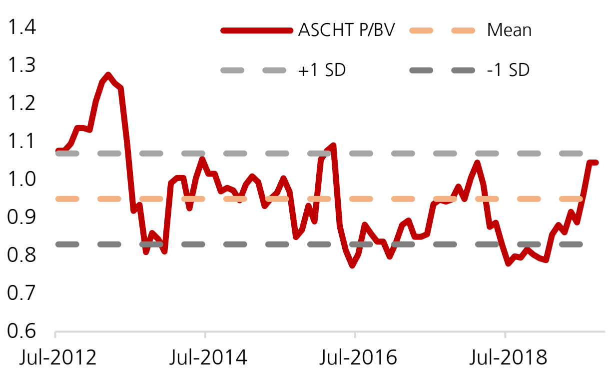
Source: DBS Bank

Income Contribution by Contract Type (FY18/19)



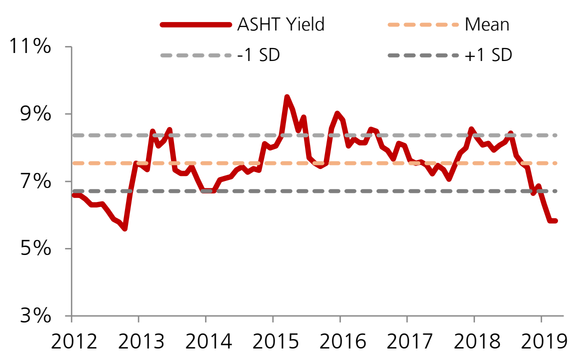
Source: DBS Bank

P/NAV Range



Source: Bloomberg Finance L.P., DBS Bank

Yield Trading Range



Source: Bloomberg Finance L.P., DBS Bank

CapitaLand Commercial Trust (CCT)

Healthy rental reversions with lowest expiring rents in FY2020. CCT continues to enjoy healthy rental reversions as average expiring rents are at its lowest level at S$9.60psf in FY2020 since the office upcycle started in 2018. The current average Grade A office market rent in 2Q2019 is S$11.30psf. As such, average rental reversions could still be in the double digit - at least 18%, if rents remain sustainable or continue to rise. The expiring leases are mainly from CapitaGreen, Six Battery Road and Asia Square Tower 2 which are newer buildings except for Six Battery Road which we believe CCT should have minimal risk in renewing or replacing the leases.

Despite a slight pick-up in office supply from FY2020F to FY2022F, we believe office rents could continue to remain elevated given that the level of new supply remains conducive to meet market demand. The planned new office completions averaging c.0.8m sqft per annum (based on a 5-year forecast) is comparable to the average demand of 0.8m sqft per annum (10-year cycle from 2009 to 2018). However, an emerging risk is a further slowdown in economic growth, which might clip a further acceleration in market rents.

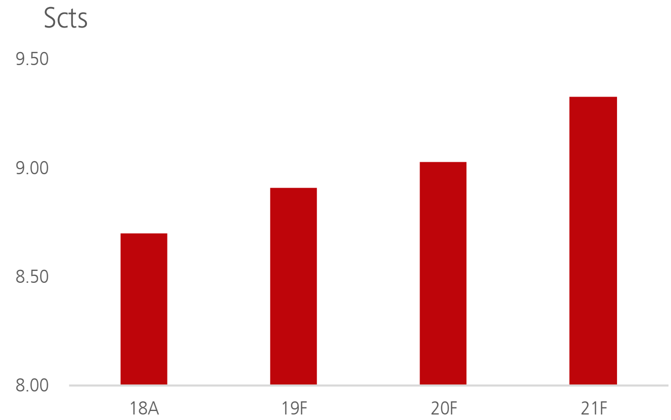
Expanding overseas exposure with second acquisition in Germany - Main Airport Centre. CCT announced its second acquisition in Germany with the acquisition of 94.9% stake in Main Airport Centre. The acquisition is priced at 4% yield based on committed occupancy of 90%. Management expects yield upside as occupancy heads higher. The long WALE of 4.7 years will improve income stability as it rides through some transitional downtime from expected AEIs.

With the second acquisition in Germany, contributions from German assets will increase from 5% to 8% of NPI and property value, which further improves its income stability.

