Asia Credit Research

CapitaLand Commercial Trust: Credit Update

Thursday, 28 July 2016

Acquiring Tenants

- **No escaping sector woes**: For 2Q2016 results, CCT reported gross revenue declining 2.2% y/y to SGD67.6mn while net property income ("NPI") fell 4.5% y/y to SGD51.5mn. Gross revenue was weighed down by weakness at Capital Tower (property gross revenue lower 7.6% y/y) and One George Street (property gross revenue lower 5.4% y/y). NPI was pressured by higher leasing commission expenses, which caused property operating expenses to increase 5.7% y/y. Despite the lower NPI, distributable income was up 1.0% due to contributions from joint ventures (Raffles City and CapitaGreen), driven by the ramping up of occupancy at CapitaGreen.

- **Sharp decline at One George Street**: Committed portfolio occupancy rates worsened q/q from 98.1% (end-1Q2016) to 97.2% (end-2Q2016), largely due to the sharp fall in occupancy at One George Street (fell from 99.4% to 91.3% q/q). We believe that the vacancies at One George Street could be driven by the departure of RBS, which was reported to vacate two floors (60,000 sqft) when their lease expired at the end of March 2016. It was last reported that ~25% of the RBS space has been pre-committed. CCT's reported committed office occupancy for its office portfolio of 96.9% remains still stronger than CBRE's Singapore core CBD office occupancy of 95.1%.

- **2H2016 lease renewals manageable, 2017 a challenge**: Despite the challenging environment given the looming supply of new office assets coming on stream from 2H2016, it was commendable that CCT was able to report positive rental reversions for leases committed in 2Q2016, as well as for most leases committed in 1Q2016. In addition, CCT was able to reduce its 2016 lease expiries further to just 4% of NLA (it was 10% as of end-2015). CCT has also started to renew 2017 expiries as well, bringing it down to 10% of NLA. The aggregate 14% of NLA to be renewed till end-2017 is a lot more manageable compared to 27% of NLA reported half a year ago. The renewals have also caused WALE to improve slightly q/q to 7.4 years (1Q2016: 7.3 years). Looking forward though, we believe there would be rental reversion pressure in 2017 (or earlier, as we expect REIT managers in general to provide lease concessions to quickly renew looming lease expiries). The Six Battery Road asset is particularly tricky, consisting of ~50% portfolio office lease expiry (by rental income) for 2017, given the high average expiring rent of SGD12.32 psf compared to CBRE's Grade A office average market rent of SGD9.50 psf for 2Q2016. There are sizable lease expiries at One George Street as well, but its average expiring rent for 2017 is a lot more manageable at SGD9.63 psf.

- **The CapitaGreen Plug**: Late May, CCT announced that it will be acquiring the balance of CapitaGreen (60%) which it does not already own. The acquisition would help improve the quality of CCT's portfolio, increasing Grade A office space from 61.8% of NLA to 66.3% of NLA. In addition, CCT expects that CapitaGreen would provide a stabilized NPI yield of 3.8%, or ~SGD61mn per annum (based on the current committed occupancy of 94.6% for CapitaGreen as of end-2Q2016). Coupled with the lack of expiring leases in 2016 and 2017, the acquisition of the

Treasury Advisory
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Tel: 6349-1886

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Tel: 6349-1810

OCBC Credit Research
Nick Wong Liang Mian, CFA
+65 6530-7348
NickWong@ocbc.com

balance of CapitaGreen could help to offset the NPI pressure resulting from the lease expires at Six Battery Road. It should be noted that unitholders have already approved of the acquisition, with the completion expected in 3Q2016.

- **Credit profile to worsen, but in line with peers**: Aggregate leverage has improved slightly q/q to 29.8% (1Q2016: 30.1%), driven by the +0.4% revaluation gain on properties. Looking forward though, as the acquisition of the balance of CapitaGreen will be entirely debt funded (assumption of SGD534mn in debt, additional borrowings of SGD393mn to be taken), management guided that aggregate leverage would worsen to pro forma 37.7%. This would bring CCT's aggregate leverage higher to a level in line with other commercial REITs. There could be some credit rating pressure on CCT, with Moody's downgrading its outlook from Neutral to Negative upon the announcement of the acquisition. We note as well that given the current pro forma aggregate leverage of 37.7%, CCT's rating of A3 is distinctly higher compared to KREIT's Moody's rating of Baa3 (KREIT's aggregate leverage is currently 39%).

- **Liquidity manageable**: Currently, CCT has no further debt maturities in 2016 (CCT announced mid-June that it and Capitaland Mall Trust have refinanced the RCS borrowings with SGD1.07bn in unsecured loan facilities (average tenure of 3.5 years). It has just SGD175mn in convertible bonds due in 2017 and a further SGD200mn due in 2018 (excluding RCS borrowings). Management has indicated that the ~SGD400mn in additional borrowings for the CapitaGreen acquisition would likely be spread out between 2018 and 2019. As such, we believe that CCT has a manageable maturity profile. In addition, CCT continues to showcase its access to capital markets, recently issuing SGD75mn in 6-year bonds to opportunistically refinance a loan due in 2020. Management reported interest coverage remains healthy at 7.2x for 2Q2016, though we expect some deterioration in the future given the additional borrowings for the acquisition. Looking forward, with CCT's credit profile largely in line with peers post the acquisition, and no near-term expectations for any improvements, we will hold CCT's Issuer Profile rating at Neutral.

