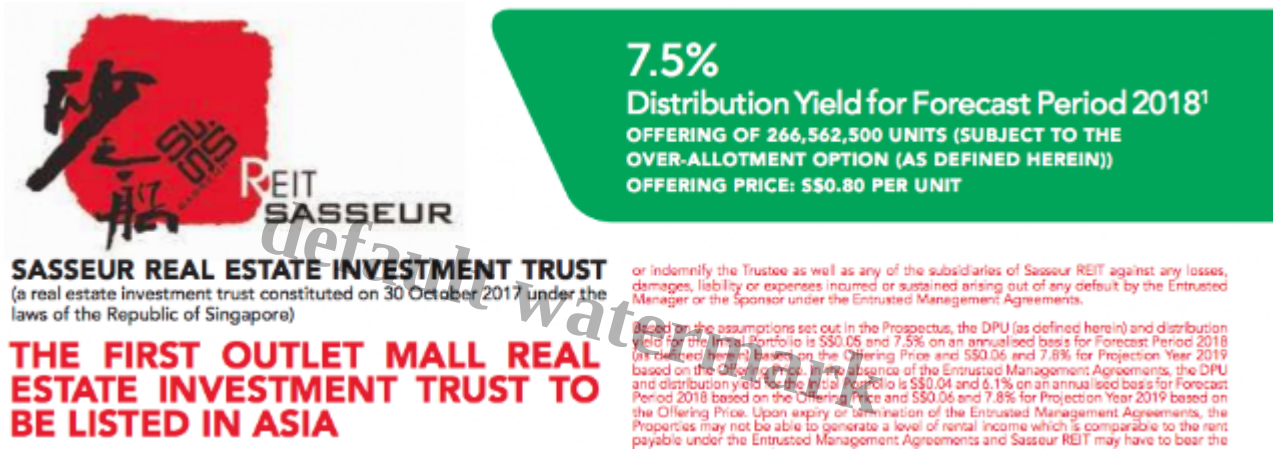
IPO Analysis: Sasseur REIT

Description

Sasseur REIT is an upcoming Chinese outlet mall portfolio that is currently open for IPO applications and will soon be listed on SGX.



This is the third retail REIT in the Peopleâ??s Republic of China (PRC) to be listed here â?? BHG and Daisin Retail Trust are the other two â?? pointing to the growth in the spending power of the Chinese middle class, which is expected to continue growing. With a CAGR of over 24% per annum, it is expected that China outlet malls will become the biggest in the world by 2030, surpassing the outlet mall markets in Europe and USA. While I wouldnâ??t place too much emphasis on these estimates, I would however review this IPO as both a dividend and growth stock for the future.

Youâ??ll currently be buying into a portfolio of 4 retail outlet malls located in Chongqing, Bishan, Hefei and Kunming.

Details:
â?? 266.6 million shares for offer at $0.80 each, raising S$396 million
â?? 13.8 million public tranche
â?? IPO closes on 26 March at noon.

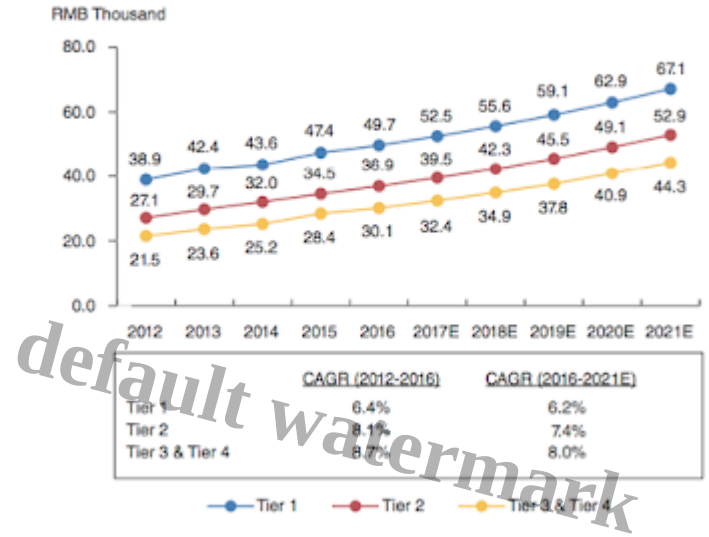
Business:
Sasseur REIT owns and manages four outlet shopping malls in China, valued at RMB 7.34 million (or S$1.5 million) in total *(although I would take these valuation numbers with a pinch of salt)*. All of these outlet malls have an occupancy rate of above 90% each, with land tenures of 30 â?? 37 years and includes 4,466 car park lots (translates into extra revenue for the REIT).

