

**Issuer
Profile:**

Neutral (4)

Ticker:

CRCT

Seow Zhi Qi

+65 6530 7348

zhiqiseow@ocbc.com

CapitaLand Retail China Trust ("CRCT")

Recommendation

- Revenue growth of 1.9% y/y in RMB terms to RMB275mn in 2Q2019 was driven by CapitaMall Xizhimen and CapitaMall Wangjing. In SGD terms though gross revenue fell by 1.9% y/y instead to SGD55.2mn due to stronger SGD against RMB.
- CRCT has seen some changes to its portfolio. Over the quarter, CRCT has proposed to acquire CapitaMall Xuefu and CapitaMall Aidemengdun in Harbin, north China and CapitaMall Yuhuating in Changsha, central China which will be funded by a 55/45 equity debt split by 3Q2019. Post results in July this year, CapitaMall Wuhu was divested. Separately, CRCT also has plans for a bundle deal in Hohhot, China where it will acquire Yuquan Mall in 2H2019 and divest CapitaMall Saihan in 2H2020 when Yuquan Mall is in operations.
- EBITDA/Interest coverage was stable q/q at 5.0x, while aggregate leverage had fallen to 33.8% from 35.5% in the preceding quarter. However, we expect aggregate leverage to climb higher to ~36% (assuming no existing cash will be used to fund the acquisitions).
- We think CRCTSP 3.25% '22 is trading fair. It is offering a yield of 2.74% and 118bps over swap for a tenor of 2 years 11 months.
- We are maintaining CRCT's Neutral (4) issuer profile on the back of its manageable credit metrics.

Relative Value

Bond	Maturity / Call date	Aggregate leverage	Ask YTC / YTM	Spread
CRCTSP 3.25% '22	04/07/2022	33.8%	2.74%	118bps
MAGIC 3.43% '22	09/03/2022	36.9%	2.41%	84bps
KREITS 3.15% '22	11/02/2022	38.4%	2.67%	109bps
SUNSP 3.025% 22	16/03/2022	38.3%	2.69%	111bps

*Indicative prices as at 7 August 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter*

Background

- CapitaLand Retail China Trust ("CRCT"), listed on the SGX in 2006, is the first pure-play China shopping mall REIT in Singapore. As at 30 June 2019, CRCT owns in a portfolio of 11 shopping malls located across eight cities in China. These properties were value at RMB16.1bn (~SGD3.2bn).
- In July 2019, CRCT divested its only mall in Wuhu for RMB210mn (SGD41.5mn). The REIT has also proposed to acquire two malls in Harbin and a mall in Changsha (to be completed in 3Q2019). Separately, CRCT is also in the midst of divesting CapitaMall Saihan and acquiring Yuquan Mall by 2H2020. Both malls are located in Hohhot, China.
- CapitaLand Group has a 38.04% cumulative stake in CRCT, which comprise a 25.75% stake held by CapitaLand Ltd and a 12.29% stake held by CapitaLand Mall Trust.

Key Considerations

- Revenue growth was driven by CapitaMall Xizhimen and CapitaMall Wangjing:** Gross revenue in RMB terms was up by 1.9% y/y (+RMB5.1mn) to RMB275mn. CapitaMall Xizhimen and CapitaMall Wangjing generated 5.1% (+RMB3.7mn) and 6.0% (+RMB3.5mn) more income y/y respectively. This came on back of higher occupancy rate as that at CapitaMall Xizhimen had improved to full occupancy from 98.7% a year ago, and CapitaMall Wangjing recorded a 0.3% higher occupancy rate as compared to 99.3% as end June 2018. These higher incomes though were partially offset by weaker performance at the other

properties, namely CapitaMall Grand Canyon, CapitaMall Qibao and CapitaMall Wuhu. In SGD terms, gross revenue was down by 1.9% y/y (-SGD1.1mn) to SGD55.2mn due to stronger SGD against RMB.