Redevelopment to drive earnings growth from FY2021. There are currently three redevelopment / refurbishment plans to improve the quality of its portfolio to drive earnings growth upon completion in FY2021 / FY2022. These are: i) redevelopment of Golden Shoe car park into a Grade A office building, CapitaSpring, which is expected to complete by 1H2021 with committed lease of 25%; ii) upgrading 21 Collyer Quay, which will be leased to WeWork for 7 years from 2Q2021; and iii) Six Battery Road's AEI comprising the podium block and 8 levels of office space which is expected to complete by 3Q2021.

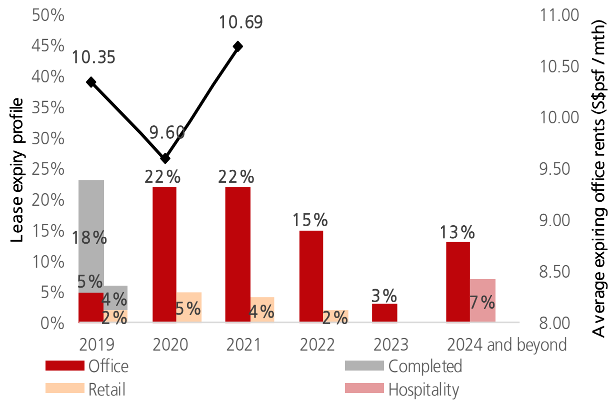
Pipeline assets for potential inorganic growth. In addition, CCT continues to look for inorganic growth opportunities both in Singapore and overseas. Given its entry into the commercial property sector in Germany, management plans to expand its overseas exposure to potentially up to c.20%, diversifying its geographical exposure and enhancing its portfolio's income resilience. In Singapore, potential pipeline assets from its Sponsor include i) call option to acquire the remaining 55% of CapitaSpring; and ii) 79 Robinson Road (also known ass ASB Tower). Overseas assets include i) Japan commercial portfolio (4 buildings) with total NLA of 107k sqm; and ii) Korea commercial portfolio (4 buildings and 1 development project) with total GFA of 118k sqm.

DPU Growth Profile



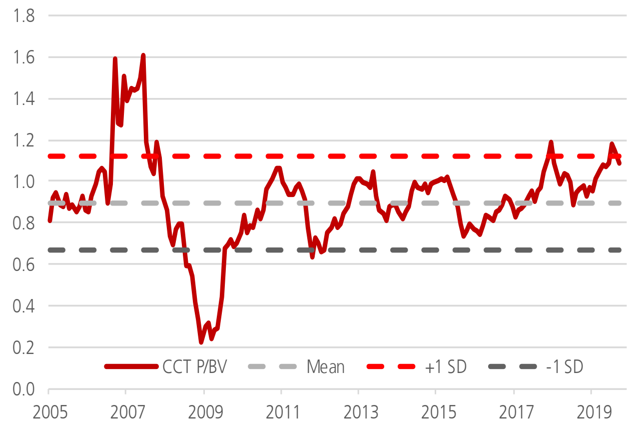
Source: DBS Bank

Lease Expiry Portfolio vs Average Expiring Office Rents



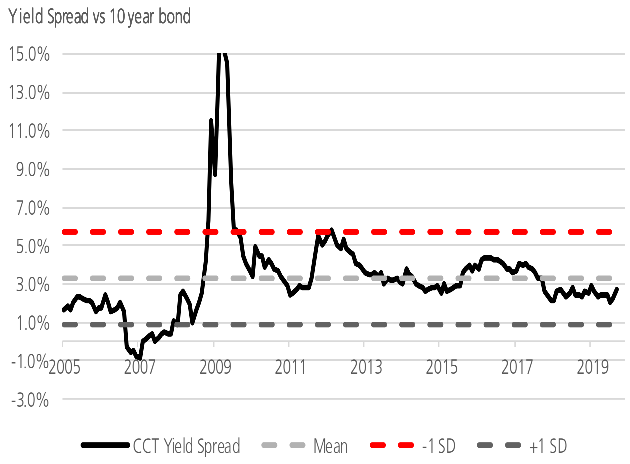
Source: DBS Bank

P/NAV Range



Source: Bloomberg Finance L.P., DBS Bank

Yield Trading Range



Source: Bloomberg Finance L.P., DBS Bank

CapitaLand Mall Trust (CMT)

One of the fastest growing retail S-REITs. The acquisition of a remaining 70% stake in Westgate at end-2018 and the recent relaunch of Funan on 28 Jun 2019 has thrust CMT back under the spotlight as one of the faster-growing large-cap S-REITs with a 2-year DPU CAGR of over 3.0%.