Strengths

1. A chance to ride on Chinaâ??s growing consumer market

The PRC outlet market industry has experienced a compounded annual growth rate (CAGR) of 30.8%, and is expected to continue its growth at a 24.2% CAGR from 2016 â?? 2021.

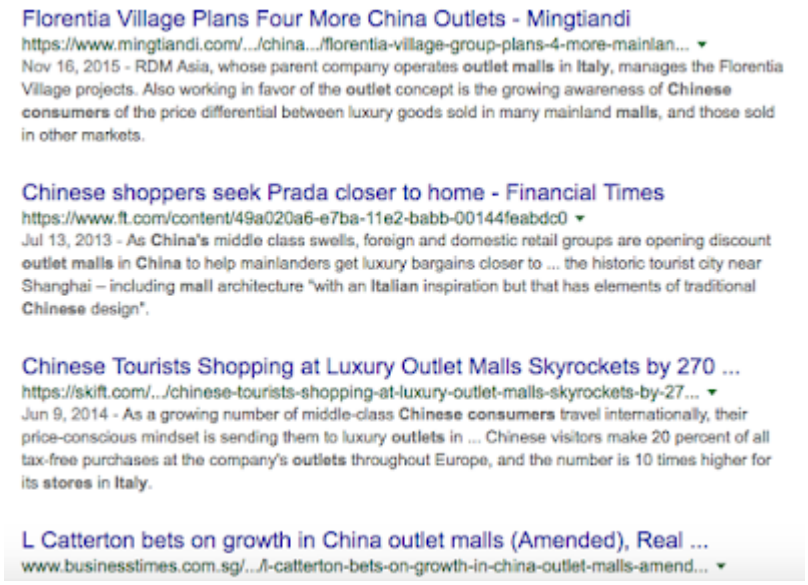
Per capita disposable income of urban households, China, 2012-2021E



default watermark

Most of you should be well familiar with how the Chinese shop and spend by now, but if you havenâ??t seen it for yourself, I kid you not when I say they can go insane at outlet malls. I saw this firsthand in both the US and Italy where the PRC folks were buying bags and bags of discounted branded stuffâ?¦whereas all I walked out with was a pair of Nike shoes, lol. These outlets get so much sales from the Chinese that even their salespeople are trained to speak in the language (I remember the shock I got when I saw the Italian salesman speak in Chinese to a PRC customer!).

Luxury Outlets Sprout in China - WSJ
https://www.wsj.com/articles/luxury-outlets-sprout-in-china-1399980825
May 13, 2014 - Familiar sights along U.S. highways and in the remote outskirts of some European cities, **outlet malls** peddling high-end brands are now popping up in **China**. Shoppers can wander a faux **Italian** village—flush with Roman architecture and flashy fountains—where a genuine Burberry trench coat, ...



Florentia Village Plans Four More China Outlets - Mingtiandi
https://www.mingtiandi.com/.../china.../florentia-village-group-plans-4-more-mainlan...
Nov 16, 2015 - RDM Asia, whose parent company operates **outlet malls** in **Italy**, manages the Florentia Village projects. Also working in favor of the **outlet** concept is the growing awareness of **Chinese consumers** of the price differential between luxury goods sold in many mainland **malls**, and those sold in other markets.

Chinese shoppers seek Prada closer to home - Financial Times
https://www.ft.com/content/49a020a6-e7ba-11e2-babb-00144feabdc0
Jul 13, 2013 - As **China's** middle class swells, foreign and domestic retail groups are opening discount **outlet malls** in **China** to help mainlanders get luxury bargains closer to ... the historic tourist city near Shanghai – including **mall** architecture "with an **Italian** inspiration but that has elements of traditional **Chinese** design".

Chinese Tourists Shopping at Luxury Outlet Malls Skyrockets by 270 ...
https://skift.com/.../chinese-tourists-shopping-at-luxury-outlet-malls-skyrockets-by-27...
Jun 9, 2014 - As a growing number of middle-class **Chinese consumers** travel internationally, their price-conscious mindset is sending them to luxury **outlets** in ... Chinese visitors make 20 percent of all tax-free purchases at the company's **outlets** throughout Europe, and the number is 10 times higher for its **stores** in **Italy**.

