EDISON

Forterra Trust

Forecasts amended for HQ delays

Development update

Real estate

Forterra Trust has provided an update on the progress of construction of The HQ, its mixed retail and office scheme in Shanghai. This is Forterra Trust's most important asset, as its value and potential revenue contribution outweighs the rest of the portfolio combined. The update confirmed that delayed development timing will shift rental contribution and earnings recovery into FY15. This was not unexpected as the reasons, if not the precise timing, had been set out in the Q313 results. NAV is not materially affected and the current substantial discount to the value of the underlying portfolio remains the primary attraction. We have adjusted our forecasts ahead of the FY13 results due at the end of this month.

Year end	Gross rental income (S$m)	PBT* (S$m)	EPS* (c)	DPS (c)	NAV/unit** (c)	Yield (%)
12/11	93.2	0.3	(29.5)	5.0	462	2.4
12/12	99.1	(9.2)	(6.2)	0.0	444	N/A
12/13e	79.3	(15.0)	(7.8)	0.0	468	N/A
12/14e	82.2	(15.6)	(7.5)	0.0	478	N/A
12/15e	142.5	6.3	0.7	0.0	531	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments. **NAV is stated net of minorities.

Short term pivots on The HQ in Shanghai

Forterra's portfolio comprises The HQ development – the focus of group finances – two rented office and logistics assets and two part-let properties held for future development. Construction, pre-letting and launch of The HQ are key and other development is likely to stay on hold until it is launched and rents stabilised. HQ pre-lets were unchanged according to the last update in Q313, at just over 50%. Of that, two-thirds is written confirmation of interest including leases under detailed negotiation and the rest is work in progress.

Sensitivities: Related to delivery of new development

Any delay in letting and launching The HQ is the most material source of sensitivity for forecasts, particularly construction timing and letting terms in a slower retail market. The effect of reported construction delays is in our forecasts. Nan Fung purchased 29.98% of Forterra, 100% of both the trustee and property managers in August. This removed uncertainty over ownership, but exits by key directors leave some uncertainty over strategy until the new team outlines its plans.

Valuation: NAV discount reflects development risk

The uncertainty inherent in completion of a major new asset contributes to a 60% discount to Q313 NAV/unit of S$4.79. Forterra has addressed concerns over finances and ownership, but timely launch of The HQ is key to the investment case. It is by far the largest component of the portfolio, and could potentially drive rental growth, stabilise finances and, in due course, fund resumed distributions.

20 February 2014

Price	**S$1.91**
Market cap	**S$485m**
	RMB4.73/S$
Net debt (S$m) as at September 2013	644
Units in issue	253.8m
Free float	55%
Code	LG2U
Primary exchange	Singapore
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(13.5)	(12.7)	12.4
Rel (local)	(11.1)	(8.3)	21.7
52-week high/low		S$2.4	S$1.6

Business description

Forterra Trust owns a portfolio of real estate investments, refurbishments and developments in Shanghai, Beijing and Qingdao. It actively manages these assets to maximise rental income and capital values.

Next event

FY13 results	February 2014

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The HQ: Forecast changes reflect development update

We have amended our FY14 forecast, extended estimates to FY15, and set out assumptions below. The prompt was an update on progress of the construction, likely timing of tenant handover and opening of new space at The HQ, Forterra's major mixed retail and office property in Shanghai.

The update provided a recap of the scheme and its condition at the end of 2013. When complete, The HQ will offer mixed office and retail, which is positioned as a "contemporary family oriented premier mall" that combines shopping, dining and other leisure. The scheme's three phases see refurbishment of existing space (HQ1/HQ2) and development of a new retail podium (HQ3).

