Asia Credit Research

OCBC Bank

# Mapletree Greater China Commercial Trust: New Credit Review

Monday, October 31, 2016

## Recommendations Summary

| Issuer Profile: | Bond Recommendation: | |
|---|---|---|
| Neutral | MAGIC 3.2 '21 | **Neutral** |
| | MAGIC 3.96 '22 | **Neutral** |
| Fundamental Analysis Considerations<br>• Good performance by key asset comprising 72% of portfolio revenue<br>• Headwinds in Beijing office market with RMB depreciation<br>• Manageable credit metrics with cap on leverage due to MAS regulation | Technical Analysis Considerations<br>• Strong parentage with Mapletree as the sponsor<br>• Potential supply risk<br>• Long duration paper | |

S&P: Not rated
Moody's: Baa1/Stable
Fitch: Not rated

Ticker: **MAGIC SP**


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## Key credit considerations

- **Portfolio anchored by Festival Walk:** Festival Walk accounts for c.72% of the portfolio's revenue. Since MAGIC's IPO in 2013, Festival Walk has been recording impressive rental reversions. Despite retail headwinds in the Hong Kong market with the decline in Chinese tourist arrivals, occupancy remains at 100%. We think that Festival Walk is well-located in Kowloon Tong and attracts local shoppers from nearby households who command high spending power. City University of Hong Kong and Hong Kong Baptist University provide another source of shopper traffic.

- **2QFY17 results dragged down by Gateway Plaza:** Results disappointed markets despite revenue growing 4.6% y/y to SGD168mn. Gateway Plaza significantly underperformed as occupancy declined to 90.5% (1QFY17: 95%) while an additional property tax of SGD 1.5mn was incurred. The office market in the Beijing's Lufthansa region is facing headwinds from an increase in supply while certain tenants are downscaling or closing operations. Otherwise, reversions and occupancy remained healthy at Festival Walk and Sandhill Plaza.

- **Manageable credit metrics with strong sponsorship**: Even though net gearing has been creeping up, we are comforted by MAS's regulations on REITs which limits debt/asset ratio to 45%. The balance sheet is also unencumbered. With Mapletree as its parent, which is in turn owned by Temasek Holdings Pte Ltd, MAGIC maintains healthy access to funding.

- **Staggered debt maturity but FX mismatch remains**: We like that MAGIC has been terming out its debt expiry with the issuance of bonds mostly in the 7-year region since its IPO. MAGIC has also been proactively refinancing the remaining debt maturing in FY17 and a part of its debt due in FY18. However, FX mismatch remains on the balance sheet, with only 3% of the debt denominated in RMB while c.27% of the properties by valuation are located in China.

- **Technical Factors**: We see the potential supply risk as HKD4bn of debt will mature in FY2018. However, for investors who like the Mapletree name, we prefer the MAGIC complex over MCTSP. MAGIC '21s offers 56bps pickup over MCTSP '21s (UW) while MAGIC '22s offer 37bps pickup over MCTSP '23s (UW).

## I) Company Background

Listed on the SGX in 7 March 2013, Mapletree Greater China Commercial Trust ("MAGIC") is a Singapore real estate investment trust ("REIT") with a mandate to invest in a portfolio of income-producing real estate in the Greater China region. Focused on Tier 1 cities in China (Beijing, Shanghai, Guangzhou, Shenzhen), MAGIC embarked on its maiden acquisition of a business park (namely, Sandhill Plaza) in June 2015. The REIT currently holds 3 commercial properties in its portfolio.

