

# CapitaLand Commercial Trust (CCT SP)

## Look Beyond the DPU Dilution

### Maintain BUY; Building in a slight DPU dip after AST2

3Q17 results were in line. The loss of income from its recent divestments was offset by distribution of its gains. While the office market has reached a turning point, negative reversions could persist in the near term as expiring rents remain high. We build in the impending acquisition of Asia Square Tower 2 (AST2) and its recent rights issue. This lowers our FY18-19E DPU by 2%. We roll forward our valuation basis and trim our TP to SGD1.77, based on an unchanged target yield of 5.0%. We believe investors should look beyond the potential DPU dilution and focus on value creation from the redevelopment of GSCP and active management of AST2. Maintain BUY.

### Results in line; Supporting DPU by distributing gains

3Q17 DPU rose 2.6% YoY to 2.36 SGD cts. Management offset the loss of income from the recent divestments with SGD3.3m of distributions from their sale. This also helps mitigate the enlarged share base from the recent CB conversions. Going forward, management could continue to support its distributions with divestment gains and other tax-exempt income on its books.

### Higher occupancy; Negative reversions could persist

Portfolio occupancy rose 0.9ppt to 98.5% with strong occupancy across the board. While the office market has reached a turning point, we expect negative rental reversions to persist in the near term as expiring rents remain higher than what's achievable in the market today. However, with 10%/33% of office space due for renewal in 2018/19, a stronger-than-expected market recovery could present upside to income.

### Value creation from AST2 and GSCP redevelopment

We believe active asset management of AST2 will offset negatives from the slight DPU dilution from this [acquisition](#). CCT will be acquiring the property at a discount to comparable properties in the vicinity and our estimated replacement cost of a new office building in the CBD. Successful redevelopment of Golden Shoe Carpark ([GSCP](#)) will crystalize 2.9 cts of development surplus when completed in 2021.

FYE Dec (SGD m)	FY15A	FY16A	FY17E	FY18E	FY19E
Revenue	273	299	320	384	391
Net property income	213	231	251	303	312
Core net profit	215	239	249	295	302
Core EPU (cts)	7.0	7.8	7.6	8.2	8.3
Core EPU growth (%)	(7.1)	10.5	(2.5)	7.8	2.3
DPU (cts)	8.6	9.1	9.1	8.8	9.0
DPU growth (%)	1.9	5.3	(0.3)	(2.4)	1.4
P/NTA (x)	0.9	0.9	0.9	0.9	0.9
DPU yield (%)	5.2	5.5	5.5	5.3	5.4
ROAE (%)	5.9	5.0	8.7	4.6	4.8
ROAA (%)	3.3	3.3	2.9	3.2	3.3
Debt/Assets (x)	0.19	0.33	0.28	0.29	0.30
Consensus DPU	-	-	8.7	8.7	8.7
MKE vs. Consensus (%)	-	-	3.6	1.1	2.6

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# BUY

Share Price	SGD 1.66
12m Price Target	SGD 1.77 (+7%)
Previous Price Target	SGD 1.81

### Statistics

52w high/low (SGD)	1.70/1.41
3m avg turnover (USDm)	11.1
Free float (%)	67.1
Issued shares (m)	2,955
Market capitalisation	SGD4.9B
	USD3.6B

### Major shareholders:

CapitaLand Ltd.	31.9%
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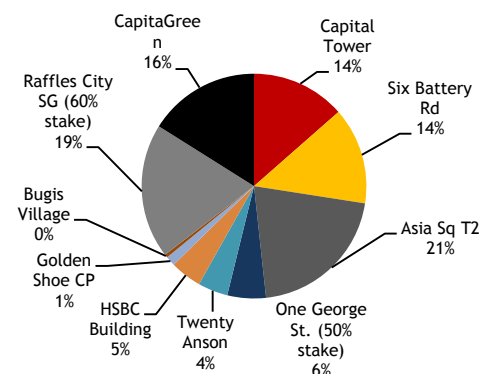
### Price Performance



	-1M	-3M	-12M
Absolute (%)	(0)	(1)	9
Relative to index (%)	(3)	(1)	(7)

Source: FactSet

### Exposure summary



Source: Maybank Kim Eng, Company

\*DPU forecasts has built-in full conversion of outstanding CBs.

