The Straits Trading Company Ltd

Burgeoning real estate conglomerate

SINGAPORE | REAL ESTATE | COMPANY UPDATE

- Building a financial real-estate franchise with sizeable assets, backed by a track record of successful asset monetisation.
- Multiple assets are available to unlock further value in the company.
- Trading at a 50% discount to RNAV of S$4.40. Dividend yield of 3% supported by S$25mn recurrent income.

Company Background

The Straits Trading Company (STC) has a history dating back to 1887 when it started out as a tin smelter. In the 1960s, it began developing and constructing multiple prestigious property projects around Singapore. 2008 was a major turning point when privately held investment group, Tecity, acquired a controlling stake in the company. This began STC's journey of transformation from a mere passive owner of low-yielding assets into an active financial investor and developer of real estate.

STC had since successfully divested S$1bn of non-core assets, refocusing on its resource business and restructured its hospitality operations. It now has three core businesses:

a. **Real estate:** Straits Real Estate (89.5%), ARA Asset Management (21%) and Suntec REIT (9.8% deemed);
b. **Hospitality:** Far East Hospitality Holdings (30%);
c. **Resources:** 54.8% stake of Bursa-listed Malaysia Smelting Corp (MSC), the third-largest tin smelter in the world.

Outlook

1. **Laying the foundation for a real estate franchise.** STC is building a financial real-estate franchise through its in-house arm, Straits Trading Real Estate (SRE). In a span of four years, SRE has monetised capital in Australia and Japan and tripled its assets under management (AUM). Its competitive strength is its nimbleness in investing in multiple forms, from direct investments to private equity real estate funds. SRE sold an Australian prime office building at an IRR of almost 25% in 2017. In 2018, it divested a Japan office fund after disposing seven office assets at an IRR of 19%. AUM grew at a 36% CAGR over the past four years. Its target is to add S$1bn in AUM within the next four years (Figure 8).
2. **Several assets to be unlocked.** Assets for potential value-unlocking include 1) S$316mn of non-core properties, including eight good-class bungalows and several townhouses in Singapore; 2) a 21% associate stake in ARA now carried at S$353mn on its books. If ARA were to be re-listed on the SGX, STC's 21% stake could be worth S$673mn. ARA plans to grow gross assets by another S$20bn in the next three years (Figure 7); and 3) the redevelopment of a 40.1-acre mixed-development project in Penang with a GDV of c.RM3bn (S$1bn).
3. **Tin to benefit the most from new technologies among metals.** In a study by Massachusetts Institute of Technology commissioned by Rio Tinto in 2018 (Figure 15), tin is expected to be the most sought-after metal by evolving technologies. Demand will come from new technologies incorporated in autonomous and electric vehicles, advanced robotics, renewable energy and advanced computing & IT. MSC is well placed to take advantage with their new plant in Klang that will raise output capacity by 50%.
4. **Attractive valuations and yield** STC trades at a 50% discount to its RNAV of S$4.40 (Figure 18). Since 2008, it has tripled its dividends. Current yield of c.3% (or S$25mn) is supported by recurring income of S$25mn from rentals, dividends and associate income.

11 June 2019

NON-RATED

LAST DONE PRICE SGD 2.18

COMPANY DATA

BLOOMBERG CODE:	STRTR SP Equity
O/S SHARES (MN) :	408
MARKET CAP (USD mn / SGD mn) :	641/ 880
52 - WK HI/LO (SGD) :	2.32 / 196
3M Average Daily T/O (mn) :	0.09

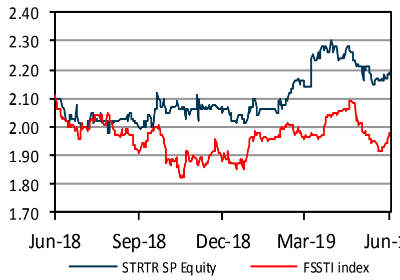
MAJOR SHAREHOLDERS

CAIRNS PTE LTD	70.1%
FRANKLIN RESOURCES INC	6.3%

PRICE PERFORMANCE (%)

	1MTH	3MTH	1YR
COMPANY	4.8	7.5	18.6
STI RETURN	(4.3)	(14)	(5.9)

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY15	FY16	FY17	FY18
Gross Rev, SGD mn	540	513	474	456
PAT, SGD mn	7	79	52	83
NAV, SGD per share	3.2	3.3	3.6	3.6
P/NAV (x)	0.7	0.7	0.6	0.6
Gearing	40%	42%	49%	54%
ROA	0.4%	3.6%	2.1%	3.2%
ROE	0.5%	5.4%	3.3%	5.2%