**Figure 1: Property Portfolio**

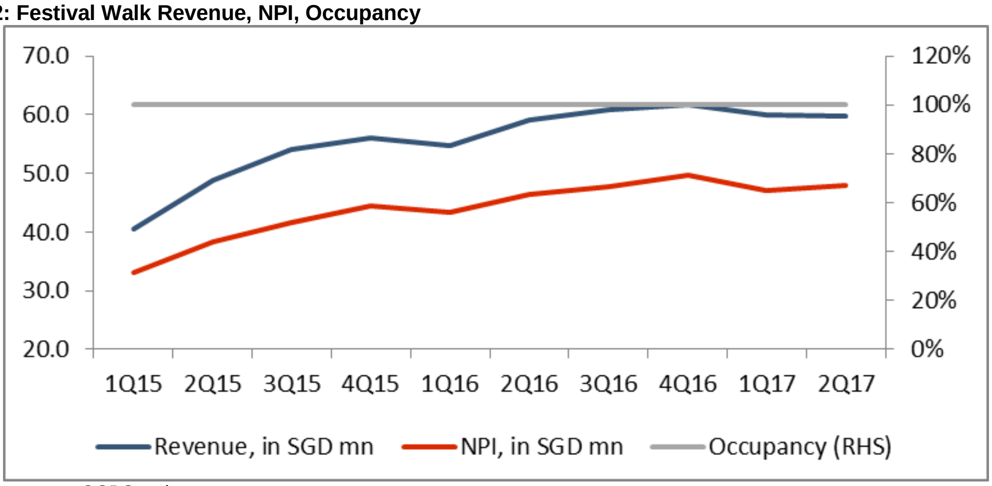
| Property | Location | Asset Type | 1HFY17 NPI (SGD mn) | Valuation (mn)* |
|---|---|---|---|---|
| Festival Walk | Hong Kong | Retail / Office | 94.9 | HKD 23,930 |
| Gateway Plaza | Beijing | Office / Retail | 30.7 | RMB 5,930 |
| Sandhill Plaza | Shanghai | Business Park | 11.0 | RMB 1,950 |

*Source: Company*
**Note: As at 31 Mar 2016*

Festival Walk (又一城)

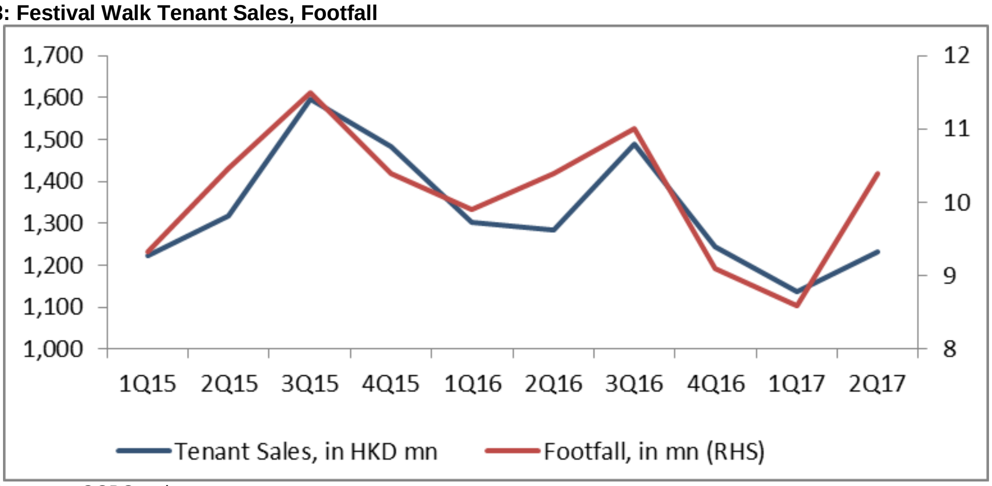
Located in Kowloon Tong, Hong Kong, Festival Walk has a lettable area of 798,372 sqft and comprises a seven-storey retail mall (73%) and a four-storey office component (27%) on top of the mall. Festival Walk is highly accessible as it is directly linked to the Kowloon Tong MTR station via direct air-conditioned pedestrian access, while buses are also available at the Festival Walk terminus. With over 200 retail stores and restaurants, the mall generated HKD5.3bn in tenant sales from a footfall of 40.4mn in FY16.

