

Sasseur REIT

China's propensity towards luxury goods



SINGAPORE | REAL ESTATE | SITE VISIT NOTE

22 April 2019

We were in China to visit two out of four of Sasseur REIT's (Sasseur) outlet malls, Chongqing mall and Hefei mall, in March 2019, during their annual Spring sale. Sasseur's outlet malls not only offer large discounts on branded goods targeted at the middle class, brand-conscious consumer, but also incorporate numerous activities and entertainment programmes to engage different age group. Unique to Sasseur is its revenue model which is based on an Entrusted Management Agreement (EMA) guaranteeing a minimum revenue level.

Company Background

Listed on the SGX Mainboard on 28 March 2018, Sasseur's portfolio consists of four retail outlet malls located in second-tier cities in China, namely; Chongqing, Bishan, Hefei and Kunming. The REIT's sponsor, Sasseur Cayman Holdings, opened the first Sasseur outlet mall (Chongqing mall) in 2008. The Sponsor's wholly owned subsidiary, Sasseur Shanghai, currently manages 10 Sasseur-branded outlet malls (including the four malls in the REIT's portfolio) in China.

Site Visit Highlights

- Luxury retail demand is here to stay, and grow**
 Chinese consumers account for 33% of luxury spending globally. Pre-2019, much of the spending has taken abroad versus in the PRC due to the lofty taxes imposed on luxury items. Recent governmental policies to reduce import tariffs, lower personal income tax and the imposition of stricter laws on *daigou* (personal shippers who purchase luxury goods abroad to be resold domestically at a profit) are primed to benefit the domestic luxury good market. Luxury outlet malls such as Sasseur's, which already have an advantage over luxury-retailers due to the large discounts offered, will also stand to benefit from these policies aimed at spurring domestic spending. The malls carry a modest number of international luxury and sporting brands (Figure 28). The most sought-after international brands such as Coach, Kate Spade, Nike, Skechers and Adidas enjoy a constant flow of customers and high conversion rates (number of customers who end up purchasing items).
- EMA revenue model underscores importance of active tenant management**
 Although there is a minimum rent guaranteed under the EMA Model, 80% of the gross revenue from which the EMA Resultant Rents (RR) are derived are based on tenant sales. Hence, active management of tenants and tenant mix is vital. Managers of the malls exhibited exemplary knowledge of tenant sales and customer spending patterns, evident that they have been actively engaged in the tenant's day-to-day operations.
- Unique mega-mall concept/first-mover in outlet mega-malls scene**
 Sasseur's malls range from 45,000sqm to 140,000sqm and the number of tenants in each mall ranges from 200 to 400. Their strategy of organising promotional days one a month (which include 4 mega-sale events called "Super Days") had helped to set them apart from the competition, with competitors attempting to replicate the success of the stellar sales raked in during the Super Days. During the Spring sale in March, stages for performance and entertainment (lucky draws and live performances) were erected in common spaces (atrium or outside the malls). Popular brands such as Coach also had tentages which featured clearance items with discounts up to 90%. Children-centric attractions such as guppy-fishing and children rides were also available outside the malls.

SITE VISIT

LAST CLOSE PRICE	SGD 0.800
FORECAST DIV	NA
TARGET PRICE	NA
TOTAL RETURN	NA

COMPANY DATA

BLOOMBERG CODE:	SASSR SP
O/S SHARES (MN) :	1,189
MARKET CAP (USD mn / SGD mn) :	701 / 951
52 - WK HI/LO (SGD) :	0.83 / 0.64
3M Average Daily T/O (mn) :	1.52

MAJOR SHAREHOLDERS (%)

SASSEUR CAYMAN HOLDINGS	57.2%
CORNERSTONE INVESTORS	19.2%
MERITZ SECURITIES CO LTD	6.6%

PRICE PERFORMANCE (%)

	1MTH	3MTH	1YR
COMPANY	8.2	24.4	6.4
STI RETURN	4.6	4.6	(0.7)

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY16	FY17	FY18
Gross Rev. (\$\$ mn)	89	91	94
Total Return After Tax (\$\$mn)	27	47	169
Dist. Inc. (\$\$ mn)	19	65	61
P/NAV (x)	0.92	1.02	0.89
DPU, adj (cents)	1.77	5.52	5.13
Dist. Yield (%)	1.7	5.4	6.4

Source: Company Data, PSR

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Investment Actions

No stock rating or price target provided, as we do not have coverage on Sasseur.

