INITIATION

REIT ▪ Singapore

CapitaLand Retail China Trust

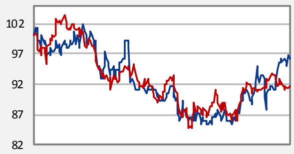
(CRCT SP)

Pure play China retail REIT – Positive asset recycling efforts to pay off by 2020

Geraldine Wong / 62 6202 1193 / geraldine.wong@kgi.com

- Chinese disposable urban income more than tripled over the last 12 years. The revision of individual income tax laws implemented since the start of 2019 to act as an additional boost to future disposable income.
- Retail malls continue to compete for shopper traffic through experiential shopping, Omni channel strategies and digital marketing. We see synergies between CRCT and other CapitaLand mall REITs who had tried and tested similar concepts and technologies.
- We expect asset recycling efforts in Hohhot to pay off by end 2020 and malls under stabilisation to be potentially divested in the next 1-2 years.

Buy (Initiation)			
Price as of 20 Mar 19 (SGD)	1.52	**Performance (Absolute)**	
12M TP (S$)	1.61	1 Month (%)	4.8
Previous TP (S$)	-	3 Month (%)	14.7
Upside, incl div (%)	13.0%	12 Month (%)	1.9
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	1,498		
Issued Shares (mn)	985		
Vol - 3M Daily avg (mn)	1.6		
Val - 3M Daily avg ($mn)	2.4		
Free Float (%)	62.14		
Major Shareholders		**Previous Recommendations**	
CapitaLand Ltd	25.3%		
CapitaLand Mall Trust	12.5%		
Matthews International	6.4%		



Financials & Key Operating Statistics

YE Dec (S$m)	2016	2017	2018	2019F	2020F
Gross revenue	214.4	229.2	222.7	223.5	233.9
Net property income	139.7	149.2	147.4	147.9	154.8
Distributable income	86.7	91.1	99.7	112.6	119.6
DPU (SGD cents)	10.1	10.1	10.2	10.4	11.0
DPU growth (%)	(5.2)	0.5	1.2	1.5	6.3
Div Yield (%)	7.3	6.2	7.5	7.6	8.1
NAV per unit (SGD)	1.7	1.6	1.6	1.6	1.7
Price / Book (x)	0.8	1.0	0.9	0.8	0.8
NPI Margin (%)	65.2	65.1	66.2	66.2	66.2
Net Margin (%)	48.5	62.4	57.2	34.6	35.9
Gearing (%)	35.1	28.0	34.8	34.7	33.7
ROE (%)	4.3	6.5	3.8	4.9	5.0

Source: Company Data, KGI Research

Investment Thesis

Growing disposable income of the mass affluent. Chinese disposable urban income more than tripled from 2006 to 2017, growing at a CAGR of 10.0%. We expect this upward trend to continue at a high single digit in the coming few years. New individual income tax laws to be effective from 2019 would likely benefit the mass affluent, the consumer group CapitaLand Retail China Trust (CRCT) targets. Standard tax deductions will increase from ¥ 42,000 per year to ¥ 60,000 per year, converting to almost a 71% savings on taxes for an individual earning ¥ 10,000 a month. We expect this to translate to retail sales of small ticket items and necessities.

The era of new retail. New retail concepts remain crucial in garnering shopper interest and traffic. We see synergies between CRCT and its sponsor CapitaLand. CapitaLand's 'smart mall' model and experiments within the space of Omni channel capabilities (Funan DigitaLife Mall), digital marketing and experiential shopping (NomadX 'phygital' store) could be replicated and modified by CRCT. These new retail concepts and technology should sit well with the digitally savvy Chinese consumers.

Portfolio rejuvenation to see effect by 2020. We anticipate the bundle deal in Hohhot (Inner Mongolia), which will transact in 2020, to be yield-accretive. CRCT will divest Saihan mall at current market value of RMB 14,823/sqm and acquire neighbouring mall, Yuquan mall at RMB 10,733/sqm, a 5.6% discount to market value. Higher rental yields can be anticipated on the grounds of higher shopper traffic driven by greater connectivity, larger leasable retail area and favourable economic outlook within the Mongolian capital.

We think that management might potentially divest the two portfolio malls that are currently under stabilisation. Capital unlocked could be put into better use through the acquisition of yield-accretive assets.

Valuation & Action

We initiate coverage on CRCT with a BUY recommendation with a target price of S$1.61, representing an upside of 13.0%, inclusive of a forward dividend yield of 6.8%. We used the DDM methodology for the valuation with a cost of equity of 8.13% and terminal growth rate of 1.0%.

CRCT currently trades at a FY18/FY19 P/B ratio of 0.9x/1.0x, a slight premium to peers focusing on China retail which trades at a forward P/B ratio of 0.8x. We believe the premium is justifiable due to higher quality assets and proactive management strategies.

Key Risks

Key risks include a slowing Chinese economy that could potentially dampen consumer sentiments further and result in the delay of consumption. We also see negative rental reversions as a threat towards the two malls under stabilisation as well as CapitaLand Qibao that will see new competition within its vicinity.

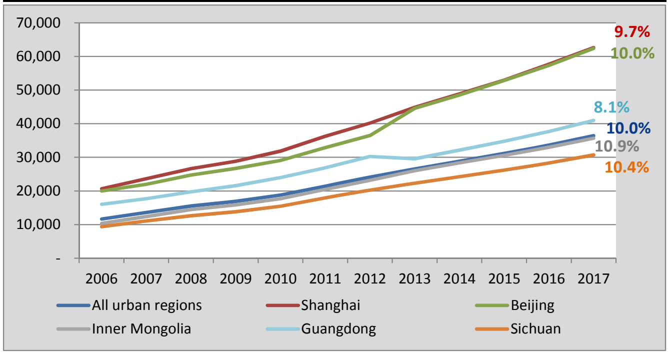
Table of Contents

Source: Company

Growing disposable income of the mass affluent

Chinese disposable income more than tripled that last 12 years. Urban disposable income per capita grew at a staggering CAGR of 10.0% from 2006 to 2017. Amongst the cities that CRCT has geographical exposure to, 12-year CAGR growth in disposable income ranged from 10.9% (Inner Mongolia) to 8.1% (in Guangdong). We expect disposable income growth to continue along this trajectory albeit at a slower pace. Additional stimulus such as income tax cuts would provide a short-term income boost to the mass affluent consumers.

Figure 1: Urban disposable income per capita in cities where CRCT has geographical exposure to (in RMB) and corresponding 12-year CAGR (%)



Source: National Bureau of Statistics, KGI Research

Income tax to provide consumption stimulus. The National People's Congress revised individual income tax laws that would take effect starting 1st Jan 2019. The new monthly tax brackets introduced will prioritize tax reductions for low to middle income earners. Standard tax deductions will be increased from ¥ 42,000 per year to ¥ 60,000 per year.

An estimation by Ernst & Young showed that a taxpayer with gross monthly wage of ¥ 60,000 will see a 16% reduction in monthly tax burden. That figure grew to 71% for an individual earning ¥ 10,000 a month. Low to middle income consumers would likely see a higher incremental boost to spending power compared to higher earners.

Figure 2: A comparison between PRC's new and old IIT Law

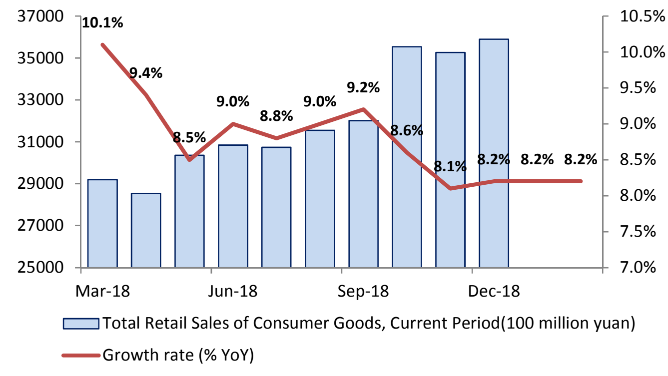
Old Tax Bracket (¥)	New Tax Bracket (¥)	Income Tax Rate (%)
Up to 1,500	Up to 3,000	3%
1,500 - 4,500	3,000 - 12,000	10%
4,500 - 9,000	12,000 - 25,000	20%
9,000 - 35,000	25,000 - 35,000	25%
35,000 - 55,000	35,000 - 55,000	30%
55,000 - 80,000	55,000 - 80,000	35%
Over 80,000	Over 80,000	45%

Source: EY, KGI Research

China expected to overtake US as world's largest consumer of goods this year. Overhead woes such as escalating trade war tensions and mounting household debt had taken a negative toll on consumer sentiments. It is unlikely for retail growth figures to see the same growth projections as disposable income.