Post-acquisition, Westgate has delivered some of the best rental reversions compared to CMT's existing portfolio, driven mainly by initiatives to improve shopper accessibility and experience, as well as active tenancy remixing. Funan also delivered commendable performance on the pre-leasing front, with committed occupancies of 95% and 98% for its retail and office blocks, respectively.

We understand that actual occupancy for the retail podium was over 80% during its launch weekend. Meanwhile, the office portion will only begin to contribute more meaningfully in the coming months as physical occupancy ramps up, further anchoring earnings momentum into FY20F.

Supply factors swinging in landlords' favour. 2019 has proved to be a defining year for Singapore's retail scene, as new mega mall launches introduced bumper supply into the market, led primarily by Funan in the downtown core region and in the Eastern region, CAPL's iconic Jewel Changi and Lendlease's PLQ Mall, which has recently completed.

Despite the onslaught of new supply, leasing conditions appear to have picked up over the past twelve to eighteen months. In addition to strong take-up at new malls, we have seen an uptick in signing rents and improved tenant sales performances across CMT's portfolio. CMT is often viewed by investors as a proxy to Singapore's retail space outlook owing to the REIT's more balanced prime/downtown vs suburban market exposure.

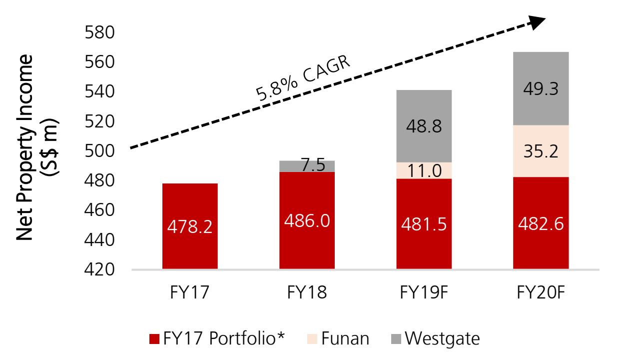
While novelty factors could result in temporary shift in shopper trends, particularly for malls in the East, the limited supply pipeline of new retail floorspace bodes well for the general leasing environment and rent prospects ahead.

Value creation journey has only just begun; AEIs to further build on CMT's premium positioning. Amid the redevelopment of Funan, the Manager has also taken on several concurrent portfolio reconstitution and enhancement opportunities. Notable initiatives over the past year include rejuvenation works at Tampines Mall and recycling of proceeds from the divestment of Sembawang Shopping Centre into Westgate, that subsequently underwent a series of improvement works. The more efficient layout is set to strengthen the mall's competitiveness over the long-term, and in just a matter of months, has translated into higher rents.

CMT's value creation story has only just begun - and remains a core part of the group's strategic focus. In 3Q19, CMT embarked on infrastructure works for two of its anchor tenants at Lot One Shoppers' Mall, which should contribute positively to space and sales productivity upon completion.

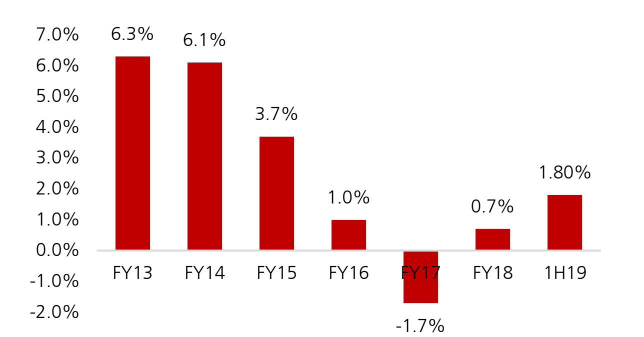
Riding on this theme, we believe the next wave of organic growth for CMT will likely come from larger-scale redevelopment opportunities, spurred by incentive schemes under URA's proposed 2019 masterplan - which would accord qualifying properties with additional GFA, for instance. While the Manager has identified a few properties that could benefit from these schemes (IMM could be one), they have yet to provide further details pending approval from the relevant authorities. While this will take time to unfold, we see this potential development as highly transformational for CMT over a three to five-year horizon.