Comparables

Sasseur currently trades at an annualised 8.4% yield which is higher than the 7.4% forecasted yield for 2018. There are no comparable S-REITs focused on outlet malls in China. China-centric retail S-REITs trade at yields between 6.8% to 8.5%.

Retail S-REITs peer relative data (arranged by Mkt. Cap.)

	Mkt. Cap. (S\$ mn)	Price (S\$)	Trailing P/NAV (x)	12M-trailing yield (%)	* Total Debt to Total Assets (%)
SASSEUR REAL ESTATE INVESTME	951	0.80	1.00	6.41	28
CAPITALAND RETAIL CHINA TRUS	1,518	1.52	1.58	6.66	35
FRASERS CENTREPOINT TRUST	2,165	2.33	2.08	5.17	29
CAPITALAND MALL TRUST	8,520	2.31	2.02	4.98	32
MAPLETREE COMMERCIAL TRUST	5,346	1.85	1.48	4.92	35
MAPLETREE NORTH ASIA COMMERC	4,221	1.33	1.32	5.64	36
SPH REIT	2,714	1.05	0.94	5.29	26
STARHILL GLOBAL REIT	1,647	0.76	0.90	5.91	35
DASIN RETAIL TRUST	492	0.88	1.39	8.25	32
BHG RETAIL REIT	354	0.70	0.81	7.37	26
Average			1.35	6.1	31.2

Source: Bloomberg (Updated: 21 April 2019), PSR

An introduction to China’s outlet mall scene

Outlet malls are a relatively new and underdeveloped market in China. In 2016, the China outlet mall industry was worth US\$7.4bn, which paled in comparison to the UK and US outlet store industry of US\$16.6bn and US\$47.4bn, respectively. While China’s population is approximately four times that of the US, Chinese spending per capita at outlet malls was only US\$6 compared to vs US\$140 in the US in 2016. This points to a supply gap in the China outlet industry.

Outlet malls in second-tier cities

Sasseur’s outlet malls are located in Tier 2 cities (Chongqing, Hefei and Kunming), characterised by rapidly expanding middle-class populations. For example, Hefei outlet mall is located near China’s second largest national science centre which is zoned for companies focusing on research in information technology, energy, health, quantum communications and cancer treatment. Subsidies of up to RMB20mn (US\$3mn) were announced in June 2018 to attract high-tech companies to set up factories in the area. Located five minutes away from this hi-tech zone, Hefei will stand to benefit from the workforce that new companies setting up in the hi-tech zone bring. As Tier 2 cities develop, the area will stand to benefit from the increased infrastructure, connectivity and accessibility.

Figure 1: Location of Sasseur’s current malls, ROFR and pipeline assets



Source: Company

Figure 2: Portfolio details

	Chongqing (2008)	Bishan (2014)	Hefei (2016)	Kunming (2016)
GFA (sqm)	73,373	68,791	141,182	88,257
NLA (sqm)	50,885	45,172	138,449	70,067
Occupancy Rate as at 30-9-17 (%)	96.0	85.6	93.3	90.7
Occupancy Rate as at 23-2-18 (%)	96.4	91.5	95.8	96.1
No. of Tenants ⁽¹⁾	414	213	283	209
Car Park Lots	500	400	1,566	2,000
Ownership Interests	100%	100%	100% ⁽²⁾	100%
Valuation (RMB m) ⁽¹⁾⁽³⁾	2,654	789	2,435	1,460
Implied Acquisition Price (RMB m)	2,452	729	2,250	1,350
Capitalisation Rates	7.5%	7.5%	7.5%	8.5%

