KGI CHINA DEVELOPMENT FINANCIAL

2019 OUR SEPTEMBER SUMMARY

IN CASE YOU MISSED IT…

SEPTEMBER HIGHLIGHTS

SINGAPORE: REITs took the spotlight, as it went on acquisition sprees due to low interest rate environments. Most significantly and recently, Mapletree Commercial Trust (MCT) has proposed buying a business park in Pasir Panjang worth S$1.55 billion from Heliconia Realty, a direct wholly-owned subsidiary of Mapletree Investments, MCT's sponsor. Should it come to fruition, it could be one of the largest acquisitions by a Singapore REIT (S-REIT) this year. Earlier this month, Mapletree Industrial Trust (MIT) entered into a joint venture with Mapletree Investments to acquire a US$1.37 billion data centre portfolio in North America, while Keppel DC REIT proposed yield-accretive acquisition of two data centres worth about S$587 million.

GLOBAL: Saudi Arabia's oil and gas production more than halved due to unprecedented attacks on two of its major oil facilities run by Aramco – the world's biggest oil producer. This represents MILLIONS of barrels PER DAY from one of the most IMPORTANT and STABLE oil producers in the world. While no casualties had been reported, oil prices soared following the attacks, as it reintroduced a 'fear premium' into the oil market. However, prices also quickly stabilised due to ample supply and availability of reserves that should theoretically be able to cover any shortfall during Aramco's recovery. US President Donald Trump had also readily authorised the release of oil from the US Strategic Petroleum Reserve (SPR) if needed, providing some comfort in the wake of the attacks. We did explain the situation in more detail after the attacks and price swings that followed – for Guangzhi's report, click here.

KEY ECONOMIC DATA

SINGAPORE: Manufacturing output fell 8% from last August mainly due to shrinking of the electronics and precision engineering clusters, marking its worst performance since December 2015. Being its fourth straight month in negative territory, many are wary of the risk of a technical recession as we await upcoming results from September's output. The STI on the other hand has picked up slightly to a positive 0.3% increase in September, bouncing from a 5.88% drop in August.

Source: Bloomberg, KGI Research

GLOBAL: The ISM Manufacturing PMI (click the link to understand what it is, and why it's important!) in the US fell to 49.1 in August 2019 from 51.2 in July, missing market expectations of 51.1, pointing to the first month of contraction in the manufacturing sector since January 2016 as new orders and employment declined amid concern about US-China trade dispute.

The US Nonfarm Payroll also underperformed, increasing by 130k in August, following a downwardly revised 159k in July and below market expectations of 158k.

Mid-month, the Federal Reserve also announced another quarter-point interest rate cut to a target range of 1.75% to 2% following slowing global growth and worsening trade tensions.

US-CHINA TRADE WAR

While China has relinquished tariffs on some US goods, as a sign of goodwill if we may, the year-long dispute has not been helped by the Trump administration now considering radical financial pressure tactics on Beijing, which could include delisting of Chinese companies from US stock exchanges. A new round of high-level talks between them is expected in Washington on 10-11th October, led by Vice Premier Liu He.

The most recent of US's tariff imposition has hit China's exports, which unexpectedly fell 1% in August from a year earlier – despite analysts' expectations of a 2.0% rise after July's 3.3% gain – as shipments to the United States slowed sharply, pointing to further weakness in the world's second-largest economy. In line with expectations for more support measures from Beijing, the People's Bank of China (PBOC) cut reserve requirements in early September by 900bn yuan to free up more funds for lending. However, PBOC has also stated that they will not follow other countries in taking any extreme steps, such as substantially cutting the required amount of reserves maintained by commercial banks or pushing interest rates below zero, as it believes that the economy is still performing within expectations despite recent signs of weakness.

