Asia Credit Research

Earnings Review: CapitaLand Commercial Trust ("CCT")

Recommendation

- Results appear flattish with revenue increasing 1.7% q/q to SGD98.0mn and NPI increasing 0.7% q/q to SGD77.7m. However, with the recovery in the office market, we expect the decline in rents to be short-lived.
- Credit metrics improved slightly, with reported interest coverage improving to 5.3x (1Q2018: 5.1x) while aggregate leverage (2Q2018: 37.9%) is expected to reduce to ~35% following the divestment of Twenty Anson (completion: 3Q2018).
- Despite the improvements in CCT's credit profile, we think the CCT curve looks fair. We prefer CITSP curve in general, given that it trades wider than the CCTSP curve while we rate City Developments Ltd with a stronger Issuer Profile of Positive (2) compared to CCT's Issuer Profile of Neutral (3).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread (bps)
CCTSP 2.96% '21	13/08/2021	0.38x	2.76%	70.0
CCTSP 2.77% '22	04/07/2022	0.38x	2.96%	83.0
CCTSP 3.17% '24	05/03/2024	0.38x	3.17%	92.1
CCTSP 3.327% '25	21/03/2025	0.38x	3.22%	89.4
CITSP 2.93% '21	24/03/2021	0.26x*	2.78%	76.5
CITSP 3.78% '24	21/10/2024	0.26x*	3.25%	95.0
CITSP 3.48% '26	15/06/2026	0.26x*	3.51%	111.4

Indicative prices as at 19 Jul 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter
**Total Debt / Total Assets*

Issuer Profile: Neutral (3)

Ticker: **CCTSP**

Background

Listed on the SGX in 2004, CapitaLand Commercial Trust ("CCT") is Singapore's first the largest office REIT with SGD11.6bn in deposited property covering 4.9mn sqft in NLA. CCT comprises 10 prime properties in Singapore, a property in Germany and 11.0%-stake in MRCB-Quill REIT. CCT is 30.0%-owned by CapitaLand Ltd ("CAPL").

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Key Considerations

- **Acquisition-fuelled growth, results likely flattish otherwise**: CCT reported 2Q2018 results. Gross revenue increased 12.0% y/y to SGD98.0mn with net property income higher by 12.5% y/y to SGD77.7mn, driven mainly by the acquisition of Asia Square Tower 2 (Nov 2017), Gallileo (19 June 2018) and higher gross rental income from CapitaGreen though the increase was partly offset by divestments of 50%-interest in One George Street, Golden Shoe Car Park and Wilkie Edge in 2017. On a q/q comparison (without most of the effects of the acquisitions), results look more flattish with revenue increasing 1.7% q/q and NPI increasing 0.7% q/q.

- **Decline in rents likely to be short-lived with the office market rebounding**: Average office rent eased by 0.5% q/q to SGD9.65 psf in 2Q2018, which is not surprising as expiring rents in 1Q2018 (SGD10.82 psf) was higher than the market rents (1Q2018: SGD9.70). However, the gap has closed significantly with market rents surging 4.1% q/q to SGD10.10 in 2Q2018 while expiring rents in 2Q2018 fell to SGD10.73. With more restrained office supply forecasted in 2018 (145k sq ft) and 2019 (556k sq ft) compared to the supply in 2013-2017 (1.0mn sq ft), we expect market rents continuing to pick up. Occupancy edged up to 97.6% (1Q2018: 97.3%) for the Singapore portfolio. Including the acquisition of Gallileo, occupancy is higher at 97.8%.

- **Portfolio repositioning:** CCT is targeting to allocate 10%-20% of deposited property for overseas acquisitions. Following the acquisition of 94.9%-interest in Gallileo for EUR342.7mn (~SGD545mn) located in Germany, we estimate that another ~SGD1.8bn headroom remains for overseas acquisitions. Meanwhile, CCT is redeveloping CapitaSpring (former Golden Shoe Car Park), which is slated for completion in 1H2021. Separately, Twenty Anson will be divested for SGD516.0mn (3Q2018 completion) and Bugis Village will be returned to the State for SGD40.7mn on 1 Apr 2019.

- **Manageable lease and debt profile**: WALE remains healthy at 6.0 years (1Q2018: 5.7 years), with just 2% of office and 1% of retail space by rental income remaining outstanding in 2018. For CapitaSpring, CCT announced that it has secured JPMorgan as an anchor tenant for 24% of the office NLA. Meanwhile, the debt maturity profile looks healthy with no refinancing required in 2018 with 3.6 years average term to maturity.

- **Slight improvements in credit metrics**: Aggregate leverage remained unchanged at 37.9% q/q despite the acquisition of Gallileo, mainly due to slight revaluation gains on most of its investment properties with overall valuation up 1.3% (SGD178.9mn) from 4Q2017 while SGD214.3mn net proceeds were raised from equity placement. Moving forward, we expect aggregate leverage to improve to ~35% following the divestment of Twenty Anson, assuming the proceeds will be used to repay debt. However, we understand that CCT may redeploy this to fund growth opportunities. There also remains SGD276.3mn in balance development cost for the development of CapitaSpring, which will be largely funded by debt. Meanwhile, reported interest coverage improved slightly to 5.3x (1Q2018: 5.1x). We are not concerned over the FX impact on the acquisition of Gallileo as CCT obtained a EUR340.6mn loan, which roughly matches the acquisition cost of the property.

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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.

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