Source: Company

Entrusted Management Agreement (EMA) Model

The manager and the trustee of the REIT and entered into a Master EMA with the Entrusted Manager (EM), Sasseur Shanghai, for all four of the REIT’s malls. The EMA has a 10 year term commencing 1 March 2018, with an option to extend for another 10 years. Under the EMA, the EM is responsible for the end-to-end-operations of the malls, including but not limited to:

- a) managing tenant relationships and tenant mix
- b) annual budgets, business plans and business strategy
- c) facilitating rental negotiations with the tenants, monitoring sales performance and evaluating prospective tenants
- d) collection of sales proceeds and other receipts
- e) ensuring brand authentication through periodic inspections

Rationale for entering into the EMA

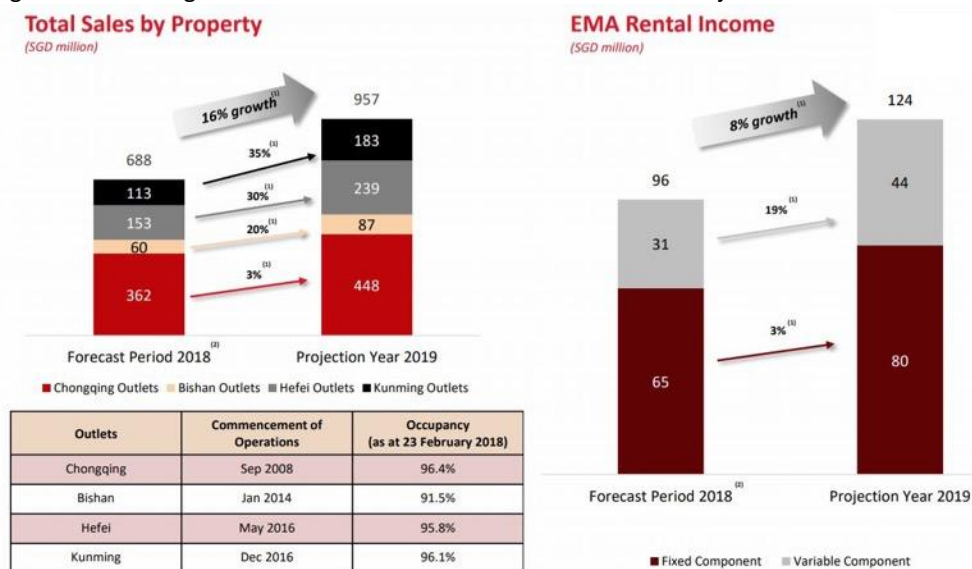
As the EM has more than 10 year of experience operating outlet malls in the PRC, the REIT will be able to leverage on the operational experience and capabilities of the EM. The EM also guarantees the MR, and hence the risks and uncertainties of the outlet mall operations are transferred from the REIT to the EM.

Ancillary tenants such as cinema, zoo and F&B operators are charged a fixed rent with an additional variable component after a predetermined sales level is met. Most of the retail tenants have short term, sales-based leases, whereby the rent is determined solely on gross turnover (GTO). As such, the EM has to actively manage the properties and carefully select and calibrate the tenant mix in order to maximise rental income. The EM also has to work closely with the tenants to help drive and maximise sales.

EMA Model explained

The Minimum Rent (MR) is guaranteed for 10 years, starting 1 March 2018. However, MR guarantee will cease if the EMA RR exceeds the stipulated MR for two consecutive years. MR for the first 2 years, the Forecasted Period 2018 and Projection Year 2019 (Figure 3), are S\$96mn (RMB472.9mn) (pro-rated) and S\$124mn (RMB611.4mn) respectively. The minimum rent for FY2020 onwards (if applicable) shall be equivalent to the Projection Year 2019 Minimum Rent. For FY2018, the REIT has surpassed the MR for the past 3 quarters since listing.