Exhibit 1: The HQ development phases

HQ1	Existing retail podium of two basement and six storeys above ground
HQ2	Existing two-level outdoor pedestrianised mall and food street, and new multilevel bridge to link HQ1 and HQ3 podiums
HQ3	New 12-storey office tower, 11-storey retail podium

Source: Forterra Trust

Delayed development timings push back revenues

Delays to progress of the development have extended the expected completion dates for individual phases. In May 2013, Forterra anticipated that HQ1 would be complete by Q413, with tenants to occupy HQ3 by end March 2014. These dates have now been pushed back due to unexpected delays in construction caused by an exceptionally hot summer, and decisions taken by new management, which carried out a development and operational review. The new team considered how to optimise overall positioning, tenant mix and launch. Consideration was given in particular to recent changes in market conditions. The decisions were still mindful of the need to minimise any financial impact and additional costs.

The outcome of that review is that:

- Forterra now expects to launch The HQ in H214
- HQ1 completion and tenant occupancy is scheduled for Q314
- HQ2 and HQ3 are now expected in Q414
- The revised estimated construction budget for HQ2 and HQ3 is c RMB899m, above the RMB861m as at May 2013

Pending further guidance on timing with the full-year results in February, we have adjusted our forecasts for The HQ for later opening and an increased development budget. These reduce forecast new office rent in FY14 by RMB230m, reflecting a minimal contribution from the new and refurbished space at The HQ in the final quarter of this year. Revenues then build during FY15 and are expected to make a full contribution in FY16.

Exhibit 2: The HQ – projected rents (RMB000s)

	FY11	FY12	FY13e	FY14e	FY15e
Existing space	286,892	260,366	206,152	220,000	220,000
New offices			-	-	53,336
New retail			-	45,826	274,955
Total	286,892	260,366	206,152	265,826	548,290

Source: Forterra accounts, Edison Investment Research forecasts

This takes into account uncertainty of occupation of the new space at launch. The retail element is only partially pre-committed at this stage, with no pre-lets for the new office space. However, Forterra has confirmed that all major existing retail pre-lets remain in place, and received no indication that any prospective tenants have altered their intentions, although the pre-commitments are not yet legally binding.

Portfolio update

The group has five assets, in Shanghai, Beijing and Qingdao. The current status of each of these properties is set out below.

Exhibit 3: Portfolio status

Asset	Performance
The HQ, Shanghai	The development of the three distinct phases of The HQ continues, but delays have been caused by unforeseen events including the impact of 2013's exceptionally hot summer on working hours. An extended period of record high temperatures in Shanghai meant government authorities required all construction work in the city to stop during certain daytime hours. New management has undertaken a detailed review to optimise the overall positioning, tenant mix and launch of the scheme, which takes into account changing market conditions and opportunities. The new strategy has sought to mitigate any impact on group performance, and now expects to launch The HQ in H214 (HQ1 completion and tenant occupancy dates in Q314, HQ2/HQ3 in Q414). The board has approved a revised construction budget estimates for HQ2/HQ3 of c RMB899m, vs RMB861m announced in May 2013. Committed occupancy for The HQ office towers as at 30 September 2013 was 93.99%. There were no further commitments from retailers for new retail space during Q313. At the period end the level of pre-commitments was steady at just above 50%. Of that, 35% was written confirmation of interest, including leases under detailed negotiation and the balance work in progress. Letting activity in Q313 reflected a quiet local retail market and Forterra's experience is that the outlook for Q413 has moderated recently. Its discussions with foreign retailers suggest that these entities still view Shanghai as a suitable location for their flagship stores. Average ground floor rent in prime areas rose by 0.8% q-o-q; vacancy rates were steady at 6.8% according to Savills and Jones Lang LaSalle data.
Forterra House, Shanghai	Period-end occupancy was 93%, below the 95% at the mid-year, although revenues were better due to lease renewals and rent reviews both in Q3 and prior periods. Forterra reported higher lettings enquiries from domestic companies, particularly financial institutions, professional services and high-tech manufacturers. These groups are among the most active occupiers In Puxi where Forterra's Shanghai assets are located. Rents were steady q-o-q at RMB9.0/sqm/day and vacancy rates in Puxi fell to 10.4% (H113: 11.1%).
Huai Hai Mall, Shanghai	Huai Hai Mall continued its transition to a pre-development condition. Occupancy fell to 23.56% as at Q313 (H113: 32.34%) and all leases are due to terminate by end Q114. Forterra announced in September 2013 that it had secured a head lease over an additional 3,404sqm of retail space, which will bring the total gross floor area under its ownership or control from 7,620sqm to 11,024sqm. It has a 20-year lease over the new space and an option to extend this for a further 10 years, which requires no additional capital commitment.
Central Park Mall, Qingdao	At the end of August Forterra announced it had agreed to restructure its original acquisition arrangements with TRIO, its JV partner in this project. This required an RMB54.7m (S$11.4m) one-off payment to Trio made on 29 August 2013, but delivered a c RMB36.9m (S$7.7m) short-term cash flow saving and overall will save Forterra RMB18.6m (S$3.9m).
Beijing Logistics Park	This property was completed in 2012 and was 100% let at launch. Forterra is progressing discussions with a prospective purchaser.

