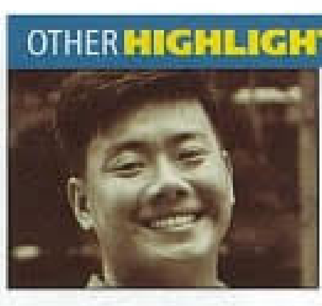

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Croesus Retail Trust's big moment

This Japanese retail property trust is breaking new ground by internalising its manager. What does that mean for investors? Will this lift its market value? Managing director Jeremy Yong explains what's happening in our Cover Story on Pages 16 to 18.

PLUS: Is this the right time for REITs?

Is this Croesus Retail Trust's big moment?

Jeremy Yong is determined to see Croesus Retail Trust garner a better market valuation. And, the strategy he is adopting to make it happen could become the model for the slew of locally listed property trusts that are not backed by a major property development group.

On June 30, unit holders of CRT passed a resolution for the trust to acquire its trustee-manager Croesus Retail Asset Management for $50 million. CRAM is 80%-owned by an entity called Croesus Partners, which is in turned 49%-owned by Yong and 51%-owned by his business partner Jim Chang. CRT will fund this largely with part of the $60 million it raised through a bond issue in April. It is also raising some $22.1 million through a preferential offering of 27.7 million new units at 79.7 cents each.

To convince investors that they remain committed to CRT, Yong and Chang will buy $16 million worth of CRT units following the completion of the internalisation. "During the course of the two-week period prior to the EGM, Jim Chang and myself made an undertaking that we would reinvest half the proceeds [from the internalisation] into the company, and that crystallises our skin in the game," Yong tells *The Edge Singapore* in a recent interview. "Our equity and future are vested in this company."

CRT is not a real estate investment trust but a business trust. However, it gave an undertaking in its listing prospectus to abide by key REIT regulations, such as keeping within the debt ceiling imposed on REITs and paying out at least 90% of its distributable income. CRT currently owns 11 suburban malls in Japan. It has ¥96.3 billion ($1.29 billion) in investment properties, and a market capitalisation of $587.9 million.

Since it was listed in 2013, however, CRT has traded at relatively higher yields than REITs that hold retail property assets. It is currently trading at a yield of 8.9%, following a recent rally. **CapitaLand Mall Trust** and **Frasers Centrepoint Trust** are trading at yields of 5.03% and 5.62% respectively. **CapitaLand Retail China Trust**, which owns Chinese suburban malls, is trading at 7.15%.

Why is CRT's yield so high? Some market watchers put it down to local investors being unfamiliar with its assets in Japan. Others suggest that it is because CRT is not backed by a major property development group. Whatever the case, any REIT or property trust that trades at high yields is at a disadvantage when it comes to raising funds and acquiring assets. Earlier this year, **Saizen REIT**, which owned residential properties in Japan, said it would divest its entire portfolio and return the cash to its unitholders. Meanwhile, the managers of **Cambridge Industrial Trust** and **IREIT Global** are up for sale.

Yong: Internalisation is the first step in unlocking value

Unlocking value

Rather than selling out and walking away, Yong is trying to make CRT stronger by injecting CRAM into it. "We believe internalisation is the first step in unlocking value," he says. According to CRT's circular to unitholders on the exercise, it pays about $9 million in fees (excluding acquisition fees) annually to CRAM. Yong explains that CRAM's operating expenditure is about 55% of that. So, CRT should see immediate cost savings of about 45% of the fees it pays, he says. According to the circular to unitholders, on a pro forma basis, CRT would see annual cost savings of ¥322 million.

Over time, the potential cost savings would grow as CRT expands. For instance, if CRT remained an externally managed trust, and its portfolio doubled in size, it would be paying CRAM $18 million a year. Yet, the cost of running the bigger portfolio is very unlikely to have doubled. "The savings would become quite significant as the portfolio grows," Yong says.

Besides the cost savings, Yong sees the internalised model leading to better governance, because the agenda and interests of management and unitholders would be more aligned. That, in turn, could lead to a bigger investor following and a higher market valuation. According to a study by Religare Research, internalised REITs in Australia and North America trade at lower yields than local externally managed REITs.

"We hope that some of the benefits in the overseas markets can be translated into Singapore," Yong says. Indeed, if the internalised model works in Singapore, then it could prompt many other independent REITs to consider this move, analysts suggest.