- **Net property income (“NPI”) rose sharply due to accounting change:** With the application of *FRS 116 Leases*, land rental expenses in 2Q2019 were excluded from property expenses instead this figure was classified as net changes in fair value of investment properties, and interest expense liabilities which is part of finance costs. Consequentially, property expenses fell by 17.4% y/y (-RMB15.6mn) to RMB73.8mn and NPI was up by 11.5% y/y (+RMB20.7mn) to RMB201mn. In SGD terms, NPI was up by a smaller extent of 7.4% y/y as the SGD was stronger against RMB. The exact impact of this accounting change cannot be determined as CRCT does not disclose the necessary figures. On a quarter-on-quarter basis (which removes the accounting change discrepancy as *FRS 116 Leases* took effect from 1 Jan 2019), we find property expenses lower by 8.5% q/q (-RMB6.9mn) and NPI higher by 1.1% q/q (+RMB2.2mn).
- **Rock Square continues to deliver good results:** CRCT holds a 51% interest in Rock Square, Guangzhou (acquire at end Jan 2018) via a joint venture. We note that Rock Square’s results are disclosed in SGD terms only. Over the quarter, gross revenue was up by 12.3% y/y to SGD5.2mn, while NPI grew by 8.6% y/y to SGD3.5mn. We think positive rental reversion could be the driver as this property has consistently recorded double digit growth in newly contracted rents over the expiring leases. Having said that, occupancy rate was only marginally better at 96.8% from 96.6% a year ago. Rock Square has 6.1% of total net lettable area expiring this year and we expect good performance to persist as year-to-date tenants’ sales had improved by 26% y/y.
- **Divested CapitaMall Wuhu:** On 10 July 2019, CRCT sold its 51% interest in CapitaMall Wuhu for RMB210mn (~SGD41.5mn). The mall has been closed since 3Q2018, following the exit of its anchor tenant.
- **Aggressive acquisition of three malls:** CRCT proposed in June 2019 to acquire three CapitaLand malls in China for RMB3.0bn (~SGD589.2mn). The malls are CapitaMall Xuefu and CapitaMall Aidemengdun in Harbin, north China and CapitaMall Yuhuating in Changsha, central China. This transaction will grow CRCT’s portfolio by ~18.5% to SGD3.8bn. The total estimated outlay of SGD505.4mn will be funded via a 55/45 equity debt split. CRCT had on 2 Aug 2019 raised SGD279.4mn equity funding to finance part of this acquisition. Based on our estimation, CRCT would have to fund a balance of SGD226mn via borrowings. This transaction is expected to be completed in 3Q2019.
 - i) CapitaMall Xuefu, opened in 2012, is a multi-tenanted mall located in the Nangang District of Harbin. Positioned as a regional retail mall, it is directly connected to the Harbin Metro and has a cluster of tertiary education institutions in the area. NPI yield is ~6.1%.
 - ii) CapitaMall Aidemengdun, opened in 2010, is a multi-tenanted mall located in the Daoli District of Harbin. This is a community mall that serves the residents living in the area. NPI yield is ~5.6%.
 - iii) CapitaMall Yuhuating, opened in 2005, is a multi-tenanted mall located in Changsha. It is an established mall within the Dongtang retail hub of Yuhua District. NPI yield is ~6.2%.
- **Bundle deal in Hohhot, China:** Apart from the abovementioned acquisitions, CRCT had in February 2019 announced that it will acquire Yuquan Mall for a purchase consideration of RMB808.3mn (~SGD159.6mn) (i.e. RMB8079 psm based on gross floor area) in 2H2019 and open the mall in 2H2020. Upon opening the mall, it will sell CapitaMall Saihan (also in Hohhot) for RMB460mn (~SGD90.8mn) (i.e. RMB10,969 psm based on gross floor area). Reason cited for pursuing the deal was that CapitaMall Saihan’s longer term potential is constrained by its relatively smaller size and a lack of metro connectivity and its own car

park. CRCT will also be looking to port over selected leases from CapitaMall Saihan. Both malls are located adjacent of each other. CRCT will be funding 59% of the purchase consideration via proceeds from the sale of CapitaMall Saihan and the balance 41% (~SGD65.4mn) with a combination of debt and existing cash.

- **Aggregate leverage expected to creep higher:** As at 30 June 2019, aggregate leverage (including the proportionate share of its JV's borrowings and deposited property) was 33.8%, up from 35.5% in the preceding quarter due to the repayment of some of its borrowings. Reported interest coverage though was stable q/q at 5.0x. CRCT has SGD38.2mn of debt due in 2019 from its unsecured money market line. With fully-unencumbered assets and SGD155.9mn of cash on hand as at 30 June 019, CRCT's credit metrics remain intact in our view. Having said that, we expect aggregate leverage to weaken slightly going forward given its heavy acquisition pipeline. Assuming no existing cash is used to fund the acquisitions mentioned above, we see adjusted aggregate leverage higher at 36.1%, though still manageable.

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

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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.

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Treasury Research & Strategy

Macro Research

Selena Ling

Head of Strategy & Research
LingSSSelena@ocbc.com

Emmanuel Ng

Senior FX Strategist
NqCYEmmanuel@ocbc.com

Tommy Xie Dongming

Head of Greater China Research
XieD@ocbc.com

Terence Wu

FX Strategist
TerenceWu@ocbc.com

Howie Lee

Thailand, Korea & Commodities
HowieLee@ocbc.com

Alan Lau

Malaysia & Indonesia
AlanLau@ocbc.com

Carie Li

Hong Kong & Macau
carierli@ocbcwh.com

Dick Yu

Hong Kong & Macau
dicksnyu@ocbcwh.com

Credit Research

Andrew Wong

Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo

Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei

Credit Research Analyst
WongHongWei@ocbc.com

Seow Zhi Qi

Credit Research Analyst
ZhiQiSeow@ocbc.com

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