Source: Forterra Q3 update

Q313 revenues reflect sale of Central Plaza in May

Third-quarter gross revenues were S$18.3m (RMB88.7m), below S$20.5m (RMB100.8m) in Q213 mainly due to the loss of rent from Central Plaza, sold for S$333m in May 2013.

Despite reduced occupancy, rent from Forterra House was 25% ahead q-o-q, due to rental uplifts agreed at lease renewals. Central Park Mall was c RMB4.1m up q-o-q, due to additional revenue received by Forterra as part of its settlement with Trio, its JV partner in the property. Income from Beijing Logistics Park (BLP) fell by RMB0.3m, an adjustment that related to amortisation of rent-free periods. We have adjusted our forecasts to reflect this without assuming further lettings. Our forecasts assume typical BLP quarterly gross revenue of c RMB7.6m.

Net property income in Q313 was S$11.6m (Q213: S$13.5m), with the majority of the reduction due to the sale of Central Plaza. There were higher contributions from parts of the let investment portfolio during the period, although occupancy was steady compared to the prior quarter (see Exhibit 4 below). Declining occupancy at Huai Hai Mall reflects lease expiries, with the property due to be fully vacant during in FY14 ahead of redevelopment, probably starting in 2015.

Exhibit 4: Portfolio occupancy				
	2012	2013		
	Q4	Q1	Q2	Q3
Investment assets				
Forterra House	100%	88%	95%	93%
Beijing Logistics Park	100%	100%	100%	100%
The HQ (existing)	94%	96%	94%	94%
Part-let/held for future development				
Huai Hai Mall	52%	32%	32%	24%
Central Park Mall (Phase 1)	68%	66%	66%	66%
Developments				
The HQ (extension)	N/A	N/A	N/A	N/A
Central Park Mall (Phases 2-4)	N/A	N/A	N/A	N/A

Source: Forterra updates

There was a S$3.4m reported pre-tax loss (Q312: profit of S$11.9m), the biggest single component of which was the S$17.7m lower net foreign exchange gains in the period, ie S$1m vs S$18.7m in Q312. The result also reflects lower net rent contributions overall at S$18.2m (Q312: S$24.3m) including Forterra House, due to lease expiries and Huai Hai Mall, where occupancy will fall progressively ahead of its development. The result included a S$4.2m gain from the restructuring of the original arrangements relating to the acquisition of Central Park Mall. The restructuring reduced outstanding consideration to S$11.4m (RMB54.7m) and cancelled the convertible notes issued to the vendor, and a rent guarantee provided by the vendor in Forterra's favour.

Group net debt increased by 3.5% to S$644m in Q313. Funding costs were 4.4% lower. Interest expense has been taken through the P&L since completion of the Beijing Logistics Park in July 2012, rather than capitalised, although the impact was in part offset by lower interest charges as debt secured on Central Plaza was repaid from the proceeds of selling the asset.

