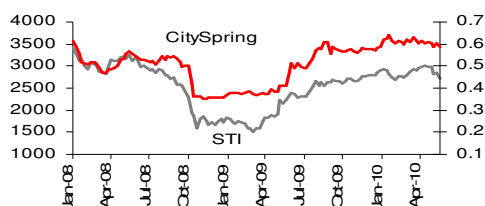


25 May 2010

Downgrade to

**HOLD**

Previous Rating: BUY

**Current Price: S\$0.595**
**Fair Value: S\$0.60**


Reuters Code	CITY.SI
ISIN Code	A7RU
Bloomberg Code	CITY SP
Issued Capital (m)	980
Mkt Cap (S\$m/US\$m)	583 / 414
Major Shareholders	
Temasek Hldgs	27.8%
Free Float (%)	72%
Daily Vol 3-mth ('000)	858
52 Wk Range	0.433 - 0.642

(\$ m)	FY09	FY10	FY11F	FY12F
Revenue	398.7	388.1	384.5	386.6
Cash Earnings	60.9	57.9	58.9	62.1
P/NAV <sup>a</sup> (x)	1.0	1.2	1.3	1.6
P/CEPU (x)	4.8	10.1	9.9	9.4
Div Yield (%)	11.8	8.2	7.1	7.1

*Note<sup>a</sup>: Equity before hedging and translation reserves (to strip out extreme volatility).*

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## CitySpring Infrastructure

### Exposed to regulatory risk.

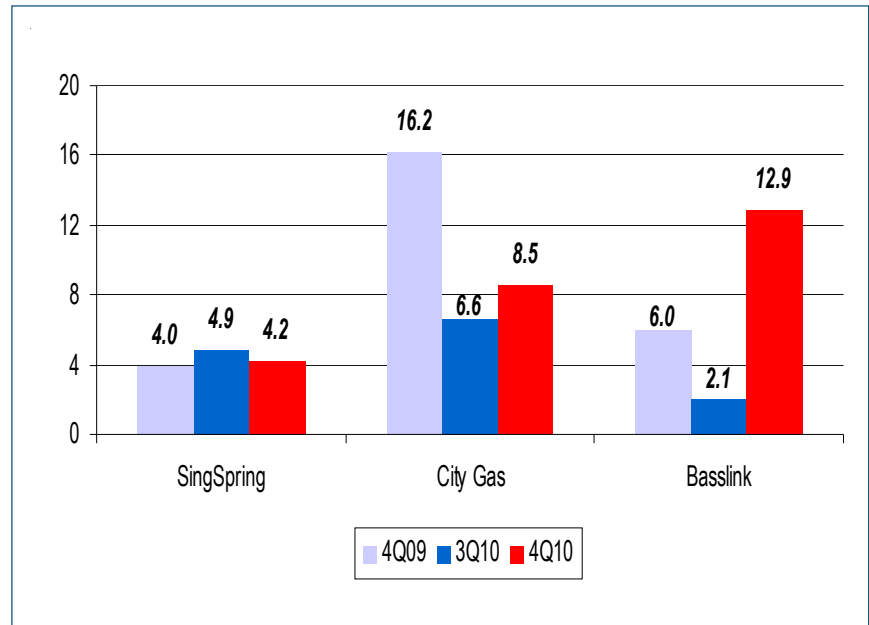
**4Q10 outperforms on Basslink.** CitySpring Infrastructure Trust (CitySpring) posted S\$118m in 4Q10 revenue, up 21.3% YoY and 23.9% QoQ. Cash earnings also rose 7.4% YoY and 115% QoQ to S\$23.4m. This was 16.5% above our estimate, despite continuing poor performance by City Gas due to the timing mismatch between City Gas' tariff revenue and fuel costs; cash earnings at City Gas fell 47% YoY but increased 28.7% QoQ to S\$8.5m. Basslink was the key contributor that lifted 4Q10 results due to positive Commercial Risk Sharing Mechanism (CRSM) payments and contributions from its telecoms services business. The trust will distribute 1.05 S cents per unit to unitholders for 4Q10, flat QoQ but down 40% YoY on the enlarged unit base post-rights issue.

