KGI CHINA DEVELOPMENT FINANCIAL

Frasers Centrepoint Trust

(FCT SP/FCRT.SI)

Structural or cyclical? Resume coverage with Outperform

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- **A disruption like no other.** The COVID-19 outbreak is raising the key question on whether this is simply a cyclical downturn, or a more serious long-term weakness for the retail sector.
- **A case for optimism.** We believe Singapore-focused retail assets should perform better given the different dynamics at play. E-commerce has always been a threat to retail malls, and recently exacerbated by the lockdowns and social distancing rules, but we expect Singapore-focused retail REITs to cope with the latest challenges.
- **Resume coverage with Outperform.** We acknowledge the challenges facing retail REITs like FCT in 2020. Investors should however look beyond the current weakness and identify positive trends shaping the future of physical retail malls. As such, we resume coverage of FCT with an Outperform, and believe its suburban malls with a natural catchment of foot traffic should recover faster than peers.

Financials & Key Operating Statistics

SGD mn	2018	2019	2020F	2021F	2022F
Gross revenue	193.3	196.4	175.5	199.9	204.2
Net property income	137.2	139.3	124.7	139.1	141.9
Distributable income	111.1	118.7	122.4	134.7	137.4
DPU (SGD cents)	12.0	12.1	10.0	11.6	12.2
DPU growth (%)	-	0%	-17%	15%	5%
Div Yield (%)	5.5%	4.6%	4.8%	5.6%	5.9%
NAV (SGD cents)	2.1	2.2	2.2	2.2	2.2
Price / Book (x)	1.0	1.2	0.9	0.9	0.9
NPI Margin (%)	71%	71%	71%	70%	70%
Net Margin (%)	86%	105%	70%	64%	64%
Gearing (%)	28.9%	29.9%	32.8%	32.8%	32.8%
ROE (%)	9%	8%	5%	5%	5%

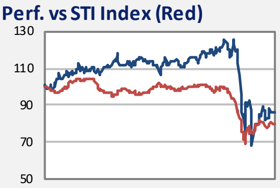
Source: Company Data, KGI Research

Financial review. 2QFY20 DPU declined 49% to 1.61 Sing cents, mainly as FCT held back 50% of distributable income as it factored in the rental waivers and uncertainty on measures to be imposed on malls after the end of the circuit breaker (CB) period. Performance was otherwise decent for its Jan-Mar 2020 period, with NPI holding steady YoY at S$36mn, although we can expect 3QFY20 to bear the full brunt of the CB measures. Occupancy was stable at 96.1% in 2QFY20. However, we note that FCT has 11.9% of NLA expiring in 2HFY20 and is highly likely to see negative rental reversion or lower occupancy rates, with the net effect resulting in uncertainty for investors over the next six months.

Million-dollar question. We think FCT's current unit price, where it is also trades below 1.0x P/B, has already factored in the weakness in 2HFY20 and we therefore expect downside risks to be minimal moving forward. However, the more important point to note is if the weakness is structural and poses long-term headwinds to FCT. This is in the scenario that social distancing measures after COVID-19 result in lower foot traffic and ultimately, a decline in revenue for both tenants and the mall owners.

Outperform - Upgrade

Price as of 8 May 20 (SGD)	2.08	**Performance (Absolute)**	
12M TP ($)	2.39	1 Month (%)	8.6
Previous TP ($)	2.51	3 Month (%)	-26.7
Upside, incl div (%)	21.5	12 Month (%)	-10.4
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	2,329		
Issued Shares (mn)	1,120		
Vol - 3M Daily avg (mn)	5.0		
Val - 3M Daily avg ($mn)	11.0		
Free Float (%)	63.5%		
Major Shareholders		**Previous Recommendations**	
TCC Assets	36.4%	26-Jul-19	N $2.51
Schroders	5.1%		
Vanguard	2.5%		



Bull thesis for FCT. We argue that there are still growth opportunities following the impact of COVID-19 for FCT. First, given its conservative gearing ratio of 33%, FCT still has significant debt headroom to either grow through acquisitions or to fund Asset Enhancement Initiatives (AEI). This is further enhanced by MAS' recent announcement to raise the regulatory gearing limit from 45% to 50%. FCT's biggest asset, Causeway Point, which accounts for 46% of NLA, may also benefit from the government's plans to develop the Woodlands Regional Centre. While its bigger malls in the north of Singapore, including Causeway Point and Waterway Point are doing well, it could potentially divest its smaller and underperforming malls, such as Anchorpoint, thereby freeing up capital.