Source: Company, PSR

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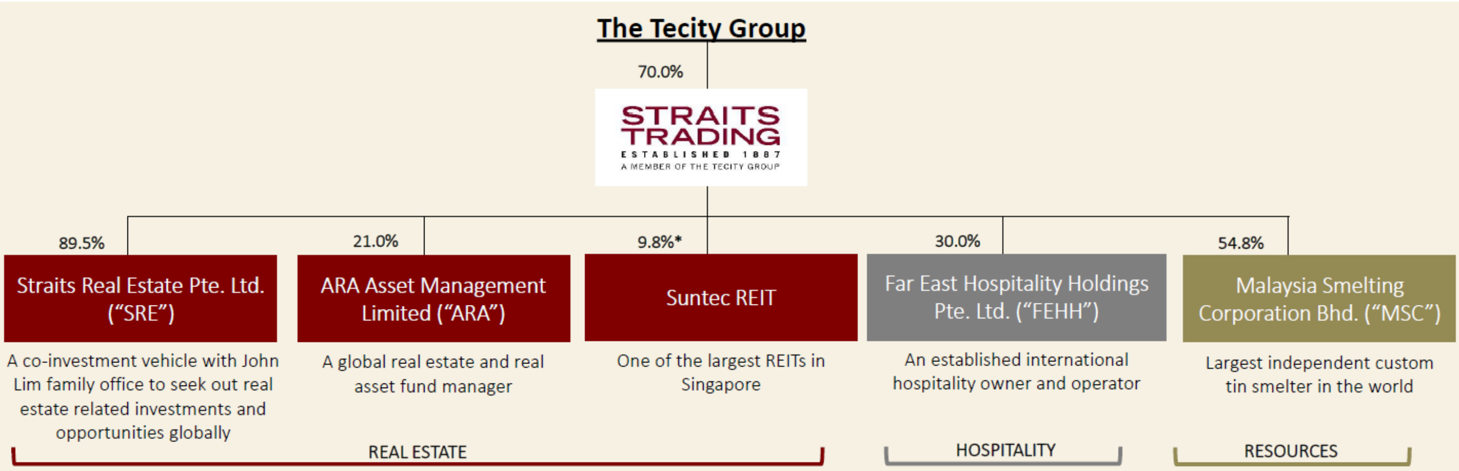
BACKGROUND

The Straits Trading Company has a history dating back to 1887 when it started out a tin smelter. Straits Trading formed its property division in 1960. It developed and constructed many prestigious projects around Singapore, including the first iconic 21-storey Straits Trading Building (1972), Great Eastern Centre and China Square Central (2002), and good class bungalows at Cable Road and Nathan Road (2006). 2008 was a major turning point when privately held investment group, Tecity, acquired a controlling stake in the company. This began STC's journey of transformation from a mere passive owner of low-yielding assets into an active financial investor and developer of real estate.

Figure 1: STC's three core pillars are real estate, hospitality and resources



Source: Company. * Aggregate interest in Suntec REIT held by STC Group of companies

REAL ESTATE

1. Straits Real Estate (89.5%): This is STC's in-house real estate investment business. The remaining 10.5% is owned by the John Lim Family Office. The objective of SRE is to build a geographically diversified portfolio of property assets that will generate attractive recurrent earnings or returns and capital upside. It may invest directly in real estate or via real estate funds. SRE's modus operandi is to invest in projects with value-add opportunity and manage them to drive capital upside. Operating since 2014, SRE has been building its scale and track record. Assets under management have grown at a 36% CAGR from S$358mn in 2014 to S$1.4bn in 2018 (Figure 8). 114 William Street (Melbourne) is an example of a property that SRE invested in and enhanced, eventually increasing its occupancy and WALE, repositioning it as an institutional-grade asset for sale. SRE later successfully monetised it for a profit of A$21.7, at an IRR of 25%. Another successful investment was the divestment of the Greater Tokyo Office Fund, with its four office buildings, for an IRR of 19%. The direct real estate portfolio of SRE is now spread across three key geographies – namely, Australia, Japan and China. There are also three property funds under SRE that invest in Japan, Malaysia and Australia.

