Singapore Company Guide
Soilbuild Business Space Reit

Version 14 | Bloomberg: SBREIT SP | Reuters: SBSR.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

18 Oct 2019

HOLD

Last Traded Price (17 Oct 2019): S$0.525 (**STI :** 3,126.14)
Price Target 12-mth: S$0.55 (4% upside) (Prev S$0.63)

Analyst
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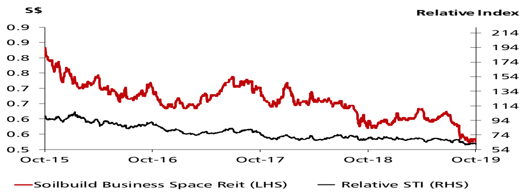
What's New

- 3Q19 NPI down 8% q-o-q due mainly to rent arrears from NK Ingredients
- 22.1% decline (q-o-q) in 3Q19 DPU mainly attributed to the 19% enlargement in shareholder base
- Positive rental reversions at business park properties; Industrial properties still facing rental pressures
- Newly acquired Grade A office building in Adelaide to contribute from 1 November

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2018A	2019F	2020F	2021F
Gross Revenue	83.8	94.5	103	103
Net Property Inc	69.9	71.9	79.9	80.7
Total Return	50.4	42.0	49.8	53.0
Distribution Inc	55.9	48.3	57.5	59.0
EPU (S cts)	4.64	3.79	3.92	4.14
EPU Gth (%)	(7)	(18)	4	6
DPU (S cts)	5.29	4.35	4.54	4.60
DPU Gth (%)	(7)	(18)	4	1
NAV per shr (S cts)	62.9	61.2	60.9	60.7
PE (X)	11.3	13.9	13.4	12.7
Distribution Yield (%)	10.1	8.3	8.6	8.8
P/NAV (x)	0.8	0.9	0.9	0.9
Aggregate Leverage (%)	37.3	36.2	34.3	34.2
ROAE (%)	7.3	5.8	6.4	6.8
Distn. Inc Chng (%):		(1)	13	-
Consensus DPU (S cts):		4.90	4.90	5.00
Other Broker Recs:		B: 1	S: 0	H: 4

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Confronting hurdles progressively

Maintain HOLD and TP of S$0.55. While business park assets continue to see positive rental reversions that will span well into next year, we continue to see headwinds within its industrial segment. We expect income weakness for its master-leases to NK Ingredients and Beng Kuang Marine to remain an overhang. Our DCF-based TP has been lowered to S$0.55 to account for the drag on earnings caused by the enlarged shareholder base, and our revised earnings estimates. Maintain HOLD.

Where we differ: Australia strategy to bear fruit over time. The recent foray into Australia may prove to be a rewarding one in time to come. Including the latest acquisition in Adelaide (Grenfell Centre), these Australian assets will provide some earnings stability and potential upside in the medium-term. The ability to continue gaining scale in Australia will provide investors comfort this diversification strategy.

Potential catalyst: Efficient use of capital. With the proposed sale of 72 Loyang Way expected to complete in the near-term, net proceeds of approximately S$34m for SBREIT could be deployed to better use. Paring down debt or redeploying proceeds to other income producing use could provide an earnings uplift in FY20F.

Valuation:

Maintain HOLD; DCF-based TP lowered to S$0.55 as we revise earnings estimates and account for the drag in earnings by the preferential offering during the quarter. After factoring incremental costs arising from uncertainty over NK Ingredients' default, the REIT still offers a decent c.8.0% yield.

Key Risks to Our View:

Potential asset revaluations. Gearing could head up to c.40% on asset devaluations, but recent capital raisings have recapitalized the balance sheet and given the REIT some buffer to work on and strengthen its tenant profile.

At A Glance

Issued Capital (m shrs)	1,260
Mkt. Cap (Sm/USm)	661 / 485
Major Shareholders (%)	
Lim family	29.1
Schroders Plc	5.2
Lim family	19.8
Free Float (%)	65.7
3m Avg. Daily Val (US$m)	0.67

GIC Industry : Real Estate / Equity Real Estate Investment

DBS
Live more, Bank less

ed: TH / sa: MA, PY, CS

WHAT'S NEW

SBREIT's 3Q19 Results dragged down by rental arrears and preferential offering

(-) 3Q19 DPU impacted by larger unit base. Led by higher contributions from its earlier Australian assets and Solaris, SBREIT's gross revenue and net property income rose by 14.2% and 8.3% y-o-y to $66.2m and $53.6m respectively for 9M19. The higher revenue was partially offset by lower contribution from Eightrium, KTL Offshore (divested in February 2018), 39 Senoko Way, West Park BizCentral and NK Ingredients. The decrease in interest income of S$1.1 million was related to the repayment of the S$55 million interest-free loan from the Sponsor and the increase in finance expenses of S$1.7 million was mainly attributed to higher loan principal and higher weighted average borrowing costs in YTD FY2019.