Figure 3: EMA RR growth based on Forecasted Period 2018 and Projection Year 2019 MR



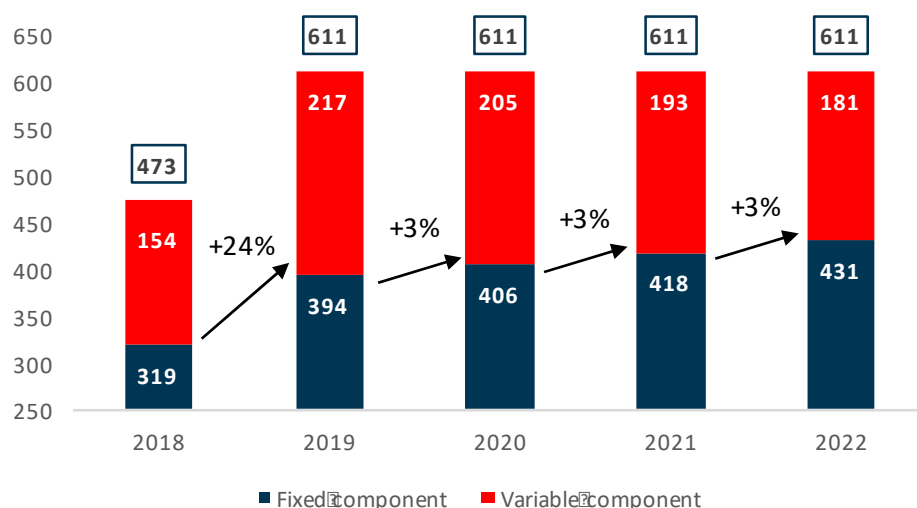
Source: Company

The EMA Resultant Rent (RR) (FY2018: S\$96mn) comprises of two parts – the fixed component (FC) (FY2018: S\$65mn) and the variable component (VC) (FY2018: S\$31). The FC is determined by the Manager and Sponsor, based on forecast Gross Revenue and Property Income of each of the Properties for Forecast Period 2018, and will grow by 24% to S\$80mn in 2019. From 2020 onwards, the FC will grow at 3% (in line with inflation). However, since the MR capped Project Year 2019's MR of S\$124mn (RMB611 mn), what this means is that the MR will stagnate from 2019 to the end of the 10 year term (2028); due to the FC growing at 3%, only the proportion of FC to VC changes as illustrated in Figure 4 and Figure 5 respectively. In the event that the malls do not generate enough sales (and consequently the EMA RR falls short of the MR), the MR will be guaranteed by the Entrusted Manager, Sasseur Shanghai. Only after the MR is satisfied does the EM get paid their base fee, which is capped at 30% of the gross revenue.

Figure 4: Illustration of minimum rent payable

Minimum rent guaranteed	2018F	2019F	2020F	2021F	2022F	Remarks (lifted from prospectus)
Total sales	3,392	4,711	-	-	-	
Gross revenue	545	795	-	-	-	
Gross revenue margin	16.1%	16.9%	-	-	-	
VC as a % of sales	4.5%	4.6%	-	-	-	
Fixed component	319	394	406	418	431	3% increment from 2019, not more than 70% of RR
Variable component	154	217	205	193	181	% of sales
EMA RR (Min. Rent)	473	611	611	611	611	
Growth in FC	-	24%	3%	3%	3%	FC component shall increase at an escalation rate of 3%, in line with inflationary expectations
Growth in MR	-	29%	0%	0%	0%	MR for FY 2020 onwards shall be equivalent to 2019 MR
FC contribution to RR	67%	64%	66%	68%	70%	Not more than 70%
VC contribution to RR	33%	36%	34%	32%	30%	Not less than 30%

