FCOT

BUY: S$1.80 (+10.43%)

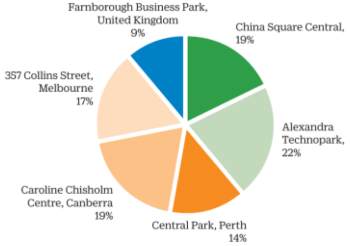
Awaiting Opportune Acquisition With Low Gearing

26 October 2019

NUS INVESTMENT SOCIETY

Company Overview

Figure 1. FCOT revenue contribution by property



Top 5 Tenants (By Gross Rental Income)	%
Commonwealth of Australia	16.6%
Rio Tinto Shared Service Pty Ltd	8.8%
Commonwealth Bank of Australia	6.9%
GroupM Singapore Pte Ltd	3.7%
Service Stream Ltd	3.5%

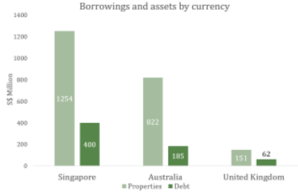
Frasers Commercial Trust ("FCOT") is a Singapore based REIT that invests primarily in income-producing commercial office properties in Singapore, Australia and the UK. It currently holds six commercial properties valued at a total of S$2.1B. FCOT has a low gearing of 29.3% and the rights of first refusal to acquire commercial properties valued at S$4B from its sponsor, Frasers Property. With its expanded investment mandate to Europe, it allows for portfolio diversification and growth opportunities.

(S$ M)	FY17A	FY18A	FY19E	FY20E
Revenue	133.3	125.1	148.2	161.2
Gr Rate (%)	*(14.8)*	*(6.2)*	18.5	8.8
NPI	78.7	77.6	85.1	87.3
Margin (%)	59.0	62.0	57.4	54.2
Net Income	45.1	39.8	79.5	84.6
Margin (%)	45.7	43	53	52
ROA	6.54	6.69	6.82	6.91
ROE	10.42	10.18	10.32	10.46
EV/EBITDA	25.36	29.07	24.27	22.14
P/E Ratio	10.68	8.29	10.54	10.80

12M Industry Outlook

Figure 2. Singapore's office vacancy rate, low net supply and high net absorption

Figure 3. FCOT's borrowings and assets by currency



1. **Demand** for Grade A & B offices is set to increase as Singapore overtakes U.S. as the world's most competitive economy and unrest in Hong Kong encourages MNCs to relocate to Singapore. Technology and co-working space companies contribute to a steady growth in demand for Singapore's office spaces, with co-working spaces spiking at a CAGR of 36% by net leasable area. The finance, insurance and government sectors along with centralization to CBD in Perth, Melbourne and Canberra has driven stronger demand for offices spaces in Australia.
2. **Supply** is expected to tighten as Singapore office vacancy rate continues to fall from 5.3% in 1Q19 to 4.8% in 2Q19. Island-wide rental has seen positive net absorption of 508,443 sf driven by the technology sector and co-working space operators. Office demand for Perth, Melbourne and Thames Valley has also increased with positive rental reversion and stable rent incentive.
3. **Risks:** Weakening of AUD. With 50% of FCOT's properties located in Australia, FCOT's income stream and DPU will be affected when converting its revenue to SGD. However, 28.6% of FCOT's total debts are in AUD to act as natural hedges.

Investment Thesis

Figure 4. FCOT debt maturity profile

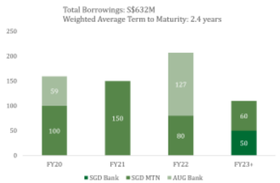


Figure 5. Gross effective rents of Grade A & B offices in Singapore's CBD

1. **Completion of Asset Enhancement Initiatives (AEI) driving revenue growth.** FCOT has 3 AEIs (Alexandra Technopark, China Square Central, Central Park) set to complete in FY19/20. The AEIs will increase the net leasable area of its properties and ability to charge a higher premium with a positive rental reversion from a rate of $3.97 in FY18 to an estimated $4.30 psf/month in FY19 for Alexandra Technopark, creating synergies with rising CBD rents.
2. **Opportunities for portfolio growth with low gearing and high fixed rate borrowings**. FCOT's low 29.3% gearing ratio provides headroom for potential additional debt of S$338M that can fund acquisitions. With no major refinancing requirement, a well spread out debt maturity profile and an average borrowing rate of 2.96% with 90.2% of its debts are fixed rate borrowings, FCOT is hedged against potential interest rate fluctuations.
3. **Revitalization of public spaces through Business Improvement District Program.** With up to $500,000 in annual funding matched by the government for 4 years, it will bolster China Place's position as a prime office space. This will improve tenancy rate and enable FCOT to demand rental premiums, increasing FCOT's DPU in the long term.

Valuations

Figure 7. Football Field

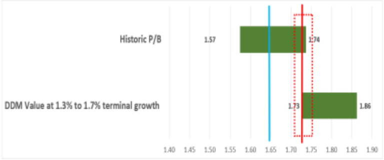


Figure 8. 6M historical P/B

Key assumptions for Dividend Discount Model (DDM):

1. FY19 dividend: $0.095
2. Terminal dividend growth rate: 1.5%
3. Cost of equity: 6.80%

Primary valuation method: DDM, price target is $1.80 (+10.43%) based on last closing price of $1.63. We assume a 1.5% y-o-y growth of distributable income. This is in line with forecasted long-term GDP growth in Singapore. We assume a constant dividend payout ratio of 66% of distributable income based on historical data.

Secondary valuation method: Blended DDM and 6M historical P/B price target stands at $1.72 (average of both valuation methods). Implied upside of +5.5% based on last closing price of $1.63 as at valuation date. Currently, it is trading at 18.9x forward P/FFO. Expectation of a reversion to the mean of 21.1x.

Dividend yield analysis: FCOT FY19 dividend yield of 5.85% exceeds historical average by ~170 bps with a payout ratio of 57%.

Prepared By: Tan Jian Zhang, Adriel Ng, Vicki Ong