Twin Engines Driving NPI Growth at 5.8% CAGR



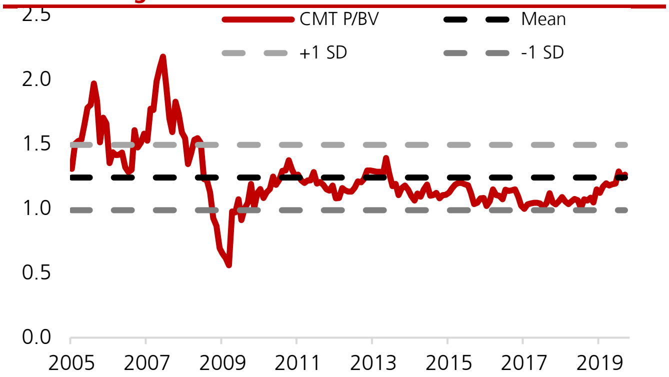
**includes Sembawang Shopping Centre*
Source: Company, DBS Bank

Recovery in Rental Reversions*



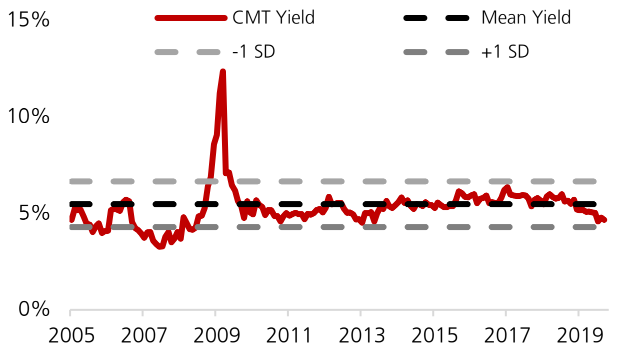
**typically compared to rent commitments three years ago*
Source: Company, DBS Bank

P/NAV Range



Source: Bloomberg Finance L.P., DBS Bank

Yield Trading Range



Source: Bloomberg Finance L.P., DBS Bank

CapitaLand Malaysia Mall Trust (CMMT)

Cautious tone on Klang Valley malls. The focus during our meetings was on operating conditions in the Klang Valley area, which the Manager acknowledged to remain challenging in the face of oversupply of mall space. We understand that approximately 7m sqft of pipeline retail mall space will be added progressively over the next few years, which will bring total NLA of shopping malls in Klang Valley nearly 30% higher from c.24m sqft currently.

Occupancy at The Mines dropped 8ppts to 80.1% in 2Q19 following the departure of anchor tenant and supermarket operator Giant. The mall also turned in negative rental reversions of c.14.9%, mainly due to strategies aimed at raising underlying occupancy. The situation at Sungei Wang is similar, occupancy has fallen to c.75% from its peak of over 90% in 2014 when adjoining mall Bukit Bintang Plaza was still in operation.

But dominant malls continue to shine. Overall, CMMT's portfolio occupancy was fairly healthy at c.90.9% (though lower q-o-q from 92.5% in 1Q19), anchored mainly by its flagship assets Gurney Plaza in Penang and East Coast Mall in Kuantan, which we believe are leading malls in their respective sub-markets. These two malls in aggregate contributed c.75% of 2Q19 portfolio NPI and should continue to shine – particularly Gurney Plaza, whose premium positioning has proven to be popular with both tourists and locals alike.

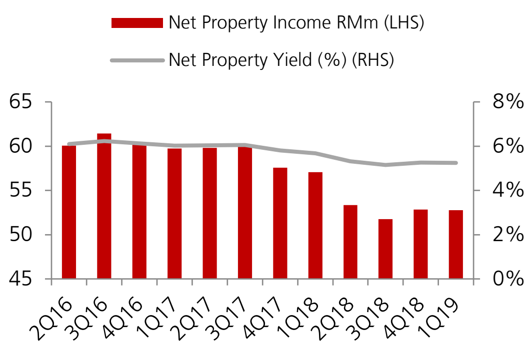
Rental reversions for Gurney Plaza averaged 3.3% in 1H19 and while headline reversions for East Coast Mall posted a 7.0% decline, which was mainly tactical in nature following the amalgamation of two shop lots, and would have otherwise been positive.

Going forward, plans to bring its F&B component up to 30% of Gross Rental Income (GRI), in line with global trends, from c.20.1% in 2Q19 could help deflect some of the challenges from e-commerce, which currently represents c.4-5% of retail spending in Malaysia. Near term, we note that approximately 31.4% of CMMT's NLA will come up for renewal in 2H19, and with Gurney Plaza constituting the majority (c.45%) of expiring leases, this could help drive a recovery in 2H19 rental reversionary trends vs 1H19.