**Exposed to regulatory risk.** While the inherent nature of the three businesses owned by the trust is fairly stable, we believe CitySpring is exposed to regulatory risk on two fronts. The lesser of the two risks stems from the ongoing<sup>1</sup> discussions with Australia's Hydro Tasmania (owned by the State of Tasmania), which is demanding an additional A\$6.9m in CRSM payments from Basslink for CY2009. While the amount is relatively small, if Hydro Tasmania's interpretation of the agreement has merit, it could have negative implications for future CRSM calculations. The greater of the two risks is on the talks with regulator Energy Market Authority (EMA) regarding the conversion, and ensuing liberalization, of the City Gas town gas network. The key negotiation uncertainties are: 1) grant of franchise monopoly status during the conversion period; 2) recovery of costs incurred in the conversion project; 3) the magnitude of any return on capital allowed through a levy determined by the EMA; and 4) the regulatory climate post-conversion and post-liberalization. We expect both these issues to play out over the next 12 months, creating (in our opinion) a significant overhang on the unit price.

**A more cautious valuation.** The manager said it is targeting for a DPU of 4.20 S cents or 1.05 S cents per quarter (unchanged from current level) for FY11. This is equivalent to a yield of 7.06% on yesterday's closing price of S\$0.595. Our DDM-derived valuation of CitySpring is now utilizing a higher discount rate of 7.2%, up from 6.4% previously. We believe investors should demand a higher risk premium, both on broader market uncertainties and the regulatory risks discussed earlier. Downgrade to **HOLD** with a revised fair value of S\$0.60 [prev: S\$0.68], or an estimated total return of 7.9%.

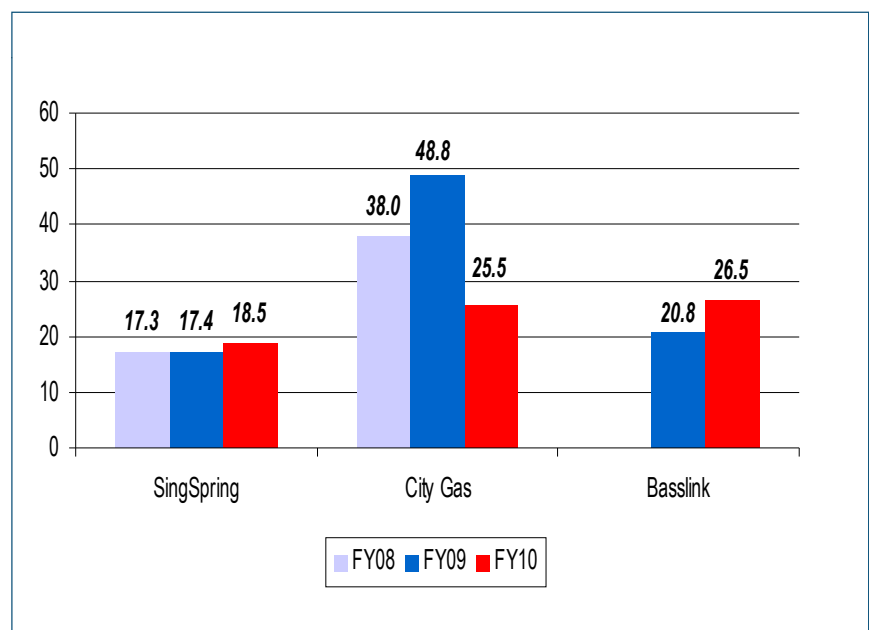
<sup>1</sup> Talks have dragged on since at least Feb 2010