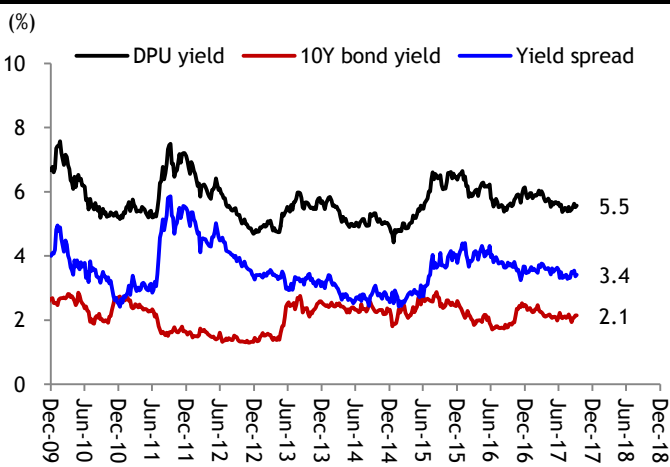
Figure 1: Quarterly profit and loss

FYE 31 Dec	3Q16 (SGD m)	2Q17 (SGD m)	3Q17 (SGD m)	Change		YTD17 (SGD m)	% of FY	FY17E (SGD m)
				QoQ %	YoY %			
Property income	74.4	87.5	74.1	(15.3)	(0.4)	251.2	78.4	320.3
Property expenses	(17.4)	(18.4)	(15.6)	(15.2)	(10.4)	(53.7)	77.6	(69.2)
<b>Net property income</b>	<b>57.0</b>	<b>69.1</b>	<b>58.6</b>	<b>(15.3)</b>	<b>2.7</b>	<b>197.5</b>	<b>78.7</b>	<b>251.1</b>
Share of results of associates & JVs	22.2	25.9	23.5	(9.3)	6.0	69.3	92.3	75.1
<b>Distributable income to unitholders</b>	<b>68.3</b>	<b>69.5</b>	<b>73.1</b>	<b>5.2</b>	<b>7.0</b>	<b>213.9</b>	<b>77.5</b>	<b>275.9</b>
<b>Distribution per unit</b>	<b>2.30</b>	<b>2.27</b>	<b>2.36</b>	<b>4.0</b>	<b>2.6</b>	<b>6.95</b>	<b>76.8</b>	<b>9.05</b>
NAV per unit (SGD)	1.75	1.85	1.84	(0.5)	5.1			
Aggregate leverage (%)^	37.8	36.0	33.9	(210)	(390)			
All-in financing cost (%)^	2.50	2.60	2.70	10	20			