Nonetheless, with a forecasted retail growth rate of 7.5% for 2019, China's total retail sales will likely end the year at $5,074 trillion and overtake US to become the largest consumer goods market. We think that CRCT is navigating through retail headwinds by including a more defensive tenant mix in selected malls such as tuition centres. Negative consumer sentiments will also likely affect bigger ticket items such as cars, to a greater extent than smaller ticket items and necessities that CRCT actively seeks to include within their tenant mix.

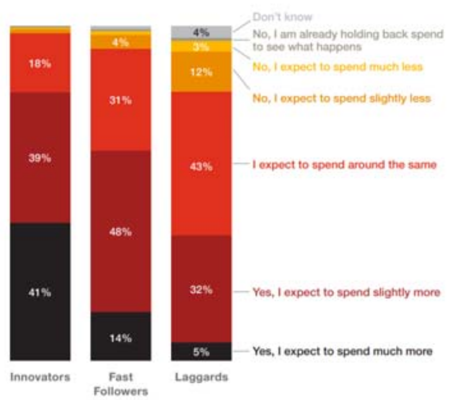
Figure 3: Total monthly Chinese retail sales on consumer goods and corresponding YoY growth rate.



Source: National Bureau of Statistics, KGI Research

Spending sentiments continue to look buoyant despite wider economic risks. PWC's consumer insights survey in China showed that consumption sentiments still look optimistic despite wider economic risks within the Chinese economy. More than 73% of consumers, categorized as Innovators (21% of consumers) and Fast Followers (52%) expect to spend at least slightly more this year compared to 2018. We are confident that the retail industry in China will gradually adapt to slowing retail sales growth. Beijing for example tightened future retail mall supply.

Figure 4: PWC's China consumer insights survey results, 2018: Do you feel confident about your personal financial situations in terms of your shopping plans for the next 12 months?



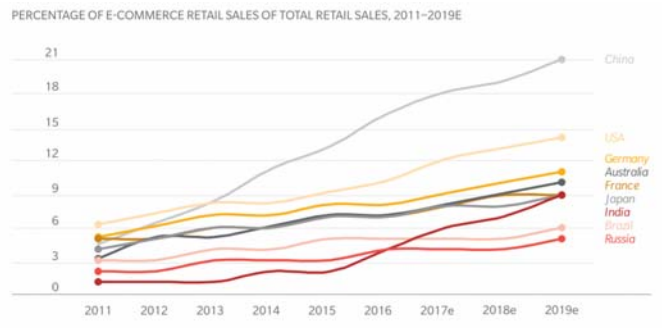
Source: PWC China consumer insights report, KGI Research

The era of new retail

As the retail landscape in China undergoes rapid changes, we believe that the various industry players – retailers and shopping malls - in the space of online and offline retail, are rapidly transforming to stay ahead of others.

Offline retail is not dead in China. Only about 21% of total sales in China is expected to be transacted online this year. While this figure is much higher in comparison with other developed countries, e-commerce players like Alibaba and JD are realizing the limitations of a pure online model and are trying to establish their physical presence. New retail models such as O2O (online-to-offline) connects online consumer following to offline retail traffic. Alibaba's disruptive O2O supermarket strategy created physical supermarket Hema, which recorded sales per floor area at five folds that of neighbouring traditional supermarkets.

Figure 5: Offline retail still dominates; E-commerce retail sales expected to make up just 21% of total retail sales value in China this year.



Source: National Bureau of Statistics of China, iResearch, Euromonitor, Oliver Wyman, KGI Research

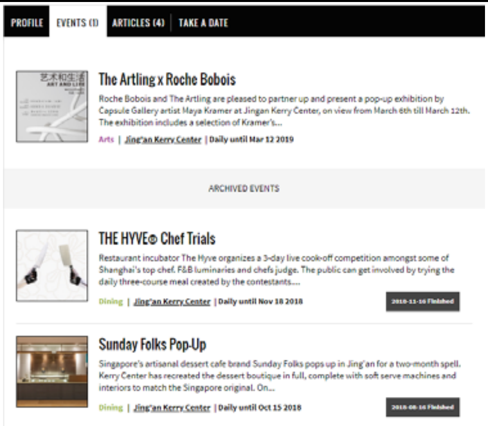
New experiences to drive shopper traffic. Experiential shopping concepts such as pop-up stores have proliferated across china, growing at a CAGR of over 100% since 2015, and will exceed 3,000 stores by 2020. Pop-up stores serve different retail purposes – selling products, enhancing brand awareness and gaining market insights - while having the flexibility of short-term leases. Pop up stores allow brands to unleash their creativity and rejuvenate the brand experience, while driving shopper traffic in return.

Figure 6: Chanel's pop up store – Coco Game Centre housed in trendy shanghai mall K11 for a period of 1.5 weeks

Source: Jing Daily, KGI Research

Malls are also factoring in lifestyle-based tenants to provide another reason for shoppers to stop by. Jing An Kerry Centre (Shanghai) incorporates cultural elements such as art exhibitions, concerts and social events on a weekly basis.

Figure 7: Jing An Kerry Centre mall social events as publicized on smartshanghai.com



Source: Smart Shanghai, KGI Research

Similarly, CRCT has been actively hosting activities such as a grand gaming competition (Minzhongleyuan mall) and a New Year countdown party (Xinnan mall). Such activities serve as a platform for the creation of memories that would cultivate a longer lasting impression on malls that go beyond just traditional retail shopping.

Figure 8: Grand gaming competition at CapitaMall Minzhongleyuan

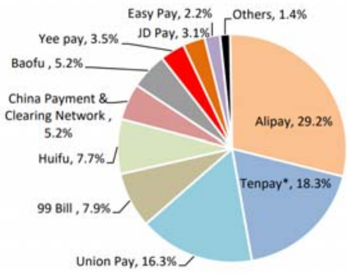
Source: Company, KGI Research

Figure 9: New Year Countdown at CapitaMall Xinnan

Source: Company, KGI Research

Connecting offline-to-online (O2O) retail. At a primary level, this could be just the seamless integration of various channels – physical, online, mobile and social. O2O retail strategies adopted in China include the connection of mobile payment methods, WeChat and Alipay, allowing orders to be processed online while at physical stores and allowing delivery directly to the door steps of consumers. Reimagining the synergies between offline and online retail could unlock endless opportunities.

Figure 10: Market share of third-party online payment services, 3Q17



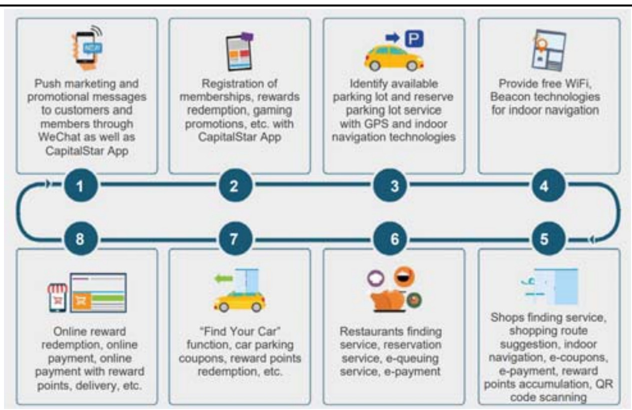
Source: iResearch, KGI Research ** Includes WeChat Pay and QQ Wallet*

Synergies between CRCT and CapitaLand – a tried and tested model. We see synergies between CRCT and CapitaLand's new retail concepts and technology which should sit well with digitally savvy Chinese consumers:
(1) CapitaLand's 'smart mall' model capabilities
(2) Digital marketing with CapitaStar reward program
(3) Experiential shopping concepts

Digital marketing initiatives – CapitaStar reward program. CapitaStar reward program aims to create stickiness through a loyalty program that can be used across all CapitaLand malls in China. Membership grew 58% YoY, with a 25% rise in active users. 95% of all tenants are onboard CapitaStar, which allows consumers to accumulate STAR$ that can be used to redeem CapitaVouchers and complimentary car parking.