Second and more importantly from a view of the underlying property performance, FCT's malls are mainly located at major suburban areas, where there is natural foot traffic from residents. Reinforcing this viewpoint is that its top 10 tenants, which accounted for 22% of Gross Rental Income (GRI) in 2QFY20, caters mainly to either groceries, F&B or small discretionary shopping (fashion brands like Uniqlo).

Valuation & Action: Upgrade to Outperform, TP of S$2.39. After more than 14 years of uninterrupted DPU growth, we expect FY20F DPU to decline 17% YoY to 10 Sing cents, rise 15% YoY to 11.6 cents in FY21F, and fully recover above 12.0 cents by FY22F. A key upside re-rating for retail REITs is the gradual relaxation of CB measures going into 2H20, and the payout of dividends which have been held back.

Risks: The key risk we see is a drop in dividends and property values as a result of negative rental reversions, notably if this trend persists beyond 2020. This would put downward pressure on P/B valuations across the retail-focused REIT sector.

Retail apocalypse? The death of physical retail stores has been a decade-long story and indeed, has been a headwind for many physical-only retailers. This long-term trend is now exacerbated by COVID-19 as consumers are now forced to purchase online. This has once again raised concerns on the long-term growth outlook of retail malls.

Squeezing growth via AEI and acquisitions. Singapore malls were actually performing well prior to the outbreak, even amidst the disruption from e-commerce. As FCT's long-term trend for DPU since IPO in the graph below shows, a combination of asset enhancements and acquisitions can help maintain growth for Singapore retail REITS.

Retail REITs will have to work harder. While we believe that concerns may have been exaggerated, we acknowledge that DPU growth has started to slow over the past few years, and if we are to factor in the impact of COVID-19, the need for inorganic expansion via mergers and acquisitions will only gain pace. However, we note two different strategies that Retail REITs have recently pursued.

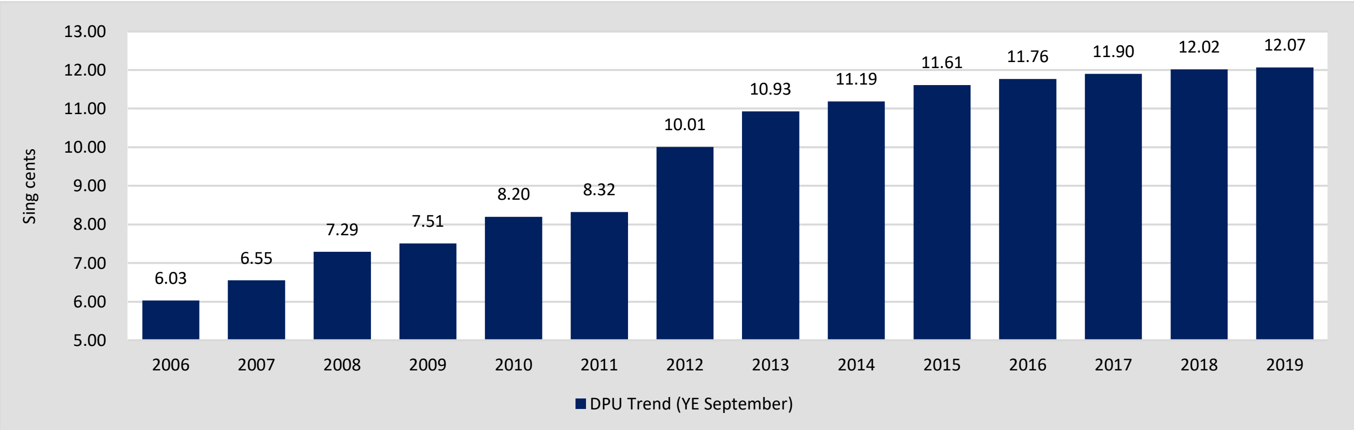
In the case of CapitaLand Mall Trust's (CT SP) merger with CapitaLand Commercial Trust (CCT SP), it has proceeded with its diversification strategy both in terms of asset type and geography. This is in comparison to FCT which has instead focused on the acquisition strategy, particularly of local retail assets, with the exception of a few in Malaysia through its 31% stake in Bursa-listed Hektar REIT (HEKT MK).