Figure 2: 320 Pitt Street, Sydney

Source: Company

Figure 3: SRE portfolio of direct investments and funds

Name	Type	Location	S$ mn	Occupancy	Acquired	NLA (sqm)	Comment
Australia							
320 Pitt Street (Figure 2)	Office	Sydney	252.0	100%	Jun-17	29,159	32 storey Grade B ofice in Sydney CBD
45 St. Georges (Figure 4)	Office	Perth	55.9	> 90%	Feb-18	10,010	Located in Perth CBD
5 Logistics assets*	Logistics	Adelaide	106.6	90%	Sep-18	93,000	WALE > 9 years
Japan							
10 properties (Figure 6)	Residential	Osaka, Tokyo	268.2	95%	2016	1016 units	More than doubled in two years
China							
My Place Mall (Figure 5)	Retail	Chongqing	161.8	95%	Dec-16	35,000	Target middle income in NanÁn District
Funds							
Japan Value Fund II		Japan	92.3	n.a.	Jun-18		Assets include office and residential.
ARA Summit Development		SE Asia/Aust.	46.0	n.a.			Exited a Melbourne office,14.4% IRR
ARA Harmony Fund III		Malaysia	70.2	> 90%			5 malls in Malaysia

Source: Company *SRE ha 80% stake in five assets. Tenants include Coca-Cola Amatil, Incitec Pivot Centre and Siemens

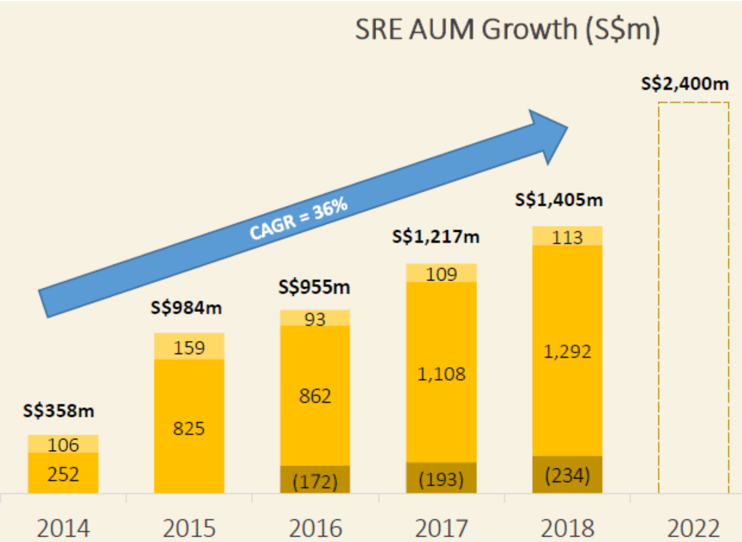
Private Equity Funds

ARA Harmony Fund III (40%): owns a portfolio of five commercial properties in Malaysia. The income-generating properties include Ipoh Parade Mall in Perak, Klang Parade Mall and Citta Mall in Selangor, 1 Mont Kiara Retail Mall and Office Tower in Kuala Lumpur, and AEON Bandaraya in Malacca.

Japan Value Fund II (40.82%): the objective is to acquire assets in the Greater Tokyo area and other cities in Japan. The fund is managed by Savills Investment Management.

ARA Summit Development Fund (89%) (substantially exited in end 2018): co-invest with developers in projects in South East Asia and Australia. The fund may invest as an equity partner to share a project's development risk and returns, or participate in a project as a mezzanine loan lender for lower risk.

Figure 8: SRE's target is to expand AUM by another S$1bn within 4 years



Source: Company

2. ARA Asset Management (20.95%): In October 2013, STC acquired a 20% stake in ARA from Cheung Kong for S$294.4mn. Established in 2002, ARA is one of the largest real estate fund managers in the region with assets under management of S$80bn. ARA was established in 2002 and listed on the SGX in 2007. In November 2016, together with a consortium that included STC, ARA was privatised for S$1.8bn (of 5% equity value to AUM).

Gross assets managed by the ARA Group is currently c.S$80.1bn across over 100 cities in 23 countries. ARA plans to grow gross assets by another S$20bn in the next three years (Figure 7). ARA is focused on the management of REITs, private real estate funds, infrastructure funds and operates country desks in China, Korea, Japan, Malaysia, Australia, Europe and the United States. ARA manages 20 REITs, six of which are listed – these are Fortune REIT, Suntec REIT, Cache Logistics Trust, Prosperity REIT, Hui Xuan REIT and ARA US Hospitality Trust.