^Change in basis points

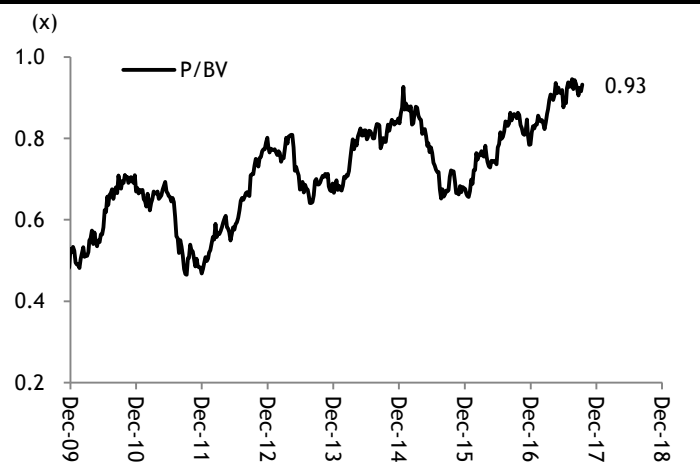
Source: Company, Maybank Kim Eng

Fig 2: Trading yield at the low end of history



Source: Bloomberg, Maybank Kim Eng

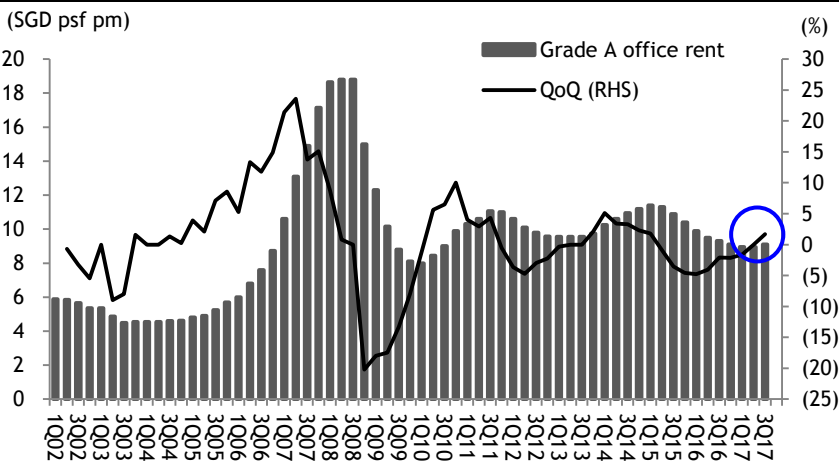
Fig 3: Peak P/BV justified by undemanding carrying value of its assets and significant gains booked from recent asset sales



Source: Bloomberg, Maybank Kim Eng

Fig 4: Grade A office rents

Preliminary data from CBRE showed a marginal uptick in rents to SGD9.10 psf pm in 3Q17.

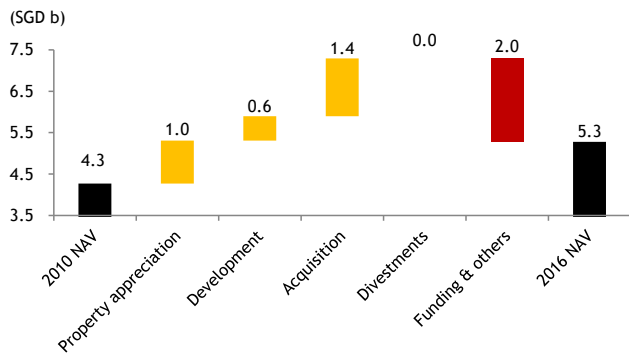


Source: CBRE, Maybank Kim Eng

## Value Proposition

- CCT is a commercial REIT with most of its office buildings in Singapore’s CBD. Backed by CapitaLand, one of the largest property developers in Singapore.
- Good proxy for Singapore’s commercial property market with SGD10b of assets after the acquisition of Asia Square Tower 2. Singapore’s office market is bottoming out.
- Record of value creation for unit holders. Redeveloped Market Street Carpark into a new office building, CapitaGreen.
- Impending redevelopment of Golden Shoe Carpark is an avenue of value creation in the future. Inorganic acquisitions can further lift DPUs.