L Catterton bets on growth in China outlet malls (Amended), Real ...
www.businesstimes.com.sg/.../l-catterton-bets-on-growth-in-china-outlet-malls-amend...

default watermark

The concept of â??faceâ?• or â??mian ziâ?• is huge in China, and you only need to see them buying to be convinced of this. Sasseur REIT offers an opportunity for investors to ride on this trend.

2. High occupancy rate and low tenant default risk.

Their outlet malls at Chongqing, Bishan, Hefei and Kunming have high occupancy rates of 96.4%, 91.5%, 95.8% and 96.1% respectively. This comprises of over 1,119 tenants which means that even if a few tenants were to default, it should not pose too much of an impact to Sasseur REIT.

Year	Chongqing Outlets	Bishan Outlets	Hefei Outlets	Kunming Outlets	Average Occupancy Rate for the Initial Portfolio
2014	99.6%	74.3%	–[1]	–[1]	88.4%
2015	99.9%	79.2%	–[1]	–[1]	90.7%
2016	97.8%	81.4%	82.1%	82.0%	86.1%
As at 30 September 2017	96.0%	85.6%	93.3%	90.7%	91.8%
As at the Latest Practicable Date	96.4%	91.5%	95.8%	96.1%	95.1%

No.	Tenant[1]	Trade Sector(s)	Lease Expiry Date	Percentage of Property Income[2] (%)
1	Tenant A	International Brands	June 2021	1.9
2	Tenant B	International Brands	July 2019	1.6
3	Tenant C	Sportswear	July 2019	1.6
4	Tenant D	Sportswear	July 2019	1.4
5	Tenant E	Men's Fashion	July 2018	1.4
6	Tenant F	Sportswear	July 2018	1.3
7	Tenant G	International Brands	September 2020	1.2
8	Tenant H	International Brands	December 2019	1.1
9	Tenant I	Women's Fashion	July 2019	1.1
10	Tenant J	Women's Fashion	March 2019	1.0
Top 10 Tenants				**13.4**
Other Tenants				**86.6**
Total				**100.0**

3. Strong sponsor and sponsor interest.

default watermark

The sponsor is Sasseur REIT is one of Chinaâ??s largest retail outlet mall operators, Sasseur Cayman Holding Ltd, which was founded in 1989 and currently manages 9 retail outlets in China. They will be the largest single unitholder with a 55% to 58% interest, which represents good news to retail investors since there will be a strong incentive for the Sponsor to ensure the REIT performs well.

The sponsor also had a 2 billion net profit for FY2016 (S$420 million) which signifies a relatively strong financial position.

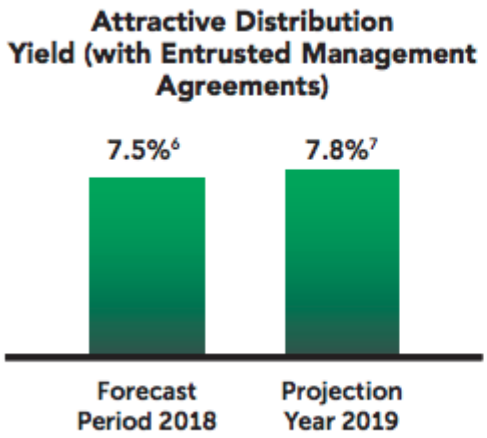
4. Positive management fee structure.

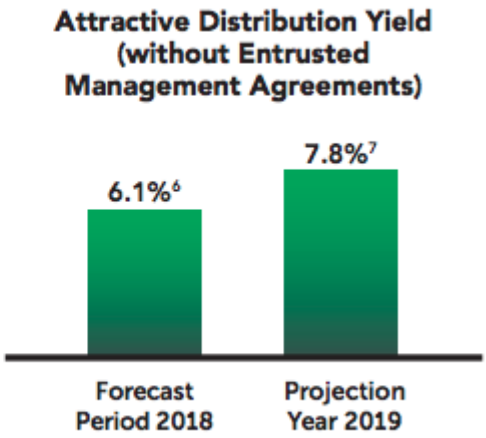
The manager will receive a 10% per annum base fee of the REITâ??s distributable income, together with a performance fee of 25% of the difference in DPU between each financial year. I like how this management fee structure is based on distributable income and DPU growth, which further aligns the interest of the manager to ensure that the REIT does well.

