

Singapore Company Guide

ESR-REIT

Version 14 | Bloomberg: EREIT SP | Reuters: ESRR.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

24 Apr 2020

BUY

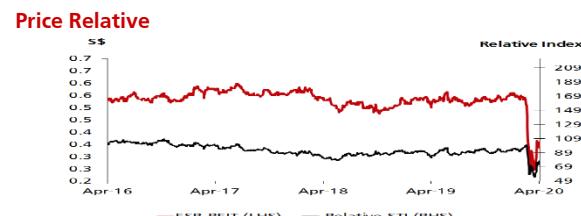
Last Traded Price (23 Apr 2020): S\$0.335 (STI : 2,542.37)
Price Target 12-mth: S\$0.43 (27% upside) (Prev S\$0.59)

Analyst

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What's New

- Provisions to earnings in 1Q20 to account for rental rebates and deferment
- S\$7m in distributable income has been retained as a prudent measure to tackle two months of shutdown due to Circuit Breaker measures
- Moderation to FY20 organic growth due to suspension of AEI and redevelopment plans amidst the COVID-19 pandemic
- Maintain BUY despite a lowered TP of S\$0.43



Forecasts and Valuation

FY Dec (\$'m)	2018A	2019A	2020F	2021F
Gross Revenue	157	253	227	245
Net Property Inc	112	188	165	177
Total Return	0.0	0.0	92.9	106
Distribution Inc	74.5	133	99.9	113
EPU (S cts)	0.10	2.75	2.65	2.99
EPU Gth (%)	(97)	2,615	(4)	13
DPU (S cts)	3.86	4.01	2.84	3.19
DPU Gth (%)	0	4	(29)	12
NAV per shr (S cts)	76.8	43.0	42.7	42.3
PE (X)	330.4	12.2	12.7	11.2
Distribution Yield (%)	11.5	12.0	8.5	9.5
P/NAV (x)	0.4	0.8	0.8	0.8
Aggregate Leverage (%)	41.6	43.8	44.0	44.1
ROAE (%)	0.2	6.1	6.2	7.0
Distn. Inc Chng (%):		(28)	(20)	
Consensus DPU (S cts):		4.0	4.00	
Other Broker Recs:	B: 6	S: 0	H: 1	

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

Provision instead of expansion

Maintain BUY with TP of S\$0.43. Provisions for receivables and retention of income have been dominating the headlines for REITs during the quarter. In addition to setting aside provisions for rental deferment and rebates, ESR REIT ("EREIT") has also taken the prudent approach of retaining S\$7m or 28% of distributable income for 1Q20. Amidst the weakening of rental rates and prolonged portfolio vacancies caused by the COVID-19 pandemic, we have revised our earnings estimate and lowered our TP to S\$0.43. With a potential upside of 26% to trading price, we maintain our BUY recommendation.

Where we differ: More conservative forecasts. Our estimates are lower than consensus on the back of more conservative reversion assumptions and higher vacancies. The delay in AEI and redevelopment plans for FY20 will also put pressure on organic growth in the near-to-medium term. Earnings growth in FY20 will be mainly only come from cost savings and higher rents from single-tenanted leases that have been converted into multi-tenanted leases.

Potential catalyst: Sooner-than-anticipated recovery. With the extension of the Circuit Breaker and more stringent measures put in place by the government, a faster-than-expected rebound after the COVID-19 outbreak could support increased activity and allow EREIT to reinstate its inorganic growth plans for the rest of FY20.

Valuation:

Maintain BUY with TP of S\$0.43. We lowered our DCF-based estimates to take into account EREIT's provisions for rental rebates and deferment, as well as the potential weakening in rental and occupancy rates.

Key Risks to Our View:

Fund-raising. Despite the recent increase in leverage limits to 50%, EREIT's relatively high gearing of (41.7%) puts it at risk of potential fund-raising to fund major capex expenses.