Yong failed to convince all of CRT's unitholders that internalising its manager was a good idea, though. During the EGM on June 30, only 66% of unitholders voted for internalisation. Yong says many unitholders accepted that an internally managed model is superior, but some took issue with the $50 million price tag for CRAM. "There was another constituent that felt the concept made sense but the deal terms could be reviewed," he says.

Attracting Japanese capital

Now, Yong is turning his attention directly to improving CRT's market value. "We're trading below book value. Our stock price has been treading water for a while and that's not acceptable. We want to close this gap. Internalisation itself is not going to do it," he says.

So what does he plan to do? Yong says he is working on plans to attract Japanese capital. "That's the next step for us. There's a lot of Japanese capital. We need to tap the lowest cost of capital to make our acquisition currency strong. The cheapest cost of capital today is Japan. We want to find ways and means to tap equity capital from Japan."

One possibility is a secondary listing of CRT in Japan. Another idea Yong has been studying is a public offer without listing, or POWL. As the term suggests, it is a form of public equity offering by non-Japanese firms in the Japanese market without a simultaneous listing on the Tokyo Exchange.

In the meantime, unitholders of CRT are likely to benefit from a stronger yen. Some 80% of CRT's rental income is in the form of fixed leases and base rent, which means it is very predictable. CRT also has a relatively long weighted average lease to expiry of 7.8 years. Expected distributions for 2HFY2016 (the trust has a June year-end) are hedged at an average rate of ¥85.01 to $1; FY2017 and FY2018 distributions are hedged at an average rate of ¥83.95 and ¥76.43 respectively. "All things being equal, DPU in Singapore dollar terms would be higher because of a superior hedge rate," Yong indicates.

CRT's DPU over the next couple of financial years could also get a lift from asset-enhancement initiatives at its Torius mall in Fukuoka City. There could also be cost savings from lower interest rates on its debt. CRT is set to refinance ¥24 billion, which accounts for 40% of its total debt. Its cost of debt in 2013 when it launched its IPO was 1.6%, but its most recent loan cost just 0.6%.

"By internalising and getting on with our strategy and growth, it will attract a lot more participation from real estate specialists and a deeper and more diverse base of investors. What we really want and what our unitholders will benefit from is a big thrust into Japan's investor base. Once we capture that, we will see cost of capital coming down, and CRT will be on its way," Yong says. ■

Croesus Retail Trust

Valuation score*	2.70
Fundamental score**	0.60
TTM PER (x)	11.75
P/NAV (x)	0.93
TTM dividend yield (%)	10.21
Market capitalisation ($ mil)	592
Shares outstanding (ex-treasury) (mil)	716.97
Beta	0.01
12-month price range ($)	0.77 to 0.94

*Valuation score — Composite measure of historical return and valuation
**Fundamental score — Composite measure of balance sheet strength and profitability
Note: A score of 3.0 is the best to have and 0 is the worst to have

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REIT/business trust manager transactions

DATE	REIT/BT	ACQUIRER	STAKE ACQUIRED (%)	PURCHASE PRICE ($ MIL)	1-YEAR FORWARD REVENUE ($ MIL)	2-YEAR FORWARD REVENUE ($ MIL)	IMPLIED VALUATION PRICE/REVENUE 1 YEAR FORWARD (TIMES)	IMPLIED VALUATION PRICE/REVENUE 2 YEARS FORWARD (TIMES)
July 7, 2008	Frasers Commercial Trust (formerly Allco Commercial REIT)	Fraser and Neave	100	75.7	11.9	14.3	6.36	5.29
Oct 28, 2008	Starhill Global REIT (formerly Macquarie MEAG Prime REIT)	YTL Corp	50	82	4.1	4.6	40.00	35.65
Nov 6, 2009	AIMS AMP Capital Industrial REIT (formerly MacarthurCook Industrial REIT)	AIMS Financial Group	50	Undisclosed	2.9	3.8	NA	NA
April 19, 2010	Starhill Global REIT	YTL Corp	50	40	4.6	4.8	17.39	16.67
Feb 2, 2016	Religare Health Trust	Fortis Healthcare	100	20.1	6.7	6.9	3.00	2.91
June 12, 2016	Croesus Retail Trust	Internalisation	100	50	10.2	10.2	4.90	4.90

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