**Figure 2: Festival Walk Revenue, NPI, Occupancy**




*Source: Company, OCBC estimates*

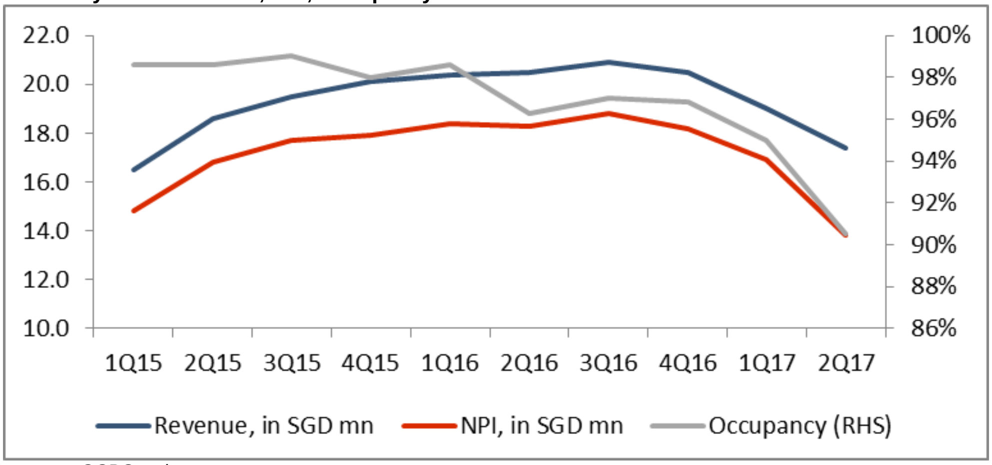
**Figure 3: Festival Walk Tenant Sales, Footfall**




*Source: Company, OCBC estimates*

Gateway Plaza (佳程廣場)
Gateway Plaza is a Grade-A office building with a GFA of 106,456 sqm, consisting of two 25-storey towers, with a 3-storey retail podium. Located in the Lufthansa Area in Beijing, China, Gateway Plaza is accessible via the Sanyuanqiao Metro station (0.7km away). In 4QFY16, MAGIC converted 800 sqm of unutilised space into a F&B area.

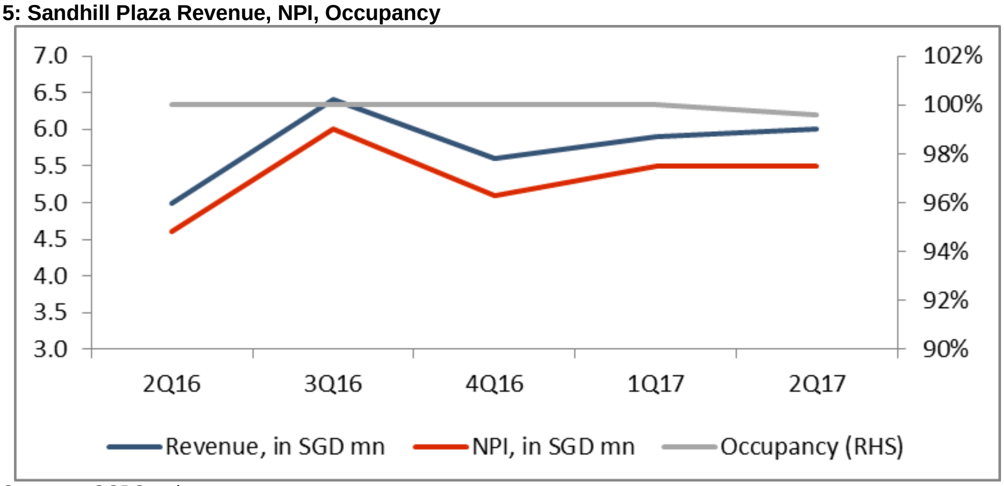
**Figure 4: Gateway Plaza Revenue, NPI, Occupancy**




*Source: Company, OCBC estimates*

Sandhill Plaza (展想广场)
Located in Zhangjiang Hi-tech Park, which is designated as part of Shanghai's Free Trade Zone in March 2015, Sandhill Plaza is a premium business park with a GFA of 83,801 sqm. Sandhill Plaza is highly accessible via road (located next to Middle Ring Highway) and subway (500m away from Metro Line 2 Guanglan Road Station).