5. Strong interest from cornerstone investors

The list includes prominent investors like JD.com (through their subsidiary, Adroit Ideology Limited), Bangkok Life Assurance PCL (a leading life insurance company in Thailand) and CKK Holdings (which operates Charles & Keith and Pedro).

6. Decent dividend yield above 6%





The expected distribution yield is 7.5% for 2018 and 7.8% for 2019. Iâ??ll look at the most conservative figure in this case, which would be the 6.1% forecast yield for this year without factoring in the EM agreements.

default watermark

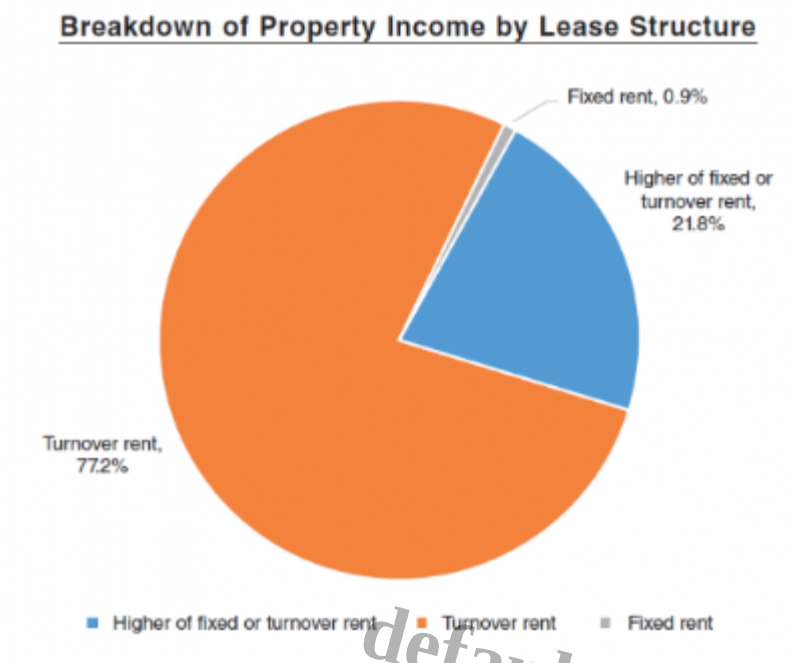
As a dividend stock, 6.1% is a fair yield that I would accept for a REIT investment, which is higher than Suntec REIT (5.2%) and Capitaland Retail China (6.0%)â?¦although it still canâ??t beat my Sabana REIT which is giving me a historical yield of over 10% based on my last purchase price, heh.

7. Fixed and variable income model.

The structure of most REITs are easy to understand â?? they lease out their assets and collect rent from tenants, which they then distribute to unitholders. However, Sasseur REIT adopts an interesting model that warrants a second look and further evaluation on its merits and downsides.

Instead of a pre-agreed rental model, or even one with escalating lease agreements structured in, Sasseur REIT instead receives a percentage of the tenantâ??s sales turnover as rental. What this means is that Sasseur REITâ??s income is highly dependent on the sales performance of its tenants, and dividends could therefore vary from year to year.

To incentivise consumer spending and sales, Sasseur REIT offers a VIP membership program where customers qualify by spending more than RMB 600 at any one of its outlets. At the moment, thereâ??s over 809,000 VIP members who contribute 50% to 65% of the sales in its outlet malls.



default watermark

Aside from these sales-based leases, a small proportion of Sasseur REITâ??s tenants are under conventional lease models where they pay a fixed rent, or the higher of turnover rent and fixed rent. These tenants include the F&B operators, cinema and other entertainment or lifestyle providers.

Its fixed income portion also comes from the fact that in the event where the resulting rent falls below the Minimum Rent, then Sasseur REIT shall be entitled to receive the shortfall. *(RMB 472.9 million or S$95.9 million for FY2018, and RMB 611.4 million or S$124 million for FY2019).* This basically provides **income support** to Sasseur REIT for the first two years whereby it is guaranteed a minimum rental, but will fall away in 2020 onwards.
This leads me to the biggest and most important risk in my next sectionâ?¦

Risks / Red Flags

1. Loss of income support after 2019

Unless the agreement is restructured to guarantee the minimum rent payment to the REIT after 2019, we could potentially see a drop in the REITâ??s income, especially if economic conditions worsen or if the Chinese cut back on their spending at outlet malls. If youâ??re investing into Sasseur REIT, you probably should keep an eye on how itâ??ll perform from the third year onwards.