'Smart Mall' model. CapitaLand's new mall, Funan DigitaLife, will become Singapore's first O2O retail mall in Singapore, potentially expanding on CapitaLand's existing 'Smart Mall' model. The mall will house Singapore's first deployment of automated guided vehicles and a 24 hour click and collect drive-through complemented by in-house warehousing functions.

Figure 11: CapitaLand's 'Smart Mall' model



Source: CapitaLand

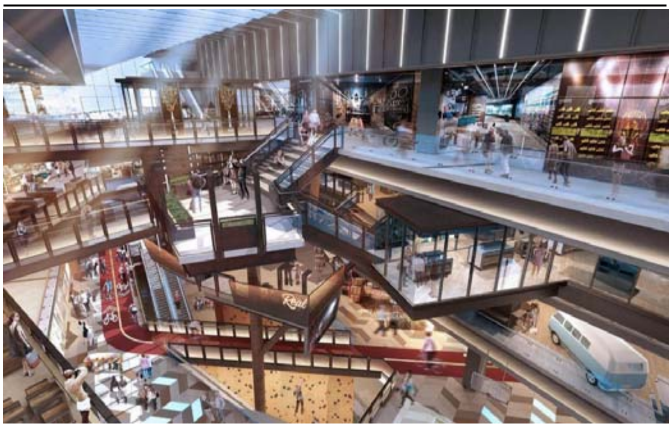
Experiential shopping concepts. NomadX is Singapore's first 'phygital' multi-label concept store offering a blend of physical and digital experience through gamified onboarding, interactive store assistance such as smart mirrors and product walls, and cashless payment. It is also CapitaLand's pioneer project aimed at connecting shopping to social activities while seamlessly bringing in concepts of sensation, discovery, instant gratification and convenience.

Figure 12: Entrance of NomadX, Singapore's first 'phygital' mall featuring ecommerce stores Taobao, Style Theory and Digital Fashion Week.

Source: Company, KGI Research

The Tree of Life is a centrepiece within the Funan DigitaLife mall and serves as a temporary space for entrepreneurs to hold classes or pilot concepts.

Figure 13: The Tree of Life, pictured here, experiments with open space concepts that would serve as temporary spaces to test pilot concepts.



Source: Company, KGI Research

Concepts that had been tried and tested by CapitaLand could be easily replicated within CRCT malls. These digital innovations and infrastructures will better serve both the needs of retailers who are transiting towards the new retail model and the modern Chinese shopper.

Portfolio rejuvenation to see the effect by 2020

Asset upcycling in Hohhot. CRCT recently announced a bundle deal to divest CapitaMall Saihan (Hohhot, Inner Mongolia) and acquire a brand new mall located directly opposite CapitaMall Saihan – Yuquan Mall. CRCT's investment rationale to acquire Yuquan mall was on the grounds of greater connectivity, larger net leasable area and to increase their geographical exposure to Inner Mongolia.

Figure 14: Key information of Saihan mall and Yuquan mall

Source: Company, KGI Research

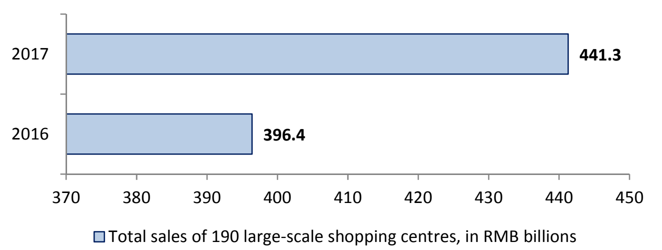
(1) Greater connectivity – Yuquan mall will enjoy direct underpass linkage to Metro Line 1 and 2 which is due for completion by 2019 and 2020 respectively.

(2) Larger scale – Yuquan mall has a leasable retail area that is 80% greater than Saihan's, and comes with 2 basement levels of carpark.

Area leased to anchor tenant would decrease from 45% to 28% after the bundle deal. This would likely translate to a higher average rental yield per NLA since rents committed to anchor tenants tend to be at a discount to non-anchor tenants. We expect the positive rental reversion to be reflected in FY2021 after CRCT successfully shifts existing tenants in Saihan mall to the new Yuquan mall.

According to iziRetail, total sales of 190 large-scale shopping malls across 51 cities in China reached RMB 441.3bn in sales in 2017, up 11.3% YoY. Having a larger mall would also allow greater tenant mix diversification to ensure that the interests of most consumer groups are met.

Figure 15: Retail sales growth across large-scale shopping malls remains resilient.



Source: iziRetail, KGI Research

(3) Expansion in cities with favourable macroeconomic outlook – Apart from an above national average disposable income growth, Hohhot is a city that is positioned for rapid growth due to increased connectivity to key Tier 1 Chinese cities and an important gateway in China's "Belt & Road Initiative". Travel time between Beijing and Hohhot will shorten to less than three hours when the construction of high-speed rail connecting the two cities completes by end 2019.

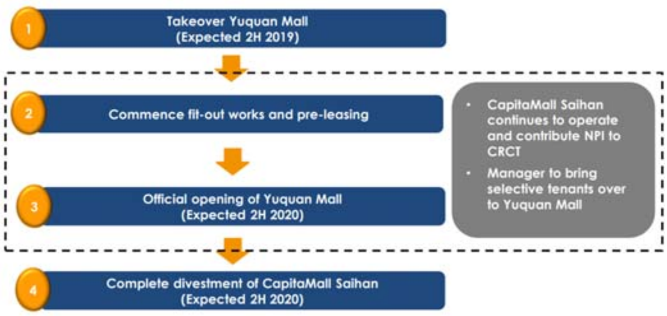
Figure 16: CRCT sees Yuquan mall as a key future threat to existing Saihan mall and bundle deal will ensure mall competitiveness in Hohhot.

- Brand new asset more than double the size of CapitaMall Saihan
- 2 basement levels of car park
- Direct link to upcoming metro line
- Enjoys excellent frontage linked to 2 main arterial roads

Source: Company, KGI Research

Hohhot deal is expected to be yield-accretive. CRCT will be divesting Saihan Mall at market value (RMB 460mn) and acquiring Yuquan Mall at an RMB 47.7mn discount to market value (RMB 856mn). The transaction is expected to take place in phases in 2020. We do not expect any revenue disruptions as the divestment of Saihan mall will only occur after the official opening of Yuquan mall. Management targets an opening occupancy of 85% - 90%.

Figure 17: Saihan mall will only be divested after the official opening of Yuquan mall.



Source: Company, KGI Research

Ample assets within sponsor's pipeline. Sponsor, CapitaLand is undergoing a portfolio reconstitution and had been timing potential divestments. Last year, CapitaLand divested a portfolio of 20 retail assets in China. We believe that more Chinese retail malls will be added to the sponsor pipeline, where CRCT will have rights of first refusal to acquire suitable properties from CapitaLand. Potential acquisitions could be the remaining 49% stake in Rock Square and malls that are within proximity to CRCT's existing malls.

Valuation

We derive a target price of S$1.61 based on DDM valuation. Our target price represents an upside of 13.0%, inclusive of a forward FY19 dividend yield forecasted at 6.8%.

Revenues: We expect rental revenue to grow from RMB1,092mn in FY18 to RMB1,097mn/RMB1,152mn for FY19/FY20, due to the anticipated completion of the bundle deal in Hohhot in 2H20. We have factored in an occupancy rate of 85% upon the opening of Yuquan Mall in 3Q20, and expect this to increase marginally to 90% in FY21.