**Figure 5: Sandhill Plaza Revenue, NPI, Occupancy**




*Source: Company, OCBC estimates*

## II) Ownership and Management

**Figure 6: Major shareholder as at 31/10/16**

| Investor | Shares | Stake |
|---|---|---|
| Temasek Holdings Pte Ltd* | 851,747,000 | 30.64% |
| Norges Bank | 215,095,353 | 7.74% |
| AIA Co Ltd | 167,200,500 | 6.02% |

*Source: Bloomberg*
**Note: Excludes Mapletree Greater China Commercial Trust Management Ltd and Mapletree Greater China Property Management Limited.*

Temasek Holdings is MAGIC's largest shareholder through Fullerton Management Pte Ltd and Mapletree Investments Pte Ltd. Mapletree Investments Pte Ltd is the Sponsor of MAGIC. The sponsor has a proven track record in managing assets and REITs, through the IPO of Mapletree Logistics Trust (28 Jul 2015), Mapletree Industrial Trust (21 Oct 2010) and Mapletree Commercial Trust (27 Apr 2011). In the sponsor's pipeline, MAGIC has been granted a right of first refusal to acquire (1) a prime commercial site of about 55,026 sqft in Kwun Tong, Kowloon, which will be developed into a Grade A office building with a GFA of 660,301 sqft and (2) Arca Building, which is a three-storey business park with a GFA of 19,695 sqm located in Beijing.

## III) Company Overview & Analysis

- **2QFY17 results dragged down by Gateway Plaza:** MAGIC announced 2QFY17 results. Revenue grew 4.6% y/y to SGD168mn mainly due to the acquisition of Sandhill Plaza and higher income from Festival Walk. However, Gateway Plaza significantly underperformed with its 1H17 contribution to revenue lower by 10.9% y/y, in part due to tenant churn while occupancy at the property declined to 90.5% (1QFY17: 95.0%). Hit with a double whammy, Gateway Plaza had to fork out an additional property tax of SGD1.5mn due to the change in property tax basis[1]. Otherwise, reversions and occupancy remained healthy at Festival Walk and Sandhill Plaza.

- **Will the good performance from Festival Walk continue?:** After having recorded impressive rental reversions (mostly over 20%) since 1QFY15, reversions have slowed to 15% as of 2QFY17 and the management expects rental reversions to moderate. We think that MAGIC has fared better than the average market, as the Colliers Hong Kong Retail Rent (Overall), has already been falling since late 2013. The Hong Kong retail market is likely to remain subdued as Chinese tourist arrivals have declined while HKD continues to strengthen against the CNY. While Festival Walk is also feeling the impact with declining tenant sales and footfall, we believe near-term performance will be stable as rents are mostly fixed and renovations of the cinemas in early 2016 may attract more traffic to the mall. We also understand that Festival Walk's occupancy cost ratio[2] is 18.3% as of 1QFY17, which does not appear excessive[3]. In fact, 2QFY17 results painted a brighter picture than earlier quarters as tenant sales fell by 4% y/y, instead of 13%-16% y/y declines seen in 4QFY16 and 1QFY17, which may indicate early signs of stabilisation.

- **Managing portfolio lease expiry:** We think MAGIC can manage the leases expiring by end-FY17 at Festival Walk (which comprise 10.6% of portfolio), given its prime location and 100% historical occupancy. Festival Walk's lease expiry profile looks well-staggered between FY17-FY19 as leases are typically signed for 3 years. On the other hand, MAGIC will have to cope with large lease expiries at Gateway Plaza amidst the challenging market conditions surrounding the Lufthansa area. There is an increase in supply of offices while demand is not keeping up with the downscaling of MNCs and closure of peer-to-peer lending companies. MAGIC expects Gateway Plaza to record positive rental reversions still, though downward pressure on occupancy rate will be faced in the near term. Management appears to be most optimistic on Sandhill Plaza's rental reversion due to the increase in demand by new enterprises for business park space surrounding the area.