Another point to note is that the percentage of distributable income will fall by 10% after two years.

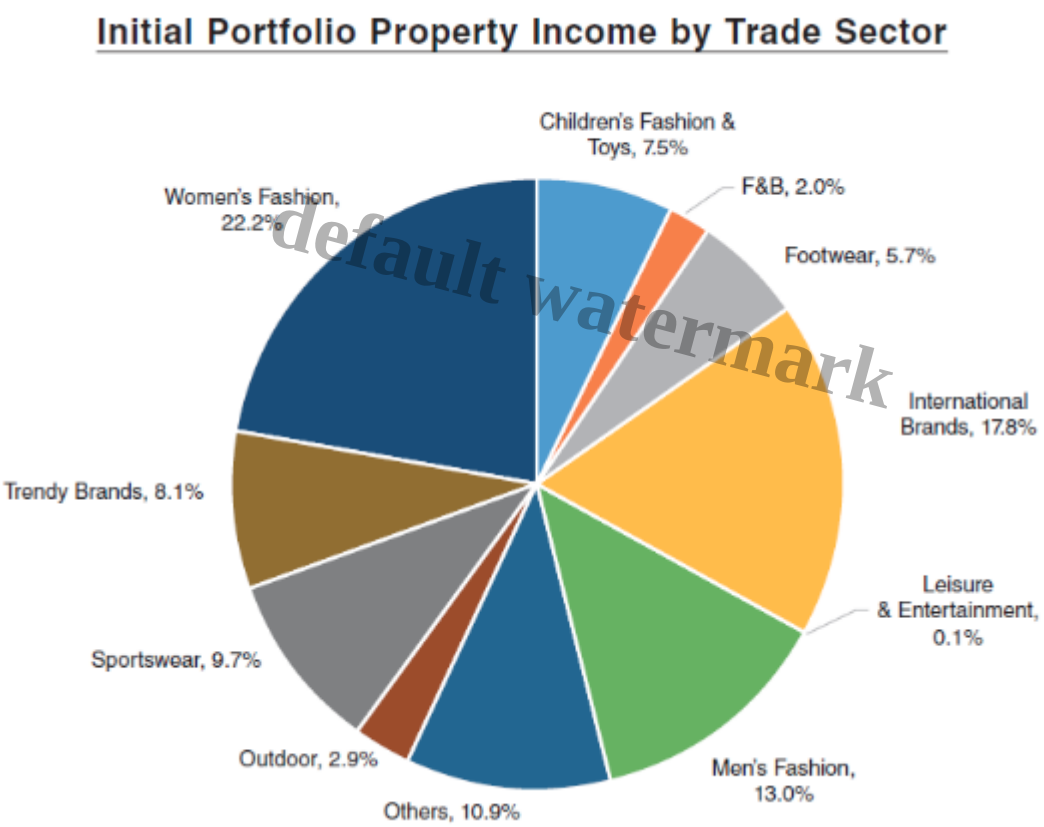
2. Extremely susceptible to economic cycles, especially recessions.

The outlet malls that Sasseur REIT owns are mainly focused on discounted luxury and high-end brand items, which makes them highly susceptible to economic cycles. In an economic boom and growing disposable income, all will be good; but in a recession where consumers tend to cut back on their discretionary spending, Sasseur REIT will surely be impacted negatively, and even more so because

their rental model is based on tenant sales turnover.

Sasseur REIT claims that â??the outlet mall industry tends to exhibit counter-cyclical characteristics and resilience during economic recessionsâ?• (page 32) but I donâ??t know how the US market consumer behaviour is supposed to be representative of how the Chinese will react in similar conditions, plus that runs contrary to what I believe so Iâ??m just going to brush this claim aside as marketing speak.