3. Suntec REIT (9.8%): STC first acquired a stake in Suntec REIT in 2014. Suntec owns seven assets, four of which are in Singapore, one in Sydney and two in Melbourne. Assets under management is S$9.9bn. STC's stake in SGX-listed Suntec REIT is recorded as investment securities. STC recognises dividend income from this REIT.

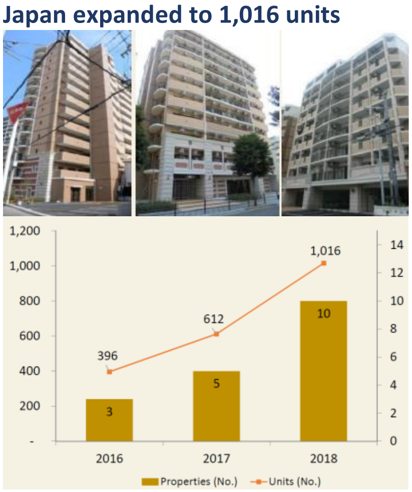
4. Singapore and Malaysia properties available for sale (100%): A S$317mn portfolio of legacy investment properties in Singapore and Malaysia is available to be monetised and for capital to be redeployed towards. These include (i) apartments/ townhouses in Gallop Green development; (ii) good class bungalows in Cable and Nathan road; (iii) several parcels of land and shophouses in Malaysia.

Figure 4: 45 St Georges Terrace, Perth

Figure 5: My Place Mall, Chongqing

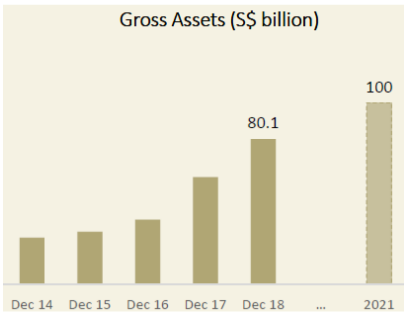
Source: Company, PSR

Figure 6: Residential properties in Japan expanded to 1,016 units



Source: Company

Figure 7: To hit S$100bn AUM by 2021



Source: Company

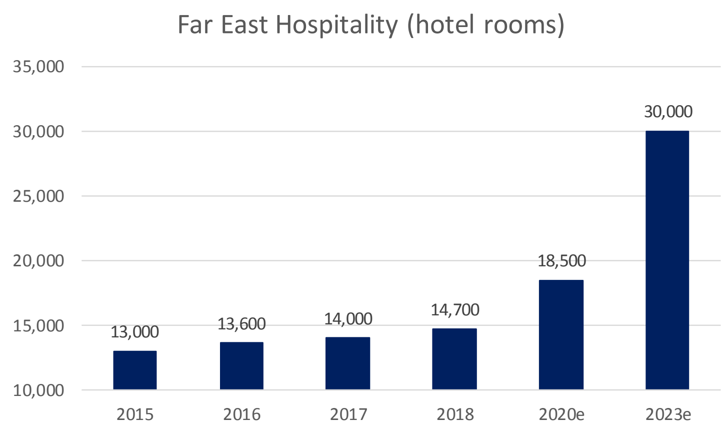
HOSPITALITY

Far East Hospitality Holdings (FEHH) (30%): In November 2013, STC formed a 30:70 joint venture, FEHH, with SGX-listed Far East Orchard. STC injected three hotel properties and 13 management contracts into this joint venture. FEHH currently owns and operates a combined portfolio of 94 properties with over 14,700 rooms across seven countries and 25 cities. FEHH also operates nine hotel brands such as Rendezvous, Oasia, Quincy, Village, Far East Collection, Adina Apartment Hotels and Adina Serviced Apartments, Vibe Hotels, Travelodge Hotels and TFE Hotels Collection. Targets to double the rooms under management from 14,700 to 30,000 in 2023.

Figure 11: The nine brands under Far East Hospitality Holdings

Source: Company

Figure 9: Far East room count target is to double in five years



Source: Company, PSR

Figure 12: The newly opened 606 room Village hotel at Sentosa

Source: Company

RESOURCES

Malaysia Smelting Corporation (MSC) (54.8%): MSC is the largest tin mining company in Malaysia and the third largest globally, in terms of output (Figure 10). The company is listed on both Bursa Malaysia and SGX.