Operating Statistics: Portfolio occupancy and WALE (based on net leasable area) stood at 97.5% and 5.3 years. We assumed that occupancy rates will remain the same in FY19 for all malls including the two malls under stabilisation within the portfolio. Occupancy for Minzhongleyuan and Wuhu were assumed to be maintained at 70.3% and 49.4% respectively. We think that CRCT might consider these two malls for divestment in the near future. CapitaLand Wuhu had been closed down since August 2018 with the exit of an anchor tenant, and is currently at a negative annual NPI of RMB 2.7mn.

Aggregate annual rent/sqm: We have forecasted annual rent per sqm to increase at an average of 0.35% YoY in FY19, conservatively below CPI inflation rate of 1.9% reported in December 2018. CRCT will be moving existing tenants from Saihan mall to the new Yuquan mall, which will officially open in 2H20 with a targeted opening occupancy of 85%-90%. Due to a lack of market comparables, we assumed that Yuquan mall will bring in the same annual rent rates as Saihan in FY18 at RMB2154/sqm. Double-digit rental reversions will be expected for FY2019.

NPI Margins: We estimate NPI margins to stagnate at 66.2% as per F18 results. Going forward, we anticipate an upward correction of NPI margins due to an enlarged property valuation base.

Income available for distribution: Without factoring in fair value changes in properties going forward, our forecasted income available for distribution increased to S$112.6mn/S$119.6mn for FY19/FY20 compared to S$99.7mn for FY18.

DPU: We derived a DPU of 10.37cents/11.02cents for FY19/FY20 based on a 90% pay-out ratio.

Cost of Equity: We used a cost of equity rate of 8.13% and a conservative terminal growth rate of 1.0%.

Figure 18: Dividend Discount Model

Fiscal year ending: December 31	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Distribution per unit (SGD cents)	10.22	10.37	11.02	11.29	11.58	11.87	12.16	12.47	12.59
YoY Growth (%)		*1.5%*	*6.3%*	*2.5%*	*2.5%*	*2.5%*	*2.5%*	*2.5%*	*1.0%*
Terminal value per unit (SGD cents)								176.50	
Cost of equity	8.13%								
Target price (SGD$)	**1.61**								
Capital Appreciation	*6.2%*								
Forward Dividend Yield	*6.8%*								
Upside/(Downside)	***13.0%***								

Source: KGI Research

Peer Comparison

We compare CRCT to other Singapore listed retail REITs and HK-listed REITs holding retail malls in China.

We note that at its forward P/B ratio of 1.0x, CRCT trades at a slight premium compared to other S-REITs focusing on the Chinese retail segment which averages at about 0.8x. However, CRCT's FY18 dividend yield is on the higher end of the spectrum at 7.5% compared to peer average at 6.5%. We think that the price premium is justifiable given CRCT's portfolio of high-quality retail malls and asset recycling efforts that will act as a short-term catalyst for DPU growth.

Figure 19: Local and global peer comparables

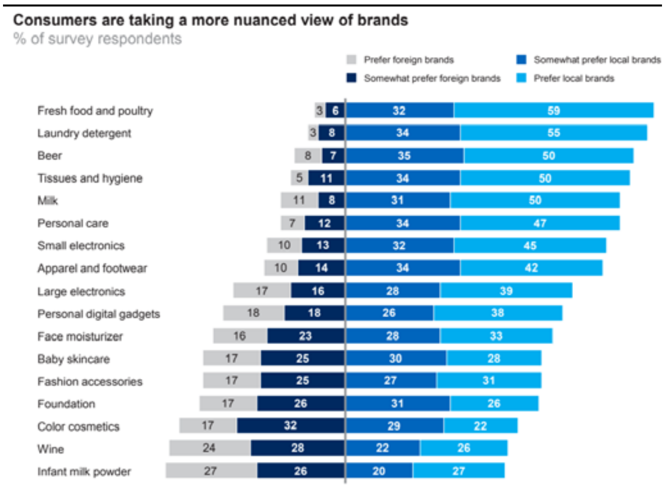
Company Name	Last Price (local $)	Currency Adj. Market Cap (US$ m)	Dividend Yield (%)		Gearing (%)	P/B (x)		6M Average daily trading volume (S$ '000)	YTD Price Performance (%)	1YR Price Performance (%)	1YR Total Returns (%)
			FY18	FY19F		FY18	FY19F				
CAPITALAND RETAIL CHINA TRUS	**SGD 1.51**	**1,101**	**7.5**	**6.8**	**39.8**	**0.9**	**1.0**	**1,951**	**11.0**	**-4.4**	**2.5**
S-REITS focusing on Chinese retail sector											
BHG RETAIL REIT	SGD 0.69	256	-	-	29.5	-	-	11	-4.2	-14.4	-3.8
DASIN RETAIL TRUST	SGD 0.86	356	-	4.3	36.3	-	0.6	398	-0.6	6.2	6.1
SASSEUR REAL ESTATE INVESTME	SGD 0.73	643	-	8.8	36.4	-	0.9	774	12.3	-8.7	-2.3
Average		**418**	**-**	**6.5**	**34.1**	**-**	**0.8**	**394**	**2.5**	**(5.7)**	**(0.0)**
Median		**356**	**-**	**6.5**	**36.3**	**-**	**0.8**	**398**	**(0.6)**	**(8.7)**	**(2.3)**
Other retail S-REITs											
FORTUNE REIT	HKD 9.98	2,451	5.7	5.4	21.7	0.5	0.6	649	12.0	14.1	12.0
CAPITALAND MALL TRUST	SGD 2.37	6,471	5.1	5.1	32.8	1.1	1.2	24,175	4.9	22.8	20.2
MAPLETREE COMMERCIAL TRUST	SGD 1.84	3,936	5.8	4.9	35.2	1.1	1.2	11,029	11.5	22.7	23.0
SPH REIT	SGD 1.05	2,009	5.5	5.4	26.8	1.1	1.1	919	5.0	7.7	12.7
FRASERS CENTREPOINT TRUST	SGD 2.28	1,566	5.3	5.4	29.6	1.1	1.1	2,140	5.1	12.3	10.4
STARHILL GLOBAL REIT	SGD 0.71	1,138	7.2	6.7	36.2	0.7	0.8	1,278	3.7	-4.7	4.4
LIPPO MALLS INDONESIA RETAIL	SGD 0.20	413	11.3	12.8	38.4	0.6	0.6	860	7.1	-50.0	-46.0
SASSEUR REAL ESTATE INVESTME	SGD 0.73	643	-	8.8	36.4	-	0.9	774	12.3	-8.7	-2.3
BHG RETAIL REIT	SGD 0.69	256	-	-	29.5	-	-	11	-4.2	1.5	-3.8
Average		**2,098**	**6.5**	**6.8**	**31.9**	**0.9**	**0.9**	**4,648**	**6.4**	**1.9**	**3.4**
Median		**1,566**	**5.7**	**5.4**	**32.8**	**1.1**	**1.0**	**919**	**5.1**	**7.7**	**10.4**
HK listed REIT with Chinese retail assets											
HUI XIAN REIT	CNY 3.37	2,889	-	7.9	28.8	0.7	0.7	10,673	5.6	7.0	12.9
YUEXIU REAL ESTATE INVESTMEN	HKD 5.36	2,130	6.3	6.3	47.1	1.0	1.0	22,351	6.8	18.1	5.6
SUNLIGHT REAL ESTATE INVEST	HKD 5.72	1,200	4.9	4.8	22.2	0.6	0.6	4,938	13.9	25.7	12.1
LINK REIT	HKD 88.25	23,713	3.7	3.1	12.6	1.0	1.0	410,508	11.3	68.6	32.2
Average		**7,483**	**5.0**	**5.5**	**27.7**	**0.8**	**0.8**	**112,117**	**9.4**	**29.8**	**15.7**
Median		**2,510**	**4.9**	**5.5**	**25.5**	**0.8**	**0.9**	**16,512**	**9.0**	**21.9**	**12.5**

Source, KGI Research

Key Risks

Foreign brands or local brands? According to McKinsey's 2017 China Consumer survey, consumers are taking a more nuanced view of brands. In past surveys conducted, Chinese consumers seem to lean more towards international brands. In recent years, the emphasis is more on brands that are able to deliver three key things – value for money products, quality products and good after-sales service. CRCT should evaluate tenant and brand mix according to changing consumer preferences. A balance should be created in securing key local brands and introducing new foreign brands within the tenant mix.