- **Not overly concerned about revenue concentration from Festival Walk:** While Festival Walk contributes 72% of MAGIC's revenue, we are not overly concerned about concentration risks. The tenant base is sufficiently diversified, with no trade sector comprising more than 22.5% of revenue while the top 10 tenants make up 27.8% of revenue. Strategically located in Kowloon Tong, shoppers from nearby households command high spending power while City University of Hong Kong and Hong Kong Baptist University provide another stable

[1] *Change of approach from cost of property to revenue.*
[2] *Gross rent divided by gross sales*
[3] *Compared to Harbour City (19.8%) and Times Square (24.5%)*

source of shopper traffic. Going forward, concentration risks may be reduced if MAGIC undertakes more acquisitions. We understand that MAGIC has been looking at potential acquisitions from its sponsor. Under its sponsor, this includes a business park property in Beijing, which likely refers to Arca Building. Under its sponsor's private equity funds, potential acquisitions include a retail mall in Foshan and one mixed development property in China. We believe that acquisitions from third parties will not be excluded, as demonstrated by MAGIC's acquisition of Sandhill Plaza from an unrelated vendor.

- **Focus on occupancy at Gateway Plaza:** Amidst slowing demand, new office supply was added in 2QFY2016, which resulted in vacancy rising to 4.4%, according to Savills. In the Lufthansa region, The Genesis contributed an increase of 100,000 sqm. We estimate that revenues fell 15% y/y at Gateway Plaza to SGD17.4mn as of 2QFY17 as a result of lower occupancy. Post-results, management has indicated that occupancy is higher as new tenants took up the vacated space. However, FY2018 will be the key challenge as more than half the leases will expire.

- **Benefits from having Mapletree sponsorship and ownership:** Mapletree owns and manages SGD34.7bn of real estate as of 31 Mar 2016, and has a proven track record in managing REITs. We believe access to funding is improved by having Mapletree, which is owned by Temasek, as the sponsor.

## IV) Financial Analysis

- **Some balance sheet FX mismatch:** While c.27% of the properties (Gateway Plaza, Sandhill Plaza) by valuation are located in China, only 3% of the debt is denominated in RMB. This has created a balance sheet impact with debt/asset increasing to 39.9% (from 39.5% in 4QFY16) as the RMB has been depreciating against the HKD. Hedging the distributable income (which mitigates risks at the dividend level) does not mitigate FX mismatch on the balance sheet. Despite issuing SGD bonds without significant SGD assets, there is no SGD currency mismatch as MAGIC has swapped the bonds into HKD.

- **Staggered debt maturity with large proportion of interest rates fixed:** The average term to maturity for debt is 3.1 yrs, with debt staggered till 2024. We like that MAGIC has been terming out the debt expiry with the issuance of mostly 7-year bonds since its IPO in 2013. While FY2018 will see a chunkier HKD4.0bn of bank debt maturing, we are not worried about refinancing with MAGIC's proven access in tapping the bond market and strong parentage. MAGIC is also proactive, and has refinanced the remaining debt maturing in FY17 and a part of the debt due in FY18. 85% of the interest cost is fixed, with a manageable all-in cost of debt of 2.89%.

- **Manageable credit metrics:** Even though net gearing has been creeping up, and Moody's may potentially downgrade MAGIC if debt/asset exceeds 45%, we are comforted by MAS's regulations which limits debt/asset ratio to 45%. Interest cover of 3.6x remains healthy as of 2Q17, in our view. With little debt headroom to acquire another property, inorganic growth may have to be funded by issuing equity or perpetual bonds. Meanwhile, the balance sheet is not encumbered.

## V) Technical Considerations

**Positives**

- Cap on indebtedness at 45% asset leverage due to MAS regulation
- Strong sponsorship with Mapletree backing
- No encumbered assets

**Negatives**

- No change of control
- Interest rate risk with long duration low coupon paper
- Large debt expiry in FY18 may create supply risk

