CapitaLand Commercial Trust

Forging ahead with AEIs and acquisition in Germany

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SINGAPORE | REAL ESTATE (REIT) | 2Q19 RESULTS

- 2Q19 NPI and DPU in line with our estimates.
- Positive rental reversions ranging 4.4% to 27.5% above the average expiring rent. Outlook positive as leases expiring in 2019/20 are below current market rents.
- 2 AEIs, seven-year lease of 21 Collyer Quay to We Work and acquisition of Main Airport Centre in Frankfurt, Germany announced.
- Maintain NEUTRAL, higher TP of S$2.18 reflects our downward revision of COE from 6.76% to 6.34% due to the lower interest rate environment, and incorporates higher revenues from AEIs, new shares from placement, and the proposed acquisition of MAC.

Results at a glance

(SGD mn)	2Q19	2Q18	*YoY (%)*	Comments
Gross Revenue	101.0	98.0	3.0%	Mainly due to contributions from Galileo (acquired Jun 18), offset by absence of income due to divestment of Twenty Anson (Aug 18). Higher gross revenue from AST2, 21 Collyer Quay and Capital Tower offset lower income from Bugis Village and Six Battery Road.
Net Property Income	78.4	77.7	0.8%	
Distributable Income	82.4	79.4	3.8%	Includes tax-exempt income of S$3.9mn.
DPU (Cents)	2.20	2.16	1.9%	

Source: Company, PSR

The Positives

+ Positive rental reversions ranging 4.4% to 27.5% above the average expiring rent. With office rents still growing, albeit at a slower rate (2Q19: 1.3% vs 1Q19: 3.2% QoQ), CCT was able to capture positive rental reversions. Reversions ranged 4.4% to 27.5% above the average expiring rents.

+ AEIs at 21 Collyer Quay and 6 Battery Road to give ROI of c.9% and c.8%. AEI at 21 Collyer Quay comes after a 14-year master lease to HSBC (ending April 2021) and capitalises on transitional occupancy downtime, before the lease to We Work kicks in early 2Q21. The AEI will cost S$45mn and the refreshed building will be able to command higher rents, giving an estimated 9% ROI. S$35mn AEI to create a new through-block link with F&B units in the retail podium, and reconfigure space in levels 3 to 10 of the office block. The office tower will remain in operation and while the AEI is conducted in phases from 1Q20 to 3Q21. ROI of c.8% is expected to come from better floor configuration as well as new F&B tenants in the podium block.

+ New seven-year lease of 21 Collyer Quay to We Work commencing early 2Q21 (post-AEI). This will put CCT's exposure to co-working operators at 7%. The lease has no break clause and periodic rental step-ups.

The Negatives

- DPU disruption is possible as revenues affected by the lack of income during AEI. 21 Collyer Quay will not be generating cash rents during the AEI and fit-out period from 2Q20 to 2Q21. However, the long runway until 2Q20 gives CCT the ability to grow revenues to offset maintain DPU stability. If approved, the proposed acquisition of MAC (elaborated below) and subsequent completion in 4Q19 will help to grow and stabilize DPUs. Options to distribute capital gains and tax savings exist which the management can explore. However, the management has also expressed that their focus will be on longer-term growth over transitional disruptions to DPU.

NEUTRAL (Maintained)

LAST DONE PRICE	SGD 2.150
FORECAST DIV	SGD 0.089
TARGET PRICE	SGD 2.181
TOTAL RETURN	5.6%

COMPANY DATA

BLOOMBERG CODE:	CCT SP Equity
O/S SHARES (MN) :	3,750
MARKET CAP (USD mn / SGD mn) :	5929 / 8062
52 - WK HI/LO (SGD) :	2.31 / 1.65
3M Average Daily T/O (mn) :	14.49

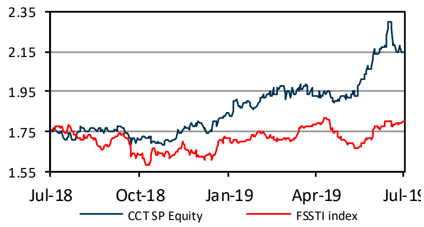
MAJOR SHAREHOLDERS (%)

CAPITALAND	30.1%
BLACKROCK INC	5.2%
VANGUARD GROUP	2.3%
SUMITOMO MITSUI ASSET MGMT	2.2%
SCHRODER INVESTMENT MGMT HK	1.5%

PRICE PERFORMANCE (%)