Sufficient cash and undrawn debt is available to complete construction of The HQ. At the end of Q313 Forterra had spent 48.8% of the approved budget of RMB861m (S$177m).

Sensitivities

The most material source of sensitivity for forecasts is the construction timing, letting and opening of The HQ. The group result is also sensitive to local letting markets, as offices are typically let for a period of three years. Revenues are thus vulnerable if a tenant vacates at the end of its lease, although Forterra has consistently been able to find replacements, and rental values have been on an upwards trajectory.

Financials

The forecasts and investment case are sensitive to successful completion and launch of The HQ, the principal component of projected growth in rents from FY15. The table below sets out our new forecasts in RMB and shows the impact of the delay to launch of The HQ, with essentially steady revenues from investment assets, Forterra House, Central Park Mall and Beijing Logistics Park.

Exhibit 5: Group revenues and expenses (RMB000s)	FY11	FY12	FY13e	FY14e	FY15e
Net rent	476,077	499,260	390,293	391,327	673,791
Business and property related tax	(60,288)	(63,188)	(50,959)	(50,872)	(87,593)
Property management fees	(15,655)	(17,055)	(11,760)	(11,740)	(20,214)
Other property operating expenses	(104,450)	(122,689)	(92,118)	(91,962)	(158,341)
Net property income	295,684	296,328	235,457	236,753	407,644

Source: Forterra accounts, Edison Investment Research forecasts

We have made small adjustments to our rent forecasts for the final quarter of 2013, based on Q313 performance and rent reviews. The impact on FY14 (Exhibit 6) is based on the following assumptions:

- Although the Beijing Logistics Park is an asset held for sale, we have assumed that it remains in the group portfolio until the end of FY15.
- Our previous forecasts for the investment properties factored in increases in revenues resulting from rent reviews and lettings to new tenants. For simplicity, we have assumed that total rents for these assets remain at levels prevailing at end FY13.
- Forecast revenues from The HQ (see Exhibit 2 and table below) for this and the next financial year are based upon assumptions that, in FY14, Forterra will receive 15% of the projected potential rent receivable from the new retail space and only a minimal contribution from new offices – we have assumed zero in our forecast – and for FY15, 90% and 70% respectively.

Exhibit 6: Comparison of previous and new forecast rents (S$m)

Forecast	Old FY14e	New FY14e	Old FY15e	New FY15e
The HQ				
- Existing space	46.2	46.2	47.0	46.5
- New retail	57.8	9.6	66.5	58.1
- New offices	11.2	Minimal	16.6	11.4
Forterra House	7.8	7.6	8.1	7.6
Central Park Mall	12.3	12.3	12.4	12.4
Huai Hai Mall	0.0	0.0	0.0	0.0
Beijing Logistics Park	6.5	6.5	6.5	6.5
Total	**141.8**	**82.2**	**157.1**	**142.5**

Source: Edison Investment Research forecasts

Forterra has previously committed to resume dividends from FY15 by the latest. We have not included any distribution in our forecasts and will revisit this after discussion with management post the full year results.

Exhibit 7: Forecast changes

	Gross rental income (S$m)		%	Adjusted PBT (S$m)		%	NAV/unit (c)		%
	Old	New	Change	Old	New	Change	Old	New	Change
FY12	99.1			(9.2)			438	444	
FY13e	80.4	79.3	-1%	(16.7)	(15.0)	-10%	456	468	+3%
FY14e	136.3	82.2	-40%	9.8	(15.6)	N/A	471	478	+2%
FY15e		142.5			6.3			531	

Source: Edison Investment Research forecasts

Valuation

The unit price is underpinned by NAV until the launch of The HQ, due in FY14, generates rent to fund a resumption of distributions. NAV/unit was S$4.79 at end Q313, a S$0.02/unit fall for the period due to RMB depreciation. That is a 60% discount, which reflects the risk inherent in the ongoing development of The HQ, by far the most valuable (73% of H113 appraisal) asset in Forterra's portfolio, which has been subject to delays mainly as a result of an exceptionally hot Shanghai summer.