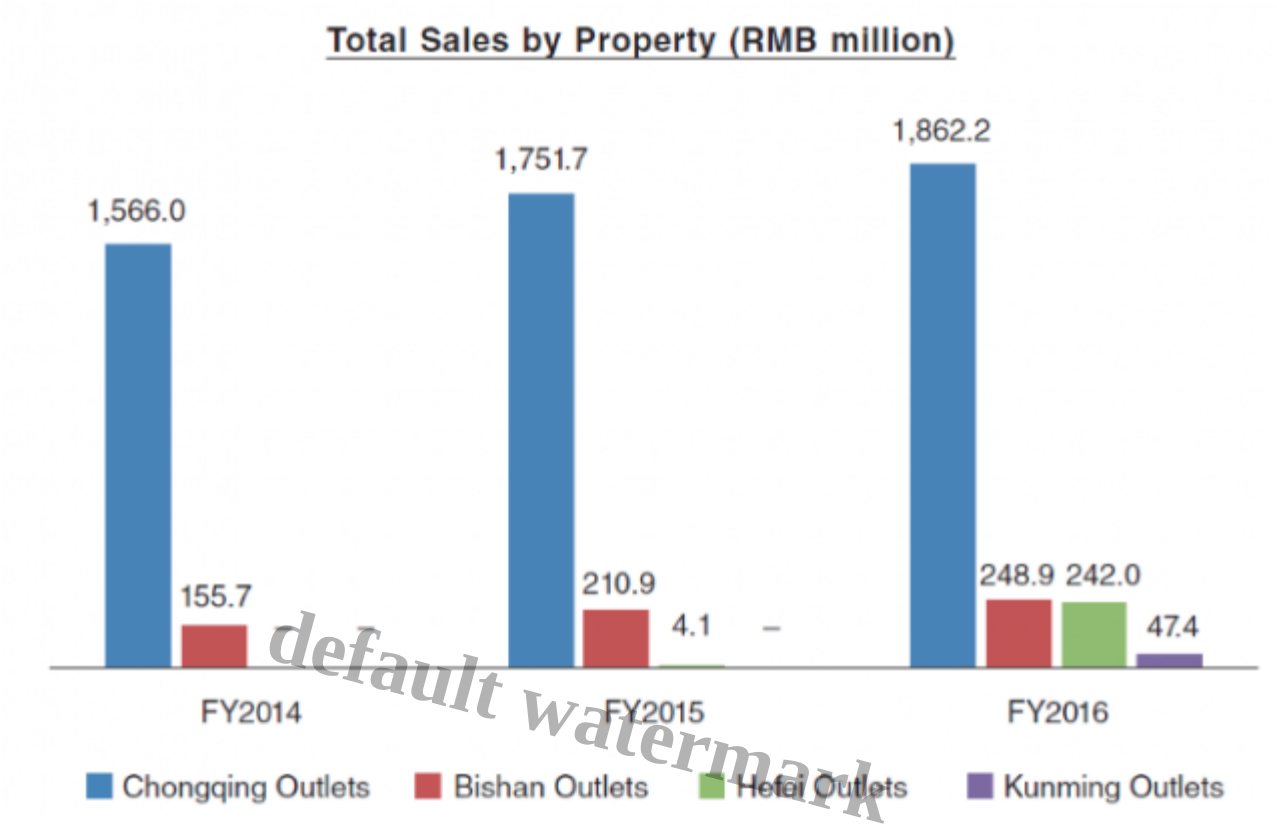
3. Heavy exposure to fashion.



Fashion accounts for almost half of Sasseur REITâ??s portfolio property income. In times of recession, weâ??ll probably see this discretionary spending on clothes and fashionable apparel be the first to go.

