Forterra Trust

Q114 results

Steady progress

Real estate

2014 will see a focus on developing the group's primary site, The Place (formerly known as The HQ) and we expect this to deliver significant revenue uplift and group profitability in 2015. Encouragingly, tenant interest in Phase 2 appears ahead of expectations at this stage, with retail pre-commitments at over 90%. The focus on core properties saw the disposal of the Beijing Logistics Park for a 25% uplift on latest valuation in Q214. Occupancy was broadly stable and rent reviews had a modest uplift.

Year end	Gross revenue (S$m)	PBT* (S$m)	EPS* (c)	DPS (c)	NAV/unit** (c)	Yield (%)
12/12	99.1	(23.6)	(7.3)	0.0	420	N/A
12/13	77.3	(37.0)	(10.0)	0.0	446	N/A
12/14e	67.9	(31.8)	(9.1)	0.0	442	N/A
12/15e	128.4	5.1	1.4	0.0	443	N/A

Note: *PBT and EPS are normalised, excl. intangible amortisation, exceptionals and share-based payments. 2012 normalisation revised (see Exhibit 5). **NAV stated net of minorities.

Q114 results

Losses per shareholder unit were reduced y-o-y to S4.1c from S6.7c as lower revenue (primarily from asset sales) was offset by lower property operating and administration expenses, reduced funding costs (less debt outstanding) and a lower impact of FX in the profit and loss account. The NAV fell c 5% primarily due to FX effects. In business terms, the key noticeable beat has been the take-up of Phase 2 of The Place, where retail pre-commitments advanced to 90% (of which 64.4% have written confirmation of interest or are in detailed negotiations on leases). The larger Phase 1 is expected to open by end Q314 and is at 70% pre-commitment. This is on track and, in our view, in line with market trends to have above 80% committed occupancy at the time of the grand opening in early 2015.

2014 and 2015 outlook

Q214 is expected to see a S$0.06 (c 1.5%) uplift to NAV from the disposal of the Beijing Logistics Park at a 25% premium to its latest valuation. Management will focus on development of The Place through most of 2014. Phase 1 will have its soft opening in Q314 and Phases 2 and 3 later in Q414. Clearly the revenue uplift will be primarily a 2015 event, while H214 is likely to see much of the administration cost associated with marketing the developments. We note that by end Q114 just 54.3% of the development expenditure on the project (RMB488m out of RMB899m) had actually been incurred. H214 is likely to see the impact of this on cash flow and the capitalisation of development costs.

Valuation: NAV discount reflects development risk

The uncertainty inherent in the completion of a major new asset contributes to a c 60% discount to basic Q114 NAV/unit of S$4.44 (diluted S$4.25). Forterra has addressed concerns over finances and ownership, and Q114 developments bode well for The Place potentially driving rental growth, stabilising finances and, in due course, allowing the fund to resume distributions.

8 May 2014

Price	**S$1.785**
Market cap	**S$453m**
	RMB4.8/S$
Net debt (S$m) as at March 2014	738
Units in issue	253.8m
Free float	59%
Code	LG2U
Primary exchange	Singapore
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(0.8)	(1.9)	(3.8)
Rel (local)	(2.1)	(8.7)	0.6
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 and Qingdao. It actively manages these assets to maximise rental income and capital values.

Next event

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Q114 key developments

The key developments in Q114 were:

- Profit and loss account:
  - Gross revenue fell to S$15.0m (Q413 S$15.2m, Q113 S$23.3m) or RMB72.4m (Q413 RMB73.7m, Q113 RMB117.8m) with the sale of Central Plaza accounting for 60% of the RMB drop and other important factors being lower occupancy at The Place, the run-down of Huai Hai Mall ahead of refurbishment, and the effect of a previous period termination of rent guarantees for Central Park Mall (revenue RMB4.8m in Q114 vs RMB5.4m in Q413 and RMB13.9m in Q113.
  - Lease renewals/new leases continue to see uplifts. Fourteen leases in The Place saw a 3.2% uplift versus 3.6% in Q413. Office vacancies in Puxi, where The Place is situated and which has a greater dependence on multinational corporations, have remained high (Q114 13.1%; end 2013 14.6%; end 2012 10.4%) and market-wide office rents have seen a marginal decline (0.9% in Q114 after 0.2% decline in Q413). Pudong has seen a fall in vacancy to 3.5% and a 1.6% rise in rents. Management in Q413 noted that there are early signs of a recovery in retail and in Q114 prime retail vacancy rates edged down to 4.4%, while ground floor base rents rose 1.7% quarter-on-quarter.
  - Total property operating expense fell from S$7.8m (Q113) to S$6.5m. Administration expenses were also reduced (S$2.3m vs S$3.1m in Q113) as were funding costs (S$12.1m vs S$14.8m in Q113).
  - Forterra has multiple FX exposure from investments valued in renminbi, the majority of its debt in US dollars and reporting in Singapore dollars. Total FX movements generated a credit to the profit and loss of S$0.5m, but an adverse S$54.2m (Q113 credit S$33.6m) in other comprehensive income.
  - Net loss per shares was 4.1c against 6.7c in Q113. As noted above, the development of The Place is expected to deliver profitability in due course.
- Balance sheet:
  - The debt-to-assets ratio was 33.7% (covenant maximum 45%) and development assets 18.3% of total assets (limit 30%). The period-end FX rate (S$1 = RMB4.94) was above the average for the period (4.80) at the end 2013 (4.79) and had an adverse effect on translating the RMB assets into S$ (driving most of the fall in NAV per share). We understand management is already in discussions with banks about re-financing its bank funding (while only 9.6% of bank loans expire in 2014, there is a big loan amortisation of The Place in Q115) and the Forum Convertible Bond potentially maturing in September 2014.
- In Q114 the flagship project was rebranded from The HQ to The Place to leverage on the recognition generated from Nan Fung's retail malls in China using this brand (Nan Fung owns 29.98% of the units in Forterra Trust). Phase 1 of the project has seen refurbishment works complete and detailed fit-out liaison is now in progress with 20 tenants, covering 30% of the retail area available to let. Retail pre-commitment remained at c 70% (written confirmation of interest or under detailed negotiation 48%) and Forterra expects the unit to be fully operational in 2015 after a soft opening at end Q314. We understand this level of pre-commitment is on track and in line with market average to have above 80% committed occupancy at the time of full launch. Phase 2, which also saw the rebranding of the food street to the Promenade, now has 90% retail pre-commitment (64% written confirmation of interest or under detailed negotiation). Phase 3 topping out was on 16 January and the interior fit-out has now started

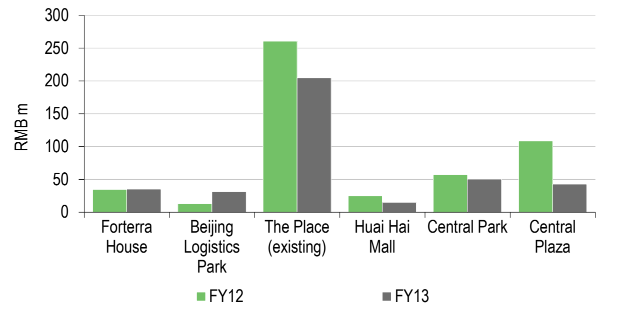
with the unit expected to open in Q414. We note the expenditure to date is just 54.3% of approved budgets (Q114 included the seasonal shut-down over Chinese New Year).

On 16 April, Forterra sold the Beijing Logistics Park at a share sale consideration of S$22.2m (RMB109.1m). The realised value of the property of RMB424m was a 25.4% (RMB86m) premium to the latest valuation (RMB338m) and generated an accounting gain of S$13.2m (to be booked as gain on sale of investments in Q214). Net cash proceeds post-repayment of loans were $$44.9m.

Gross revenue and occupancy

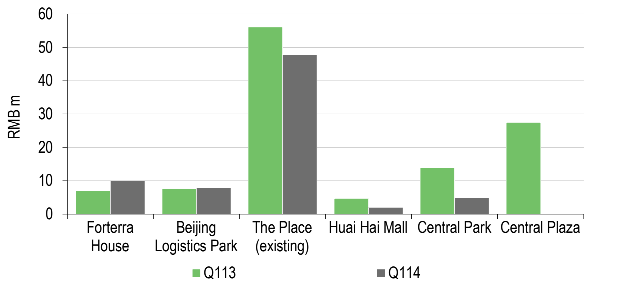
The reported gross revenue is given below for both the full year and the first quarter.

Exhibit 1: Full year gross revenue (RMBm)



Source: Forterra Trust, Edison Investment Research

Exhibit 2: Q1 gross revenue (RMBm)



Source: Forterra Trust, Edison Investment Research

Exhibit 3: Portfolio occupancy (%)

	Q412	Q113	Q213	Q313	Q413	Q114
Investment assets						
Forterra House	100%	88%	95%	93%	93%	93%
Beijing Logistics Park	100%	100%	100%	100%	100%	100%
The Place (existing)*	94%	96%	94%	94%	92%	90%
Part-let/held for future development						
Huai Hai Mall	52%	32%	32%	24%	14%	10%
Central Park Mall (Phase 1)	68%	66%	66%	66%	66%	66%

Source: Forterra Trust, Edison Investment Research. Note: *Office component only of The Place.