Total return before distribution was $2.6m lower primarily due to the absence of a non-recurring gain on divestment of KTL Offshore. This resulted in a 9.0% y-o-y decline in distributable income to $36.9m

(-) NK Ingredients still in arrears. Since the court hearing on 20 August on NK Ingredients rental arrears, the Manager has agreed to give NK Ingredients a 2-month rent holiday (up to end-October). This has put further pressure on the 3Q19 earnings as NK Ingredients makes up approximately 7% of SBREIT's NPI.

Should NK Ingredients eventually vacate the premises, management highlighted that they could potentially consider redeveloping the site, which we view positively. With an estimated redevelopment cost of $60m, SBREIT will be able to maximise plot ratio from the current 0.55x, to 1x. This, in our view will result in higher revenues and asset values in the medium-term, which will be value accretive to the REIT.

(+/-) Pockets of positives from portfolio. Despite the slight negative rental renewals at the industrial properties, the positive renewals at the business park properties translated to an overall positive reversion of 1.0% in 3Q19.

Negative renewals were mainly at Tuas Connection and West Park, while Solaris was the main source of upside in rentals. Improvement in occupancies at the business parks were also the positives in portfolio management for the quarter. Occupancy at Solaris is currently at 94%, and Eightrium occupancy increased from 75% to 84% q-o-q.

Occupancy at 72 Loyang Way at c.25% is below optimal levels but the sale of the property is expected to go through in the near-term (pending approval from authorities), and will be a positive development in our view. Management expects the occupancy at 39 Senoko Way (currently at 34%) to improve once the AEIs are completed.

Rejuvenation works at Solaris (amounting to $4m) commenced in 3Q19 and is expected to complete in 8 months. SBREIT believes that this enhancement works would reinforce Solaris' position in the one-north business park precinct and enable them to retain and attract quality tenants.

(+) Temporary decline in gearing to 36.5%. Once the acquisition of Grenfell Centre in Adelaide is completed in 4Q19, gearing is projected to head back up to 38%. This is still lower than the 39.4% gearing in 2Q19, in part due to the preferential offering.

All-in interest cost fell marginally to 3.56% in 3Q19, and we do not expect any increase in all-in cost even with the additional debt taken to fund the Grenfell Centre acquisition.

The lower gearing, coupled with divestment proceeds from 72 Loyang Way will provide a good buffer for SBEIT, should there be any devaluation in the portfolio at year-end.

(+) Australian properties increasing in significance. Post the acquisition of Grenfell Centre, SBREIT's Australian portfolio will make up 19.7% of GRI.

Grenfell Centre currently has a committed occupancy of more than 88%, and management is confident that occupancy rates would improve given the property's ideal location. Weighted Average Lease Expiry (WALE) of the property is also at a healthy 5.0 years, and annual rental escalations are between 3.50% and 3.75%. The initial NPI yield of 7.67% for Grenfell Centre will only begin contributing to SBREIT from 1 November.

With the long WALEs and in-place annual rental escalations, the three Australian properties will provide stability and help to mitigate any uncertainties in the Singapore portfolio.

Quarterly / Interim Income Statement (S$m)