### NAV changes

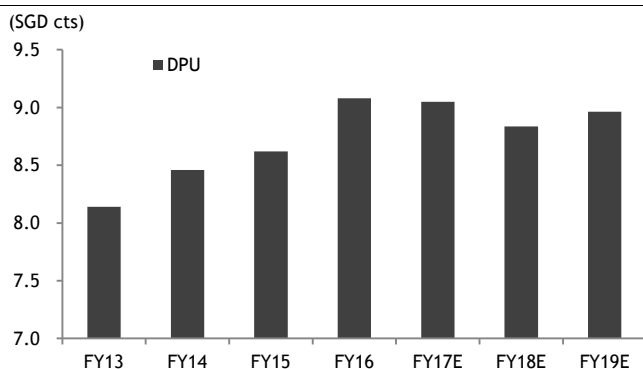


Source: Company, Maybank Kim Eng

## Financial Metrics

- We forecast stable DPUs as incremental contributions from CapitaGreen should ensure income stability.
- Aggregate leverage could fall to 32% after recent divestments and CB conversions. Gearing remains comfortable at 37.1% after its impending acquisition of Asia Square Tower 2.
- CCT could mitigate income loss from the redevelopment of Golden Shoe and recent asset sales by distributing SGD34m worth of tax-exempt income on its books.
- Distribution yields could stay low on narrowing office cap rates. Golden Shoe redevelopment offers DPU upside beyond our forecast horizon.

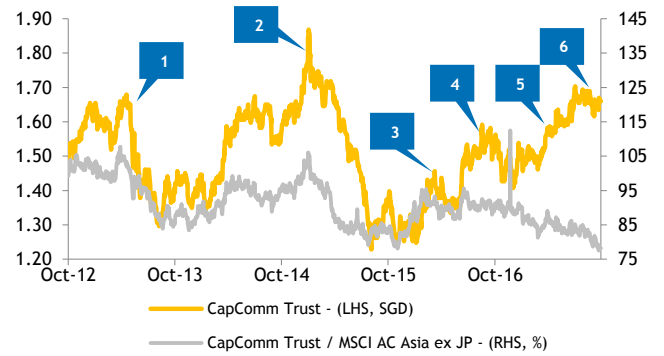
### Chart Header



Source: Company

## Price Drivers

### Historical share price trend



Source: Company, Maybank Kim Eng

1. Fed raised interest rates. Global yield assets sold off.
2. Office rents peaked in Singapore. Concerns about oversupply.
3. Sharp fall in bond yields on heightened risk aversion after Brexit. Rotation to stable income-producing properties.
4. Fed announces second rate hike. Yield sensitive assets under pressure.
5. Sale of a 50%-stake in One George Street and fringe asset Wilkie Edge at significant premiums over book.
6. Acquisition of Asia Square Tower 2.

## Swing Factors

### Upside

- Appreciation in capital value of its properties.
- Successful redevelopment of assets such as Golden Shoe Carpark.
- Earlier-than-expected rebound in office rents.

### Downside

- Sharper-than-expected declines in office rents or occupancy.
- Overpaying for acquisitions.
- Cost overruns in any redevelopment projects.