Valuation

The unit price is underpinned by NAV until the launch of The Place, due in FY14, generates rent to fund a resumption of distributions. Basic NAV/unit was S$4.44 (diluted S$4.25) at Q114, down somewhat from the end-2013 numbers (S$4.68 and S$4.46 respectively) due to the operating loss and FX movements. However, the current share price is at a c 60% discount. We believe the risk inherent in the ongoing development of The Place, together with some concerns about Shanghai office vacancy drive the discount, which should reduce as the project is delivered.

We also note that there is a cumulative deferred tax liability in relation to the change in fair value of investment properties of S$383m. The timing of when this liability becomes due is complex, not least given the international nature of the holding companies. We believe some investors include it with equity in assessing what they consider to be the real fair value of the company. It is a material factor, adding over S$1.50 per share and increasing the discount further if added back.

In March 2011, in connection with the acquisition of Huai Hai Mall (Shanghai) and Central Park Mall (Qingdao), the group issued a convertible bond. Bondholders confirmed at the end of September 2013 that they would not elect to exercise their right to redeem on change of control and have until September 2014 to convert at S$2.10/share. Full conversion would result in the issue of c 28.43m units, which were not included in the 2013 dilution calculations because of the prevalent share price. We understand management is preparing for both exercise and redemption – our modelling assumes this debt is repaid and replaced by cheaper funding in September 2014.

Financials

Our FY14 forecasts are given below and are based on the following assumptions:

- That total rents remain at levels prevailing at end FY13. This is a conservative view given rent renewals are seeing an uplift, albeit at a slower pace than earlier in 2013.
- The bond funding cost has a cash coupon 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). We have assumed this will be replaced by bank debt and hence expense falls further in 2015 (2014 is lower than 2013 with the repayment of debt on the Central Plaza disposal). We expect that management will explore multiple options available in the market to optimise the refinancing when due.
- We have reviewed our forecasts for The Place given the level of pre-interest indicated and adjusted our numbers for the other units in light of Q114 experience. We have also included the full period effect of the lower Central Park Mall income post re-negotiations in H213. Expenses and funding costs were both somewhat better than we expected and we have carried this improvement forward. The net effect of all these changes is a minor adjustment to underlying PBT estimates. The 2014 loss is reduced by the sale of Beijing Logistics Park (profit on disposal S$13.2m). The NAV has reduced given the FX impact in Q114 is carried forward.

Exhibit 4: Forecast changes

	Gross revenue (S$m)		%	Adjusted PBT (S$m)		%	NAV/unit (c)		%
	Old	New	Change	Old	New	Change	Old	New	Change
FY14e	76.9	67.9	-12%	(32.0)	(31.8)	1%	460	442	-4%
FY15e	139.5	128.4	-8%	5.0	5.1	2%	461	443	-4%

Source: Edison Investment Research forecasts

Exhibit 5: Key financials – profit and loss (S$000s)

	2012	2013	2014e	2015e
Gross rental income	98,985	76,950	67,689	128,198
Other income	134	333	176	203
Gross revenue	**99,119**	**77,283**	**67,864**	**128,401**
Total property operating expenses	(40,288)	(28,411)	(27,128)	(50,718)
Net property income	**58,831**	**48,872**	**40,737**	**77,682**
Gain on sale	0	22,166	13,200	0
Trustee Manager fees	(16,316)	(16,129)	(14,226)	(15,916)
Administrative expenses	(11,708)	(12,212)	(10,104)	(11,085)
Other expenses	0	(663)	0	0
Finance income	205	382	525	600
Finance costs	(54,587)	(57,280)	(48,688)	(46,200)
Net FX	30,666	(19,511)	477	0
Change in fair value of derivatives	(1,084)	1,103	85	0
Change in fair value of investment properties	70,381	(13,641)	0	0
PBT	**76,388**	**(46,913)**	**(17,994)**	**5,081**
Current income tax	(2,110)	(2,115)	154	(203)
Deferred tax	(27,611)	(3,483)	284	(1,067)
Profit after tax	**46,667**	**(52,511)**	**(17,556)**	**3,811**
Non-controlling interests	(4,250)	3,259	629	(229)
Attributable profit after tax	**42,417**	**(49,252)**	**(16,927)**	**3,582**
Average closing number of units ("shares") – basic	253.6	253.7	253.8	253.8
Average closing number of units ("shares") - fully diluted	256.2	253.7	253.8	253.8
Basic earnings per unit ("share") - S$c	16.7	(19.4)	(6.7)	1.4
Fully diluted earnings per unit ("share") - S$c	16.6	(19.4)	(6.7)	1.4

Source: Forterra Trust, Edison Investment Research

Exhibit 6: Key financials – reconciliation statutory to adjusted estimates (S$000s)