FY Dec	3Q2018	2Q2019	3Q2019	% chg yoy	% chg qoq
Gross revenue	19.8	22.4	21.2	7.0	(5.2)
Property expenses	(3.6)	(4.0)	(4.2)	18.6	5.1
Net Property Income	16.2	18.3	17.0	4.5	(7.5)
Other Operating expenses	(1.5)	(1.5)	(1.4)	(5.3)	(7.8)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	(3.4)	(4.8)	(4.7)	(40.1)	0.5
Exceptional Gain/(Loss)	0.0	(0.2)	(0.4)	nm	nm
Net Income	11.3	11.8	10.4	(8.3)	(12.2)
Tax	0.0	(0.1)	(0.1)	nm	1.3
Minority Interest	0.0	0.0	0.0	-	-
Net Income after Tax	11.3	11.8	10.3	(9.0)	(12.3)
Total Return	11.3	11.8	10.3	(9.0)	(12.3)
Non-tax deductible Items	1.89	1.48	1.84	(2.6)	24.9
Net Inc available for Dist.	13.2	12.6	11.6	(12.5)	(7.9)
Ratio (%)					
Net Prop Inc Margin	81.9	82.0	80.0		
Dist. Payout Ratio	100.0	200.0	100.0		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Newly acquired Australian assets anchor resilience. Given a myriad of factors ranging from heightened supply pressures and an unfortunate scenario of tenant defaults, SBREIT has been trading sideways and broadly underperforming the S-REIT market since June 2015. Supply-side challenges resulting in persistent negative rental reversionary trends have also weighed on its operating performance and DPUs.

Given fixed rental escalations, SBREIT's acquisitions in Australia helped to augment stability as softness in the industrial space continues to bottom out. With the addition of a third property, Australia now make up close to 20% of the REIT's GRI.

Solaris provides additional earnings buffer ahead of a sustained recovery in industrial rents. Following the expiry of its master lease in August 2018, Solaris continues to contribute more meaningfully to SBREIT's top-line performance. Riding on positive reversions of c.10%, contributions to GRI rose to 33% in 3Q19 from 26% in 2Q18. As the Manager continues to execute on renewals at Solaris, coupled with contributions from its Australian assets, this provides a larger earnings buffer as industrial rents continue to bottom out.

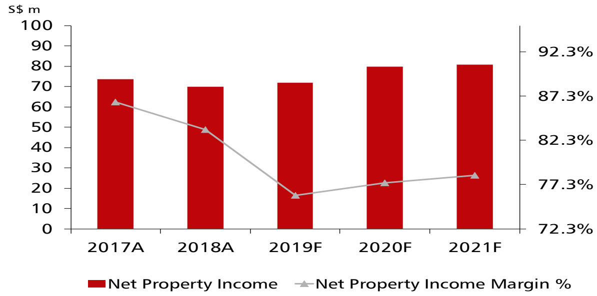
Ability to drive occupancy rates higher will improve earnings trend in the future. While the REIT maintained full occupancy rates from IPO till 2015, we started to see signs of a deterioration as tenants vacated their premises at its multi-tenanted properties (Tuas Connection and WestPark BizCentral) and the master tenant defaulted at 72 Loyang Way (c.8% of top line then).

Occupancy levels for non-master lease tenants have improved from a low of 80.2% in 1Q18. However, there remains room for further optimisation, particularly at Eightrium, as the Manager continues to ramp up on marketing efforts for the approximate c.16% vacancies.

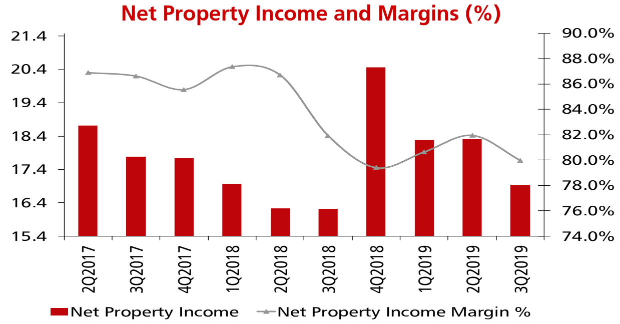
Ability to maintain occupancies and defend current rents amid several asset-specific challenges will be a key indicator of earnings potential over the medium-term.

Interest rate risk is not a major concern for now. We have not found any meaningful correlation between interest rates and SBREIT's price. This could be due to the Manager's proactive management of the REIT's debt profile which has largely mitigated interest rate risks.