FYE 31 Dec	FY15A	FY16A	FY17E	FY18E	FY19E
<b>Key Metrics</b>					
Price/DPU(x)	19.3	18.3	18.3	18.8	18.5
P/BV (x)	0.9	0.9	0.9	0.9	0.9
P/NTA (x)	0.9	0.9	0.9	0.9	0.9
DPU yield (%)	5.2	5.5	5.5	5.3	5.4
FCF yield (%)	5.5	32.5	3.8	6.8	6.9
<b>INCOME STATEMENT (SGD m)</b>					
Revenue	273.2	298.6	320.3	384.0	390.9
<b>Net property income</b>	<b>212.8</b>	<b>231.3</b>	<b>251.1</b>	<b>303.0</b>	<b>311.9</b>
Management and trustee fees	(17.6)	(17.6)	(18.4)	(23.1)	(23.3)
Net financing costs	(32.1)	(46.2)	(61.8)	(66.4)	(71.2)
Associates & JV	97.3	85.7	75.1	81.1	83.6
Exceptionals	0.0	(8.9)	0.0	0.0	0.0
Other pretax income/expenses	66.5	27.1	260.4	0.0	0.0
<b>Pretax profit</b>	<b>307.4</b>	<b>261.8</b>	<b>508.9</b>	<b>297.2</b>	<b>304.5</b>
Income tax	(0.1)	(1.2)	0.0	(2.6)	(2.6)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
<b>Total return avail to unitholders</b>	<b>307.3</b>	<b>260.6</b>	<b>508.9</b>	<b>294.6</b>	<b>301.9</b>
Preferred Dividends	0.0	0.0	0.0	0.0	0.0
Distributable inc to unitholders	254.5	269.0	276.1	319.1	324.4
<b>BALANCE SHEET (SGD m)</b>					
Cash & Short Term Investments	81.2	160.0	91.3	104.6	94.9
Accounts receivable	43.5	41.6	41.6	41.6	41.6
Property, Plant & Equip (net)	1.3	1.4	1.5	1.6	1.7
Investment properties	4,961.7	6,590.5	7,328.5	7,328.5	7,328.5
Intangible assets	3.4	2.1	1.1	0.1	0.1
Investment in Associates & JVs	1,452.4	1,189.8	1,560.3	1,636.2	1,736.2
Other assets	49.0	65.7	66.4	67.0	67.7
<b>Total assets</b>	<b>6,592.5</b>	<b>8,051.1</b>	<b>9,090.8</b>	<b>9,179.7</b>	<b>9,270.7</b>
ST interest bearing debt	0.0	173.5	0.0	0.0	0.0
Accounts payable	37.3	52.8	52.8	52.8	52.8
LT interest bearing debt	1,254.9	2,457.2	2,580.0	2,680.0	2,780.0
Other liabilities	66.2	89.2	90.1	91.0	91.9
<b>Total Liabilities</b>	<b>1,358.4</b>	<b>2,772.6</b>	<b>2,722.8</b>	<b>2,823.7</b>	<b>2,924.7</b>
Shareholders Equity	5,234.1	5,278.5	6,367.9	6,355.9	6,346.0
Minority Interest	0.0	0.0	0.0	0.0	0.0
<b>Total shareholder equity</b>	<b>5,234.1</b>	<b>5,278.5</b>	<b>6,367.9</b>	<b>6,355.9</b>	<b>6,346.0</b>
<b>Total liabilities and equity</b>	<b>6,592.5</b>	<b>8,051.1</b>	<b>9,090.8</b>	<b>9,179.7</b>	<b>9,270.7</b>
<b>CASH FLOW (SGD m)</b>					
<b>Cash flow from operations</b>	<b>196.8</b>	<b>203.1</b>	<b>249.0</b>	<b>293.7</b>	<b>302.4</b>
Capex	(0.2)	(0.2)	(0.1)	(0.1)	(0.1)
Acquisitions & investments	0.0	(356.9)	(368.3)	(75.0)	(100.0)
Disposal of FA & investments	0.0	0.0	0.0	0.0	0.0
Dividend income from associates	87.2	90.7	72.8	80.3	83.6
Other investing cash flow	(23.3)	7.0	(473.6)	2.3	2.6
<b>CF from investing activities</b>	<b>63.7</b>	<b>(259.4)</b>	<b>(769.2)</b>	<b>7.5</b>	<b>(13.9)</b>
Dividends paid	(251.9)	(257.1)	(297.5)	(319.1)	(324.4)
Interest expense	(33.4)	(71.5)	(65.8)	(68.7)	(73.8)
Change in debt	5.0	463.7	(50.6)	100.0	100.0
Equity raised / (purchased)	0.0	0.0	865.4	0.0	0.0
Other financial activities	0.0	0.0	0.0	0.0	0.0
<b>CF from financing activities</b>	<b>(280.4)</b>	<b>135.1</b>	<b>451.5</b>	<b>(287.8)</b>	<b>(298.3)</b>
Effect of exchange rate changes	0.0	0.0	0.0	0.0	0.0
<b>Net cash flow</b>	<b>(19.9)</b>	<b>78.8</b>	<b>(68.7)</b>	<b>13.3</b>	<b>(9.8)</b>