Figure 20: Chinese consumers prefer local brands for fresh food and poultry and foreign brands for infant milk powder.



Source: National Bureau of Statistics, KGI Research

Boycott diplomacy remains a threat. The term was coined for China's willingness to boycott imported goods to inflict economic pain. We had seen this happen to Japanese cars over territorial dispute in the East China Sea and South Korean goods due to the THAAD anti-missile system events. Recently, brands that were boycotted by the Chinese were Apple and Dolce & Gabbana. Retail malls would find themselves in a difficult situation dealing with tenants that see risks of brand boycott.

Broader market risk. Beijing is now targeting economic growth of between 6% and 6.5% this year, marking the slowest growth in almost three decades, as government and corporate debt mounts and trade tensions with the U.S. have depressed manufacturing output and consumer sentiment. These broader market risks may continue to dampen consumer sentiments and result in the delaying of expenditure.

Higher operating costs a threat to operating margins. Over the recent years, operating costs in China have elevated significantly, largely driven by surging rental and labour costs, as well as higher expenditure on sustainability initiatives. Concurrently, more capital expenditure had to be dedicated to the adoption of new retail technologies and business models as a crucial part of retail competitiveness. All these may further increase the financial burden of retail mall operators and affect their profitability.

Risk of negative rental reversions. China has nearly 4,450 shopping centres (four times the number compared to the US) and it is estimated that an additional 7,000 malls are to open by 2025. The Chinese Academy of Social Sciences also estimates that one-third of China's malls may close down by 2020 if they do not aim to transform with times. Supply of retail malls within the next few years is likely to remain moderately high based on CBRE's forecast. As a results, revenue rental across retail malls might see lower occupancy or risk negative rental reversions.

Company Overview

First pure-play China retail REIT listed in Singapore.
CRCT REIT is the first and largest pure-play China retail REIT listed in Singapore. The REIT invests, directly or indirectly, in a diversified portfolio of income-producing retail properties located primarily in China, Hong Kong and Macau.

The REIT manager seeks to capture value and sustainable shareholder returns via a three-pronged approach:
(1) Growth optimisation through proactive asset management
(2) Value creation through asset enhancement and reconstitution strategies
(3) Capitalisation of yield-accretive acquisitions

Property Portfolio.
As at 31 December 2018, CRCT's total AUM was valued at approximately S$3.0bn. CRCT holds 11 retail malls across 8 cities in China, spanning a total NLA of 521,960 sqm. All malls are positioned as one-stop family-oriented retail destinations with a focus on shopping, dining and entertainment.

Multi-tenant retail malls make up the vast majority of CRCT's portfolio at 86%. Multi-tenanted malls reflect greater price sensitivity to the latest market rental yields as compared to rents of CRCT's master-leased malls that have remained relatively stable over the past 5 years.

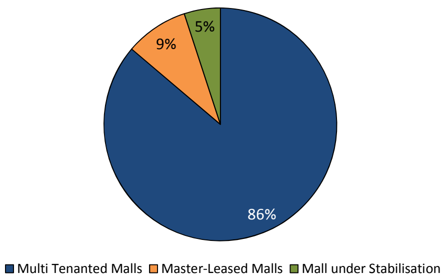
Fashion (28%), food & beverage (27%) and beauty & healthcare (7%) make up the top rental income grossing tenant categories. Anchor tenants - characterised by the largest net lettable area take up - are the supermarkets (24%), department stores (20%) and food & beverage (15%) segments.

Portfolio WALE by NLA stood at 5.3 years as of end Dec 2018 and portfolio occupancy at 97.5%. A total number of 760 leases will be due for renewal, representing 27.5% of total gross rental income. This is with the exception of CapitaLand Wuhu, which had been closed since August 2018 due to the exit of an anchor tenant. We think that management might seek to divest the two underperforming malls under stabilisation – Wuhu and Mingzhongleyuan.

Figure 21: CRCT owns 11 quality shopping malls across 8 cities in China

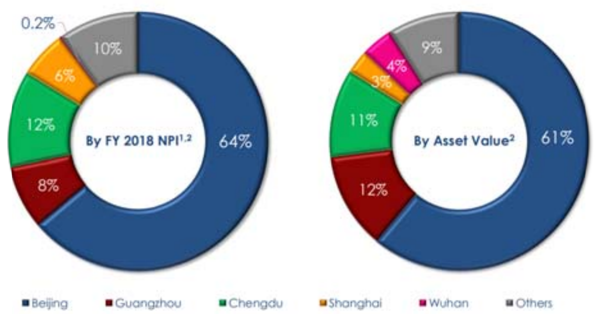
Source: Company, KGI Research

Figure 22: Multi-tenant leases make up majority of portfolio valuation



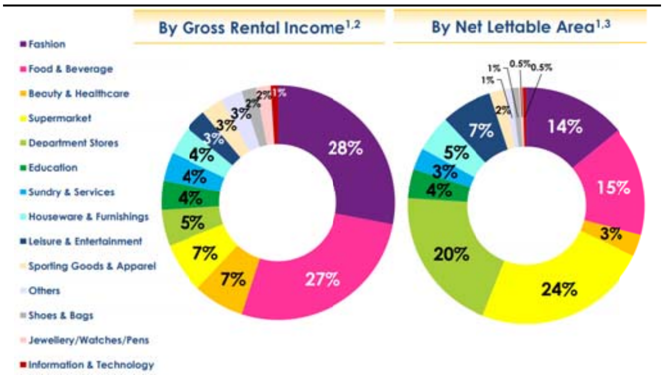
Source: Company, KGI Research

Figure 23: NPI largely derived from Tier 1 and 2 cities; AUM geographical breakdown based on NPI (LHS) and Asset Valuation (RHS)



Source: Company, KGI Research

Figure 24: Tenant classification by gross rental income (LHS) and net lettable area (RHS)



Source: Company, KGI Research
** As of 31 Dec 18*
** Includes master-leased malls*

Capital Management.
With the extension of the S$120mn bridge loan due in 2019 to 2024, average term to maturity will be extended to 3.47 years. Approximately 80% of debt and 80% of distributable income is hedged at a fixed interest and exchange rate. This provides a safety net for future distributions made in SGD terms, hedged against the risk of near-term yuan fluctuations as the trade war progresses.

The sponsor – CapitaLand
CRCT is managed by CapitaLand Retail China Trust Management Limited, an indirect wholly owned subsidiary of CapitaLand Limited. CapitaLand limited is Asia's largest real estate company headquartered and listed in Singapore. CRCT has rights of first refusal to purchase assets held by CapitaLand Mall China Income Fund I, II, & III and CapitaLand Mall Development Fund III.

Early last year, CapitaLand divested a portfolio of 20 retail assets in China as part of a portfolio reconstitution strategy. We believe that more Chinese retail malls will be added to the sponsor pipeline, where CRCT will have first right of refusal to acquire suitable properties, especially those within CRCT's existing cities.

