Asia Credit Research

Earnings Review: CapitaLand Commercial Trust (“CCT”)

Issuer Profile: Neutral (3)

Ticker: **CCTSP**

Background

Listed on the SGX in 2004, CapitaLand Commercial Trust (“CCT”) is Singapore’s first listed and one of the largest commercial REITs, with SG10.7bn in deposited properties as at 24/04/18. It comprises ten prime properties in Singapore, as well as investments in Malaysia. About ~90% of net property income (1Q2018) is generated from Raffles City Singapore (RCS, 60%-owned), Asia Square Tower 2, CapitaGreen, Capital Tower, Six Battery Road and HSBC Building. CCT is 32.1%-owned by CapitaLand Ltd (“CAPL”).

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Recommendation

- With CCT’s debt headroom limited as aggregate leverage is already at ~38%, it would be insightful to consider how CCT would fund its maiden non-Singapore acquisition (should it happen).
- Underlying portfolio performance looks to be strengthening, with CCT benefitting from the recovery of the Singapore office market. We will retain our Neutral (3) Issuer Profile.
- When comparing against the CAPITA curve (which we deemed to be fully valued)[1], the recent CCTSP’24s and CCTSP’25s look to offer some concession (we hold CCT at Neutral (3) Issuer Profile), reflecting CCT’s higher leverage. That being said, given the technical pressure on duration, there is no strong incentive for an outright overweight.

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread
CCTSP 3.17% ‘24	05/03/2024	37.9%	3.23%	76bps
CCTSP 3.327% ‘25	21/03/2025	37.9%	3.40%	86bps
CAPITA 3.75% ‘24	02/08/2024	33.5%	3.13%	63bps

Indicative prices as at 26 April 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter

Key Considerations

- **Revenue boost from acquisition**: CCT reported 1Q2018 results, with gross revenue up 7.7% y/y to SGD96.4mn. This was largely driven by the acquisition of Asia Square Tower 2 (“AST2”, completed on 01/11/17). The acquisition helped to offset the 50% divestment of One George Street (“OGS”, June 2017), divestment of Wilkie Edge (September 2017) and Golden Shoe Car Park redevelopment (closed July 2017). The Golden Shoe Car Park redevelopment has been formally named CapitaSpring, with the project slated for completion in 1H2021. For CCT’s existing portfolio, performance at Twenty Anson was weak with property revenue down 19.3% y/y to SGD4.6mn. As committed occupancy for the building remains high at 94.3% (1Q2017: 93.0%), some tenants may be still in the rent-free / fitting out period. Looking forward, it is worth noting that management highlighted the limited acquisition opportunities for 3rd party assets in Singapore, and that they are exploring investments in other developed markets. Specifically, they intend to focus on core assets in gateway cities and to leverage off CAPL’s overseas platform. The target is to keep such assets at 10% – 20% of total deposited properties, or ~SGD2.1bn. In our view, foreign assets may offer more opportunities for CCT to grow, and may have longer WALE on average. That said, foreign assets may introduce FX risk to the portfolio. For example, peer REITs have reported weaker performance from Australia assets due to the depreciation of the AUD against the SGD in 1Q2018. Translation losses have also affected the revaluation of Australia assets (in SGD terms) in the past when AUD weakened.

- **Pressure on rental reversion receding**: Portfolio NPI benefited from the higher revenue, increasing 10.5% y/y to SGD77.2mn (with only Twenty Anson reporting NPI declines). Looking forward, CCT seems to indicate that its rental reversion is finally starting to recover, with committed rents largely higher than expiring rents for the quarter. We believe that things may remain volatile for the balance of 2018 as average expiring rents stand at SGD10.82 psf/mth while 1Q2018 Grade A market rents (source: CBRE) were SGD9.70 psf/mth. The hurdle rate is set to fall with average expiring rents in 2019 and 2020 declining to SGD10.37 psf/mth and SGD9.45 psf/mth respectively. Conversely, market clearing rents are expected to

[1] OCBC Asia Credit - CMT Earnings Review 1Q2018 (25 Apr)

pick up given the sharp decline in office supply for 2019 (556,000 sqft) and 2020 (782,000 sqft).

- **Vacancy and lease expiry manageable**: WALE is healthy at 5.7 years (2017: 5.9 years). Just 5% of NLA remains outstanding for 2018 lease expiry. In fact, CCT had started working on 2019's sizable lease expiries (31% of NLA), having extended 4% of NLA (this was JP Morgan committing to 155,000 sqft of space at CapitaSpring) and a further 6% of NLA in advance talks. Portfolio committed occupancy remained unchanged at 97.3% q/q. It should be noted that committed occupancy at AST2 only improved slightly q/q to 90.8% (4Q2017: 90.5%). That being said, this is higher than the 88.7% committed occupancy that was projected as part of the acquisition proposal last year. CCT had also announced that the Singapore government has exercised their right to take back Bugis Village (121,000 sqft, 2.2% of portfolio NPI) on 01/04/19. Bugis Village was last valued at SGD44mn.

- **Leverage stable, maturity profile extended**: Aggregate leverage inched higher to 37.9% (2017: 37.3%) due to additional borrowings taken. CCT had managed to extend its average debt maturity to 3.9 years (4Q2017: 2.4 years), in part with its SGD300mn 6-year bond issued in February 2018 and SGD200mn 7-year bond issued in March 2018. CCT also refinanced SGD1120mn in bank loans (these were the bridge financing taken to acquire AST2) due in 2019 to 2022 (SGD448mn) and 2023 (SGD300mn). As such, 2018 and 2019 maturities are largely resolved. Reported interest coverage remains healthy at 5.1x.

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Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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