CapitaLand Integrated Commercial Trust (SGX:C38U)

BUY: SGD 2.17 (+15.4%)

Basic Information

Last traded price: SGD 1.88
12M Target Price: SGD 2.17
Potential upside: 15.4%
52w high/low (SGD): 2.18/1.74
Div Yield (%): 5.57
DPU: 5.30 cents

Issued shares (K): 10942
Market capitalisation: SGD12638m
GICS sector: Real Estate

Figure 1: 5Y trend of CICT's share price

Executive Summary

This report is initiating coverage on CapitaLand Integrated Commercial Trust (CICT, Ticker SGX:C38U), with a BUY rating and a SGD 2.17 (+15.4%) 12M target price.

Overview of the business and the company

- CICT is the largest integrated commercial real estate investment trust (REIT) in Singapore that owns and manages a diversified portfolio containing high-quality commercial properties.
- As of Dec 2022, CICT has a predominant portfolio in Singapore comprises of 21 properties in Singapore (93%), two properties in Germany and three properties in Australia, valued at a total of SGD24.2b.
- The portfolio is diversified with 40% office assets, 30% retail assets and 30% integrated development assets.
- It is managed by CapitaLand Invest (CLI) - a leading global real estate investment manager with SGD121b in real estate AUM.
- Temasek Holdings Pte Ltd is the single largest shareholder of CICT with a deemed interest of 19.73% mainly via its investment in CLI.
- In 1H 2023, it reported a gross revenue of SGD386.3M, up 11.0% YoY and Net Property Income of SGD276.0M, up 9.0% YoY.

Industry overview

- In 1H 2022, office and retail SREIT sectors have been hit the hardest, suffering -33.6% total returns for office REITS and -15.1% total returns for retail SREITS, due to ongoing effects of Covid19 where work from home and online shopping has became more normalised.

- In 2023, SREITs has seen good recovery prospects. Among other international REITS, it offers the highest cumulative total return of 4.73% in Apr 2023. (Fig 2) Influx in tourism from China and other countries and increasing demand of good quality office post Covid19 might further improve SREIT's occupancy rate and revenue growth, along with accretive acquisitions.

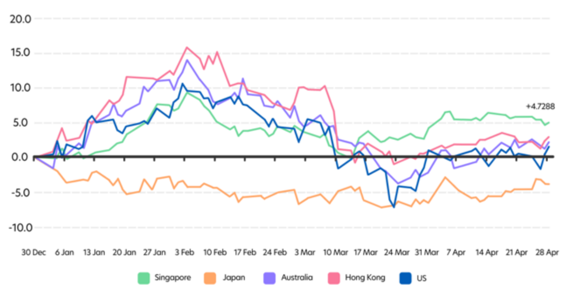


Figure 2: Cumulative Total return of REITs markets in early 2023 (%) (Source: UOB insights)

- However, high interest rates causes higher borrowing cost and lower distributable income. Its property valuation could be negatively impacted due to higher capitalisation rate. This will cause a higher gearing level and potentially breach SREIT's loan to valuation limit and cause refinancing risk (such as Manulife US REIT which recently breached its loan covenants).

- Market expects that the FED Rate hike is near its peak, and interest rate may decrease from 2H 2024. SREITS is still in its recovery stage, and while it may not offer immediate returns, it might likely grow stronger as the economy becomes better. Furthermore, given real estate's anti-inflation nature, SREIT would still have a steady performance even with high interest rates. Thus, it is possibly a good buy time for long term investors to purchase REITS now at its undervalued share price.