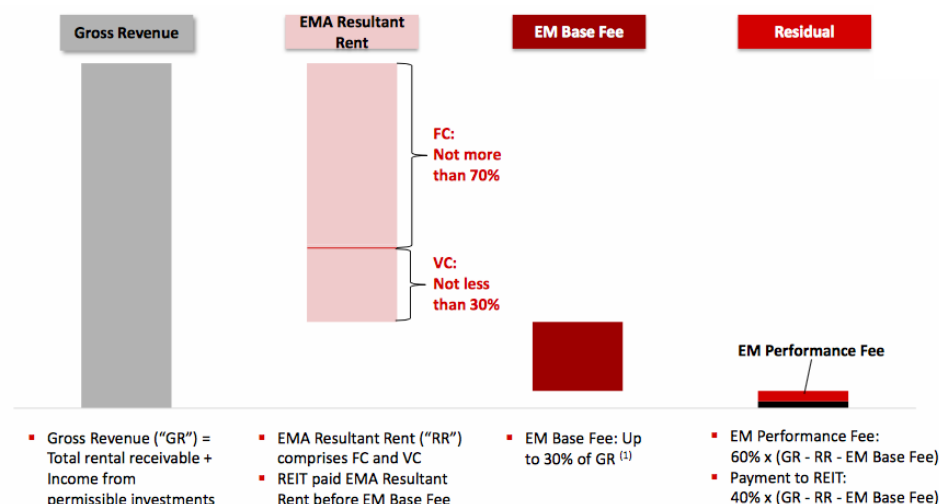
Source: Company, PSR

Figure 5: FC and VC's contribution to MR from 2018 to 2022 (in RMB mn)


Source: Company, PSR

The EMA Model is structured to provide downside protection while allowing upside potential. Should the malls do better than anticipated, the EMA RR will increase with the VC – as the VC, which is directly pegged to GTO of the malls, has to contribute at least 30% of the EMA RR. If there is surplus after paying the EM base fees and EM performance fees, the balance will accrue to unitholders of the REIT.

Figure 6: Calculation of EMA RR and EM base fees



The EM Fee arrangement is pegged to the performance of the Properties so as to incentivise the Entrusted Manager and align its interest with the long-term interest of the REIT and its unitholders

Source: Company

EMA Base and Performance Fees

The EMA Base Fee will be paid out to the EM and is the lower of:

- 30% of Gross Revenue
- Gross Revenue p.a. minus EMA RR

In the event that the gross revenue is less than the MR, the EM will not receive any base fees.

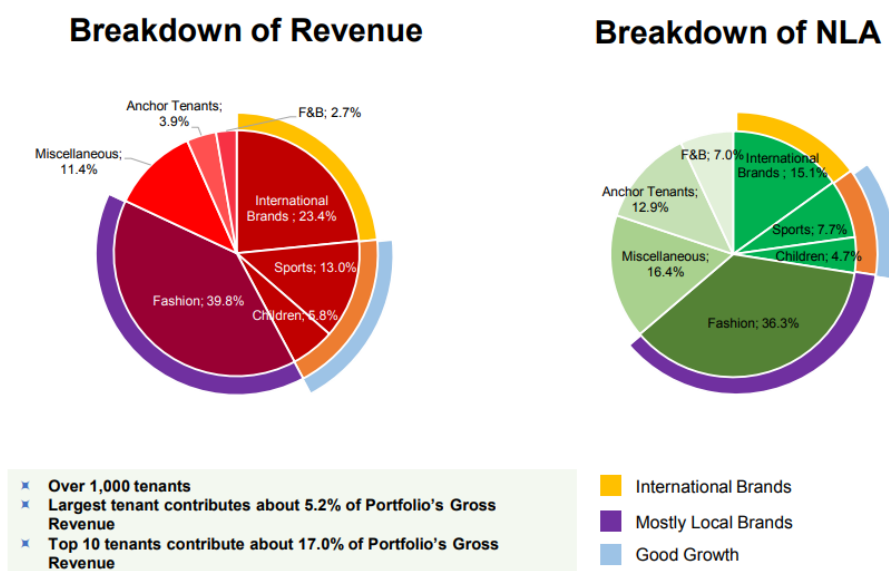
EMA performance fees paid to the EM will be 60% of the residual of the gross revenue after the EMA RR and base fees are paid out, the remaining 40% of the residual will flow back to the REIT.