FYE 31 Dec	FY15A	FY16A	FY17E	FY18E	FY19E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	4.0	9.3	7.3	19.9	1.8
Net property income growth	3.7	8.7	8.6	20.7	2.9
Core net profit growth	(6.0)	11.2	4.0	18.5	2.5
Distributable income growth	2.1	5.7	2.6	15.6	1.7
<b>Profitability ratios (%)</b>					
Net property income margin	77.9	77.5	78.4	78.9	79.8
Core net profit margin	78.7	80.1	77.6	76.7	77.2
Payout ratio	82.7	87.1	58.5	108.3	107.5
<b>DuPont analysis</b>					
Total return margin (%)	nm	87.3	nm	76.7	77.2
Gross revenue/Assets (x)	0.0	0.0	0.0	0.0	0.0
Assets/Equity (x)	1.3	1.5	1.4	1.4	1.5
ROAE (%)	5.9	5.0	8.7	4.6	4.8
ROAA (%)	3.3	3.3	2.9	3.2	3.3
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	4.9	2.9	3.3	3.3	3.2
Net gearing (%) (excl. perps)	22.4	46.8	39.1	40.5	42.3
Net interest cover (x)	6.0	4.6	3.8	4.2	4.1
Debt/EBITDA (x)	6.5	12.4	11.1	9.6	9.6
Capex/revenue (%)	0.1	0.1	0.0	0.0	0.0
Net debt/ (net cash)	1,173.7	2,470.7	2,488.7	2,575.4	2,685.1
Debt/Assets (x)	0.19	0.33	0.28	0.29	0.30

Source: Company; Maybank

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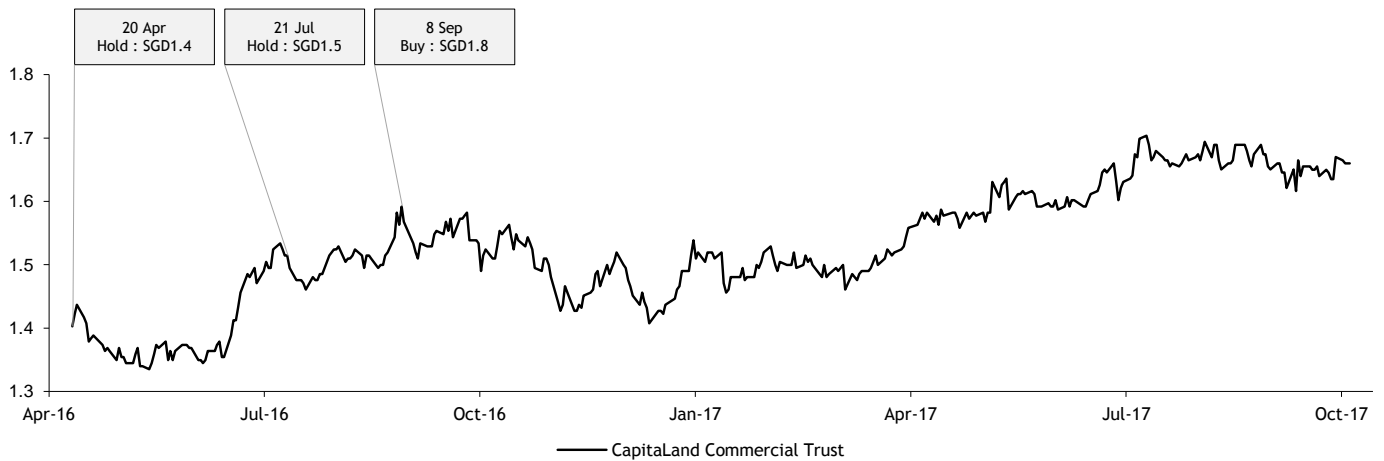
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