Investment thesis

Strong rental reversion that underpins **future revenue growth** even in weak economy

- In the first half of FY2023, CICT's retail portfolio enjoyed positive rental reversion of 6.9%, and that of office portfolio is 9.6% based on average committed rents for incoming leases versus average rents for expiring leases.
    - This is because CICT has good quality assets in good locations, such as 51.2% of its assets situated in central CBD districts where there is high retail traffic and business demand, and 28.2% assets in Singapore suburban retail which demonstrated resilient returns even during Covid19. Following Covid19, CICT has achieved stronger rental reversions.
- CICT has a strong sponsorship and its manager CLI has the right of first refusal of CapitaLand Development's completed assets
    - This provides a strong pipeline for CICT and allows it to acquire prime assets at reasonable prices, such as CapitaSpring and its near-completion AEI project at Clark Quay. Its newest property CapitaSpring received the president design award, and has an occupancy rate of 100% currently.
    - It is one of the few large scale REITS that has such a pipeline, with other much smaller scaled REITS like Keppel DC Reit, MapleTree Logistics Trust, Frasers Centrepoint Trust and Frasers Logistics and Commercial Trust.

Strong capability of financing and **efficient capital management** under current **high interest rate environment** to maintain steady dividend yield

- High percentage of fixed rate loans
    - As part of the Reit manager's prudent and efficient capital management, CICT maintained 78% of its loans on a fixed interest rate, reducing its vulnerability to sudden changes or hikes in interest rates.
    - As a result, CICT's average borrowing cost of debt remained low at 3.2% for 1H2023 compared to 2.7% for 2022 when SORA O/N rate increased sharply from 0.15% to 3.6% over the past 20 months.

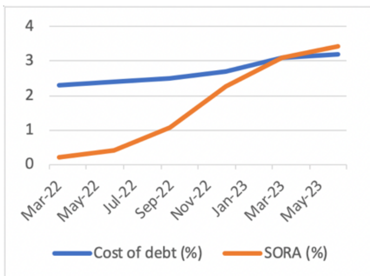


Figure 3: Graph of SORA and CICT's cost of debt over past 20 months

- Able to obtain competitive funding cost, with a recent bond issuance in 2Q 2023 of SGD400million at 3.93% for a 7-yr tenor
- Able to maintain high NPI margin of above 70%.

Diversified, **quality assets** under **strong management**

- Weighted Average lease expiry is 5.6 years as of 1H2023, so CICT has a steady income stream and less vulnerable to market fluctuations amidst the current high interest rate environment
- In 1H 2023, CICT's office occupancy rates stands at 95.4%, up by 0.6ppts QoQ . Its retail occupancy rates is at 97.8%, up by 0.2ppts QoQ.
    - High occupancy rates indicate a strong ability to retain tenants and pricing their rentals higher during the inflation will affect its occupancy rates to a small extent.
- Healthy and diverse mix of tenant profiles where no single tenant contributes to more than 5.4% of CICT's total Gross Rental Income, reducing concentration risk.

Catalyst

- Post Covid19 tourism recovery and according to Singapore Tourism Board, expected number of tourist arrivals will reach 12-14 million in 2023, which is a sharp rise compared to 6.31 million in 2022 and 0.33 million in 2021. It is highly likely that CICT will continue enjoying sustained growth.

Financial Analysis

Please refer to attached financial model for CICT to view historical financial data and future projections. Some assumptions included within financial model

Key financial statistics extracted

	2H 2021	1H 2022	2H 2022	1H 2023
Distributable income per unit ($)	0.0522	0.0522	0.0536	0.0530
Revenue (m)	659.4	687.6	754	775
Revenue growth rate		4.3%	9.7%	2.7%
NPI (m)	478.9	501.6	541.7	552.3
NPI yield	72.6%	73.0%	71.8%	71.3%
Share of result from Joint Venture (m)	133.5	6.4	36.1	5.6

Good performance and steady growth

- Revenue income has increased steadily, with a sharp increase in 2H 2022 due to CICT's new acquisitions.
- In the financial model, revenue growth is projected to follow after 1H 2023's growth of around 2.7% per half annum, then slowly decreasing to 1.5% per half annum to be around normal CPI rates of 2-3% per annum.