Figure 7: Illustration of outperformance

Outperformance	2018F	2019F	2020F	2021F	2022F	Remarks
Total Sales	4,410	5,292	5,821	6,403	7,044	
% Growth in Sales	30%	20%	10%	10%	10%	
Gross Revenue	710	852	937	1,031	1,134	
Gross Revenue Margin	16.1%	16.1%	16.1%	16.1%	16.1%	
VC as % of Sales	4.5%	4.5%	4.5%	4.5%	4.5%	
Fixed Component	319	394	406	418	431	3% increment from 2019, not more than 70% of RR
Variable Component	198	238	262	288	317	% of Sales
EMA RR	517	632	668	706	748	
Growth in FC	-	24%	3%	3%	3%	FC component shall increase at an escalation rate of 3% in line with inflationary expectations
Growth in MR	-	22%	6%	6%	6%	
FC contribution to RR	62%	62%	61%	59%	58%	Not more than 70%
VC contribution to RR	38%	38%	39%	41%	42%	Not less than 30%
GR minus RR	1193	1220	1269	1325	1386	
EM Base Fees	1193	1220	1269	1309	1340	Lower of GR minus RR or 30% of GR
Residual	119	119	119	115	146	
EM Performance Fees	119	119	119	119	128	60% of Residual after RR and Base Fees
Total Unitholders of REIT	119	119	119	119	118	40% of Residual after RR and Base Fees

Source: Company, PSR

Figure 8: Breakdown of revenue and NLA by trade sector



As at 31 Dec 2018

Source: Company

Point-of-sale and cash management system

As an added layer of security, all sales generated by tenants will be collected by the EM and held in the bank accounts of the respective malls. The sales proceeds less rent payable to the mall will be released to the tenants approximately 1.5 to 2 months after the sale.

In the 3 quarters since listing in March 2018, Sasseur has managed to exceed their Forecast Year 2018 sales and gross revenue projections. Figure 8 below summarises the performance of the REIT for 4Q18 and FY18.

Figure 9: Performance for 4Q18 and FY18

	FY2018			4Q18		
	Actual	Forecast	Variance	Actual	Forecast	Variance
Fixed Component (RMB mil)	291.2	291.2	-	95.7	95.7	-
Variable Component (RMB mil)	153.5	142.0	+8.1%	61.1	55.6	+9.9%
EMA Rental Income ¹ (RMB mil)	444.7	433.2	+2.6%	156.8	151.3	+3.7%
Exchange Rate (RMB/\$)	4.948	4.930	+0.4%	5.033	4.930	+2.1%
EMA Rental Income ¹ (\$ mil)	89.9	87.9	+2.2%	31.2	30.7	+1.6%
Distributable Income (\$ mil)	60.5	53.8	+12.6%	23.6	18.4	+28.1%
DPU (S cents)	5.128	4.554	+12.6%	1.999	1.561	+28.1%

Source: Company

Observations from our site visit

The two malls we visited, Chongqing and Hefei mall, boasted many popular international brands. The brands such as Coach, Kate Spade, Salvatore Ferragamo, which are more well-received, were located on the first floor. Despite the large floor area, the malls were indeed well occupied - consistent with the reported portfolio occupancy of c.91.8%. International brands, located on the first floor and basement, were the main draw and had the most shopper traffic. Domestic brands filled the remaining 2 to 4 floors. However, shopper traffic at domestic brand stores paled in comparison to international brands. The cinema and zoo (Hefei mall only) took up the highest floors.