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WHAT WE'VE BEEN UP TO

BBG Ticker	Company Name	Industry	Currency	Last Traded	Target Price	Potential Upside
UAG SP	UNI-ASIA GROUP LTD	Financials	SGD	0.73	1.24	70%
CSE SP	CSE GLOBAL LTD	Information Technology	SGD	0.47	0.64	38%
FRKN SP	FRENCKEN GROUP LTD	Industrials	SGD	0.69	0.81	17%
MUST SP	MANULIFE US REAL ESTATE INV	Real Estate	USD	0.89	1.01	13%
KDCREIT SP	KEPPEL DC REIT	Real Estate	SGD	1.89	1.95	3%
GERL SP	GEO ENERGY RESOURCES LTD	Energy	SGD	0.15	0.14	-4%

Prices retrieved as of market close on 01 October 2019

UNI-ASIA GROUP LIMITED – OUTPERFORM

UAG's valuations are trading at distressed levels, which we believe is not justified given its diversified businesses and potential growth from its hotel operations. Even if we were to strip out its highly cyclical shipping business, we estimate UAG's minimum fair value to be around S$0.82. We thus reiterate our **OUTPERFORM** recommendation and TP of S$1.24, based on a sum of-the-parts (SOTP) valuation of its three businesses. Our TP implies a conservative 0.6x FY20F BVPS and 8.5x FY20F EPS, supported by an attractive 6% dividend yield. We also recently visited UAG's hotel business and residential developments in Tokyo, check our LinkedIn post here for some photos. For Joel's full report, click here.

CSE GLOBAL – OUTPERFORM

CSE is currently trading at 11/8/7x 2019/20/21F EPS, which is attractive in our view given its solid balance sheet, asset light model and stable recurring free cash flows. We thus maintain our **OUTPERFORM** recommendation with a bump in its TP to S$0.64, and believe that average EPS growth of around 16% p.a. over the next 3 years is achievable on the back of improving industry dynamics. Management has guided that it will maintain the 2.75 SG cents dividend in FY19 - the same as in the last four years - implying an above industry yield of 5.9%. For Joel's full report, click here.

FRENCKEN GROUP LIMITED – OUTPERFORM

We upgraded Frencken to **OUTPERFORM** and maintain our TP of S$0.81 as its share price now offers a good entry point, with an improved inventory level among top EMS players as the basis for a recovery of earnings in the technology supply chain. As a bonus, we believe Frencken is an attractive takeover target for a larger company given the group's diverse client and product base, which would be the key catalyst for its share price. For Joel's full report, click here.

MANULIFE US REIT – OUTPERFORM

We maintain **OUTPERFORM** with TP of US$1.01. We increased our TP from US$0.98 to US$1.01, in part due to a rental uplift from 400 Capitol beginning from 2020 and a reduction in our risk free rate by 25 bps to realign with the current dovish interest rate environment. DPU will likely remain flattish alongside an enlarged units base at 6.3/6.3 US cts for FY20/FY21 (previously 6.5/6.5 US cts); catalyst remains the near-term benchmark inclusion within the FTSE EPRA Nareit Developed Asia Index by Dec 2019. For Geraldine's full report, click here.

KEPPEL DC REIT – OUTPERFORM

Upgraded to **OUTPERFORM** with TP increased from S$1.71 to S$1.95, factoring incremental rents starting from 1Q20 following the completion of acquisition by 4Q19. The twin acquisitions will deliver yield accretion in the range of 9.4% - 12.4%, with tax transparency supporting the higher end of the spectrum. Our DPU for FY20/FY21 increased to 9.0Scts / 9.5Scts (previously 7.7 Scts/8.0 Scts) calculated on the enlarged units base. For Geraldine's full report, click here.

GEO ENERGY RESOURCES LIMITED – NEUTRAL

We maintain our **NEUTRAL** recommendation on the back of a cautious outlook on the coal sector in the next 12 months. Despite the announcement of the acquisition of the two mines, our TP of S$0.14 remains unchanged until we have certainty of the deal. We have not made any changes to our DCF-backed forecasts and assumptions. For Joel's full report, click here.

OCTOBER OUTLOOK

THE HYPED LENDLEASE IPO – JUSTIFIED?

The Lendlease REIT IPO has received a lot of market buzz, with multiple financial blogs giving their opinions on whether the public tranche is worth subscribing to. In fact, one of our analysts spotted the large posters placed at the new Paya Lebar Quarter, which certainly helped in drumming up public interest. Now that the 14.5x oversubscribed public tranche has closed, attention will be given to how the stock will perform out of the gates. Amongst the team, we have bulls and bears on whether it is a worthy asset to add to your portfolio, and here are some quick initial thoughts.