At A Glance

Issued Capital (m shrs)	3,506
Mkt. Cap (\$'m/US\$m)	1,175 / 825
Major Shareholders (%)	
Tong Jinquan	24.7
E-Shang Infinity Cayman Ltd	7.7
Free Float (%)	67.6
3m Avg. Daily Val (US\$m)	7.9
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	

WHAT'S NEW

Provision instead of expansion

1Q20 earnings lowered by provisions and income retention

- As a precautionary measure, some provisions to income were made in 1Q20 coupled with the retention of S\$7m in distributable income
- Revenue declined 7.5% q-o-q to S\$57.8m due mainly to conversion of two single-tenanted properties into multi-tenanted properties and provision for rental rebates
- 1Q20 DPU of 0.50 Scts is a 50% q-o-q decline; payout ratio fell to 72%
 - o Amount retained is based on the approach to provide for rent deferrals and rebates for up to 10% of tenants; retail/F&B tenants make up close to 7.5% of EREIT's portfolio
 - o Absence of capital distributions in 1Q20; S\$5.6m in capital distributions were paid out in 4Q19
 - o More than S\$60m remaining for capital distribution but EREIT will only pay it out to supplement income from assets that are going through AEIs/redevelopments
 - o As there are currently no AEIs/redevelopments, EREIT has decided not to tap on any capital distribution
- Without the retention in distributable income, DPU would have been 0.697 Scts
 - o Expect the same level of distribution retention in the next quarter due to extension of Circuit Breaker
 - o Any unutilised portion of retained income will be paid out once operations return to normalcy
- Percentage of late rental payments remains stable at 2%; has been at this level over the past few years
 - o Based on stress testing done by EREIT, approximately 25% of revenues each quarter is required for working capital and financing
 - o EREIT will only face cash flow problems if more than 75% of tenants defer their rents

Portfolio performance remains healthy despite challenging operating landscape

- Portfolio occupancy remained stable at 90.5% (no change q-o-q) with a healthy tenant retention rate of 87.1%

- The two single-tenanted properties that have been converted into multi-tenanted leases currently have occupancies of 88.9% and 100%
 - o We expect an increase in income from these two properties that have been converted (13 Jalan Terusan and 30 Teban Gardens)
- 900,000 sqft of NLA in renewals and new leases were signed in 1Q20
 - o Slight dip in rental reversion of 0.1%
- Bulk of remaining 12.6% of leases expiring in FY20 will be in 2Q20 and 3Q20
 - o Already in advanced negotiations with close to 9% of the 12.6% leases expiring, and rent reviews for these leases are expected to remain flat
 - o May see some weakness in rent reviews going forward, especially the single-tenanted leases that are due to expire
- More than 50% of industrial tenants still remain operational during this Circuit Breaker period
- A very healthy portfolio average security deposit of 5.5 months; provide protection for EREIT in the event of any rental defaults
- Except for AEI works that are ongoing at UE BizHUB, all other AEI/redevelopment plans for FY20 have been put on hold amidst this COVID-19 pandemic

Stable credit metrics boosted by new MAS guidelines

- Gearing inched up q-o-q from 41.5% to 41.7%
 - o All-in cost of debt improved from 3.92% in 4Q19, to 3.81% in 1Q20
 - o Interest coverage ratio remains healthy at 3.35x
- The refinancing of the entire S\$160m of MTN expiring in FY20 has already been pre-committed
 - o Expect further savings in financing costs with all-in cost of borrowings to improve to 3.7% after refinancing
 - o Weighted average debt expiry to also improve from the current 2.4 years to 2.9 years

Our thoughts

In our revised forecasts, we have taken on a more conservative approach to rental occupancy rates. We have factored in some negative rental reversions for multi-tenanted leases, as well as lower occupancy rates in FY20. We believe that the full brunt of the Circuit Breaker measures will only be felt in 2Q20, before these restrictions are gradually lifted in 3Q20.