The positive side of only focusing on Singapore retail properties. While there are merits to CT/CCT's strategy as it will be able to pursue integrated developments of a much larger scale, we believe that FCT's approach could also benefit from lower risks in terms of forex fluctuations and supply/demand imbalance. According to URA data, the supply of retail space in Singapore is expected to taper of gradually, increasing by only 1.2% per annum of total available retail space in 2020-2022.

The bigger concern is on demand. Singapore's retail vacancy rate was stable at 7.5% as at 4Q19, but we expect this to increase in 2H20 considering the recessionary environment. For now, mall tenants can defer rental payments for up to six months while REITs will not be allowed to evict tenants during this time. While this gives tenants a temporary reprieve, they will still have to fulfil their contractual obligations once the relief period is over. Hence, we will only see the impact of higher vacancy rates in 3Q20.

However, we expect FCT to perform relatively better given its well-located malls in suburban areas which should be able to hold up better than peers. As we see a shift in short-term spending, households will likely increase spending on daily necessities and reduce discretionary spending on luxury and durable goods. F&B outlets near residential areas which are open for takeaway or delivery may outperform higher-end restaurants which are mainly located in business districts.

Figure 1: FCT's DPU grew at a 5.5% CAGR since IPO in 2006



Source: Company data, KGI Research

Figure 2: Retail REITs peer comparison

BB ticker	Company Name	Last Price (local $)	Currency Adj. Market Cap (S$ m)	Trailing 12M Dividend Yield (%)	FY20F Dividend Yield (%)	FY21F Dividend Yield (%)	Gearing (%)	Current P/B Ratio (x)	6M Average daily trading volume (S$ '000)	YTD Price Performance (%)
FCT SP	FRASERS CENTREPOINT TRUST	SGD 2.08	2,329	4.2	4.8	5.6	32.8	0.9	8,632	-26.0
	RETAIL		23,643	7.0	7.5	8.6	36.2	0.7	11,141.6	(22.8)
CT SP	CAPITALAND MALL TRUST	SGD 1.85	6,827	6.3	5.5	6.6	31.5	0.9	42,113	-24.8
MCT SP	MAPLETREE COMMERCIAL TRUST	SGD 1.90	6,294	3.0	4.6	5.1	34.2	1.1	39,994	-20.5
MAGIC SP	MAPLETREE NORTH ASIA COMMERC	SGD 0.89	2,859	8.5	7.6	8.2	41.6	0.6	13,847	-23.7
SPHREIT SP	SPH REIT	SGD 0.79	2,180	5.7	5.4	6.7	28.2	0.7	3,416	-26.2
SGREIT SP	STARHILL GLOBAL REIT	SGD 0.48	1,052	9.3	8.5	9.2	37.0	0.6	1,830	-33.8
CRCT SP	CAPITALAND RETAIL CHINA TRUS	SGD 1.35	1,651	7.3	6.1	7.3	43.0	0.9	5,851	-16.1
LREIT SP	LENDLEASE GLOBAL COMMERCIAL	SGD 0.58	678	2.2	7.4	9.0	35.1	0.7		-37.6
SASSR SP	SASSEUR REAL ESTATE INVESTME	SGD 0.73	869	9.0	8.4	9.0	30.9	0.8	2,679	-18.1
LMRT SP	LIPPO MALLS INDONESIA RETAIL	SGD 0.14	401	16.3	13.1	16.8	39.8	0.6	1,180	-39.1
DASIN SP	DASIN RETAIL TRUST	SGD 0.80	516	2.6	7.8	7.9	44.3	0.6	249	-4.8
BHGREIT SP	BHG RETAIL REIT	SGD 0.62	316	6.2			32.1	0.7	257	-9.5