	1MTH	3MTH	1YR
COMPANY	0.9	11.4	26.3
STI RETURN	2.7	2.6	7.3

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY17	FY18	FY19e	FY20e
Gross Rev (SGD mn)	337	394	399	429
NPI (SGD mn)	265	315	318	343
Dist Inc. (SGD mn)	289	322	338	355
P/NAV (x)	1.09	0.95	1.18	1.17
DPU, adj (Cents)	8.7	8.7	8.9	9.2
Distribution Yield	4.5%	5.0%	4.1%	4.3%

Source: Company Data, Bloomberg

Valuation Method

DDM (Cost of equity 6.34%, Terminal Growth 1.85%)

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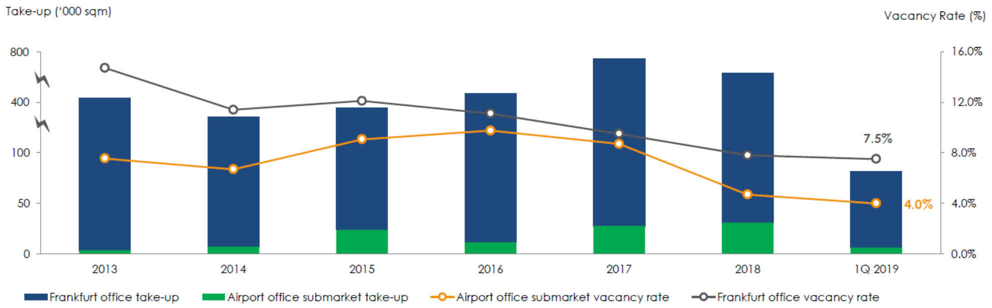
- A slight dip in occupancy, mainly due to AST2. Occupancy at AST2 fell 2.3pp from 98.1% in 1Q19 to 95.8% in 2Q19, due to non-renewal of a single tenant.

What else was new?

The proposed acquisition of 94.5% effective stake in Main Airport Centre (MAC), an 11-story office building located in near the 3rd busiest airport in Frankfurt, Germany. Total acquisition outlay is expected to be S$390 and translates to a 4.0% NPI yield (based on committed occupancy of c.90%) and pro-forma 1H19 DPU accretion of 1% (40% debt) to 2.5% (100% debt). Pro-forma leverage expected to increase from 34.8% to 35-37% and will increase CCT's exposure to Germany from 5% to 8%.

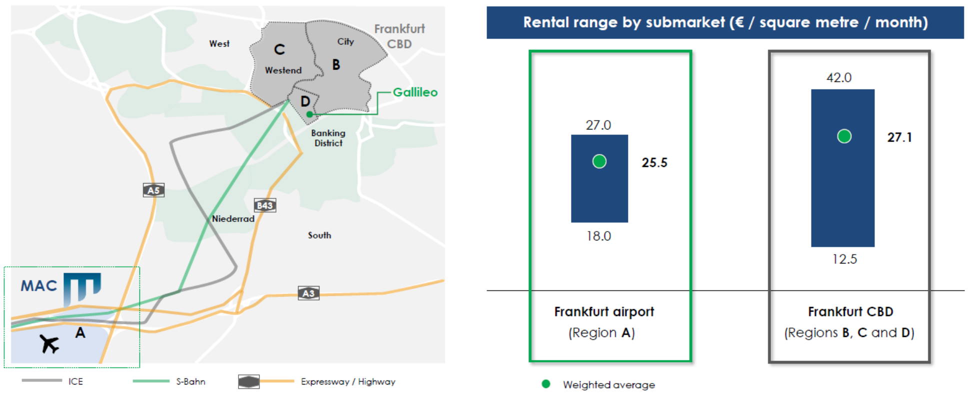
Marco conditions for the airport submarket look positive with vacancy rates for the airport submarket (4.0%) consistently lower than the broader Frankfurt office market (7.5%). The airport submarket rents are also competitive relatively to CBD districts. (€25.5 vs €27.1 psm/month).