A number of issues that weighed on the valuation at the start of this year have been addressed. The investment by Nan Fung, which acquired 29.98% of the group in August and 100% of the trustee and property managers, removed uncertainty over a substantial stake. However, resignations since by the trustee manager CEO, chairman and another director suggest the group's new investor has strong views on strategic direction, which we expect Forterra clarify in due course.

We await an outline of the new CEO's strategy and will comment on the implications for the group's investment and development strategy in due course. In the intervening period this has arguably created another area of uncertainty, which contributes to the discount to NAV.

New management team in place

In November the group appointed Mr Andrew Choo Seah as the new CEO and Mr Chun Wai Nelson Tang as a non-executive director. They replaced Richard David and Peter Sugden, the previous trustee-manager CEO and chairman.

Mr Seah has a strong 30-year background in property and project design, development and management in Hong Kong and overseas, and was most recently deputy general manager of Sino Ocean Land, Beijing.

His recent career is set out below:

- 2013 – deputy general manager, Sino Ocean Land;
- 2012-13 – group property adviser, UOA Development BHD, Malaysia;
- 2010-12 – project director, Rainbow Land Holdings, Tianjin, PRC; and
- 1997-2008 – head, property division central support, Kowloon-Canton Railway, HK.

Mr Tang is currently vice-president (investments) at Nan Fung Development. He leads the sourcing, evaluation, execution and management of property and other deals for the Nan Fung Group of Companies in the PRC. His experience of specific PRC markets includes Beijing, Shanghai, Hangzhou, Shenyang, Chengdu, Chongqing and Shenzhen, where he has established relationships with local and national developers.

Forum convertible not redeemed despite change of ownership

Under the terms of the Forum CB agreement, Forterra's bondholders hold the right to redeem in full if there is a change of ownership. Although the sale of the trustee-manager to Nan Fung in August 2013 constituted a change of control, the bondholders confirmed at the end of September that they would not elect to exercise their right to redeem.

The S$59.7m Forum convertible bond was outstanding at end Q313. It was issued in March 2011 in connection with the group's acquisition of Huai Hai Mall (Shanghai) and Central Park Mall (Qingdao). The latest date for conversion at S$2.10 is September 2014 and full conversion would result in the issue of c 28.43m units. The bond funding cost is 6% pa, although at redemption bondholders will receive the principal, plus an additional sum necessary to generate a 16.75% pa yield, compounded semi-annually (less all cash interest paid).