MSC's end-product is refined tin bars. It has a tin mine in Perak - Rahman Hydraulic - with an annual production of around 2,300MT per annum. It is considered the largest operating open-pit hard rock tin mine in Malaysia (Figure 14). Tin ore extracted from this mine is processed into tin-in-concentrates which are then converted into refined tin metal products at the smelter in Butterworth, Penang. The mine meets 10% of MSC requirements, with the remaining raw materials sourced locally or overseas.

Figure 13: Types of demand for tin (2018)

Types of demand	k MT	% of total
Solders	174.9	47%
Chemicals	66.9	18%
Tinplate	48.4	13%
Lead-acid batteries	33.5	9%
Copper alloys	18.7	5%
Others	29.8	8%
	372.2	

Source: ITA, PT Timah, PSR

Figure 10: Top 5 largest tin producers in the world

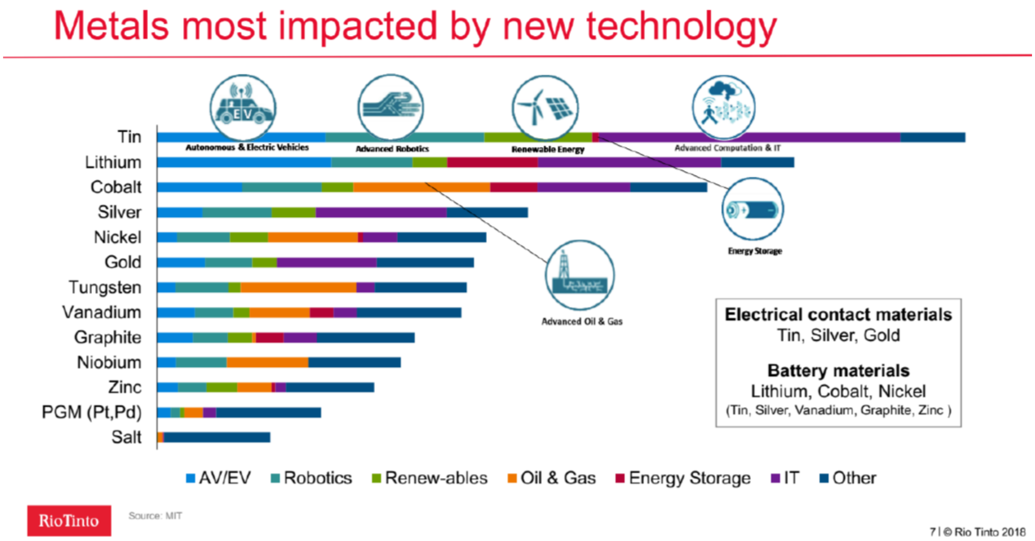
000 MT	Country	2014	2015	2016	2017	2018
Yunnan Tin	China	75.9	75.5	76.0	74.5	77.8
PT Timah	Indonesia	27.6	27.4	23.8	30.2	33.4
MSC	Malaysia	35.0	30.2	26.8	27.2	27.1
Yunnan Chengfeng	China	22.9	16.6	20.1	26.8	22.9
Minsur	Peru	24.2	20.2	19.6	18.0	18.3

Source: International Tin Association, PT Timah, PSR

Figure 14: Rahman Hydraulic operates largest open pit tin min in Malaysia

Source: Company

Figure 15: Tin would be the most positively impacted metal by new technologies

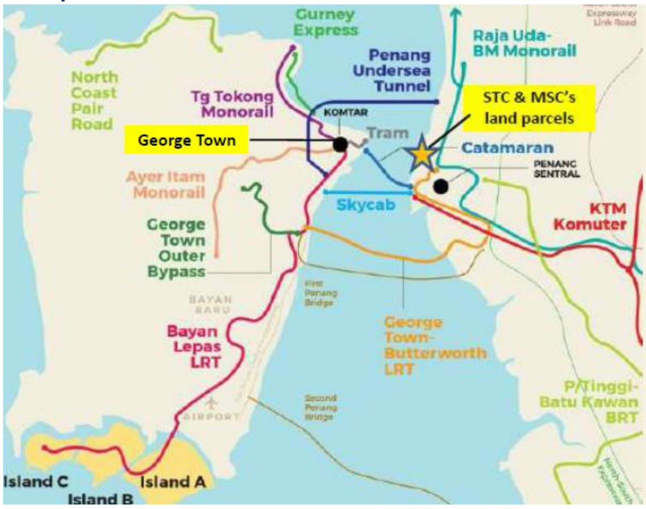


Source: Rio Tinto

MSC will be relocating from its current plant in Butterworth (operational since 1902) to a new smelter in Pulau Indah, Port Klang. The new facility will be using a more efficient smelting process - Top Submerged Lance furnace. The new plant will boost maximum production capacity by 50% or up to 60,000 tonnes p.a.