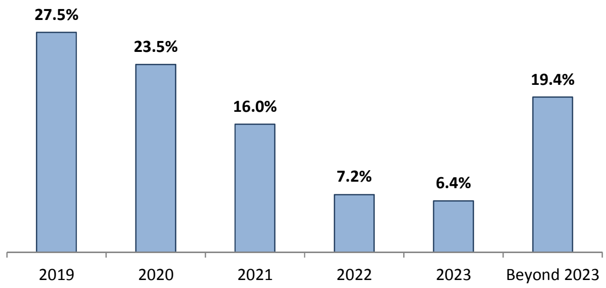
Figure 28: Potential acquisition – Remaining 49% stake in Rock Square that is currently held by CapitaLand

Source: Company, KGI Research

Figure 29: Potential acquisition – CapitaMall SKY+, located approximately 10km away from CRCT''s Rock Square mall

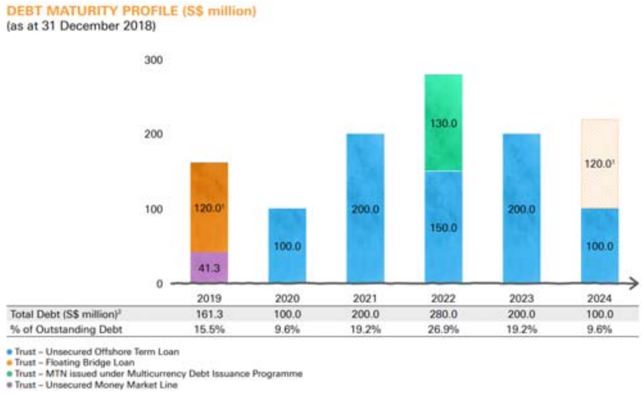
Source: Company, KGI Research

Figure 25: Lease expiry profile by NLA at 31 Dec 2018, Wale of 5.3 years



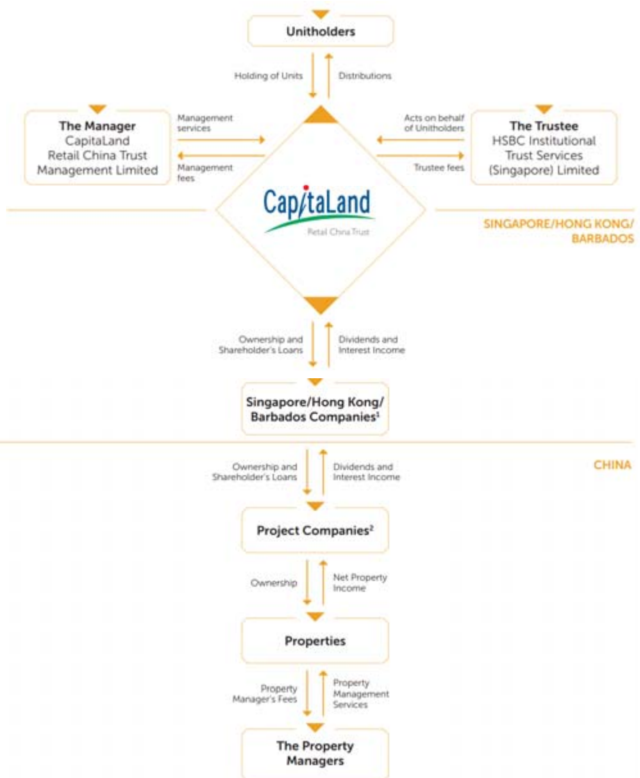
Source: Company, KGI Research

Figure 26: Debt maturity profile as at 31 Dec 2018



Source: Company, KGI Research

Figure 27: CRCT's Trust Structure



Source: Company, KGI Research

Company Snapshot

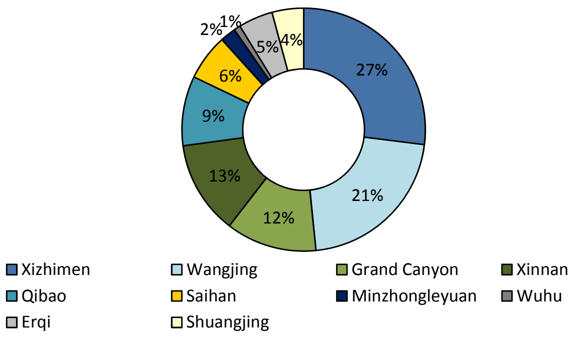
Figure 30: Company profile

Listed on the Mainboard of the Singapore Exchange since 2006, CapitaLand Retail China Trust (CRCT) is the first S-REIT with a focus on China shopping mall real estates. With an AUM of over S$3.0bn, CRCT owns 11 retail malls across 8 Chinese cities. CRCT's strategically position all malls as one-stop family-oriented shopping, dining and entertainment destination.

CRCT is managed by CapitaLand Retail China Trust Management Limited, an indirect wholly owned subsidiary of CapitaLand Limited, one of Asia's largest real estate companies headquartered and listed in Singapore.

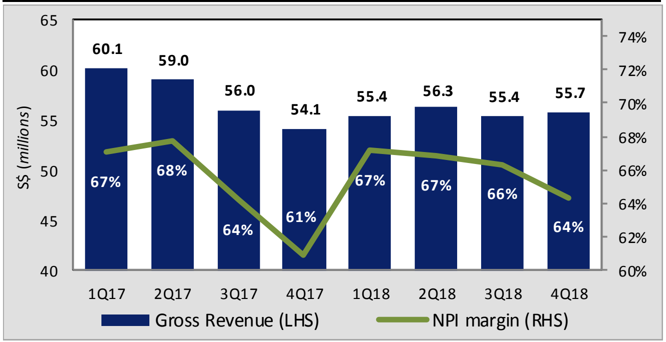
Source: Company

Figure 31: FY17 Revenue breakdown by segment (in S$, millions)



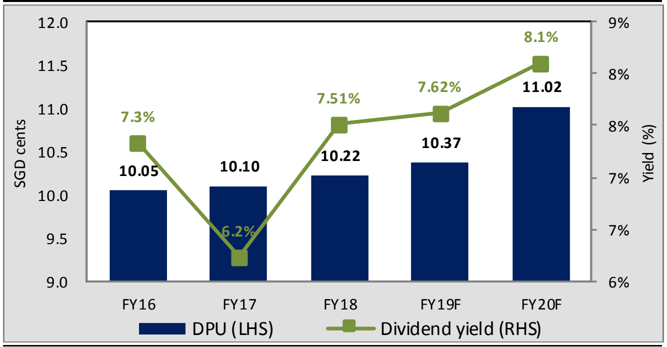
Source: Company

Figure 32: Revenue breakdown (in S$, millions) vs NPI margin (%)



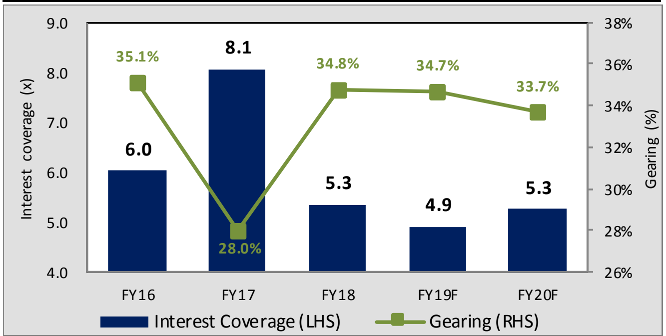
Source: Company Data, KGI Research

Figure 33: DPS (SGD cents) and Dividend yield (%)



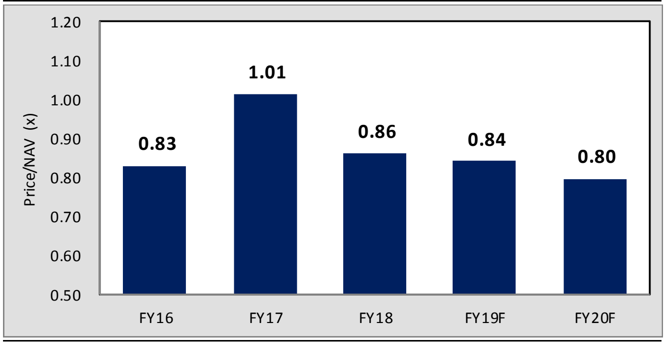
Source: Company Data, KGI Research

Figure 34: Interesting coverage and gearing



Source: Company Data, KGI Research

Figure 35: Price/NAV

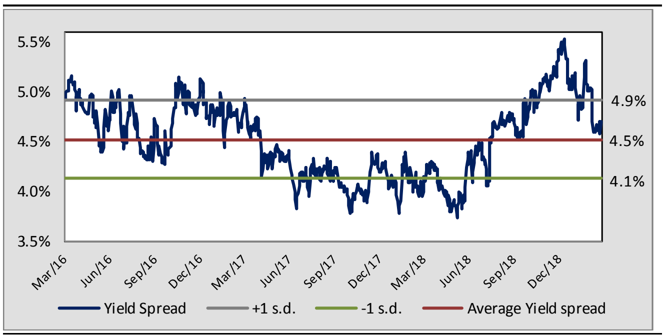


Source: Company Data, KGI Research

Figure 36: 3 Year historical P/B ratio (x)

Source: Company Data, KGI Research

Figure 37: Yield spread above 10Y government bond yield



Source: Company Data, KGI Research

China retail property market outlook

New supply remains significant. New retail supply in 17 major cities across China is forecasted to total 7.6 million sqm in 2019, although some new projects may be delayed to officially open in 2020. Oversupply risk is likely to hit Wuxi and Shenzhen the hardest from F19 to F21. Amongst the cities that CRCT has the greatest geographical exposure to, oversupply risk in Beijing is predicted to be low while that for Chengdu and Guangzhou is predicted to be moderate.