**Exhibit 1: Quarterly revenue performance by business (\$m)**



Source: OIR estimates, CitySpring

**Exhibit 2: Yearly revenue performance by business (\$m)**



Note: FY08 is about 14 months long, reflecting the trust's Feb 2007 IPO

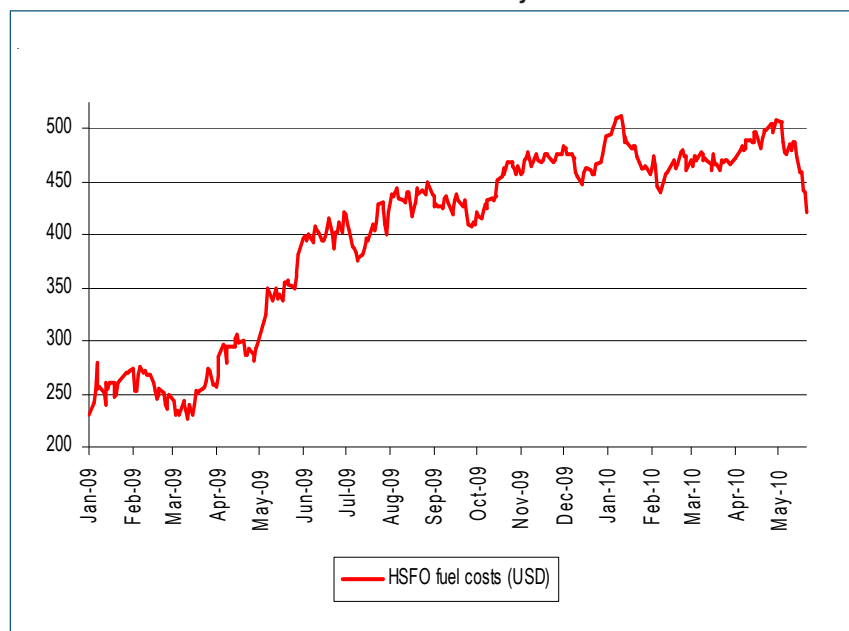
Note: Basslink was acquired part-way through FY08. We don't include contributions in the analysis here

Source: OIR estimates, CitySpring

**What is CRSM?** The commercial risk sharing mechanism or CRSM is designed to share the market risk of operating in the National Electricity Market between Basslink and Hydro Tasmania. Payments under CRSM are based on differences between the top 30 and bottom 50 electricity pool prices and can range from up to 25% of base power cable revenues or up to negative 20% of revenues depending on the volatility of electricity prices in Victoria. While the CRSM is designed to have a neutral effect in the long term, it creates a level of volatility in Basslink's revenue (offering both upside and downside).

**Fuel costs for City Gas.** City Gas' fuel costs have shot up significantly since Mar 09. City Gas can only review its tariff once every three months, which creates a timing mismatch between tariff revenue and fuel costs. Over time, the business is expected to be net neutral to fluctuations in fuel costs.

**Exhibit 3: HFSO fuel costs from Jan 09 to May 10**



Source: Bloomberg

**Details on City Gas conversion project.** Singapore plans to convert the existing town gas network into natural gas, liberalizing the residential market. The conversion process, which may take five years to complete, was earlier intended to begin in 2010. City Gas would likely undertake the conversion project jointly with PowerGas, with City Gas carrying out the conversion of the gas appliances of its customers. At IPO, the trust had estimated that City Gas could spend S\$200m on conversion costs (implementation, customer education, etc) over the conversion period. CitySpring is likely to fund the conversion costs through a combination of debt (City Gas is geared at below 50% of capital) and operating cash flows. The manager is currently in discussions with the regulator, the Energy Market Authority (EMA).

### Cityspring's Key Financial Data

#### Interim Results

Year ended 31 Mar (S\$m)	4Q10	4Q09	% YoY	3Q10	% QoQ
Revenue	118.0	97.3	21.3%	95.2	23.9%
Other income	1.1	0.7	54.3%	0.9	28.5%
Fuel and electricity costs	-37.9	-21.2	78.7%	-31.5	20.2%
Transportation costs	-18.4	-17.5	5.1%	-18.2	0.9%
Depreciation and amortisation	-13.8	-12.1	14.2%	-14.0	-1.4%
Finance costs	-21.3	-20.4	4.3%	-20.3	4.8%
Other expenses	-24.1	-37.4	-35.6%	-20.4	17.8%
Income tax	0.0	2.3	n.m.	6.3	n.m.
Minority interest	0.3	0.2	12.4%	0.4	-29.2%
PATMI	1.8	-0.4	n.m.	-1.4	n.m.
Cash earnings	23.4	21.8	7.4%	10.9	114.9%
Units (m)	979.9	490.0		979.9	
DPU (S cents)	1.05	1.75	-40.0%	1.05	0.0%