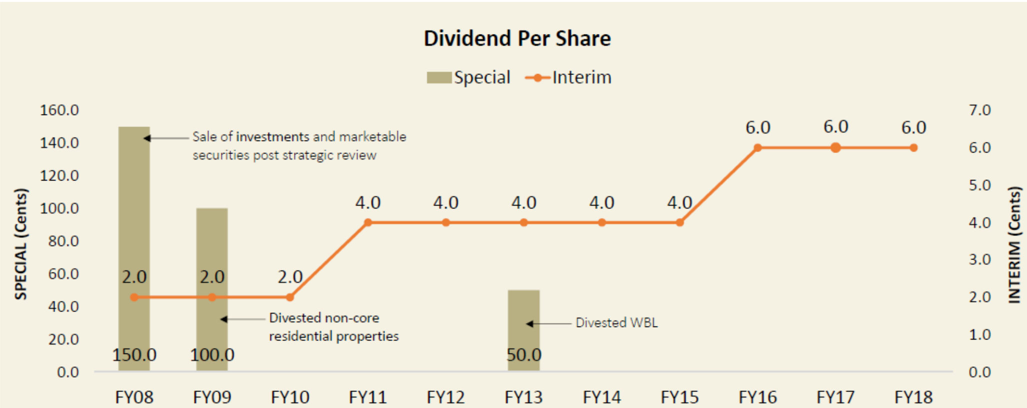
In view of the relocation, MSC and STC signed a Memorandum of Understanding (MOU) to jointly redevelop a 40.1 acre land site comprising the current factory land (13.9 acres) and adjacent land (26.2 acres) into a integrated waterfront development. The site is freehold and is near the new Penang Sentral, which will be the new transport hub of Penang (Figure 16).

Figure 16: The upcoming mixed-development (~RM3bn GDV) is near the new Penang Sentral transport hub



Source: Company

Figure 17: Dividend per share has tripled since 2008



Source: Company

RNAV

Our RNAV of STC is S$4.40 (Figure 18).

(i) Investment properties and private equity real estate are valued as at end FY18.

(ii) We added an incremental ARA market valuation to the FY18 book value. We valued ARA's equity valuation at 4% equity value* to the S$80bn AUM, or 18.2x PE. This gives us a S$3.2bn equity value for ARA, with STC's 21% stake being S$673mn.

(iii) We adjusted MSC's valuation upwards marginally to match its latest market value.

(iv) We excluded the potential development gains from the RM3bn Penang project, as it is several years away and we have insufficient information to reasonably forecast the development gains.

(v) We also excluded potential upside from divesting STC's legacy S$317mn investment properties.

Figure 18: STC RNAV Estimates

RNAV Table	S$mn	S$ per share
Book value FY18	1,467	3.60
Add:		
- Incremental ARA value	320	0.78
- Incremental MSC value (listed)	5	0.01
RNAV	1,792	4.40
Outstanding shares (mn)	407.6	

Source: Company, PSR

Figure 19: FY18 recurrent income of around S$25mn from the real estate

	S$mn
Operating profit - real estate #	14.7
- rental	*27.3*
- dividend	*12.8*
- interest income(cash-flow)	*14.6*
Associates	25.4
Less: Interest expense	(15.5)
Less:Taxes	(12.7)
	24.6
FY18 dividends	(24.5)

Source: Company, PSR

#Excludes income from resources business where net profit was S$6.7mn. Our estimate of real estate operating profit is S$46mn less implied fair value gain within interest income of S$31.3mn.

**Based on data provided in 22Mar19 Circular on Capitaland acquisition of Ascendas and Singbridge. Some of the equity to AUM valuations used were Blackstone 4.8% and Cohen and Steers 3.2%. Incidentally, ARA was privatised at 5% equity to AUM or PE of 17.9x.*

APPENDIX 1: Understanding the financials

Revenue

STC has multiple sources of revenue and income.