Stable NPI Yield and profitability

- NPI yield is stable at around 71-73%, and projections for following NPI yields will also be around 71%.
- CICT is able to remain profitable due to good quality assets and high occupancy rates, reducing its vulnerability to huge economy fluctuations. It also has proactive capital management, keeping costs low despite the high interest rate environment.
- Its Joint Venture with CLI for CapitaSpring project has contributed mostly to the share of result from Joint Venture. The projected earnings from this Joint Venture may remain at around 5-6m per half annum due to its current maximum occupancy rate.

Stable Dividend yield

- With a stable and high NPI yield, its distributable income would also be stable to pay-out its dividends.
- CICT achieved a YoY DPU increase in 1H2023 despite more than two-thirds of S-Reits reported a YoY DPU decline in 1H2023 due to higher financing costs.

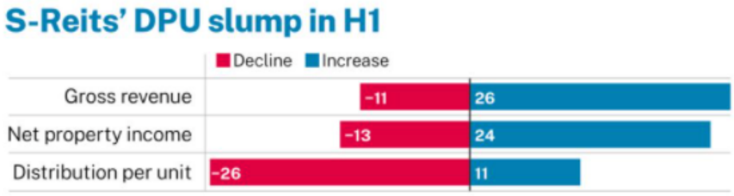


Figure 4: Number of SREITS under each category, Source from Business Times

Overall performance and projections

- It is likely to maintain its stable performance with estimated growths in revenue and dividend pay-outs. Financial forecast is done only for future 3FYs due to its consistent performance.

Credit Analysis

Metrics	2H2021	2H2022	1H2023
Loans on fixed interest rates	83%	81%	78%
Average Debt to maturity ratio	3.9yrs	3.9yrs	4.3yrs
Interest coverage	4.1x	3.7x	3.3x
Average leverage	36.2%	40.4%	40.4%
Average cost of debt	2.3%	2.7%	3.2%

Moody's Investors Service has affirmed an "A3" issuer rating for CICT on 26 June 2023. Overall, while creditworthiness have been decreasing with lower interest coverage and higher cost of debt, it can be attributed by Fed's sharp interest rate hike from 0% to 5.5% in the past 18 months. CICT has a very strong and proactive capital management, and have low financial risks for investors.

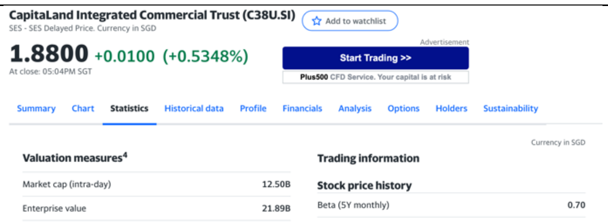
Valuation

The Discounted Dividend Model valuation is used as CICT is required to distribute at least 90% of its taxable income each year as dividends, and most REIT's investors' key focus are on REIT yields and growth.

From the forecasted financial performance and cash flow of CICT, the dividend growth is forecasted. Using Capital Asset Pricing Model CAPM to estimate the discount rate, the net present value or target price for CICT is determined to be **$2.17**. Since the current share price is at $1.88, it is recommended to buy. The following is an estimate of how CAPM was used to derive discount rate.

CAPM: $ER_i = R_f + \beta_i(ER_m - R_f)$

ERi - Expected return of investment	Discount rate is calculated to be 6.7%, rounded up to 7.0%
Rf – Risk-free rate	3.2% (using bond yield of 10-yr Singapore Government Bond)
βi – beta of investment	0.70

	 *Figure 5: CICT's 5Y monthly Beta from Yahoo! Finance*
(ERm - Rf) – Market risk premium	5.0% (taken from Country Default Spreads and Risk Premiums published by New York)

Investment Risks

- Prolonged interest rate hike can lead to weak economy, lowering demands for office and retail spaces.
- Increasing interest rate could increase capitalisation rate and discount rates, leading to lower valuations and lower distributable dividends.
- As CICT has some investment properties in the overseas market, it could suffer from Forex risks such as depreciation of the country's currency could lead to loss of profits when converted back to Singapore currency.