We understand that EREIT will be shelving all AEl/redevelopment plans for FY20, except UE BizHub which is already ongoing. As such, we have also delayed our expectations of organic growth in the near future, and the only main upside to earnings this year will be potential cost savings in borrowings. On the M&A front, EREIT will also likely hold

back until there is more clarity and stability in the economic landscape.

Despite the muted outlook in earnings, we take comfort in EREIT's relatively manageable rent expiries (9% of 12.6% lease expiries already in advanced negotiations) this year as well as having completed all refinancing needs. The increase in gearing limits set by the MAS will also lift the overhang on EREIT's relatively high gearing currently, and minimise the risk of any fund-raising in FY20.

Our TP has been cut to S\$0.43, but we maintain our BUY call on EREIT due to the 26% potential upside in share price from current levels.

ESR-REIT

Critical Factors

Ongoing portfolio rejuvenation. Over the past year, EREIT has demonstrated its commitment to rejuvenate its portfolio post acquisition of Viva Industrial Trust's portfolio. The recent completion of AEI works at 30 Marsiling Industrial Estate Road 8 has led to improved earnings for the asset. The Manager has also divested two non-core assets and recycled the capital into a modern ramp-up logistics facility at 48 Pandan Road. AEI at UE BizHub East has also begun and will enable the REIT to attract more tenants and command stronger rents once completed.

Post merger, EREIT has also shown that the enlarged platform gives the Manager greater flexibility and muscle to accelerate its planned AEI initiatives, thus unlocking shareholder value over the longer term.

Company-led initiatives to help sustain DPU as oversupply risks

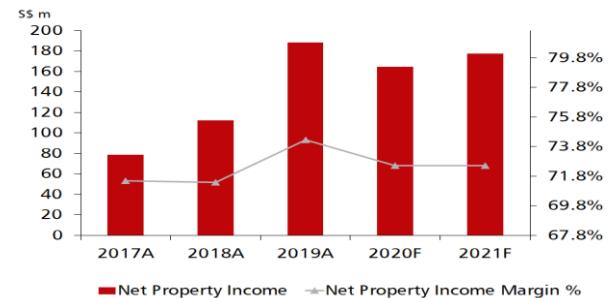
dissipate. Post merger, we anticipate temporary weakness to DPU on negative near-term effects arising from (i) the enlarged share base, (ii) softness in occupancy rates due to consolidation of tenant spaces, and (iii) capex requirements for AEIs.

Other benefits resulting from the merger include trust-level savings, lower management fees and cheaper debt financing for the enlarged entity, which had kicked in from end-FY19. As oversupply risks continue to dissipate over the medium term, we believe these company-led initiatives would continue to augment the REIT's resilience ahead of a sustained recovery in underlying rents.

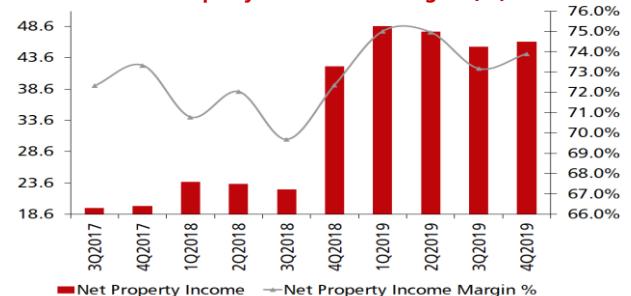
Interest rates not a key risk factor. We have found minimal correlation between the 10-year bond yield and the price of EREIT. Interest-rate risks are likely to be mitigated by the proactive management of the REIT's debt profile.

As such, we believe that EREIT's distributions are well hedged against interest rate movements, with 100% of interest rates hedged into fixed rates.