Opening occupancy for new malls remains positive. According to CBRE, the average opening rate of new projects in 2018 reached 88.6% and is expected to remain similar or slightly higher in 2019.

Figure 38: Retail supply from 2018 to 2025

Source: Savills Research, KGI Research

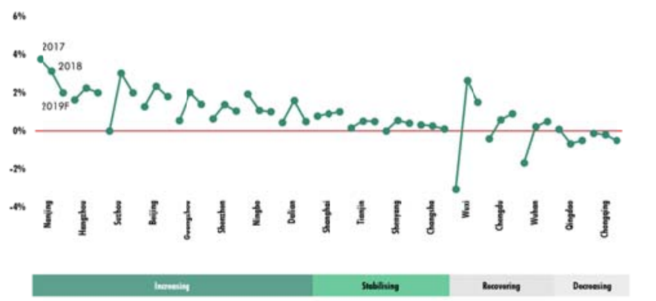
Around 700,000 sqm of retail space in these 17 cities closed in 2018, and increasing vacancy rates in several malls led to further closures. Some renovated projects that reopened in 2018 with high-quality tenants and low vacancy rates include Shanghai Shimao Shopping Plaza and Beijing Fangshan Paradise Walk.

Figure 39: China retail property market supply and demand forecast

Source: CBRE Research, KGI Research

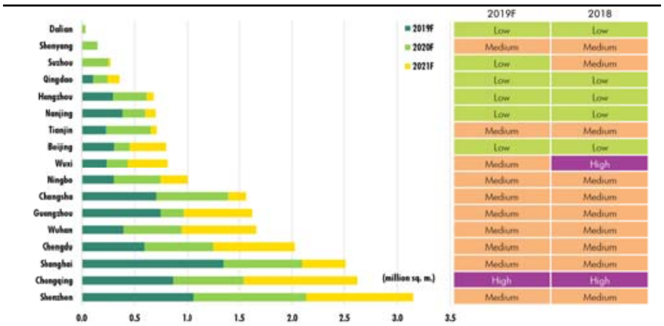
CBRE expects ground floor rents of shopping malls in China's 17 major cities to record steady growth of between 0%-3% in 2019. Just two cities, Qingdao and Chongqing, will experience a rental decline, mainly due to oversupply. Data shows that rental income of shopping malls operated by major shopping mall developers recorded double digital YoY growth of 14.3% in 1H18. Rental income rose by 11.5%, 14.9% and 13.9% YoY in Tier1, Tier2 and Tier3 cities respectively.

Figure 40: Rents poised for steady growth throughout most cities



Source: CBRE Research, KGI Research

Figure 41: Oversupply risk highest in Shanghai and Chengdu amongst the 8 cities CRCT has presence in.



Source: CBRE, KGI Research

Four Chinese cities continue to be retail darlings. Shanghai, Beijing, Shenzhen and Chengdu remained on the top of retailers' index ranking for five consecutive years. These cities continue to lead in terms of economic development as global financial and technology hubs. Shanghai, Beijing and Shenzhen ranked top amongst Chinese cities as financial hubs in the latest Global Financial Centres Index. According to Business Insider's top global 20 high-tech cities, Beijing, Shanghai and Shenzhen ranked 16, 17 and 20 respectively.

These four cities are likely to remain at the forefront of economic development in China. We anticipate retail consumption to continue escalating through an increasing city population size and above average disposable income.

Financial forecasts

Figure 42: Forecasted Financials (2016A – 2020F)

INCOME STATEMENT (SGD mn)	2016A	2017A	2018A	2019F	2020F
Gross revenue	214.4	229.2	222.7	223.5	233.9
Property expenses	(74.6)	(80.0)	(75.3)	(75.6)	(79.1)
Net property income	**139.7**	**149.2**	**147.4**	**147.9**	**154.8**
REIT Manager's fees	(11.9)	(12.9)	(14.1)	(14.1)	(14.5)
REIT Trustee's fees	(0.4)	(0.4)	(0.5)	(0.5)	(0.5)
Net interest expense	(19.4)	(21.0)	(20.4)	(21.8)	(21.8)
Other expenses	(1.5)	(1.2)	(1.7)	(7.7)	(4.7)
Net profit/(loss)	**106.5**	**113.6**	**110.8**	**103.9**	**113.3**
Change in fair value - investment ppty	41.2	41.5	68.4	0.0	0.0
Total return before tax	**145.6**	**207.3**	**184.0**	**111.5**	**121.3**
Income tax	(41.6)	(64.2)	(56.5)	(34.3)	(37.3)
Total return after tax	104.0	143.1	127.5	77.3	84.0
Distributable income	86.7	91.1	99.7	112.6	119.6

BALANCE SHEET (SGD mn)	2016A	2017A	2018A	2019F	2020F
Cash and cash equivalents	136.1	186.5	173.9	184.8	199.1
Trade and other receivables	12.8	37.1	108.5	108.9	113.9
Other current assets	0.0	0.0	0.0	0.0	0.0
Total current assets	**149.0**	**223.6**	**282.4**	**293.6**	**313.1**
Investment properties	2,628.4	2,441.0	2,439.1	2,439.1	2,509.1
Intangibles, others	6.1	3.4	261.2	260.0	260.0
Total assets	**2,783.5**	**2,668.1**	**2,982.7**	**2,992.8**	**3,082.2**
Trade and other payables	64.5	59.6	61.0	61.2	64.0
Other current liabilities	48.8	50.8	54.6	54.6	54.6
Total current liabilities	**113.3**	**110.4**	**115.6**	**115.8**	**118.6**
LT Borrowings	977.8	747.5	1,038.0	1,038.0	1,038.0
Other non-current liabilities	240.7	242.1	257.5	257.5	257.5
Total liabilities	1,331.8	1,100.0	1,411.1	1,411.3	1,414.2
Unitholders' funds and reserves	1,451.7	1,568.1	1,571.6	1,581.4	1,668.0
Total liabilities and equity	**2,783.5**	**2,668.1**	**2,982.7**	**2,992.8**	**3,082.2**

CASH FLOW STATEMENT (SGD mn)	2016A	2017A	2018A	2019F	2020F
Total return before tax	**104.0**	**143.1**	**127.5**	**77.3**	**84.0**
Depreciation & Amortisation	2.1	1.7	1.3	1.3	1.3
Other non-cash adjustments	25.8	(2.3)	9.4	86.1	86.4
Changes in working capital	6.6	1.0	3.8	(0.2)	(2.2)
Taxes paid	(18.7)	(27.3)	(24.1)	(24.1)	(24.1)
Cash flows from operations	**119.9**	**116.3**	**117.8**	**140.4**	**145.3**
Capital expenditure	(21.1)	(15.1)	(11.4)	(36.4)	(36.4)
Cash flows from investing	**(313.0)**	**175.0**	**(336.4)**	**(29.7)**	**(29.7)**
Borrowings raised / (repaid)	275.9	(230.1)	289.4	0.0	0.0
Equity raised / (bought back)	(0.0)	102.3	(0.1)	0.0	0.0
Dividends paid	(52.5)	(82.6)	(44.3)	(99.8)	(101.3)
Other financing cashflow	(12.4)	(28.4)	(33.3)	0.0	0.0
Cash flows from financing	**211.0**	**(238.8)**	**211.7**	**(99.8)**	**(101.3)**
FX Effects, Others	(8.1)	(2.1)	(5.6)	0.0	0.0
Net increase in cash	**9.8**	**50.4**	**(12.6)**	**10.9**	**14.4**
Beginning Cash	126.3	136.1	186.5	173.9	184.8
Ending cash	**136.1**	**186.5**	**173.9**	**184.8**	**199.1**