Exhibit 8: Financial summary

S$m	19 May to end Dec 2010	2011	2012	2013e	2014e	2015e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Gross rental income	39.6	93.2	99.1	79.3	82.2	142.5
Total property operating expenses	(17.0)	(35.2)	(40.3)	(31.3)	(32.5)	(56.3)
Net property income	22.6	58.1	58.8	48.0	49.7	86.2
EBITDA	6.1	34.7	32.1	26.2	27.5	52.7
Operating Profit (before amort. and except.)	6.1	34.7	32.1	25.8	27.1	52.3
Intangible Amortisation	0.0	0.0	0.0	0.0	0.0	0.0
Change in fair value of investment properties	33.0	312.5	70.4	41.9	0.0	0.0
Gain on sale of subsidiaries	0.0	0.0	0.0	18.0	0.0	0.0
Operating Profit	39.2	347.1	102.5	85.7	27.1	52.3
Net Interest	(15.5)	(34.4)	(41.3)	(40.8)	(42.7)	(46.0)
Other non-recurring finance costs	(22.7)	(9.7)	(15.5)	(9.3)	(11.9)	0.0
Foreign exchange gains/FV changes in derivatives	51.6	(4.7)	30.7	0.0	0.0	0.0
Profit Before Tax (norm)	(9.4)	0.3	(9.2)	(15.0)	(15.6)	6.3
Profit Before Tax (FRS 3)	52.6	298.3	76.4	35.6	(27.5)	6.3
Tax	(0.8)	(2.1)	(2.1)	(0.5)	0.8	(0.2)
Profit After Tax (norm)	(10.1)	(1.8)	(11.3)	(15.5)	(14.8)	6.1
Profit After Tax (FRS 3)	39.6	209.4	46.7	22.5	(26.7)	6.1
Average Number of Shares Outstanding (m)	240.9	254.8	253.6	253.8	253.8	253.8
EPS - normalised (c)	(4.2)	(29.5)	(6.2)	(7.8)	(7.5)	0.7
EPS - normalised and fully diluted (c)	(4.2)	(29.5)	(6.2)	(7.8)	(7.5)	0.7
EPS - (IFRS) (c)	16.4	53.4	16.7	7.2	(12.2)	0.7
Dividend per share (c)	5.0	5.0	0.0	0.0	0.0	0.0
Gross Margin (%)	57.0	62.3	59.4	60.5	60.5	60.5
EBITDA Margin (%)	15.5	37.2	32.4	33.0	33.4	37.0
Operating Margin (before GW and except.) (%)	15.5	37.2	32.4	32.5	33.0	36.7
BALANCE SHEET						
Fixed Assets	1,875.5	2,670.4	2,237.9	2,437.9	2,577.4	2,717.0
Intangible assets	0.0	0.0	0.0	0.0	0.0	0.0
Investment properties	1,874.2	2,668.6	2,236.7	2,436.7	2,576.2	2,715.8
Property, plant & equipment	1.3	1.8	1.2	1.3	1.2	1.2
Current Assets	127.9	89.3	578.7	347.9	261.4	261.5
Available for sale financial investments	15.8	0.0	0.0	0.0	0.0	0.0
Debtors	8.1	43.7	99.9	65.0	65.0	65.0
Cash	103.9	45.6	42.1	214.6	127.3	127.4
Assets held for sale	0.1	0.0	436.7	68.3	69.1	69.1
Current Liabilities	(73.3)	(170.8)	(472.2)	(179.9)	(181.2)	(185.6)
Creditors	(66.5)	(98.2)	(443.5)	(155.4)	(155.4)	(155.4)
Short term borrowings	(6.8)	(72.6)	(28.7)	(24.6)	(25.8)	(30.2)
Long Term Liabilities	(972.6)	(1,287.1)	(1,087.9)	(1,282.4)	(1,309.7)	(1,309.7)
Long term borrowings	(649.6)	(838.4)	(718.9)	(874.8)	(893.3)	(893.3)
Other long term liabilities	(323.0)	(448.7)	(369.0)	(407.6)	(416.4)	(416.4)
Net Assets	957.4	1,301.8	1,256.5	1,323.4	1,348.0	1,483.3
CASH FLOW						
Operating Cash Flow	11.8	37.7	51.9	47.6	27.5	52.7
Net Interest	(32.5)	(28.3)	(41.3)	(40.8)	(42.7)	(46.0)
Tax	0.0	(1.5)	(2.3)	(2.0)	(2.6)	(3.0)
Capex	(4.7)	(38.8)	(52.8)	(70.0)	(89.3)	(8.0)
Acquisitions/disposals	81.1	(145.5)	0.0	85.9	0.0	0.0
Financing	25.6	(6.4)	0.4	0.0	0.0	0.0
Dividends	(6.0)	(19.1)	0.0	0.0	0.0	0.0
Net Cash Flow	75.2	(202.0)	(44.1)	20.7	(107.0)	(4.3)
Opening net debt/(cash)	604.5	552.5	865.4	705.5	684.8	791.8
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0	0.0
Other	(23.2)	(110.9)	204.0	(0.0)	0.0	0.0
Closing net debt/(cash)	552.5	865.4	705.5	684.8	791.8	796.1

Source: Forterra accounts, Edison Investment Research estimates

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