	2012	2013	2014e	2015e
Statutory PBT	76,388	(46,913)	(17,994)	5,081
Less gain on sale	0	(22,166)	(13,200)	0
Less net FX	(30,666)	19,511	(477)	0
Less change in FV derivatives	1,084	(1,103)	(85)	0
Less change in FV Investment property	(70,381)	13,641	0	0
Adjusted PBT	**(23,575)**	**(37,030)**	**(31,756)**	**5,081**
Standard tax rate	25%	25%	25%	25%
Standard tax	5,894	9,258	7,939	(1,270)
Adjusted PAT	**(17,681)**	**(27,773)**	**(23,817)**	**3,811**
Minority	(888)	2,517	629	(229)
Adjusted post tax attributable to unit holders	**(18,569)**	**(25,255)**	**(23,188)**	**3,582**
Normalised earnings per unit ("share") - S$	(7.3)	(10.0)	(9.1)	1.4

Source: Forterra Trust, Edison Investment Research

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Exhibit 7: Key financials – balance sheet (S$000s)

	2012	2013	2014e	2015e
Investment properties	**2,236,656**	**2,438,479**	**2,448,282**	**2,478,282**
Property, plant, & equipment	1,208	979	891	891
Total non-current assets	2,237,864	2,439,458	2,449,173	2,479,173
Derivative financial asset	0	0	0	0
Trade & other receivables	99,946	54,913	27,047	27,047
Cash & equivalents	42,080	108,244	80,000	80,000
Available for sale	436,684	75,510	0	0
Total current assets	**578,710**	**238,667**	**107,047**	**107,047**
Total assets	**2,816,574**	**2,678,125**	**2,556,220**	**2,586,220**
Interest bearing borrowings	**(648,903)**	**(617,223)**	**(342,698)**	**(342,698)**
Debt securities	(69,995)	0	0	0
Derivative financial liabilities	(1,128)	0	0	0
Trade & other payables	0	0	0	0
Deferred tax liabilities	(367,906)	(393,601)	(381,273)	(382,340)
Total non-current liabilities	**(1,087,932)**	**(1,010,824)**	**(723,971)**	**(725,038)**
Interest bearing borrowings	**(23,377)**	**(91,789)**	**(492,640)**	**(517,762)**
Debt securities	(5,170)	(79,470)	0	0
Derivative financial liabilities	(166)	(85)	0	0
Current tax liability	(123)	(415)	0	0
Trade & other payables	(102,897)	(102,262)	(88,350)	(88,350)
Available for sale	(340,438)	(70,242)	0	0
Total current liabilities	**(472,171)**	**(344,263)**	**(580,990)**	**(606,112)**
Total liabilities	**(1,560,103)**	**(1,355,087)**	**(1,304,961)**	**(1,331,150)**
Net assets	1,256,471	1,323,038	1,251,259	1,255,070
Non-controlling interests	(129,620)	(134,030)	(129,721)	(129,950)
Unitholders' equity	1,126,851	1,189,008	1,121,538	1,125,120
NAV per unit ("share") – basic S$	**4.44**	**4.68**	**4.42**	**4.43**
NAV per unit ("share") – fully diluted S$	**4.20**	**4.46**	**4.42**	**4.43**

Source: Forterra Trust, Edison Investment Research

Exhibit 8: Key financials – cash flow (S$000s)

	2012	2013	2014e	2015e
Cash generated from operations	**49,597**	**849**	**15,311**	**50,778**
Net cash from investing activities	**(52,589)**	**93,334**	**(52,496)**	**(29,700)**
Financing activity	(42,583)	(48,155)	(46,710)	(46,200)
Other	35,893	121,234	39,323	0
Change in net debt (inc held for sale)	(9,682)	167,262	(44,571)	(25,122)
Opening net debt (including held for sale)	**(871,232)**	**(880,914)**	**(713,652)**	**(758,223)**
Closing net debt (including held for sale)	**(880,914)**	**(713,652)**	**(758,223)**	**(783,345)**
	2012	2013	2014e	2015e
Short term debt	(28,547)	(171,259)	(492,640)	(517,762)
Long term debt	(718,898)	(617,223)	(342,698)	(342,698)
Total debt	(747,445)	(788,482)	(835,338)	(860,460)
Cash	42,080	108,244	80,000	80,000
Net debt	(705,365)	(680,238)	(755,338)	(780,460)
Restricted cash	6,026	3,630	3,795	3,795
Net debt adjusted for restricted cash	(711,391)	(683,868)	(759,133)	(784,255)
Cash & equivalents held for sale	8,133	4,696	910	910
Interest bearing borrowings held for sale	(177,656)	(34,480)	0	0
Total net debt (including held for sale)	(880,914)	(713,652)	(758,223)	(783,345)

Source: Forterra Trust, Edison Investment Research

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