1. Revenue is derived from MSC tin mining operations (94% in FY18) and real estate rental income (6% in FY18). Rental income is from the real estate owned directly under SRE or STC. These include 45 St. Georges, the five logistics assets in Australia, Chongqing mall, the ten properties in Japan and the portfolio of good class bungalows, apartments, townhouses and shop lots in Singapore and Malaysia.

2. Other income is another large part of group earnings, which includes:
(i) Dividend income: Sourced from the 9.8% stake in Suntec REIT.
(ii) Interest income: Earned from A$119.2mn (S$125mn) shareholder note issued by 320P Trust. The trust holds 320 Pitt Street real estate.
(iii) Fair value changes in investment properties
(iv) Other income

3. Associate income: The associate income for STC is from ARA and FEH (Figure 20).

Figure 20: PBT break-down (2018)

Division	S$ mn	% Total
SRE	63.1	63%
ARA	24.2	24%
Tin	16.3	16%
Far East	0.6	1%
Others	(4.5)	-5%
	99.6	

Source: Company, PSR

Cost

Biggest component of operating cost relates to the tin mining operations. Excluding mining cost, the largest expense are employee and finance costs (Figure 21).

Figure 21: Expense breakdown (2018)

Types of expense	S$mn	% of total
Employee expense	29.7	6%
Depreciation	5.95	1%
Cost of mining	379.8	76%
Finance cost	27.17	5%
Other expenses	38.5	8%
- exchange loss	*10.5*	*2%*
- admin expenses	*10.6*	*2%*
Income tax	16.97	3%
	498.1	

Source: Company, PSR

Balance Sheet

Assets: Around one-third of STC's assets are investment properties. The largest investment properties are the Singapore bungalows and apartments, and the 10 Japan residential apartment blocks, followed by the associates - the single largest asset being the 21% stake in ARA (Figure 22).

Figure 22: Break-down of total assets

Asset type	S$mn	% of total
Associates	617.7	24%
- ARA	*353.3*	*14%*
- FEHH (include $71.9mn loan)	*113.3*	*4%*
- Greater Tokyo Office Fund	*38.0*	*1%*
- ARA Harmony Fund III	*74.1*	*3%*
- Japan Value Fund 2	*38.9*	*2%*
Other associates	8.8	0%
Joint Venture - 320P Note	144.6	6%
Investment properties	910.4	35%
- Chongqing mall	*161.8*	*6%*
- 45 St Georges Terrace	*58.8*	*2%*
- Adelaide logistics portfolio	*106.6*	*4%*
- 10 Japan residential	*275.0*	*11%*
- Singapore bungalow/apartments	*272.2*	*11%*
- Malaysia properties	*44.4*	*2%*
Investment securities	249.1	10%
- Suntec REIT	*142.8*	*6%*
- Other quoted equities	*41.1*	*2%*
Cash	244.9	10%
Inventories	162.7	6%
Plant property and equipment	38.3	1%
Land under development (Butterworth)	62.9	2%
Others	137.0	5%
TOTAL ASSETS	2,576.3	

Source: Company, PSR

Liabilities: STC's gross debt is around S$864.5mn. Bulk of the debt is secured bank loans. The interest rates are 0.5% to 5.2% for floating rate debt and 3.7% for fixed rate notes.

Figure 23: Bulk of the liabilities are secured bank loans (as at FY18)

Liabilities	S$mn	% of total
Borrowings	864.5	88%
- secured bank loans	*618.4*	*63%*
- unsecured bank loans	*96.4*	*10%*
- unsecured notes	*149.6*	*15%*
Trade & other payables	75.3	8%
Others	38.0	4%
	977.7	

Source: Company, PSR

Financials

Income Statement

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17	FY18
Gross Revenue	**765**	**540**	**513**	**474**	**456**
Dividend and interest income	14	36	37	32	59
FV changes	(5)	(20)	6	17	29
Other income	36	(4)	28	1	11
Total revenue + other income/(loss)	**809**	**551**	**585**	**524**	**555**
Costs of tin mining and smelting	(687)	(481)	(447)	(423)	(380)
Employee benefits expense	(30)	(27)	(31)	(31)	(30)
Finance costs	(30)	(16)	(19)	(23)	(27)
Other expenses	(45)	(45)	(37)	(27)	(44)
Share of results of equity-accounted associates and joint ventures	15	28	45	38	26
PBT	**33**	**11**	**95**	**57**	**100**
Income tax (expense)/credit	(9)	(3)	(16)	(6)	(17)
PAT	**24**	**7**	**79**	**52**	**83**