*Source: Bloomberg, KGI Research *Blue rows indicate our top picks*

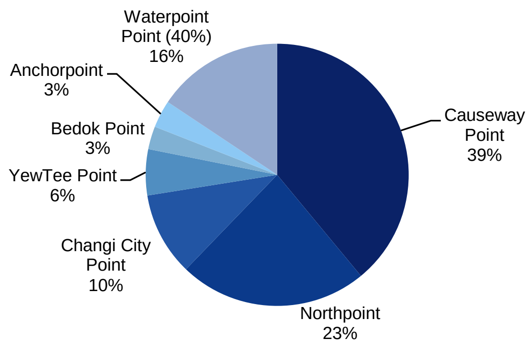
Company profile

Frasers Centrepoint Trust (FCT) is a Singapore real estate investment trust (REIT) listed on Singapore Exchange Securities Trading Limited (the SGX-ST) since 5 July 2006. FCT's portfolio consists of seven quality Singapore suburban malls located in residential areas and positioned to serve necessity shopping needs to the nearby residential catchment. The REIT is managed by the Frasers Centrepoint Asset Management Ltd., a real estate management company and subsidiary of Frasers Centrepoint Limited.

The REIT also owns five suburban retail properties through its 24.8% stake in PGIM ARF, as well as a portfolio of suburban retail properties in Malaysia through its 31.2% stake in Bursa-listed Hektar REIT.

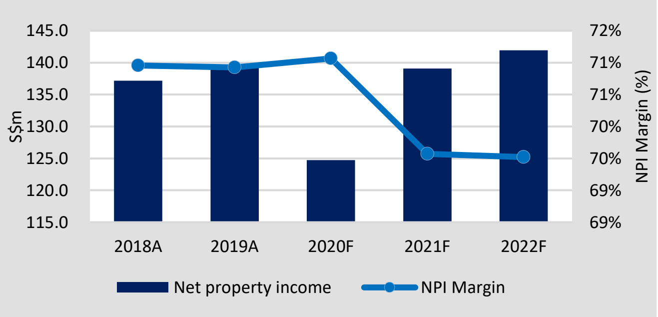
Source: Company

Figure 6: Portfolio breakdown by valuation (as at end Sep-2019)