**Relative Value**

| Issue | Maturity | Ask Price | Ask YTW | Bond Rating | Debt/Asset |
|---|---|---|---|---|---|
| MAGIC 3.2 '21 | 8/9/2021 | 101.0 | 2.98 | NR/Baa1/NR | 0.40x |
| MAGIC 3.96 '22 | 9/3/2022 | 101.75 | 3.07 | NR/Baa1/NR | 0.40x |
| MCTSP 3.2 '21 | 12/4/2021 | 103.25 | 2.42 | NR/Baa1/NR | 0.37x |
| MCTSP 3.25 '23 | 3/2/2023 | 103.15 | 2.70 | NR/Baa1/NR | 0.37x |
| FCTSP 3 '20 | 21/1/2020 | 100.25 | 2.92 | BBB+/NR/NR | 0.28x |

*Indicative spreads based on offer prices from Bloomberg on 31/10/16

The closest comparable in our view is MCTSP given 1) the same Mapletree parentage, 2) exposure to both retail and office properties and 3) concentration to one property which anchors the portfolio performance (MCTSP: VivoCity, MAGIC: Festival Walk). For investors who like the Mapletree name, we prefer the MAGIC complex in spite of the potential supply risk. MAGIC '21s look interesting relative to MCTSP '21s (UW) for a 56bps pickup. Similarly, we prefer MAGIC '22s over MCTSP '23s (UW) for a 37bps pickup for a shorter tenor by 1-year. However, we prefer FCTSP '20s (OW) over MAGIC '21s with a similar yield for a shorter 1.6Y maturity.

## VI) Conclusion & Recommendation

**We initiate coverage of MAGIC with an Issuer Profile of Neutral** as we find that MAGIC offers a stable profile as it is anchored by Festival Walk which comprises 72% of the portfolio's revenue. We are not worried over the portfolio concentration as occupancy at Festival Walk has not fallen below 100% since 30 Sep 2013 due to strong demand, and we expect rentals to continue reverting higher even amidst the subdued retail market. Despite the poorer results in 2Q17, the results taken in totality since its IPO in 2013 has been decent. Going forward, the headwinds in the Beijing office market and depreciation of the RMB may impact the balance sheet. However, we note that some headroom remains before MAGIC hits the 45% cap on asset leverage. Meanwhile, MAGIC has demonstrated continued access to the bond markets with the issuance 3 bonds in 2016, in both SGD and HKD. While we prefer the MAGIC complex over the MCTSP complex, we think that MAGIC '21s and MAGIC '22s, which offer c.120bps over swaps, are fair in our view. Therefore, we have a **Neutral recommendation on the bonds**.