Per share data

Y/E Dec, SGD	FY14	FY15	FY16	FY17	FY18
NAV	3.32	3.18	3.34	3.62	3.60
DPS (Cents)	4.00	4.00	6.00	6.00	6.00

Cash Flow

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17	FY18
CFO					
Net Income, adj.	25	11	95	57	100
Adjustments	4	(6)	(93)	(59)	(82)
WC changes	(81)	(107)	17	(16)	(9)
Income taxes paid	(16)	(6)	(8)	(12)	(11)
Net finance costs	(23)	9	(2)	(5)	(1)
Cashflow from operating activities	**(91)**	**(98)**	**9**	**(34)**	**(4)**
CFI					
Proceeds from disposal of PPE/inv ppty	459	43	175	25	16
Proceeds from redemption of a debt instrument	-	-	-	36	19
Proceeds from disposal of investment securities	47	-	-	-	40
Capex on PPE	(7)	(5)	(19)	(4)	(7)
Capex on inv properties	(4)	(198)	(115)	(25)	(332)
Investment in an associate and a joint venture	-	(115)	(56)	(151)	(41)
Purchase of investment securities	(181)	(39)	(31)	(39)	-
Return of capital on associates	1	-	-	65	54
Dividend income	28	20	23	20	36
Others	(88)	53	0	78	5
Cashflow from investing activities	**256**	**(241)**	**(22)**	**5**	**(208)**
CFF					
Dividends paid	(16)	(16)	(16)	(24)	(24)
Share issuance	5	30	13	2	19
Drawdown/(repayment) of short-term borrowings	52	18	35	(33)	(53)
Drawdown/(repayment) of long-term borrowings	(13)	83	35	25	166
Finance costs paid	-	-	-	(9)	
Others	18	153	(2)	38	152
Cashflow from financing activities	**46**	**99**	**66**	**101**	**94**
Net change in cash	**211**	**(240)**	**52**	**72**	**(118)**
CCE, end*	**485**	**239**	**291**	**362**	**245**

Balance Sheet

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17	FY18
ASSETS					
PPE	36	34	53	56	38
Investment properties	400	606	554	587	910
Land under development	-	-	-	-	63
Associates and JV	428	559	639	789	774
Investment securities	202	202	256	264	200
Others	107	29	30	35	35
Non Current Assets	**1,174**	**1,429**	**1,532**	**1,731**	**2,021**
Inventories	96.1	88.8	119.6	154.9	162.7
Trade and other receivables	113.8	92.1	111.6	78.6	83.0
Investment securities	78.7	178.3	112.5	76.9	48.8
Cash and short-term deposits	480	239	291	362	245
Others	50	58	38	29	16
Current Assets	**819**	**656**	**672**	**702**	**555**
Total Assets	**1,992**	**2,085**	**2,205**	**2,434**	**2,576**
LIABILITIES					
Borrowings, non-current	243	374	186	553	617
Others	10	12	16	16	30
Non-Current Liabilities	**254**	**386**	**202**	**569**	**647**
Trade and other payables	77	123	92	70	75
Borrowings, current	223	178	434	216	247
Others	32	29	18	8	8
Current Liabilities	**332**	**329**	**544**	**294**	**331**
Total Liabilities	**586**	**715**	**746**	**863**	**978**
EQUITY					
Shareholder Equity	**1,406**	**1,370**	**1,459**	**1,571**	**1,599**

Valuation Ratios

Y/E Dec	FY14	FY15	FY16	FY17	FY18
P/NAV (x)	0.66	0.69	0.65	0.60	0.61
Distribution yield	1.8%	1.8%	2.8%	2.8%	2.8%
Growth & Margins	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**
Growth					
Revenue	-	-29.4%	-4.9%	-7.8%	-3.7%
PBT	-	-67.1%	772.9%	-39.5%	73.4%
NAV per share	-	-4.2%	5.0%	8.4%	-0.6%
Margins					
PBT margin	4.3%	2.0%	18.5%	12.1%	21.9%
PAT margin	3.1%	1.4%	15.3%	10.9%	18.1%
Key Ratios					
Gearing	33.2%	40.3%	42.5%	48.9%	54.1%
ROA	1.2%	0.4%	3.6%	2.1%	3.2%
ROE	1.7%	0.5%	5.4%	3.3%	5.2%

Source: Company, Phillip Securities Research (Singapore) Estimates
*CCE for FY14 includes disposal group classified as held for sale

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