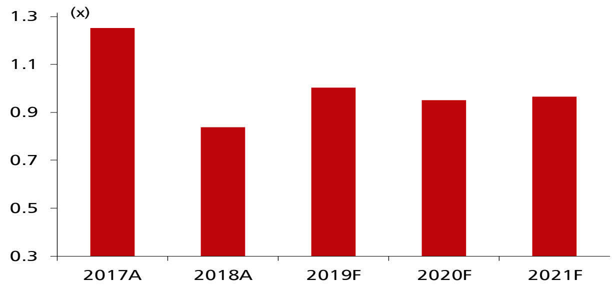
Net Property Income and Margins (%)



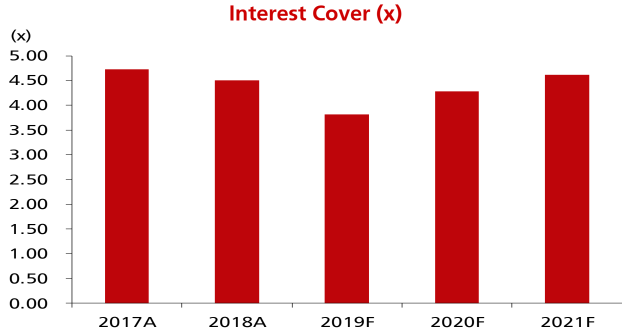
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Gearing has fallen to temporarily to 36.5%. Post-completion of the Grenfell Centre acquisition, SBREIT's gearing is projected to rise to c.38%. This means that any acquisition going forward will likely be funded through a mix of equity and debt.

Prudent capital management; c.93% of interest costs hedged into fixed rates. While SBREIT has hedged a higher proportion of its borrowings into fixed rates, it could still enjoy upside from a lower interest rate environment.

Share Price Drivers:

Better-than-expected operational performance. Better-than-projected rental reversions from its main assets - namely Solaris West Park Biz Central and Tuas Connection - will mean upside to our DPU forecasts, implying higher TPs.

Upside from redevelopments. While security deposits have been fully drawn down in July 2019 following tenant NK Ingredients default in early 2019, we note that SBREIT has been seeking out alternatives for the asset. We understand that the Manager is currently exploring opportunities with prospective tenants, with further upside from the unlocking of unutilised GFA through redevelopments or potential divestments.

Acquisitions. Potential acquisitions in Singapore and Australia should support DPUs going forward. After its latest acquisition, the Manager could still be on the lookout for opportunities in Australia to diversify the REIT's earnings base.
However, given the REIT's high implied yields, finding an accretive deal might be tough. The REIT will also have to raise capital to part fund any deal.

Key Risks:

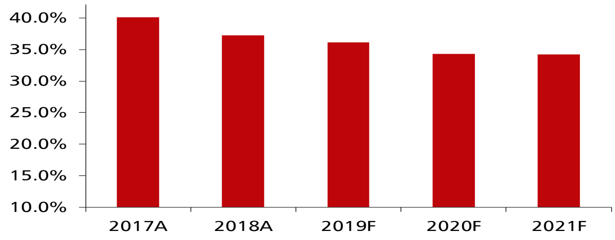
Look out for potential asset revaluations as persistent negative rental reversionary trends for industrial assets may result in lower asset valuations and potential downside to SBREIT's current NAV of S$0.60.

Tenancy defaults, particularly for NK Ingredients, may amplify the pressure on DPU declines. However, this may incentivise SBREIT to step up redevelopment plans to unlock unutilised GFA. We have yet to factor in upside from potential redevelopments.

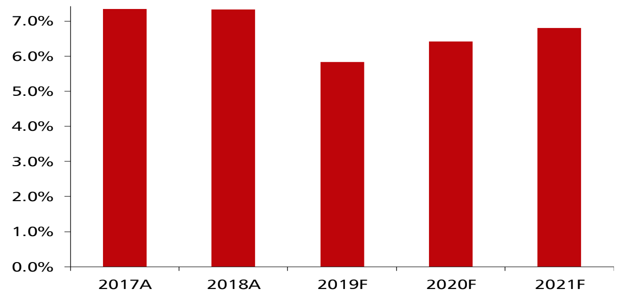
Company Background

Soilbuild Business Space REIT (SBREIT) is a real estate investment trust that invests in income-producing real estate used primarily for business space purposes in Singapore. Its flagship asset is Solaris, located in one-north business park.