# Mapletree Greater China Commercial Trust

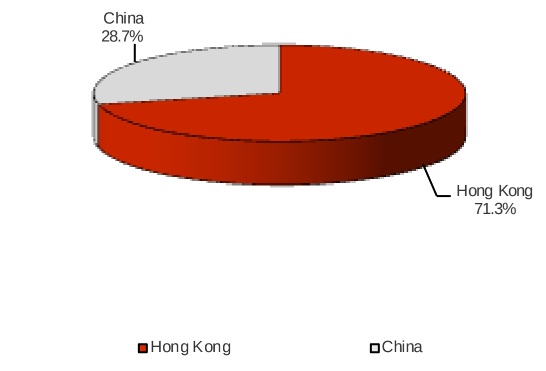
**Table 1: Summary Financials**

| Year Ended 31st Mar | FY2015 | FY2016 | 1H2017 |
|---|---|---|---|
| **Income Statement (SGD'mn)** | | | |
| Revenue | 281.1 | 336.6 | 168.0 |
| EBITDA | 206.8 | 252.4 | 126.5 |
| EBIT | 206.3 | 252.0 | 126.3 |
| Gross interest expense | 40.8 | 65.0 | 35.3 |
| Profit Before Tax | 352.7 | 465.9 | 92.9 |
| Net profit | 318.9 | 428.1 | 77.7 |
| **Balance Sheet (SGD'mn)** | | | |
| Cash and bank deposits | 125.1 | 206.1 | 176.1 |
| Total assets | 5,488.1 | 6,153.5 | 6,007.4 |
| Gross debt | 1,984.0 | 2,422.3 | 2,398.7 |
| Net debt | 1,858.9 | 2,216.2 | 2,222.7 |
| Shareholders' equity | 3,260.2 | 3,416.2 | 3,306.8 |
| Total capitalization | 5,244.1 | 5,838.4 | 5,705.6 |
| Net capitalization | 5,119.0 | 5,632.3 | 5,529.5 |
| **Cash Flow (SGD'mn)** | | | |
| Funds from operations (FFO) | 319.4 | 428.6 | 77.9 |
| * CFO | 223.0 | 264.9 | 99.5 |
| Capex | 0.7 | 0.7 | 0.1 |
| Acquisitions | 5.0 | 335.3 | 1.6 |
| Disposals | 0.0 | 0.0 | 0.0 |
| Dividends | 168.7 | 188.3 | 104.0 |
| Free Cash Flow (FCF) | 222.3 | 264.2 | 99.4 |
| * FCF Adjusted | 48.6 | -259.4 | -6.2 |
| **Key Ratios** | | | |
| EBITDA margin (%) | 73.5 | 75.0 | 75.3 |
| Net margin (%) | 113.4 | 127.2 | 46.2 |
| Gross debt to EBITDA (x) | 9.6 | 9.6 | 9.5 |
| Net debt to EBITDA (x) | 9.0 | 8.8 | 8.8 |
| Gross Debt to Equity (x) | 0.61 | 0.71 | 0.73 |
| Net Debt to Equity (x) | 0.57 | 0.65 | 0.67 |
| Gross debt/total capitalisation (%) | 37.8 | 41.5 | 42.0 |
| Net debt/net capitalisation (%) | 36.3 | 39.3 | 40.2 |
| Cash/current borrowings (x) | 0.5 | 0.4 | 0.8 |
| EBITDA/Total Interest (x) | 5.1 | 3.9 | 3.6 |

*Source: Company, OCBC estimates*

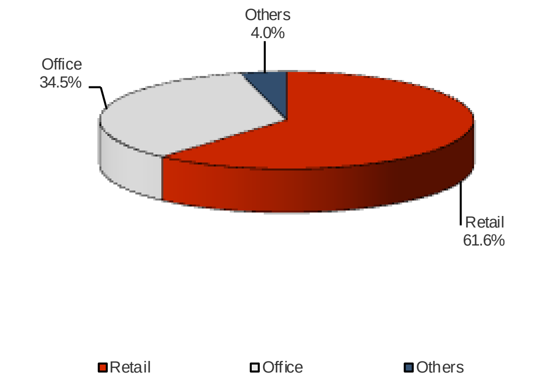
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO before deducting interest expense*

**Figure 1: Revenue breakdown by Geography - 1H2017**




*Source: Company*

**Figure 2: Revenue breakdown by Segment - 1H2017**



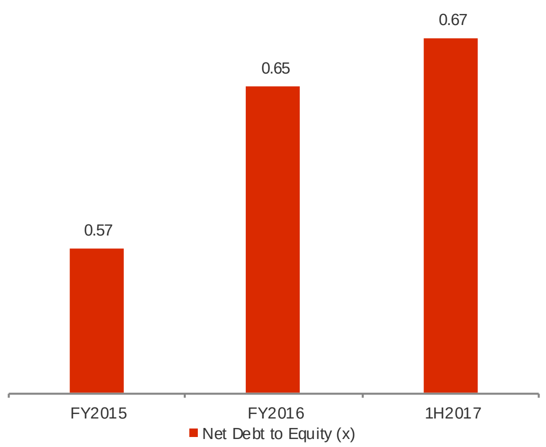

*Source: Company*

**Figure 3: Debt Maturity Profile**

| Amounts in (SGD'mn) | As at 30/9/2016 | % of debt |
|---|---|---|
| . | | |
| **Amount repayable in one year or less, or on demand** | | |
| Secured | 0.0 | 0.0% |
| Unsecured | 226.2 | 9.4% |
| | **226.2** | **9.4%** |
| **Amount repayable after a year** | | |
| Secured | 0.0 | 0.0% |
| Unsecured | 2172.6 | 90.6% |
| | **2172.6** | **90.6%** |
| **Total** | **2398.7** | **100.0%** |

*Source: Company*

**Figure 4: Net Debt to Equity (x)**




*Source: Company, OCBC estimates*