KEY RATIOS	2016A	2017A	2018A	2019F	2020F
DPU (SGD cents)	10.1	10.1	10.2	10.4	11.0
Dividend yield (%)	7.3	6.2	7.5	7.6	8.1
NAV per share (SGD cents)	1.7	1.6	1.6	1.6	1.7
Price/NAV (x)	0.8	1.0	0.9	0.8	0.8
Profitability					
NPI Margin (%)	65.2	65.1	66.2	66.2	66.2
Net Margin (%)	48.5	62.4	57.2	34.6	35.9
ROE (ex. Property FV gain) (%)	4.3	6.5	3.8	4.9	5.0
ROA (ex. Property FV gain) (%)	2.3	3.8	2.0	2.6	2.7
Financial Structure					
Interest Coverage Ratio (x)	6.0	8.1	5.3	4.9	5.3
Gearing Ratio (%)	35.1	28.0	34.8	34.7	33.7

Source: KGI Research

Operating statistics

Figure 43: Operating Statistics (2015A – 2021F)

	Xizhimen	Wangjing	Grand Canyon	Xinnan	Qibao	Saihan	Yuquan Mall	Rock Square	Minzhongleyuan	Wuhu	Anzhen	Erqi	Shuangjing
NLA (sqm)													
2015A	50,090	53,698	45,159		51,157	30,913			22,995	37,447	43,443	92,356	51,224
2016A	50,278	53,959	45,348	36,190	51,176	30,984			22,731	36,550	43,443	92,356	51,227
2017A	50,452	51,554	45,805	36,074	51,243	31,032		53,107	23,318	35,826	43,443	92,356	51,193
2018A	50,452	51,554	45,805	36,074	51,243	31,032		53,107	23,318	35,826		92,356	51,193
2019F	50,452	51,554	45,805	36,074	51,243	31,032		53,107	23,318	35,826		92,356	51,193
2020F	50,452	51,554	45,805	36,074	51,243	31,032	75,309	53,107	23,318	35,826		92,356	51,193
2021F	50,452	51,554	45,805	36,074	51,243		75,309	53,107	23,318	35,826		92,356	51,193
Occupancy (%)													
2015A	98.0%	99.8%	98.0%		97.0%	99.9%			70.7%	65.3%	100.0%	100.0%	100.0%
2016A	97.8%	99.6%	96.6%	98.2%	94.1%	100.0%			93.6%	64.4%	100.0%	100.0%	100.0%
2017A	98.2%	98.4%	98.5%	99.0%	94.6%	99.9%		96.4%	78.0%	69.7%	100.0%	100.0%	100.0%
2018A	99.9%	99.4%	97.5%	99.5%	95.3%	100.0%		98.4%	70.3%	49.4%		100.0%	100.0%
2019F	99.9%	99.4%	97.5%	99.5%	95.3%	100.0%		98.4%	70.3%	49.4%		100.0%	100.0%
2020F	99.9%	99.4%	97.5%	99.5%	95.3%	90.0%	34.0%	98.4%	70.3%	49.4%		100.0%	100.0%
2021F	99.9%	99.4%	97.5%	99.5%	95.3%		90.0%	98.4%	70.3%	49.4%		100.0%	100.0%
Gross Revenue (RMB, millions)													
2015A	272.9	213.0	145.2		102.2	60.8			15.9	15.8	82.4	51.0	45.9
2016A	279.7	214.0	139.8	27.5	105.4	62.7			12.3	9.4	82.2	51.0	45.6
2017A	287.9	224.5	144.6	131.1	99.6	64.1			26.6	8.7	39.8	49.4	45.8
2018A	294.7	233.7	131.9	135.7	101.2	66.8		*Accounted for as Share of JV	23.0	9.4		50.0	45.7
2019F	295.4	235.7	131.9	136.1	101.6	68.3			23.0	9.4		50.0	45.7
2020F	295.9	237.0	131.9	136.4	101.8	62.1	58.9		23.0	9.4		50.0	45.7
2021F	295.9	237.0	131.9	136.4	101.8		155.9		23.0	9.4		50.0	45.7
NPI (RMB, millions)													
2015A	191.2	154.8	93.3		46.2	31.6			-11.0	-6.4	66.2	40.5	37.0
2016A	195.8	153.3	89.4	15.2	50.7	35.8			-9.0	-6.5	66.7	41.5	36.7
2017A	200.8	158.5	91.0	89.7	45.5	38.7			1.3	-6.7	32.8	42.2	36.8
2018A	208.9	166.2	88.5	94.4	47.6	38.6		*Accounted for as Share of JV	1.9	-2.7		42.8	36.8
2019F	209.3	167.6	88.5	94.7	47.8	39.4			1.9	-2.7		42.8	36.8
2020F	209.7	168.5	88.5	94.9	47.9	35.9	41.2		1.9	-2.7		42.8	36.8
2021F	209.7	168.5	88.5	94.9	47.9		109.1		1.9	-2.7		42.8	36.8
Gross profit by property (%)													
2015A	70.1%	72.7%	64.3%		45.2%	51.9%			-68.9%	-40.6%	80.4%	79.5%	80.6%
2016A	70.0%	71.7%	64.0%	55.1%	48.1%	57.1%			-73.1%	-69.6%	81.1%	81.4%	80.6%
2017A	69.7%	70.6%	62.9%	68.4%	45.7%	60.4%			4.9%	-77.0%	82.3%	85.4%	80.3%
2018A	70.9%	71.1%	67.0%	69.6%	47.0%	57.7%		*Accounted for as Share of JV	8.4%	-28.9%		85.6%	80.6%
2019F	70.9%	71.1%	67.0%	69.6%	47.0%	57.7%			8.4%	-28.9%		85.6%	80.6%
2020F	70.9%	71.1%	67.0%	69.6%	47.0%	57.7%	70.0%		8.4%	-28.9%		85.6%	80.6%
2021F	70.9%	71.1%	67.0%	69.6%	47.0%		70.0%		8.4%	-28.9%		85.6%	80.6%
Property valuation (RMB, millions)													
2015A	2,882	2,156	2,020		495	425			535	221	995	615	568
2016A	2,951	2,285	2,068	1,527	495	445			525	207	1,001	631	573
2017A	3,075	2,375	2,090	1,536	495	456		1,714	528	193	1,001	638	583
2018A	3,293	2,543	2,095	1,550	470	460		1,734	515	193		645	590
2019F	3,293	2,543	2,095	1,550	470	460		1,734	515	193		645	590
2020F	3,293	2,543	2,095	1,550	470	460	856	1,734	515	193		645	590
2021F	3,293	2,543	2,095	1,550	470		856	1,734	515	193		645	590

Source: KGI Research

** Grey areas represent the absence of a property during the corresponding financial year*

KGI's Ratings

Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

Disclaimer

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities. This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. You should independently evaluate particular investments and consult an independent financial adviser before dealing in any securities mentioned in this report.

This report is confidential. This report may not be published, circulated, reproduced or distributed and/or redistributed in whole or in part by any recipient of this report to any other person without the prior written consent of KGI Securities. This report is not intended for distribution and/or redistribution, publication to or use by any person in any jurisdiction outside Singapore or any other jurisdiction as KGI Securities may determine in its absolute discretion, where the distribution, publication or use of this report would be contrary to applicable law or would subject KGI Securities and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by KGI Securities to be reliable. However, KGI Securities makes no representation as to the accuracy or completeness of such sources or the Information and KGI Securities accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. KGI Securities and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of KGI Securities and its connected persons are subject to change without notice. KGI Securities reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) KGI Securities, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) KGI Securities, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; and (3) the officers, employees and representatives of KGI Securities may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business".)

However, as of the date of this report, neither KGI Securities nor its representative(s) who produced this report (each a "research analyst"), has any proprietary position or material interest in, and KGI Securities does not make any market in, the securities which are recommended in this report.

Each research analyst of KGI Securities who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of KGI Securities or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including KGI Securities' total revenues, a portion of which are generated from KGI Securities' business of dealing in securities.