Enlarged unit base after rights issue

1) Positive CRSM payments on Basslink  
2) Contributions from Basslinks Telecoms

## CitySpring Infrastructure Trust's Key Financial Data

EARNINGS FORECAST					BALANCE SHEET				
Year Ended 31 Mar (\$m)	FY09	FY10	FY11F	FY12F	As at 31 Mar (\$m)	FY09	FY10	FY11F	FY12F
Revenue	398.7	388.1	384.5	386.6	Cash (ex restricted cash)	96.8	98.9	101.0	107.6
Other income	5.5	3.3	1.6	1.6	Restricted cash	29.1	34.0	34.0	34.0
Other gains/losses - net	(22.8)	6.1	0.6	0.6	Plant, property and equipment	1079.4	1257.2	1208.1	1155.3
Fuel and electricity costs	(133.7)	(124.2)	(119.9)	(122.3)	Finance lease receivable	178.6	171.4	160.0	148.6
Finance costs	(87.2)	(85.4)	(81.0)	(80.4)	Total assets	1913.6	2189.4	2122.5	2065.1
Total expenses	(432.5)	(414.4)	(404.6)	(407.2)	Borrowings	1557.1	1537.7	1544.1	1550.0
Income tax	1.3	26.0	0.0	0.0	Total liabilities	1765.0	1760.8	1756.9	1763.2
Minority interest	0.5	1.4	(1.3)	(1.3)	Minority interests	12.7	10.4	5.1	(0.2)
PATMI	(50.2)	7.9	(16.7)	(17.2)	Total unitholders' funds	148.5	428.7	365.6	302.0
Cash earnings	60.9	57.9	58.9	62.1	Total liabilities and equity	1913.6	2189.4	2122.5	2065.1
<b>CASH FLOW</b>					<b>KEY RATES &amp; RATIOS</b>				
Year Ended 31 Mar (\$m)	FY09	FY10	FY11F	FY12F		FY09	FY10	FY11F	FY12F
Net cash from operations	76.9	50.4	62.3	63.2	Units outstanding	490.0	979.9	979.9	979.9
Purchase of PP&E	(4.3)	(3.2)	(5.0)	(1.0)	DPU (S cents)	7.0	4.9	4.2	4.2
Net investing cash flow	(4.2)	(3.2)	(5.0)	(1.0)	Cash earnings/unit (S cents)	12.4	5.9	6.0	0.0
Repayment of borrowings	(373.9)	(237.0)	(10.0)	(10.5)	P/NAV <sup>^</sup> (x)	1.0	1.2	1.3	1.6
Distributions to unitholders	(33.6)	(37.7)	(41.2)	(41.2)	Dividend yield (%)	11.8	8.2	7.1	7.1
Net financing cash flow	(39.5)	(50.6)	(55.2)	(55.7)	P/CEPU (x)	4.8	10.1	9.9	9.4
Net cash flow	33.1	(3.3)	2.1	6.6	EV/EBITDA* (x)	22.5	15.4	15.5	15.7
Currency translation effects	(4.4)	5.4	0.0	0.0	Cash earnings to revenue (%)	15.3	14.9	15.3	16.1
Cash at beginning of yr	68.1	96.8	98.9	101.0	Distr cash to cash earnings (%)	56.3	68.2	69.9	66.3
Cash at end of yr (ex restricted)	96.8	98.9	101.0	107.6	Debt to total assets (x)	0.8	0.7	0.7	0.8

Note\*: Adjusted for SingSpring's lease receivable repayment

Note^: Equity before hedging and translation reserves (to strip out extreme volatility).

Source: Company data, OIR estimates

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**SHAREHOLDING DECLARATION:**

The analyst's immediate family holds units in CitySpring.

**RATINGS AND RECOMMENDATIONS:**

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- However, OIR's fundamental views and ratings (Buy, Hold, Sell) are medium-term calls within a 12-month investment horizon. OIR's Buy = More than 10% upside from the current price; Hold = Trade within +/- 10% from the current price; Sell = More than 10% downside from the current price.

- For companies with less than S\$150m market capitalization, OIR's Buy = More than 30% upside from the current price; Hold = Trade within +/- 30% from the current price; Sell = More than 30% downside from the current price.

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For OCBC Investment Research Pte Ltd



Carmen Lee  
Head of Research

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