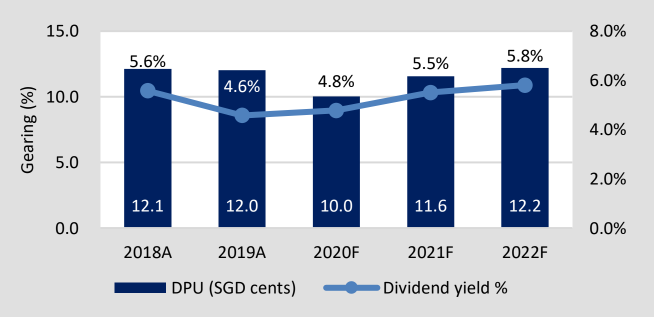
Source: Company Data, KGI Research

Figure 3: NPI and NPI margins



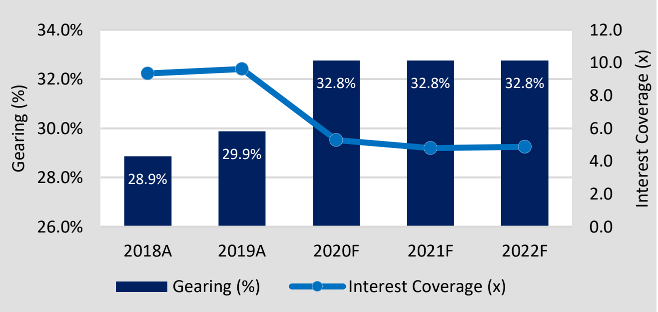
Source: Company Data, KGI Research

Figure 7: DPU and Dividend yield



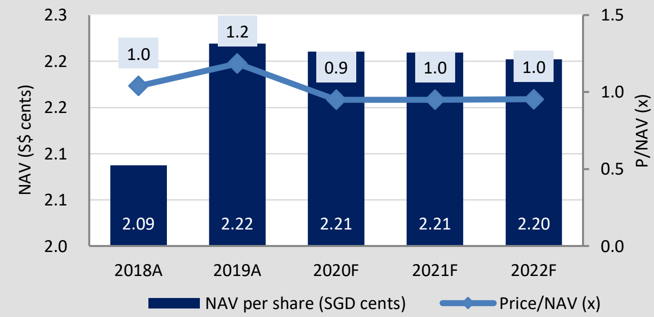
Source: Company Data, KGI Research

Figure 4: Interest coverage ratio and gearing ratio



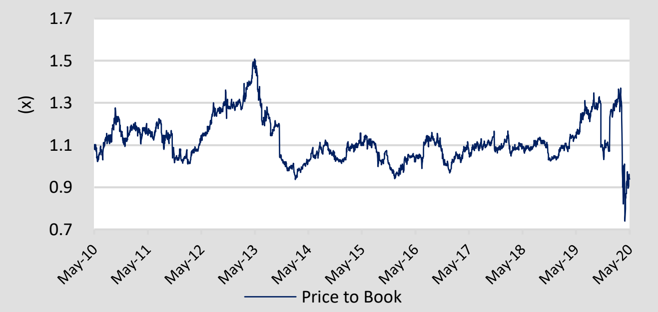
Source: Company Data, KGI Research

Figure 8: NAV per share (S$) and P/NAV



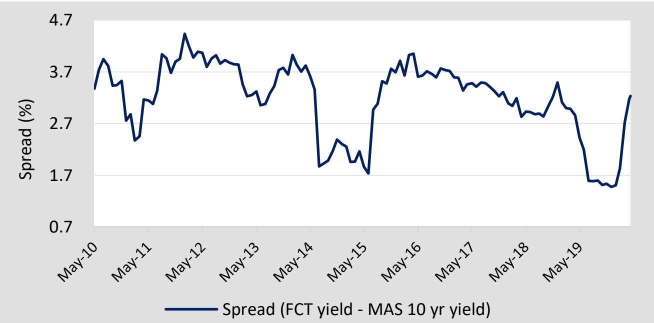
Source: Company Data, KGI Research

Figure 5: Historical P/B band (10 years)