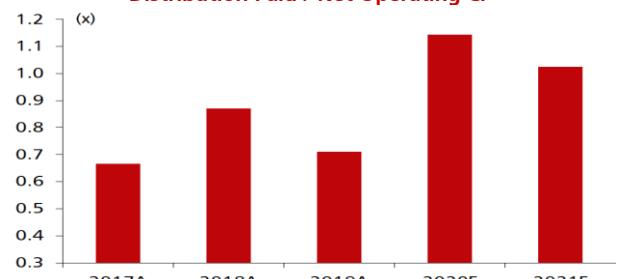
Net Property Income and Margins (%)



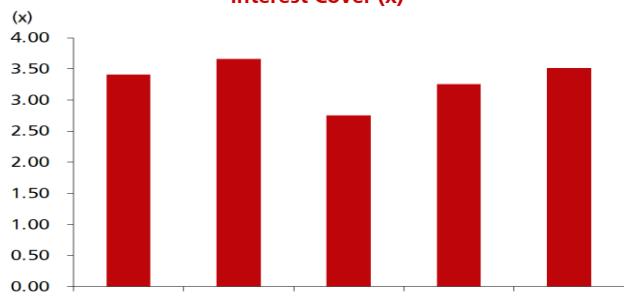
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

ESR-REIT

Balance Sheet:

Gearing remains stable. Gearing has increased beyond 40% but remains at the lower end of management's comfortable range, supported by steady financial metrics (ample interest cover, EBITDA coverage, etc.). That said, while the Manager sees optimal gearing at a lower level of between 35% and 40%, it will only address this issue on the back of a planned acquisition which will be accretive to the REIT.

The recent increase in gearing limits set by the authorities from 45% to 50% has also eased risks for the need of any near-term recapitalisation exercise.

Proactive capital management. EREIT has refinanced all of its expiring loans that are due in FY20. In addition, the Manager has fixed close to 100% of its interest rates, meaning that volatility due to fluctuations in interest rates should only have a marginal impact on distributions.

Share Price Drivers:

Pick-up in occupancy rate. We believe that expected vacancies and earnings weakness arising from property conversions from single- to multi-tenanted could be an overhang on the stock. The ability to retain tenants will alleviate such risks and may result in higher prices.

Acquisitions could go beyond Singapore. The Manager remains keen to grow the portfolio through acquisitions. Given the limited accretive deals in Singapore, EREIT has broadened its investments to Australia, Japan, and China, which the Manager has identified as having similar sovereign risks and transparency characteristics as Singapore.

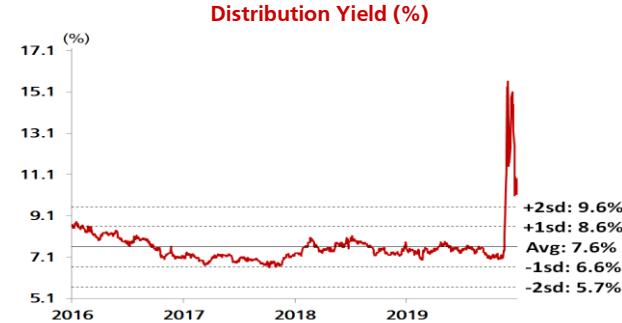
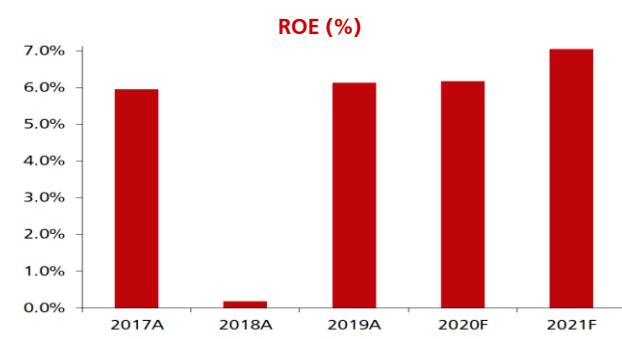
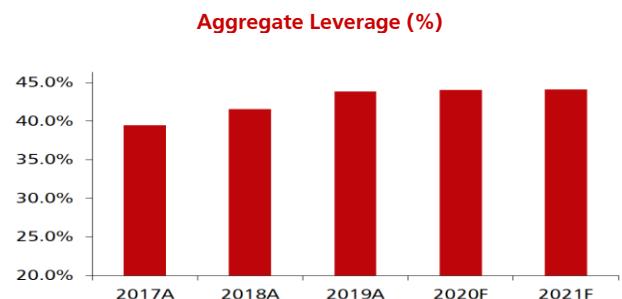
Key Risks:

Interest rate risk. Any increase in interest rates will result in higher interest payments, which will reduce income available for distribution and result in lower distribution per unit (DPU) to unitholders. That said, EREIT has substantially hedged its interest rate exposure.

Economic risk. A deterioration in Singapore's economic outlook could have a negative impact on industrial rents and occupancies as companies cut back production and require less space. Industrial rents have a strong correlation with GDP growth and the current COVID-19 pandemic could pose a challenge to rental and occupancy rates.

Company Background

ESR-REIT (EREIT, previously known as Cambridge Industrial REIT) is a real estate investment trust which invests primarily in income-producing industrial assets located in Singapore.



Source: Company, DBS Bank

Income Statement (\$\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Gross revenue	110	157	253	227	245
Property expenses	(31.3)	(44.9)	(65.1)	(62.2)	(67.1)
Net Property Income	78.4	112	188	165	177
Other Operating expenses	(9.2)	(11.7)	(17.5)	(17.3)	(17.4)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	(1.5)	0.0	0.0
Net Interest (Exp)/Inc	(20.3)	(27.4)	(61.9)	(45.3)	(45.5)
Exceptional Gain/(Loss)	0.22	(299)	(5.4)	0.0	0.0
Net Income	49.2	(226)	102	102	115
Tax	0.0	(0.1)	0.0	0.0	0.0
Minority Interest	(0.8)	(4.2)	(3.8)	(2.0)	(2.0)
Preference Dividend	(0.6)	233	(6.1)	(7.0)	(7.0)
Net Income After Tax	47.8	1.95	91.6	92.9	106
Total Return	0.0	0.0	0.0	92.9	106
Non-tax deductible Items	50.9	308	117	7.00	7.00
Net Inc available for Dist.	50.9	74.5	133	99.9	113
Growth & Ratio					
Revenue Gth (%)	(2.1)	43.0	61.3	(10.4)	7.8
N Property Inc Gth (%)	(4.7)	42.8	67.7	(12.5)	7.8
Net Inc Gth (%)	(9.8)	(95.9)	4,588.4	1.4	13.5
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	71.5	71.4	74.3	72.6	72.6
Net Income Margins (%)	43.6	1.2	36.2	41.0	43.1
Dist to revenue (%)	46.4	47.5	52.4	44.1	46.0
Managers & Trustee's fees	8.4	7.5	6.9	7.6	7.1
ROAE (%)	6.0	0.2	6.1	6.2	7.0
ROA (%)	3.1	0.1	2.9	2.9	3.3
ROCE (%)	4.7	4.4	5.6	4.7	5.1
Int. Cover (x)	3.4	3.7	2.8	3.3	3.5

Source: Company, DBS Bank

Lower earnings due to
lower rental and occupancy
assumptions

Balance Sheet (S\$m)