Figure 10: Summary of portfolio performance

Outlet	NLA(\$sqm)	Occ.(%)	Sales (RMB\$mn)	YoY(%)	Vs. Forecast (%)
Chongqing	50,855	99.8	1,731	+12.1	+6.0
Hefei	138,449	97.6	764	+53.9	+9.6
Kunming	70,067	94.2	567	+58.5	+8.0
Bishan	47,308	87.9	309	+26.8	+14.7
Portfolio	306,679	95.2	3,371	+27.6	+7.9

Source: Company, PSR

Chongqing mall

The first Sasseur mall and the crown jewel, brought in RMB1,730mn in FY18 while Hefei, Kunming and Bishan bringing in RMB760mn, RMB570mn and RMB310mn respectively. This is despite Chongqing having the second smallest floor area among the assets in the portfolio. As such, the real estate is more expensive and hence, there is less area allocated for entertainment and exhibitions. There were smaller attractions such as a mini-farm with tortoises, iguanas, rabbits and even an alpaca. Although small, the mini-farm was a hit with younger children and activities and exhibitions such as these help to entertain the children while the adults shop. Located on the higher floors, which were dedicated to retailers of children's clothes and toys, were shops that provided pay-per-play games such as guppy-fishing and coloured-sand art.

Hefei mall

With almost 3 times the NLA of Chongqing mall, Hefei mall is the only mall in the portfolio that boasts a zoo, along with a 17 screen cinema facility. The operators of the Matata Zoo and UME Cinema injected c.S\$3mn each into their facility. The most popular stores at Hefei are Coach, Nike, Skechers (Figure 29) and Adidas. These stores and have a consistent flow of customers and are almost always packed. Other notable stores at Hefei are Fila, Under Armour and Kate Spade.

Managers of the malls

We met the respective managers of the malls and it was clear from how well they knew about the tenant sales and customer spending patterns that they were actively engaged in tenant's day-to-day operations. Active management has been cited as one of the key factors that helped grow tenant sales by 27.6% YoY on a portfolio level. On a portfolio level, Sasseur beat their sales and DPU forecast by 7.9% and 12.6% respectively for FY18 (Figure 9 and 10).

Images from our site visit

Figure 11: Façade of Chongqing outlet mall



Source: PSR

Figure 12: Façade of Chongqing outlet mall



Source: PSR

Figure 13: Façade of Chongqing outlet mall



Source: PSR

Figure 14: Mini farm attraction at Chongqing mall



Source: PSR

Figure 15: Mini farm attraction at Chongqing mall



Source: PSR

Figure 16: Multi-brand store carrying Fendi, YSL, Gucci etc.