Planned AEIs to position CMMT for the long haul. Negative impact arising from the ongoing AEI for Jumpa (NLA of c.112,000 sqft) at Sungei Wang Plaza has been largely reflected in 2Q19 DPU but is poised for a turnaround from end-3Q19 as ongoing works near completion. While pre-leasing commitment is estimated to be c.65%, we expect interest from prospective tenants to increase given its favourable location along the premier shopping belt, which should see occupancy heading back above 80-85% in the near-term, according to management.

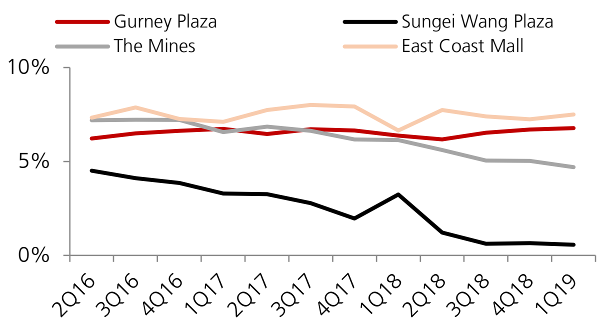
Beyond Sungei Wang Plaza, there are plans to launch a value enhancement initiative for Gurney Plaza in late 2H19, which includes the reconfiguration of shop lots at level four to create a new food street (from home furnishing previously). The Manager is optimistic that the improved offerings would enhance the value proposition and growth profile of its crown jewel over the long-term.

NPI Yield on a Bottoming Trend



Source: Company, DBS Bank

Sungei Wang a Temporary Drag on NPI Yield Amid Ongoing AEI



Source: Company, DBS Bank

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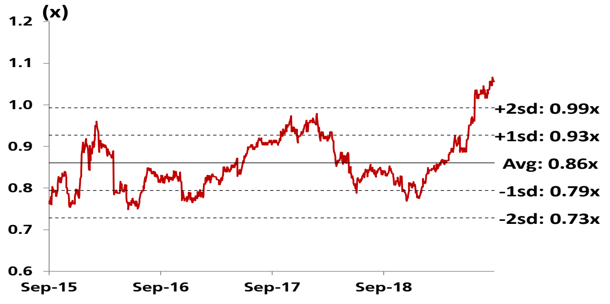

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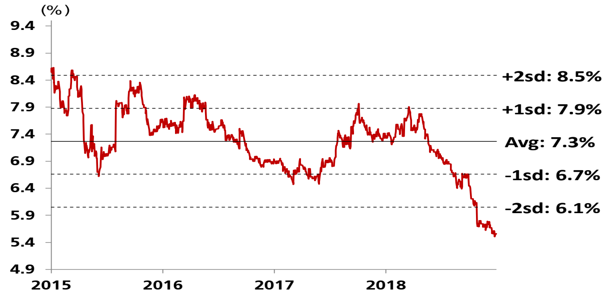
Yield Trading Range



Source: Bloomberg Finance L.P., DBS Bank

CapitaLand Retail China Trust (CRCT)

Focus back to core Tier 1 and 2 cities following successful CapitaMall Wuhu divestment. CRCT's assets are largely located in Tier 1 and 2 provincial capital cities - each serving a unique catchment area and generally well-connected via major transportation links. Underlying tenancies are tailored to the unique demographic profiles of each catchment area.

The Beijing (Tier 1) properties, though fairly mature, helps augment DPU stability, and should continue to do well on the back of limited new supply around the third and fourth ring roads. Meanwhile, the group's less mature assets in Tier 2 cities should continue to benefit from higher capital inflows as international brands venture out and expand their retail footprint to capture positive demographic trends in these new geographies. Likewise, the group's three newly acquired properties - CapitaMall Xuefu, CapitaMall Aidemengfun and CapitaMall Yuhuating - will provide CRCT access into the Harbin and Changsha regions come 3Q 2019.

Going forward, contributions from Tier 1 cities should continue to dominate as CRCT maintains a disciplined approach towards AUM expansion and DPU growth. The gravitation towards dominant assets in higher growth markets is also likely to remain a recurrent theme going forward, which offers a balance between stability and growth.

Rising above e-commerce challenges. Apart from RMB volatility, discussions on the retail landscape were mainly centered around the slowdown in headline retail sales growth in China and e-commerce related challenges.

To smoothen out exchange rate volatilities, we understand that at least 50% of distributable income is typically hedged forward by six months. Next, while the Manager observed that headline retail sales growth of c.6% in 2018 was notably lower compared to the double-digit levels delivered five years ago, attention was drawn to the enlarged retail sales base of approximately RMB38.1 tn in 2018 - an expansion of nearly 60% since 2013, which is commendable.