4. High concentration risk â?? Chongqing outlet

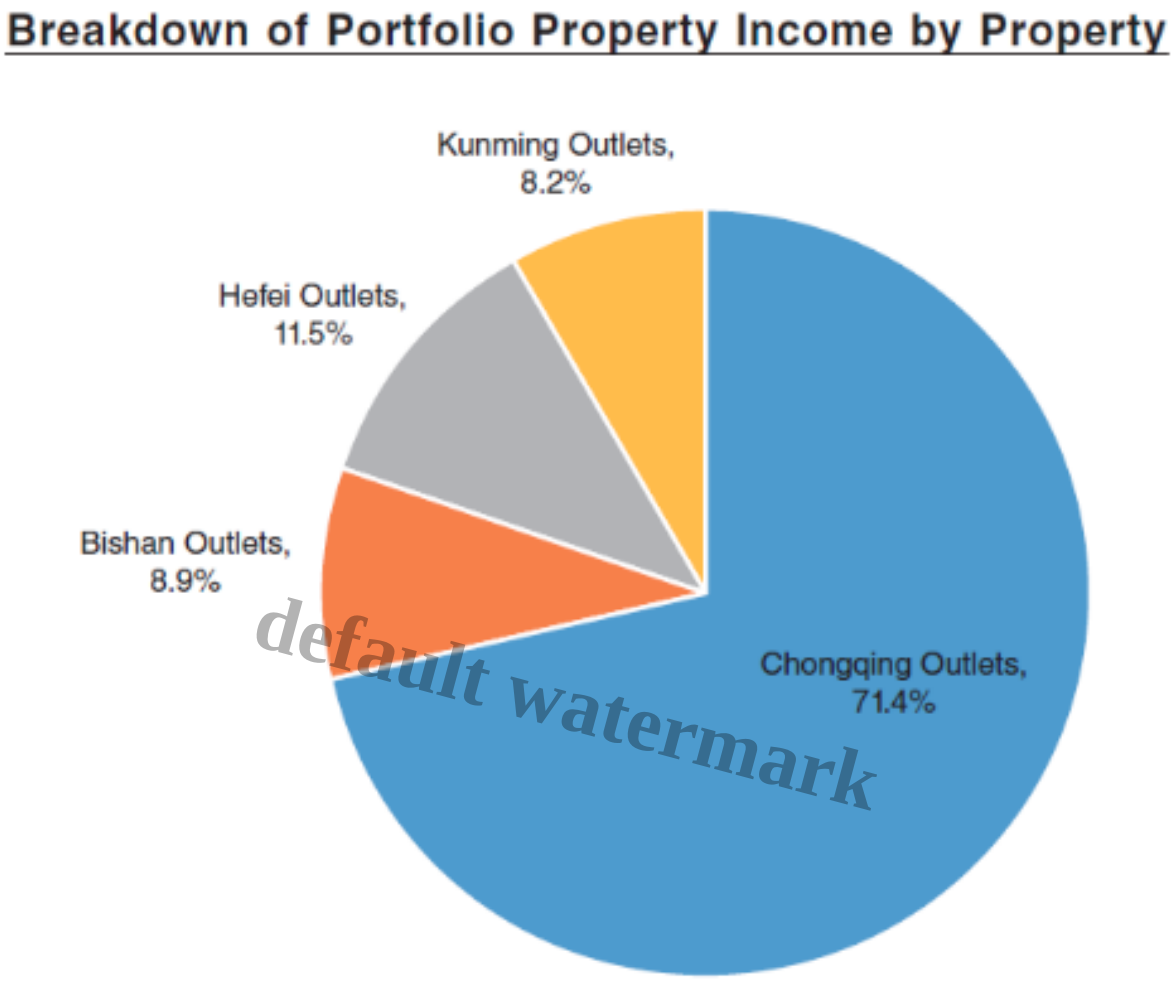
Another factor Iâ??m pretty uncomfortable with is the fact that out of its 4 outlet malls, Sasseur REIT derives a majority of its sales and revenue from its Chongqing outlet. Take a look at how the different malls compare.



default watermark

Now, thereâ??s a good explanation for this â?? the Hefei and Kunming outlets became operational only in 2016, so thereâ??s limited data for us to analyse. In contrast, Chongqing has been operating since 2008.

However, given that Chongqing outlets accounted for over 70% of its income last year, this makes me a little uneasy given the high concentration risk.



5. Whatâ??s the actual gearing ratio?

Based on its IPO prospectus (page 163), Sasseur REIT claims that its gearing ratio stands at 30.3%, which leaves them with enough room to take up more debt for acquisitions and growth if they need to.

However, Iâ??m not so certain about the accuracy of this because based on its unaudited pro forma financial statements (page 155), I arrived at a ratio of 40.8% for 30 Sept 2017 instead (630,155,000 / 1,552,002,000), and this is considered high if we compare it against the other REITs listed here.

6. Short land tenure and weighted average lease expiry (WALE)

At 30 â?? 37 years remaining on its land tenure, this seems rather short at first glance, but thereâ??s apparently a good reason (page 110) when you consider Chinaâ??s Urban Land Regulations, which stipulate that maximum term is up to 40 years for commercial, tourism and entertainment use. The Chongqing outlets are held under the land use right for commercial use, limited to 40 years, which includes the time taken for developing the land. Sasseur REIT states that it will be able to apply for renewal of this land use right at least a year in advance of its expiry.