Source: Company Data, KGI Research

Figure 9: Spread between FCT's div yield and Singapore 10-year yield



Source: Company Data, KGI Research

Financials

FYE 30 Sep					
INCOME STATEMENT (SGD mn)	**2018A**	**2019A**	**2020F**	**2021F**	**2022F**
Gross revenue	193.3	196.4	175.5	199.9	204.2
Property expenses	(56.2)	(57.1)	(50.8)	(60.8)	(62.2)
Net property income	**137.2**	**139.3**	**124.7**	**139.1**	**141.9**
REIT Manager's fees	(15.2)	(16.8)	(16.3)	(14.1)	(14.3)
REIT Trustee's fees	(2.0)	(1.9)	(1.9)	(2.2)	(2.3)
Net interest expense	(20.0)	(23.9)	(28.5)	(33.7)	(33.7)
Net profit/(loss)	**99.9**	**96.7**	**78.0**	**89.0**	**91.6**
Change in fair value - investment ppty	62.7	93.3	0.0	0.0	0.0
Others	4.1	16.0	44.2	39.2	39.2
Total return before tax	**166.8**	**206.0**	**122.2**	**128.2**	**130.9**
Income tax	0.0	(0.0)	(0.0)	0.0	0.0
Net income	166.8	205.9	122.2	128.2	130.9
Distributable income	111.1	118.7	122.4	134.7	137.4
BALANCE SHEET (SGD mn)	**2018A**	**2019A**	**2020F**	**2021F**	**2022F**
Cash and cash equivalents	21.9	13.1	109.3	107.5	101.1
Trade and other receivables	3.0	3.1	4.4	4.7	4.9
Other current assets	0.1	0.0	0.0	0.0	0.0
Total current assets	**24.9**	**16.2**	**113.8**	**112.2**	**106.0**
Investment properties	2,749.0	2,846.0	2,851.7	2,851.7	2,851.7
Investment in associates and others	66.4	748.6	753.3	753.3	753.3
Total assets	**2,840.4**	**3,610.9**	**3,718.8**	**3,717.3**	**3,711.1**
Trade and other payables	62.5	70.0	68.1	67.9	69.0
Borrowings	217.0	295.0	360.0	360.0	360.0
Total current liabilities	**279.5**	**365.0**	**428.1**	**427.9**	**429.0**
LT Borrowings	595.6	744.8	783.4	783.4	783.4
Other non-current liabilities	31.5	30.1	31.7	31.6	32.2
Total liabilities	**906.6**	**1,139.8**	**1,243.1**	**1,242.9**	**1,244.5**
Unitholders' funds and reserves	1,933.5	2,471.1	2,475.7	2,474.3	2,466.5
Total liabilities and equity	**2,840.2**	**3,610.9**	**3,718.8**	**3,717.2**	**3,711.0**
CASH FLOW STATEMENT (SGD mn)	**2018A**	**2019A**	**2020F**	**2021F**	**2022F**
Total return before tax	**166.8**	**206.4**	**122.2**	**128.2**	**130.9**
Share of JV and associates results	(3.8)	(37.3)	(47.7)	(43.2)	(43.2)
Changes in working capital	11.8	2.3	22.9	22.9	22.9
Other non-cash adjustments	(38.0)	(39.8)	16.8	37.8	37.8
Cash flows from operations	**136.9**	**131.6**	**114.2**	**145.7**	**148.4**
Distribution from JV and associate	4.0	12.8	27.3	15.7	15.7
Acquisition of investment properties	0.0	(664.5)	0.0	0.0	0.0
Other investing cashflow	(15.5)	(8.9)	(8.0)	0.0	0.0
Cash flows from investing	**(11.6)**	**(660.6)**	**19.3**	**15.7**	**15.7**
Borrowings raised / (repaid)	15.0	229.1	103.9	0.0	0.0
Equity raised / (bought back)	0.0	437.4	0.0	0.0	0.0
Dividends paid	(112.2)	(113.6)	(112.4)	(129.6)	(136.7)
Other financing cashflow	(19.8)	(31.7)	(28.9)	(33.7)	(33.7)
Cash flows from financing	**(117.0)**	**521.1**	**(37.3)**	**(163.4)**	**(170.4)**
FX Effects, Others	0.0	0.0	0.0	0.0	0.0
Net increase in cash	**8.3**	**(8.0)**	**96.2**	**(2.0)**	**(6.3)**
Beginning Cash	13.5	21.9	13.1	109.3	112.5
Ending cash	**21.9**	**13.9**	**109.3**	**107.4**	**106.1**
KEY RATIOS	**2018A**	**2019A**	**2020F**	**2021F**	**2022F**
DPU (SGD cents)	12.1	12.0	10.0	11.6	12.2
Dividend yield %	5.6%	4.6%	4.8%	5.5%	5.8%
NAV per share (SGD cents)	2.1	2.2	2.2	2.2	2.2
Price/NAV (x)	1.0	1.2	0.9	0.9	0.9
Profitability (%)					
NPI Margin	71%	71%	71%	70%	70%
Net Margin	86%	105%	70%	64%	64%
ROE	9%	8%	5%	5%	5%
ROA	6%	6%	3%	3%	4%
Financial Structure					
Interest Coverage (x)	9.3	9.6	5.3	4.8	4.9
Gearing (%)	28.9%	29.9%	32.8%	32.8%	32.8%

Source: Company Data, KGI Research

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Rating	Definition
Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
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