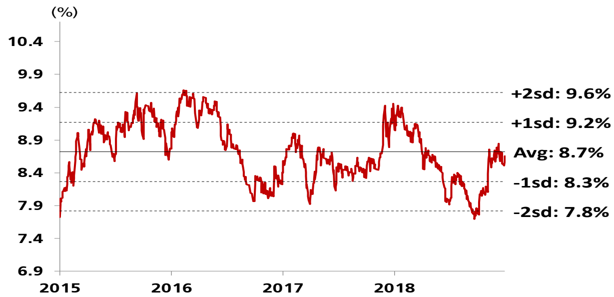
Aggregate Leverage (%)



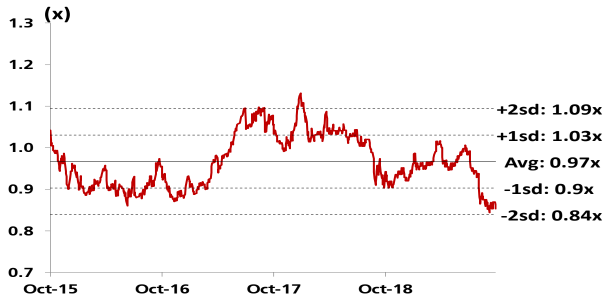
ROE (%)



Distribution Yield (%)



PB Band (x)



Source: Company, DBS Bank

Income Statement (S$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Gross revenue	84.8	83.8	94.5	103	103
Property expenses	(11.3)	(13.8)	(22.6)	(23.2)	(22.3)
Net Property Income	**73.5**	**69.9**	**71.9**	**79.9**	**80.7**
Other Operating expenses	(7.3)	(6.8)	(8.9)	(9.0)	(7.2)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(14.0)	(14.0)	(16.5)	(16.6)	(15.9)
Exceptional Gain/(Loss)	0.0	1.01	0.0	0.0	0.0
Net Income	**52.2**	**50.1**	**46.5**	**54.3**	**57.6**
Tax	0.0	(0.1)	(0.6)	(0.6)	(0.6)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	(1.0)	(3.9)	(3.9)	(3.9)
Net Income After Tax	**52.2**	**49.0**	**42.0**	**49.8**	**53.0**
Total Return	(28.3)	50.4	42.0	49.8	53.0
Non-tax deductible Items	88.2	5.46	6.28	7.77	5.94
Net Inc available for Dist.	59.9	55.9	48.3	57.5	59.0
Growth & Ratio					
Revenue Gth (%)	4.5	(1.2)	12.8	9.1	(0.1)
N Property Inc Gth (%)	4.0	(4.8)	2.9	11.0	1.0
Net Inc Gth (%)	3.8	(6.1)	(14.3)	18.4	6.6
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	86.6	83.5	76.1	77.5	78.4
Net Income Margins (%)	61.6	58.5	44.5	48.3	51.5
Dist to revenue (%)	70.6	66.7	51.1	55.8	57.3
Managers & Trustee's fees	8.6	8.1	9.4	8.8	7.0
ROAE (%)	7.4	7.3	5.8	6.4	6.8
ROA (%)	4.2	4.0	3.2	3.6	3.9
ROCE (%)	5.5	5.3	4.9	5.2	5.5
Int. Cover (x)	4.7	4.5	3.8	4.3	4.6

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	3Q2018	4Q2018	1Q2019	2Q2019	3Q2019
Gross revenue	19.8	25.8	22.7	22.4	21.2
Property expenses	(3.6)	(5.3)	(4.4)	(4.0)	(4.2)
Net Property Income	16.2	20.5	18.3	18.3	17.0
Other Operating expenses	(1.5)	(2.2)	(1.6)	(1.5)	(1.4)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(3.4)	(4.1)	(4.6)	(4.8)	(4.7)
Exceptional Gain/(Loss)	0.0	(0.7)	0.02	(0.2)	(0.4)
Net Income	**11.3**	**13.4**	**12.1**	**11.8**	**10.4**
Tax	0.0	(0.1)	(0.1)	(0.1)	(0.1)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	**11.3**	**13.3**	**12.0**	**11.8**	**10.3**
Total Return	11.3	14.7	12.0	11.8	10.3
Non-tax deductible Items	1.89	1.63	1.29	1.48	1.84
Net Inc available for Dist.	13.2	15.4	12.7	12.6	11.6
Growth & Ratio					
Revenue Gth (%)	6	30	(12)	(1)	(5)
N Property Inc Gth (%)	0	26	(11)	0	(8)
Net Inc Gth (%)	(1)	18	(10)	(2)	(12)
Net Prop Inc Margin (%)	81.9	79.4	80.6	82.0	80.0
Dist. Payout Ratio (%)	100.0	100.0	200.0	200.0	100.0