Property	Chongqing Outlets	Bishan Outlets	Hefei Outlets	Kunming Outlets
Address	No. 1 Aotelaisi Road, Beibuxin District, Chongqing, PRC (重庆市北部新区奥特莱斯路1号)	No. 9 Baiyang Road, Bishan District, Chongqing, PRC (重庆市璧山区白羊路9号)	No. 1888 Changning Avenue, Gaoxin District, Hefei, Anhui Province, PRC (安徽省合肥高新区长宁大道1888号)	No. 181 Aotelaisi Avenue, Anning City, Kunming, Yunnan Province, PRC (云南省昆明市安宁市奥特莱斯大道181号)
Commencement of Operations	September 2008	January 2014 (Soft launch); October 2014 (Zones A and B) and February 2016 (Zone C)[4]	May 2016	December 2016
Expiry Date of Land Use Rights	11 May 2047	21 September 2051, 24 September 2051[5]	19 July 2053	16 April 2054

Another point to note is that at 3.2 years, the WALE is quite short in contrast to other REITs listed on SGX.

Property	Chongqing Outlets	Bishan Outlets	Hefei Outlets	Kunming Outlets	Total/Average
WALE by Committed NLA as at 30 September 2017 (years)	2.8	3.5	3.6	2.7	3.2
WALE by Property Income for the month of September 2017 (years)	0.9	1.8	2.1	2.5	1.2

default watermark

7. Forex risk

Lastly, as Sasseur REIT receives its income in RMB and pays out dividends in SGD, weâ??ll be exposed to forex risk in this case, as with the other REITs listed here locally which derive a majority of their income from overseas markets.

Financials

With its NAV at $0.773 per unit, the current IPO price represents a fair value to NAV (1.03 P/NAV ratio). Then again, it is hard to expect any decent REIT to price its offering at a significant discount to NAV.

Moreover, donâ??t forget that Sasseur REIT will be distributing 100% of its distributable income until 31 December 2019, with a promised yield of above 7% if all goes well for the next 2 years.

Iâ??ve also not really discussed much about its growth potential (highlighted on page 11) where Sasseur REIT has been granted a right of first refusal (ROFR) from the Sponsor, giving it the opportunity to acquire the Sponsorâ??s Xiâ??an and Guiyang outlets, which commenced operations on 30 September and 9 December last year respectively. In addition, the Sponsor also manages 3 other pipeline properties in Hangzhou, Nanjing and Zhongdong Changchun, which were not injected into Sasseur REITâ??s current portfolio since these properties are not currently owned by the Sponsor.

My suspicion is that due to

(i) the stability of dividend payouts and income support for the next 2 years,
(ii) the expected CAGR for Chinaâ??s outlet mall market and
(iii) the potential asset growth for Sasseur REIT in acquiring *(2 to 5)* more outlet malls in the near future that explains why the IPO price is valued as such.

Conclusion

Having seen firsthand on the Chinese consumersâ?? shopping and spending tendencies, Iâ??m inclined to apply for this IPO placement just to ride on this booming market, which I believe should continue to grow unless a serious economic recession hits China. However, Iâ??m wary of Sasseur REITâ??s income support model, high gearing ratio and over-reliance on Chongqing outlets.

It is also interesting to note that Sasseur REIT seems to have invested quite seriously into its marketing efforts to push out this IPO, as seen from this huge booth that they set up at Raffles Place *just to* distribute its IPO prospectusâ?¦*which you can easily find online here.*

default watermark



Nonetheless, there was a good video that shows how traffic and activities at the outlet malls look like, although the girls manning the booth couldnâ??t tell me where I could find the link so I can rewatch it back at home in detail. I was a bit disappointed as I had

thought this was a golden chance to perhaps speak with its investor relations team, or at least an insider who would be able to share more insights into the malls that Sasseur REIT owns, but the girls manning the booth couldnâ??t really answer my questions, saying that they were mainly hired to distribute the prospectus to potential retail investors in the area.

With its unique offering and demand for its IPO, I wonâ??t be surprised if its share price flies after listing. Itâ??s worth a shot, but not a big one based on the risk factors Iâ??ve identified above. Hence Iâ??ll be applying for a small tranche for now and watch this closely for further developments.

What about you?

With love,
Budget Babe

default watermark

Category

1. Investing
2. IPOs
3. Stocks
4. Uncategorized