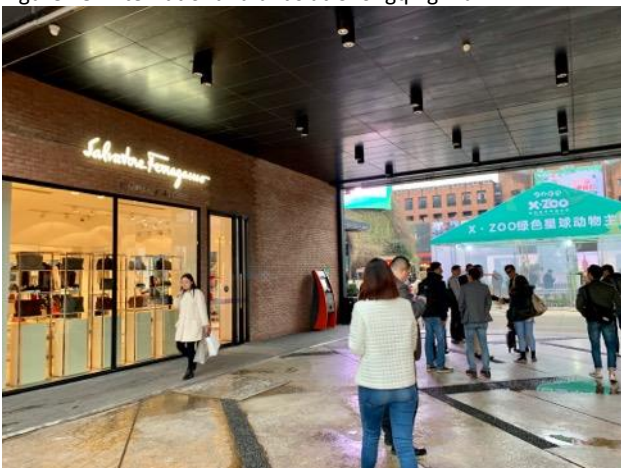
Source: PSR

Figure 17: Chongqing Coach



Source: PSR

Figure 18: International brands at Chongqing mall



Source: PSR

Figure 19: International brands at Chongqing mall



Source: PSR

Figure 20: Popular domestic brands at Chongqing



Source: PSR

Figure 21: Popular domestic brands at Chongqing



Source: PSR

Figure 22: Cinema at Chongqing mall



Source: PSR

Figure 23: View of Chongqing mall



Source: PSR

Figure 24: Façade of Hefei mall



Source: PSR

Figure 25: Façade of Hefei mall – art and photo-taking opportunities



Source: PSR

Figure 26: Activities for children at Hefei mall



Source: PSR

Figure 27: Activities for children at Hefei mall



Source: PSR

Figure 28: Store directory at Hefei mall



Source: PSR

Figure 29: Third most popular store at Hefei, Skechers



Source: PSR

Figure 30: Walk of fame at UME cinema in Hefei mall



Source: PSR

Figure 31: UME cinema at Hefei features 17 screens



Source: PSR

Figure 32: Activities for children at Hefei mall



Source: PSR

Figure 33: Matata zoo at Hefei mall



Source: PSR

Figure 34: Matata zoo at Hefei mall



Source: PSR

Figure 35: Matata zoo at Hefei mall



Source: PSR

Figure 36: Matata zoo at Hefei mall



Source: PSR

Figure 37: Matata zoo at Hefei mall



Source: PSR

Figure 38: Matata zoo at Hefei mall



Source: PSR

Figure 39: Scheduled entertainment and lucky draws at Hefei mall



Source: PSR

Financials

Statement of Total Return and Distribution Statement

Y/E Dec, SGD mn	FY16	FY17	FY18
EMA rental income	89	91	94
Management fee	(5)	(6)	(6)
Trustee fee	(0)	(0)	(0)
Other expenses	(13)	(1)	(11)
Net Finance (Expense)/Inc	(24)	(22)	(21)
FV change, Inv. Properties	(3)	3	183
Total Return Before Tax	44	66	237
Taxation	(17)	(19)	(68)
Total Return After Tax	27	47	169
Attributable to:			
Unitholders	27	47	169
Distribution adjustments	(8)	18	(109)
Income available for distribution	19	65	61

Per unit data

Y/E Dec	FY16	FY17	FY18
NAV (S\$)	0.87	0.78	0.90
DPU (cents)	1.77	5.52	5.13

Cash Flow

Y/E Dec, SGD mn	FY16	FY17	FY18
CFO			
Total Return Before Tax	44	66	237
Adjustments	29	27	(143)
WC changes	(3)	6	13
Cash generated from ops	71	99	107
Others	(11)	(13)	(4)
Cashflow from ops	59	87	103

CFI

Purchase of Inv. propty., net	-	-	-
Capex, net	-	-	(1)
Others	-	-	-
Cashflow from investments	-	-	(1)

CFF

Share issuance, net	-	-	-
Net borrowings	123	(4)	-
Distributions	(19)	(65)	(19)
Interest Paid	(22)	(18)	(18)
Others	(54)	-	43
Cashflow from financing	28	(87)	7
Net change in cash	87	(1)	109
Effects of exchange rate	(0)	(0)	(1)
Ending cash	93	90	165

Source: Company, Phillip Securities Research (Singapore) estimates

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

**Figures for FY17 and FY18 are for 9M ended Sep 2017 and Dec2018

Balance Sheet

Y/E Dec, SGD mn	FY16	FY17	FY18
ASSETS			
Investment properties	1,386	1,386	1,539
Deferred tax	2	6	-
Total non-current assets	1,389	1,392	1,539
Cash	69	109	204
Trade receivables	4	7	26
Others	46	44	-
Total current assets	118	160	229
Total Assets	1,507	1,552	1,769
LIABILITIES			
Borrowings	26	33	8
Trade payables	16	27	143
Others	42	69	8
Total current liabilities	83	129	158
Borrowings	502	502	486
Deferred tax liabilities	-	-	51
Others	-	-	0
Total non-current liabilities	502	502	537
Total Liabilities	585	630	695
Net assets	922	922	1,074
Represented by:			
Unitholders' funds	922	922	1,074

Valuation Ratios

Y/E Dec	FY16	FY17	FY18
P/NAV (x)	0.92	1.02	0.88
Distribution Yield (%)	1.7	5.4	6.5
Growth (%)			
Revenue	NA	2.0%	2.5%
Distributable income	NA	245.3%	-7.0%
DPU	NA	210.7%	-7.0%
Key Ratios			
Gearing (%)	NA	36.0%	29.0%

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