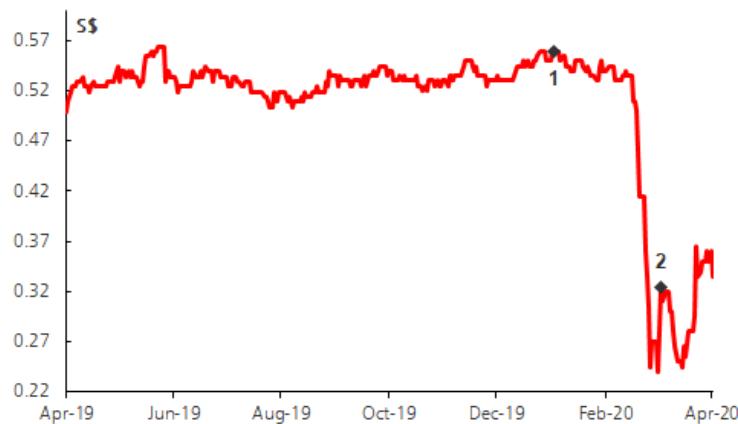
FY Dec	2017A	2018A	2019A	2020F	2021F
Investment Properties	1,652	3,016	2,934	2,937	2,940
Other LT Assets	0.0	0.0	267	267	267
Cash & ST Invts	11.7	17.7	15.7	5.05	4.29
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	8.37	11.1	12.1	17.3	18.7
Other Current Assets	23.6	5.70	0.0	0.0	0.0
Total Assets	1,696	3,051	3,230	3,227	3,231
ST Debt	155	282	160	160	160
Creditor	28.6	58.2	47.8	45.4	48.9
Other Current Liab	60.6	61.1	63.7	63.7	63.7
LT Debt	515	986	1,031	1,036	1,041
Other LT Liabilities	6.78	32.4	267	267	267
Unit holders' funds	930	1,631	1,660	1,653	1,646
Minority Interests	0.0	0.0	0.0	2.05	4.10
Total Funds & Liabilities	1,696	3,051	3,230	3,227	3,231
Non-Cash Wkg. Capital	(57.3)	(102)	(99.4)	(91.7)	(93.9)
Net Cash/(Debt)	(658)	(1,251)	(1,175)	(1,191)	(1,197)
Ratio					
Current Ratio (x)	0.2	0.1	0.1	0.1	0.1
Quick Ratio (x)	0.1	0.1	0.1	0.1	0.1
Aggregate Leverage (%)	39.5	41.6	43.8	44.0	44.1
Z-Score (X)	0.7	0.3	0.7	0.7	0.7

Source: Company, DBS Bank

Cash Flow Statement (S\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Income	49.2	6.22	95.5	95.0	108
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc/(Loss)	0.0	0.0	1.52	0.0	0.0
Chg in Wkg.Cap.	(0.3)	(35.1)	(1.2)	(7.7)	2.20
Other Operating CF	20.1	96.7	83.8	0.0	0.0
Net Operating CF	69.0	67.8	180	87.3	110
Net Invn in Properties	(63.3)	(149)	(12.6)	(3.0)	(3.0)
Other Invnts (net)	(241)	0.0	0.0	0.0	0.0
Invnts in Assoc. & JV	0.0	0.0	(44.6)	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	1.86	0.0	0.0
Other Investing CF	0.11	0.05	0.02	0.0	0.0
Net Investing CF	(304)	(149)	(55.4)	(3.0)	(3.0)
Distribution Paid	(46.0)	(59.0)	(128)	(99.9)	(113)
Chg in Gross Debt	308	43.5	(77.6)	5.00	5.00
New units issued	(0.1)	141	147	0.0	0.0
Other Financing CF	(19.4)	(37.7)	(66.3)	0.0	0.0
Net Financing CF	243	87.6	(125)	(94.9)	(108)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	7.95	6.01	(0.5)	(10.6)	(0.8)
Operating CFPS (S cts)	5.29	5.34	5.43	2.70	3.05
Free CFPS (S cts)	0.43	(4.2)	5.02	2.40	3.03

Source: Company, DBS Bank

Target Price & Ratings History

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	24 Jan 20	0.56	0.59	BUY
2:	25 Mar 20	0.33	0.59	BUY

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

Source: DBS Bank

Analyst: Dale LAI

Derek TAN

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

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