Balance Sheet (S$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Investment Properties	1,111	1,230	1,367	1,338	1,340
Other LT Assets	1.25	0.0	0.0	0.0	0.0
Cash & ST Invts	11.7	15.1	15.3	16.0	18.2
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	3.94	2.58	0.95	1.03	1.03
Other Current Assets	54.1	0.57	0.57	0.57	0.57
Total Assets	**1,182**	**1,248**	**1,383**	**1,355**	**1,359**
ST Debt	147	39.9	39.9	39.9	39.9
Creditor	10.6	14.0	9.45	10.3	10.3
Other Current Liab	21.9	22.2	22.7	22.7	22.7
LT Debt	327	425	460	425	425
Other LT Liabilities	6.04	14.4	14.4	14.4	14.4
Unit holders' funds	669	732	837	843	847
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**1,182**	**1,248**	**1,383**	**1,355**	**1,359**
Non-Cash Wkg. Capital	25.4	(33.0)	(30.7)	(31.4)	(31.4)
Net Cash/(Debt)	(463)	(450)	(485)	(449)	(447)
Ratio					
Current Ratio (x)	0.4	0.2	0.2	0.2	0.3
Quick Ratio (x)	0.1	0.2	0.2	0.2	0.3
Aggregate Leverage (%)	40.1	37.3	36.2	34.3	34.2
Z-Score (X)	0.8	0.8	0.8	0.8	0.8

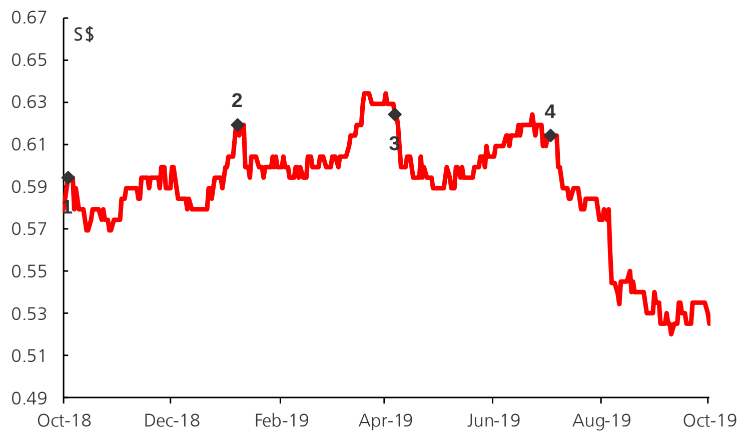
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Pre-Tax Income	52.2	50.1	46.5	54.3	57.6
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	0.0	0.0	0.0	(0.6)	(0.6)
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(37.9)	58.4	(2.9)	0.77	0.0
Other Operating CF	34.9	(43.0)	4.48	5.97	4.14
Net Operating CF	**49.3**	**65.6**	**48.1**	**60.5**	**61.1**
Net Invt in Properties	(0.4)	(118)	(137)	29.0	(2.0)
Other Invts (net)	0.0	54.7	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.0	(1.4)	0.0	0.0	0.0
Net Investing CF	**(0.4)**	**(64.8)**	**(137)**	**29.0**	**(2.0)**
Distribution Paid	(61.7)	(55.0)	(48.3)	(57.5)	(59.0)
Chg in Gross Debt	0.0	(10.3)	35.1	(35.0)	0.0
New units issued	(1.1)	5.58	106	7.77	5.94
Other Financing CF	0.0	63.5	(3.9)	(3.9)	(3.9)
Net Financing CF	**(62.8)**	**3.74**	**89.0**	**(88.7)**	**(57.0)**
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	(14.0)	4.56	0.13	0.76	2.14
Operating CFPS (S cts)	8.32	0.68	4.59	4.71	4.77
Free CFPS (S cts)	4.67	(5.0)	(8.0)	7.05	4.61

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	19 Oct 18	0.59	0.65	BUY
2:	23 Jan 19	0.62	0.65	BUY
3:	22 Apr 19	0.62	0.63	HOLD
4:	19 Jul 19	0.61	0.63	HOLD

***Note**: Share price and Target price are adjusted for corporate actions.*

Source: DBS Bank

Analyst: Derek TAN

Singapore Research Team

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 18 Oct 2019 08:20:27 (SGT)
Dissemination Date: 18 Oct 2019 09:37:58 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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