Figure 1: Lower vacancy rates for Frankfurt airport submarket compared to overall Frankfurt office vacancy



Source: Company, CBRE Research

Figure 2: Frankfurt airport submarket rents competitive relative to CBD district rents



Source: Company, CBRE Research

This proposed acquisition comes one year after the acquisition of Galileo, CCT's first foray overseas, located in the Frankfurt CBD Banking district. CapitaLand will hold the remaining 5.5% stake in Galileo. If approved by the unitholders at the September 2019 EGM, the acquisition will be headed for a 4Q19 completion.

CCT has closed the private placement of c.102mn new units for $220mn, 98.5% or S$216.7mn will be used to partially fund the acquisition of MAC. Without further equity raising, the LTV for this acquisition will be c.56%.

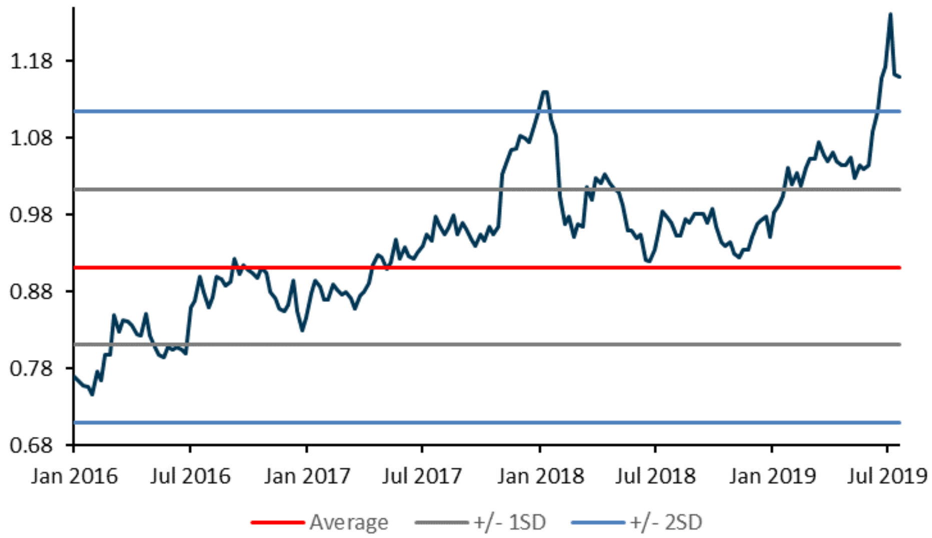
Outlook

Outlook remains positive for CCT, with expiring rents for 2019 and 2020 on the downtrend ($10.35/$9.60 psf, 2021: $10.69 psf), below the average market rent of $11.30. Average annual supply of office space coming onto the market from 2019 to 2023 (0.8mn sqft) is 27% lower than the 10-year average supply of 1.1mn sqft and should help to support rents and deliver positive rental reversions for CCT.

Maintain NEUTRAL with higher TP of $2.18 (prev. $1.93).

We revise our forecasts to incorporate newly announced AEIs, new shares from placement to fund the acquisition of MAC, and the proposed acquisition of MAC. Our higher TP of $2.18 is partly due to the items previously mentioned, and a downward revision of our COE from 6.76% to 6.34%, due to the lower interest rate environment. We maintain NEUTRAL due to the run-up in prices year-to-date and the expensive valuation of >2 std. dev P/NAV which CCT now trades at. Our TP translates to a distribution yield of 4.1% and limited upside of 1.5%.

Figure 1: Historical P/NAV (x)



Source: Bloomberg, PSR

PhillipCapital

Financials

Statement of Total Return and Distribution Statement

Y/E Dec, SGD mn	FY16	FY17	FY18	FY19e	FY20e
Gross Revenue	**299**	**337**	**394**	**399**	**429**
Total Property expenses	(79)	(72)	(79)	(80)	(85)
Net Property Income	219	265	315	318	**343**
Finance costs	(50)	(69)	(85)	(76)	**(83)**
Base Asset management Fees	(6)	(7)	(8)	(8)	**(8)**
Performance Asset management fees	(9)	(9)	(12)	(12)	**(14)**
Net income before JV and associates	160	180	213	223	**240**
Net tax and other adjustments	15	(1)	(306)	(103)	**(107)**
Distribution from JVs	93	98	97	111	**111**
Total distributions for the year	**269**	**289**	**322**	**338**	**355**

