

# Capitacommercial Trust

Revamping 6 Battery Road

<b>OUTPERFORM</b>	Maintained
<b>S\$1.13</b>	Target: S\$1.37
Mkt.Cap: S\$3,185m/US\$2,267m	
REIT	

CCT SP / CACT.SI

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## S\$92m to revamp crown jewel

**Maintain Outperform.** The manager of CCCT announced last Friday that it will be spending S\$92m on the asset enhancement of its crown jewel, 6 Battery Road. Separately, Standard Chartered will be giving up 70,000sf of its space in 2011. We believe the asset enhancement is a defensive move to position CCT's crown jewel positively against new buildings which will be completed over the next few years. We also believe management will be able to find replacement tenants for Standard Chartered's space in view of improving indicators for office space. We factor in higher capex costs, but not potentially higher rents as these would only come through after 2015. We also maintain our renewal rent estimates for 6 Battery Road as a 35% decline in FY11 rents had been incorporated earlier. We make no material change to our DPU estimates and target price of S\$1.37, still based on DDM valuation (discount rate 7.8%). CCT offers a dividend yield of 7.1% and remains the cheapest large-cap SREIT (0.8x P/BV). We see stock catalysts from improving office demand indicators.

**No change to net lettable area (NLA).** The asset enhancement work will include a revamping of common areas (lobby, reception area, turnstiles), M&E upgrade of electrical power supplies, "green features" etc. and enhancement of office space (increasing ceiling heights, air-conditioning and sprinkler systems, lift lobbies and restroom finishing). There will be no change to net lettable area.

**Completion expected in 2013.** The work will be carried out from 3Q10 to 2013. However, the rectification of defects may stretch into 2015. To minimise disruptions to tenants, refurbishment of the interior of tenants' space and restrooms will be carried out only during the interim period when new tenants fit out their space. Hence, we do not expect significant downtime. The estimated cost of S\$92m will be spread over six years with chunkier payments in 2012 (S\$30m) and 2013 (S\$28m). The manager will be funding the capex with cash on hand.

**Returns on investment (ROI) of 8.1%** have been forecast on a stabilised basis by management. This translates into incremental net property income of S\$7.4m. The manager expects 20% of this increment to come from cost savings from "green features" to be installed, and 80% from potentially higher rental reversions.

**Key tenant, Standard Chartered, will give up 70,000sf of space by 2011.** This represents 14% of the NLA at 6 Battery Road. Nonetheless, StanChart will retain 120,000sf of space in a separate lease which will expire only in 2020. Management is in talks with prospective tenants for the space which will be given up, both new and existing tenants who are looking to expand. We believe this is an opportune time for CCT to reduce its tenant-concentration risks by leasing out the space to more than one tenant.

**Decline in renewal rents anticipated.** From CCT's 1Q10 results presentation, expiring leases in 6 Battery Road have a high average rent of S\$15.93psf. We have assumed a 35% decline in renewal rents to S\$10.35psf. We believe the prospect of leasing the space to more than one tenant is likely to limit any southward march in renewal rents.

**Impact on CCT.** In our view, the asset enhancement is a defensive and necessary move to position CCT's crown jewel positively against new buildings which will be completed over the next few years. Furthermore, a lack of new supply in 2013 when the bulk of the refurbishment work will be completed should appeal to prospective tenants, since there will not be much competition. We are not overly concerned about Standard Chartered giving up its space in FY11 as we believe a revival in demand for office space is increasingly apparent (refer to our report "**Four turning points in office rents**" dated 20 May 10). We increase our capex assumptions to factor in the cost of the asset enhancement, but not any increased rents as these would only come through after 2015. There is no material change to our DPU forecasts and target price of S\$1.37, still based on DDM valuation. CCT offers a dividend yield of 7.1% and remains the cheapest large-cap SREIT (0.8x P/BV). We see stock catalysts from improving office demand indicators.

**Figure 1: Projected asset-enhancement payments**

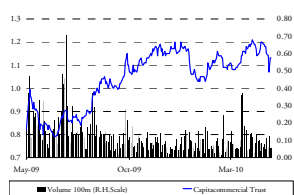
Year	Amount	% of total	Remarks
2010	S\$9 mil	10%	AEI in progress
2011	S\$15 mil	16%	AEI in progress
2012	S\$30 mil	33%	AEI in progress
2013	S\$28 mil	30%	Completion of AEI
2014	S\$7 mil	8%	For defects rectification
2015	S\$3 mil	3%	For defects rectification
<b>Total</b>			<b>S\$92.0 mil</b>

Source: Company

#### Financial summary

FYE Dec	2008	2009	2010F	2011F	2012F
Revenue (S\$ m)	335.3	403.3	406.0	412.2	421.6
Net property income (S\$ m)	233.5	300.2	304.5	309.2	316.2
Net property income margins (%)	69.6%	74.4%	75.0%	75.0%	75.0%
Pretax profit (S\$ m)	331.7	(839.2)	215.0	218.9	225.3
Net profit (S\$ m)	331.7	(839.2)	214.9	218.8	225.2
Distributable profit (S\$ m)	153.0	198.5	224.9	228.9	235.4
EPU (S cts)	23.7	(29.8)	7.6	7.8	8.0
EPU growth (%)	(77%)	(226%)	126%	2%	3%
P/E (x)	4.8	nm	14.8	14.5	14.1
Core EPU (S cts)	8.8	6.7	7.6	7.7	8.0
Core EPU growth (%)	5%	(24%)	14%	2%	3%
Core P/E (x)	12.9	16.9	14.9	14.6	14.2
Gross DPU (S cts)	11.0	7.1	8.0	8.1	8.4
Dividend yield (%)	9.7%	6.2%	7.1%	7.2%	7.4%
P/BV (x)	0.4	0.8	0.8	0.8	0.8
ROE (%)	8.2%	(20.7%)	5.4%	5.5%	5.7%
Asset leverage (%)	37.3%	32.9%	28.6%	28.7%	28.7%
EV/EBITDA (x)	19.9	17.3	15.6	15.5	15.3
% change in DPU estimates			N/A	N/A	N/A
CIMB/Consensus (x)			1.11	1.16	1.22

#### Price chart



Source: Bloomberg

Source: Company, CIMB Research, Bloomberg

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**NEUTRAL:** The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.

**UNDERPERFORM:** The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

**TRADING BUY:** The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

**TRADING SELL:** The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 3 months.

### SECTOR RECOMMENDATIONS

**OVERWEIGHT:** The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

**NEUTRAL:** The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

**UNDERWEIGHT:** The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.

**TRADING BUY:** The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 3 months.

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**NEUTRAL:** Expected total returns of between -15% and +15% over the next 12 months.

**UNDERPERFORM:** Expected negative total returns of 15% or more over the next 12 months.

**TRADING BUY:** Expected positive total returns of 15% or more over the next 3 months.

**TRADING SELL:** Expected negative total returns of 15% or more over the next 3 months.

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