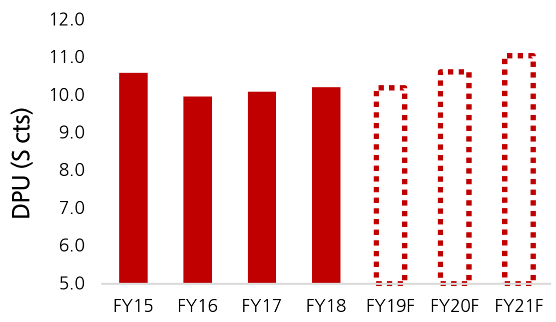
While e-commerce in China gained higher market share in 2018, expanding 3.4% y-o-y to 18.4%, physical channels still continued to dominate. The expansion of online retailers like Alibaba into physical space further illustrates the importance of having a balanced online-to-offline strategy and by extension, continues to underscore the relevance of brick-and-mortar concepts in modern consumerism.

CRCT's portfolio of favourably located and well-managed malls positioned to necessity shopping have proven to fare better in this regard. Coupled with the introduction of more experiential-based concepts, shopper engagement initiatives, targeted tenant repositioning exercises and active tenancy adjustments, have enabled CRCT to rise above e-commerce headwinds and deliver growth. This is evidenced by the group's strong tenant sales growth of 6.7% y-o-y for 1H19 and positive rental reversion of c.7.5%.

Replication of Rock Square success story, M&A to supercharge growth. Proactive tenant remixing and repositioning opportunities post the Rock Square acquisition have translated into consistent double-digit rental reversions, ranging between 15.1% to 29.3%. The 26% y-o-y growth in tenant sales bodes well for sustainability of rents, and further demonstrates the Manager's ability to identify lucrative M&A opportunities and extract lasting value. CRCT is likely to employ a similar strategy for its three newly acquired properties, which should feature positively in rental reversions and DPU growth over the medium term.

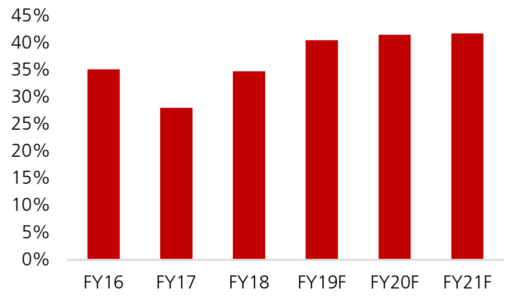
Management is keen to acquire especially assets with growth potential in tier 1 and 2 cities, which implies that scope for asset enhancements will remain a key factor when evaluating acquisitive opportunities that may arise in future. Meanwhile, from a geographical perspective, priority is likely to remain with provincial cities with positive demographic trends, particularly cities where the Sponsor already has a presence. Riding on robust demand fundamentals and visible organic growth catalysts - which coupled with selective value-accretive M&A opportunities, could supercharge CRCT's growth in the years ahead.

Execution on Organic and Inorganic Growth Catalysts to Drive Record DPUs



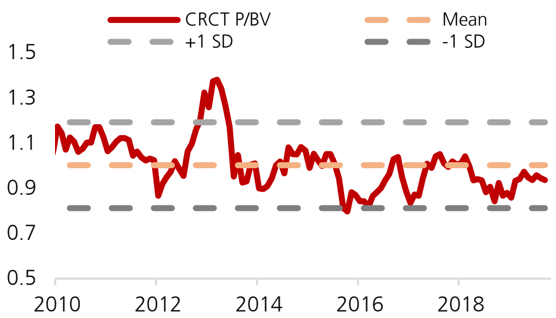
Source: Company, DBS Bank

Gearing Profile: Headroom Remains



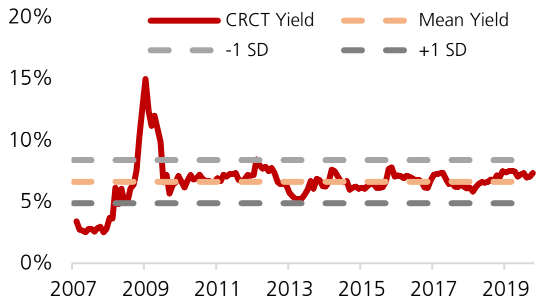
Source: Company, DBS Bank

P/NAV Range



Source: Bloomberg Finance L.P., DBS Bank

Yield Trading Range



Source: Bloomberg Finance L.P., DBS Bank

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