CapitaCommercial Trust

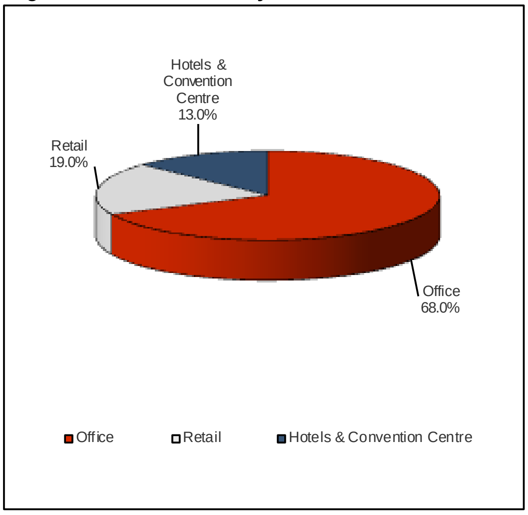
Table 1: Summary Financials

Year Ended 31st Dec	FY2014	FY2015	1H2016
Income Statement (SGD'mn)			
Revenue	262.6	273.2	134.4
EBITDA	189.3	196.7	95.8
EBIT	185.5	193.7	94.7
Gross interest expense	36.4	36.0	19.1
Profit Before Tax	448.9	307.4	135.9
Net profit	448.9	307.3	135.7
Balance Sheet (SGD'mn)			
Cash and bank deposits	101.1	81.2	103.1
Total assets	6,521.1	6,592.5	6,645.3
Gross debt	1,240.2	1,254.9	1,323.5
Net debt	1,139.1	1,173.7	1,220.3
Shareholders' equity	5,153.5	5,234.1	5,226.8
Total capitalization	6,393.7	6,489.0	6,550.3
Net capitalization	6,292.6	6,407.8	6,447.2
Cash Flow (SGD'mn)			
Funds from operations (FFO)	452.7	310.2	136.8
CFO	188.5	196.8	97.4
Capex	30.1	21.3	3.9
Acquisitions	0.0	0.0	0.0
Disposals	0.0	0.0	0.0
Dividends	242.8	251.9	128.8
Free Cash Flow (FCF)	158.4	175.5	93.6
FCF Adjusted	-84.3	-76.4	-35.3
Key Ratios			
EBITDA margin (%)	72.1	72.0	71.3
Net margin (%)	170.9	112.5	100.9
Gross debt to EBITDA (x)	6.6	6.4	6.9
Net debt to EBITDA (x)	6.0	6.0	6.4
Gross Debt to Equity (x)	0.24	0.24	0.25
Net Debt to Equity (x)	0.22	0.22	0.23
Gross debt/total capitalisation (%)	19.4	19.3	20.2
Net debt/net capitalisation (%)	18.1	18.3	18.9
Cash/current borrowings (x)	0.4	NM	NM
EBITDA/Total Interest (x)	5.2	5.5	5.0

Source: Company, OCBC estimates

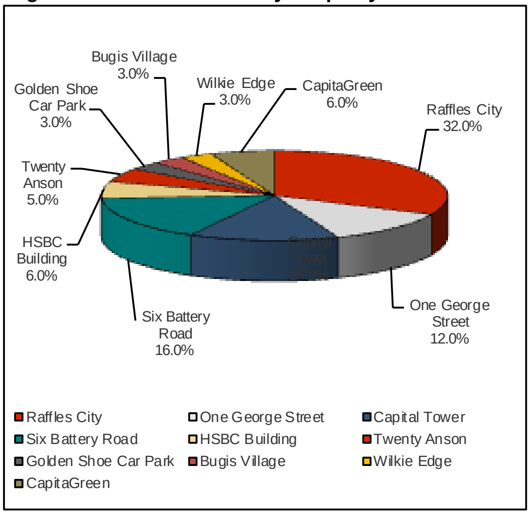
** FCF Adjusted = FCF - Acquisitions - Dividends + Disposals*

Figure 1: Gross Rental by Sector - 1H2016



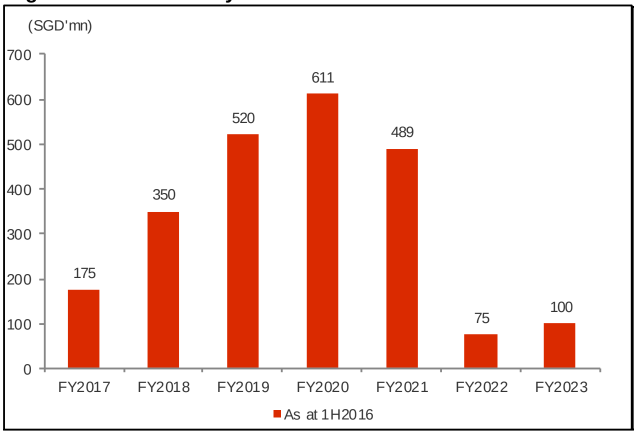
Source: Company

Figure 2: NPI breakdown by Property - 1H2016



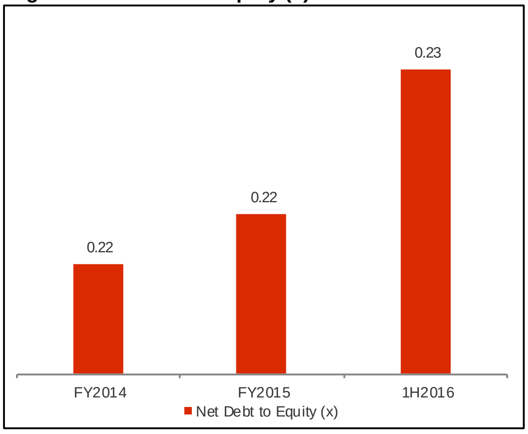
Source: Company

Figure 3: Debt Maturity Profile



Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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