Balance Sheet

Y/E Dec, SGD mn	FY16	FY17	FY18	FY19e	FY20e
ASSETS					
Investment properties	6,591	7,408	7,614	8,011	8,086
Trade and other receivables	42	43	49	48	51
Cash and cash equivalents	160	123	175	70	32
JVs	1,190	1,732	1,763	1,923	1,989
Total Assets	**8,051**	**9,354**	**9,691**	**10,094**	**10,199**
LIABILITIES					
Trade and other payables	53	90	64	68	73
Interest bearing liabilities (Current)	-	-	121	148	272
Interest bearing liabilities (Non-current)	2,457	2,720	2,493	2,770	3,030
Convertible bonds	173	-	-	-	-
Total Liabilities	**2,773**	**2,937**	**2,781**	**3,061**	**3,091**
EQUITY					
Shareholder Equity	**5,279**	**6,417**	**6,909**	**7,033**	**7,108**

Per share data (SGD)

Y/E Dec	FY16	FY17	FY18	FY19e	FY20e
Net asset value per unit	1.78	1.78	1.84	1.82	1.84
DPU (S$)	0.091	0.087	0.087	0.089	0.092

Cash Flow

Y/E Dec, SGD mn	FY16	FY17	FY18	FY19e	FY20e
CFO					
Total return for the year before tax	262	583	529	335	356
Adjustments	42	-	300	302	326
WC changes	(16)	(3)	(16)	-	1
Net cash from operating activities	203	251	282	308	328
CFI					
Net cash from investing activities	(259)	(902)	59	(402)	(19)
CFF					
Interest Paid	(72)	(65)	(71)	(76)	(83)
Distributions to Unitholders	(257)	(280)	(304)	(338)	(355)
Net cash used in financing activities	207	(255)	(288)	(11)	(347)
Net (decrease)/increase in cash/equi	150	(37)	52	(105)	(39)
Cash and cash equivalents at 31 Dec	**231**	**123**	**175**	**70**	**32**

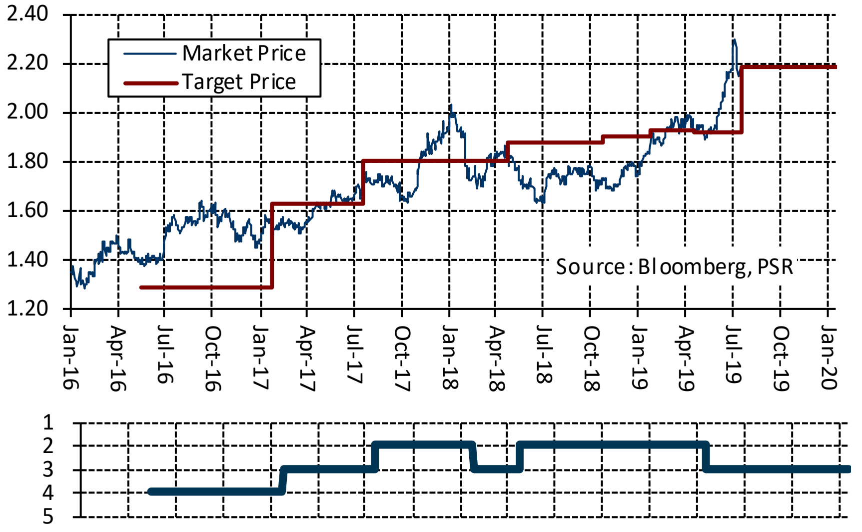
Valuation Ratios

Y/E Dec	FY16	FY17	FY18	FY19e	FY20e
P/NAV	0.81	1.09	0.95	1.18	1.17
Distribution yield (%)	6.3%	4.5%	5.0%	4.1%	4.3%
NPI yield (%)	3.3%	3.6%	4.1%	4.0%	4.2%
Growth & Margins (%)	**FY16**	**FY17**	**FY18**	**FY19e**	**FY20e**
Growth					
Revenue	9.3%	13.0%	16.7%	1.2%	7.5%
Net property income (NPI)	8.7%	14.8%	18.5%	1.2%	7.8%
DPU	5.3%	-4.6%	0.5%	2.3%	3.3%
Margins					
NPI margin	77.5%	78.7%	79.9%	79.8%	80.1%
Operating Income Margin	53.7%	53.3%	54.1%	56.0%	56.0%
Key Ratios					
Net Gearing	30.5%	29.1%	27.0%	28.9%	32.4%

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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