At 5.8% projected yield, Lendlease REIT can be seen to be offering a very decent return, relative to what's available on the market. Its Italian office property is a tricky asset to valuate, but can offer some needed diversification from the retail sector. A case could be made for the yield to converge towards 5.5% when it begins to trade, which is closer to what other SG retail REITs are offering. There can also be further upside from equity raisings, if good properties (JEM, maybe PLQ but too early to tell) are added and are yield accretive.

That being said though, even with the 1% dividend yield premium over other retail REITs like CapitaLand Mall Trust and SPH REIT, Lendlease REIT only has two assets. Thus, there is a high probability that its sponsor may inject more assets into the REIT, which would then require investors to put in more capital. There is also concentration risk as 70% of the total portfolio value and gross rental income is derived from 313@Somerset, while the remaining gross rental income is derived from a single master-leased office property in Milan, Italy.

Nonetheless, we are looking forward to the results as it commences trading later today, 2nd October.

WHAT TO EXPECT THIS OCTOBER

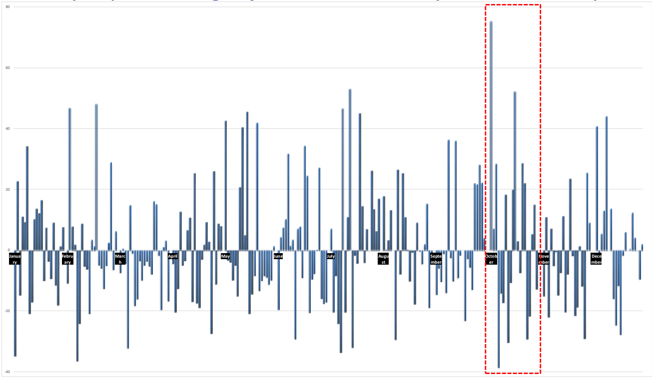
While all eyes would be on the US-China trade talk on 10th to 11th October, and the outcome of the Brexit deadlock throughout the month, there are some other key events that we would keep our eyes on. Here's what you can expect for October:

Day	Date	Event
Thursday	October 10th	Federal Reserve, September FOMC Meeting Minutes
Friday	October 11th	Reserve Bank of Australia, Financial Stability Review (FSR)
Tuesday	October 15th	Reserve Bank of Australia, FSR Meeting Minutes
Thursday	October 17th	Council of the European Union, European Council Meeting
Friday	October 18th	Council of the European Union, European Council Meeting
Thursday	October 24th	European Central Bank, Press Conference and Interest Rate Decision
Tuesday	October 29th	Federal Reserve, FOMC Press Conference
Wednesday	October 30th	Federal Reserve, FOMC Press Conference

In the meantime, we would also be observing relations between Saudi Arabia, Iran and the US. We believe that crude oil, as per Guangzhi's report here, is that barring extreme circumstances such as war, we believe prices will trade between the US$60-70 per barrel range. Nonetheless, Saudi's Crown Prince Mohammed bin Salman urged the world to take "strong and firm action to deter Iran", despite their denial of responsibility, and prevent the situation from escalating further, with support from US Secretary of State Mike Pompeo. The Crown Prince has also very recently warned that crude prices could spike to unimaginably high numbers in the case of an armed conflict, in addition to what would basically be a total collapse of the global economy.

Overall, we see a lot of uncertainty brewing in October, despite the CBOE Volatility Index (VIX) (a measure of the 30-day implied volatility by the S&P 500 index also known as the "fear gauge" or "fear index") taming this month as US-China trade tensions seemed to ease and Treasury yields bounced back from their historic lows. Over the last 20 years, October has been no stranger to volatility, with some of the largest price swings both ways, as seen in the graph. We are expecting no different for the upcoming month, as there is apparently no lack of catalysts to unhinge an already unstable market – from US President Trump's potential impeachment to escalating tensions between multiple pairs of countries to Brexit. We may already be seeing the start of the spikes with a 14% increase in the VIX yesterday, 1st October.

Monthly % price change of the CBOE Volatility Index, over 20 years



Source: Bloomberg, KGI Research

KGI's Ratings	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.
	Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon
	Not Rated (NR)	The stock is not rated by KGI Securities.
	Restricted (R)	KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances.