Singapore Company Guide

Ascendas REIT

Version 17 | Bloomberg: AREIT SP | Reuters: AEMN.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

24 Jul 2020

BUY

Last Traded Price (23 Jul 2020): S$3.43 **(STI :** 2,612.35)
Price Target 12-mth: S$4.00 (17% upside) (Prev S$3.45)

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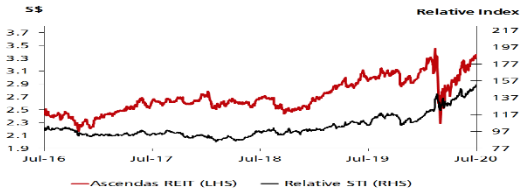
What's New

- 1H20 operating and financial metrics remain resilient
- Brighter reversionary prospects a bright spot; organic growth outlook stable.
- Acquisitions is a catalyst to reaccelerate growth momentum.
- Riding on multiple tailwinds; BUY, lift TP to S$4.0

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2019A	2020F	2021F	2022F
Gross Revenue	699	1,072	1,094	1,110
Net Property Inc	538	775	846	860
Total Return	377	523	586	591
Distribution Inc	375	543	606	611
EPU (S cts)	9.78	14.5	15.9	15.8
EPU Gth (%)	(36)	48	10	(1)
DPU (S cts)	11.5	15.0	16.2	16.4
DPU Gth (%)	(28)	31	8	1
NAV per shr (S cts)	216	215	216	215
PE (X)	35.1	23.7	21.5	21.7
Distribution Yield (%)	3.3	4.4	4.7	4.8
P/NAV (x)	1.6	1.6	1.6	1.6
Aggregate Leverage (%)	38.6	39.3	39.5	39.6
ROAE (%)	4.6	6.7	7.4	7.3
Distn. Inc Chng (%):		(7)	2	1
Consensus DPU (S cts):		15.3	16.0	16.3
Other Broker Recs:		B: 18	S: 1	H: 2

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

Fuel cells of the new economy

Maintain BUY, TP raised to S$4.00. We have raised our TP for Ascendas REIT (A-REIT) to S$4.00 in anticipation that A-REIT will catch up with its large cap peers in terms of valuation. We believe that investors have neglected A-REIT's myriad of structural tailwinds which will drive earnings and capital values higher in the longer term. The REIT remains in a virtuous cycle of growth and we see a boost from potential accretive acquisitions. We lift our TP to S$4.00 as we lower our WACC assumptions and assume S$500m worth of acquisitions.

Where we differ: Multiple structural tailwinds. A-REIT's value is in its diversity and exposure to multiple structural tailwinds. While investors have focused on acceleration in demand for logistics (27% of AUM) and datacenters (5%), most have largely ignored A-REIT's valuable business parks exposure (43% of AUM - 32% in SG, 11% in the US) which would benefit from the future trend towards decentralised offices as more companies adopt flexible working arrangements.

Where will A-REIT's next billion in Acquisition come from? A-REIT's share price is trading within a virtuous cycle at an implied cost of capital that is conducive for accretive acquisitions We believe the next billion in deals will likely come from its Singapore business park properties in One North region, which its Sponsor may be looking to divest and should be well received by investors. We have assumed conservatively assumed S$500m in our estimates.

Valuation:

Our DCF-based TP is raised to S$4.00 as we assume (i) lower WACC of 5.8% (from 6.1%); and (ii) acquisitions of S$500m.

Key Risks to Our View:

Interest-rate risk. An increase in lending rates will negatively impact dividend distributions.

At A Glance

Issued Capital (m shrs)	3,620
Mkt. Cap (Sm/USm)	12,417 / 8,959
Major Shareholders (%)	
Ascendas Pte Ltd	19.2
Blackrock	6.0
Free Float (%)	74.8
3m Avg. Daily Val (US$m)	29.2

GIC Industry : Real Estate / Equity Real Estate Investment (REITs)

WHAT'S NEW

Fuel cells of the new economy

(+) 1H20 DPU of 7.2 Scts (-11% y-o-y, -3% h-o-h).
Ascendas REIT (A-REIT) reported a 14.6% and 11.1% rise in 1H20 revenues and net property income (NPI) to S$521.2m and S$388.0m respectively. The stronger performance was largely driven by contribution from 28 properties in the US and two business parks acquired in December 2019. This was partially offset by rental rebates provided to eligible tenants (c.S$9.6m), income vacuum from divestments and ongoing developments, and lower occupancies in Singapore. Distributable income rose by 3.7% y-o-y to S$263.2m. The drop in DPU was largely due to the enlarged unit base and a one-off DPU boost of 0.25 Scts a year ago from a rollover tax adjustment excluding this, the drop would have been lower at 8.0%.

(+) Balance sheet metrics stable; natural hedges in place defend NAV against forex volatility.
Gearing stayed stable at 36.1% (vs 35.1% a quarter ago) which was due to incremental debt taken to fund the recent acquisition of a 25% stake in The Galaxis. Overall financial metrics remain stable - ICR ratio at 4.2x and 92% of its properties are unencumbered. Debt cost remained stable at 2.9% with c.81% of interest costs fixed. A-REIT has taken a natural hedging strategy in its overseas investments with Australia (77% hedged), GBP (100%) and USD (100%) implying minimal volatility to NAVs from currency movements.

Outlook & Our recommendation

(+) Quiet optimism that the worst is over.
Stripping off the contribution from new acquisitions in the US, organic performance was respectable. While we understand A-REIT estimates rental rebates to be S$20m in total (before property tax rebates of a similar amount), close to half of this has been disbursed. Depending on the trajectory of the economic recovery, the actual amount may be lesser than expected. That said, we have been conservative and have assumed rebates of S$20m in our FY20F earnings projections.

(+) Slight dip in occupancy rates expected; but brighter outlook for reversions.
A-REIT's portfolio occupancy rates maintained stable, dipping 2 ppts to 91.5%, driven from Australia (98.4%, +1.1 ppt q-o-q, with marginal dips in Singapore (87.9%,-0.7ppt), UK (97.5%, stable) and USA (92.1%, -0.8ppt). A-REIT's same-property occupancy for Singapore properties remained flattish at 85.0% in June 2020, arresting the dip seen in this segment over the past few quarters.

Rental reversions have been tracking above our estimates at 4.3% in 1H20 (4.3% in 2Q20, 8.0% in 1Q20). We saw strong rental reversions across its markets (Singapore +4.0%, Australia +16.6%, US +16.2%). We note that the Singapore's rental reversionary performance was impacted by a tenant in the Hi-specs segment (-30.6% negative rent reversions).

Looking ahead, the sense we get from management is one of quiet optimism as the economy gradually grinds itself back towards pre-COVID levels. A-REIT's leading position within the business parks, hi-spec industrial properties, and logistics sectors will enable the REIT to capture a wider spectrum of industries. Key sources of demand for 1H20 mainly came from the logistics, engineering & IT/datacenters.

(+) The world is its oyster as acquisition momentum to restart and drive further upside. With A-REIT trading at a conducive cost of capital, we believe that acquisitions will remain a big part of its strategy in 2H20, augmenting a stronger growth profile in 2021 and beyond. We have assumed S$500m in acquisitions in our estimates (60% equity/40% debt) which we believe can be achieved through (i) acquiring a part of its Sponsor's pipeline of business park assets, and (ii) third party acquisitions in UK, Australia and the US.

(+) Time to fuel multiple structural tailwinds; TP raised to S$4.00, implying target FY21 yield of 4.0%. A-REIT has been lagging its other industrial S-REIT leaders (MINT and MLT) YTD and we believe it is time for A-REIT to reclaim its spot among the top. We see multiple structural tailwinds for A-REIT: (i) Greater adoption of e-commerce driving demand for logistics properties (in SG, UK and Australia totalling 27% of AUM); (ii) Increasing demand for datacenters (c.5% of AUM) from IoT, cloud adoption etc.; (iii) Unique to A-REIT is its deep seated exposure in the business parks segment (43% of AUM - SG: 32%, US: 11%). The trend towards more flexible working arrangements by companies may drive a decentralisation trend which would benefit A-REIT and fuel redevelopment of its older science park properties with higher plot ratios.

(-) Estimates revised. We have revised our estimates down by 7% in FY20F on the back of rental rebates coupled with lower occupancy assumptions and higher unit base. We have also priced in acquisitions of S$500m by end of FY20F.

Half year financial metrics

Summary of results (S$'m)	1H20	1H19	% y-o-y	2H19	% Chg
Revenue	521.2	455	14.6%	469	11%
Net property income	388	349	11.1%	360	8%
Distributable income	263.2	254	3.7%	251	5%
DPU (est)	7.27	8.153	-10.8%	7.49	-3%
Quarterly rental reversion (%)	4.30%	2.7%	-	6.0%	-
Aggregate leverage	36.10%	37.2%	-	35.1%	-
Interest Coverage Ratio	4.2x	4.2x	-	4.0x	-

Source of all data: Company, DBS Bank

Relative performance vs industrial large caps

Source: Bloomberg Finance L.P., DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Rebound in occupancy rates to provide upside to earnings. A-REIT's Singapore portfolio's occupancy rate is projected to remain stable in the medium term and hover around the c.85% level as the Manager looks to actively engage tenants and new prospects. Given A-REIT's scale in Singapore, the Manager continues to attract a diverse tenant base to its properties, despite the competitive operating environment. The key reasons are the variety of asset types and its focus on business parks and hi-tech properties, which continue to see good demand.

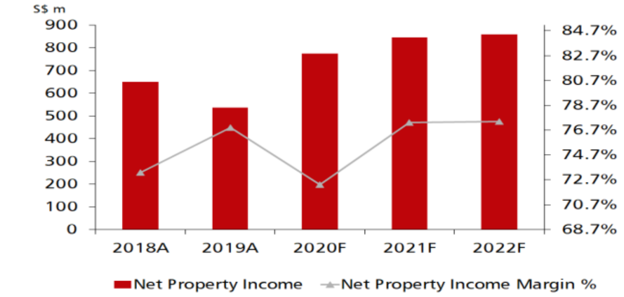
Looking ahead, with close to c.10% of the portfolio still vacant, the ability to backfill the unoccupied space provides upside potential to our earnings estimates. A long portfolio-weighted average lease expiry (WALE) profile of 4.2 years means good earnings visibility for the REIT.

Potential upside to DPUs on bright outlook from Business Park segment and Australia exposure. Rental reversionary trends are moderating but are expected to remain in the low- to mid-single-digit range in the coming year, which is commendable. Given the narrowing spread between passing and market rents, we expect rental reversionary trends to remain flattish or even turn negative for selected sectors. We are positive on A-REIT's business and science park exposure which accounts for close to 37% of portfolio value. We project its Australian portfolio to deliver resilient earnings, backed by a weighted average lease expiry (WALE) of 4.5 years.

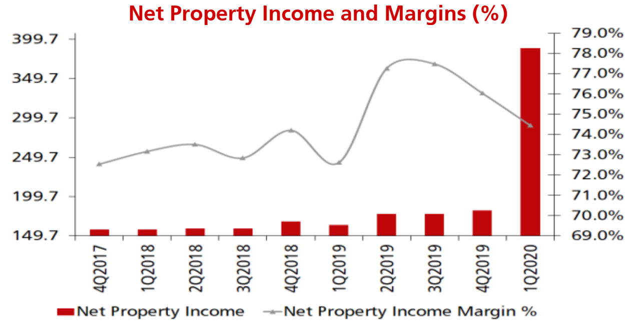
Overseas acquisitions to infuse diversity and stability to the REIT. A-REIT has regularly embarked on acquisitions and development projects, which have helped the REIT deliver sustained growth in distributions over time. The Manager has, over time, built up a substantial presence in Australia and the UK and now the US which forms c.30% of assets. The Manager remains focused on deepening its presence in its core markets to add diversity to the REIT's exposure and build resilience across business cycles.

US diversification brings benefits. While a new geography brings about its own element of risk, we believe that the US portfolio will over time prove to be beneficial for A-REIT. The properties are in key technology hubs in San Diego, Raleigh and Portland which see strong technology push in these cities' GDP, employment and leasing demand. We anticipate upside to the initial yield of 6.4% for the US portfolio when the leases are due in the coming years. In-built escalations of 2.5-4.0% anchor the REIT's organic growth.

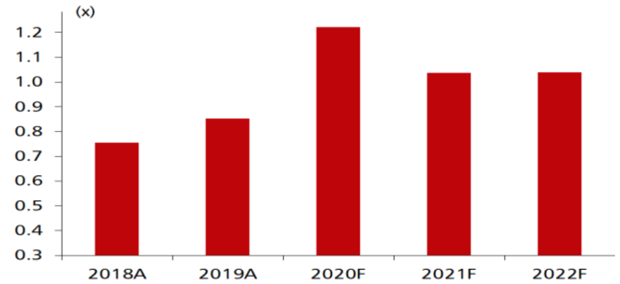
Net Property Income and Margins (%)



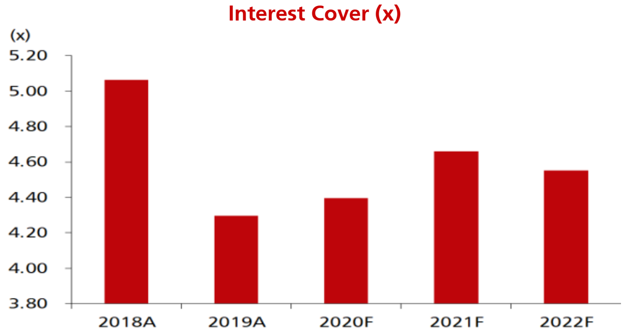
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Optimal gearing level of c.35%. A-REIT's gearing is stable at close to the lower end of management's comfortable 35-40% range. We believe that there is still capacity for management to utilise its debt headroom for acquisitions, but any significant deals could mean potential issuance of new equity.

Well-staggered debt maturity profile. The Manager adopts a prudent interest-rate risk management strategy with a weighted average cost of debt of 3.0% and c.80% hedged to fixed rates. The debt tenure is long at c.3.7 years, with a well spread-out refinancing profile ensuring no concentration risk.

Share Price Drivers:

Direction of 10-year long bonds impacts share price. Seen by investors as a key S-REIT proxy, A-REIT's share price has typically been closely linked to investors' perception on the direction of the US benchmark 10-year bond yields. A fall in 10-year bond yields on the back of a delay in Fed hikes is likely to mean a higher share price.

Capital recycling strategy. With limited third-party acquisition opportunities in Singapore, A-REIT regularly looks to divest older, lower-yielding properties and recycle the capital into asset-enhancement exercises (AEI), development projects or acquisitions. The aim is to optimise portfolio returns and distributions which have a positive impact on its share price.

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.

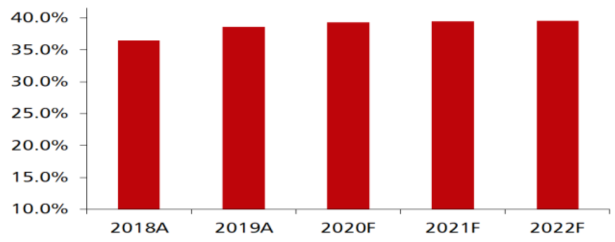
Environment, Social, Governance:

A-REIT is committed to upholding high standards of corporate governance, transparency, and accountability. The REIT has also enacted a Green Policy which details environmental targets and guidelines for implementation across its businesses. Its carbon emissions and electricity consumption for Singapore operations fell by 1.53% and 0.52% respectively over the course of the year.

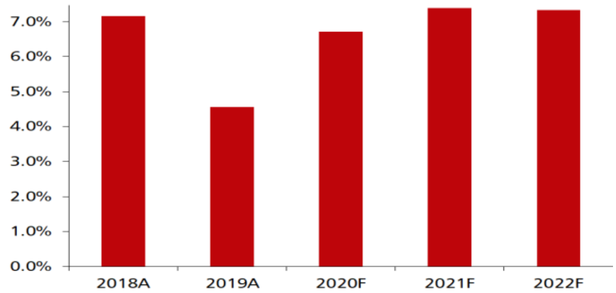
Company Background

A-REIT is Singapore's first and largest listed business space and industrial real estate investment trust. It has a diversified portfolio comprising assets in Singapore, UK, Australia and recently the US. A-REIT is managed by Ascendas Funds Management (S) Limited, a wholly owned subsidiary of the Singapore-based Ascendas-Singbridge.

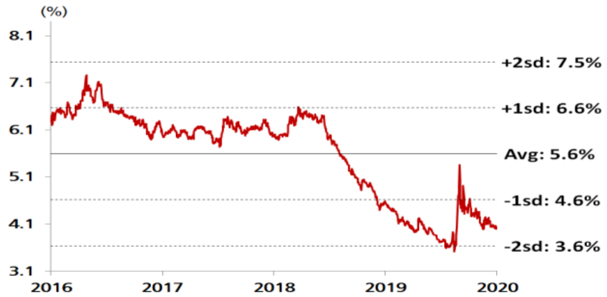
Aggregate Leverage (%)



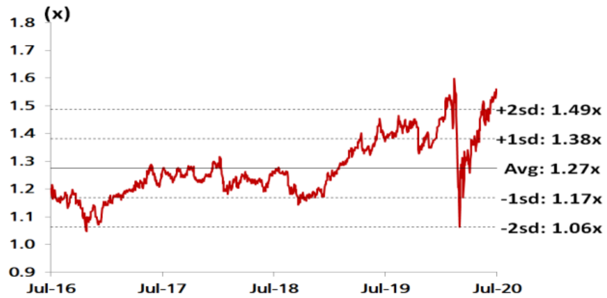
ROE (%)



Distribution Yield (%)



PB Band (x)



Source: Company, DBS Bank

Income Statement (S$m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Gross revenue	886	699	1,072	1,094	1,110
Property expenses	(237)	(161)	(296)	(248)	(251)
Net Property Income	650	538	775	846	860
Other Operating expenses	(62.1)	(50.3)	(76.0)	(77.6)	(79.0)
Other Non Opg (Exp)/Inc	11.1	(17.1)	0.0	0.0	0.0
Associates & JV Inc	0.49	0.41	6.12	6.12	6.12
Net Interest (Exp)/Inc	(116)	(113)	(159)	(165)	(172)
Exceptional Gain/(Loss)	5.09	3.22	0.0	0.0	0.0
Net Income	488	360	546	610	615
Tax	(14.4)	(20.7)	(12.1)	(13.1)	(13.5)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	(14.3)	(10.7)	(10.7)	(10.7)	(10.7)
Net Income After Tax	460	329	523	586	591
Total Return	489	377	523	586	591
Non-tax deductible Items	(17.4)	(12.5)	13.6	13.9	14.2
Net Inc available for Dist.	486	375	543	606	611
Growth & Ratio					
Revenue Gth (%)	2.8	(21.1)	53.3	2.1	1.5
N Property Inc Gth (%)	3.2	(17.2)	44.2	9.1	1.6
Net Inc Gth (%)	(3.5)	(28.4)	59.1	11.9	0.9
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	73.3	76.9	72.3	77.3	77.4
Net Income Margins (%)	51.9	47.1	48.8	53.6	53.2
Dist to revenue (%)	54.8	53.7	50.7	55.4	55.1
Managers & Trustee's fees	7.0	7.2	7.1	7.1	7.1
ROAE (%)	7.2	4.6	6.7	7.4	7.3
ROA (%)	4.2	2.6	3.8	4.1	4.1
ROCE (%)	5.3	3.7	5.0	5.4	5.4
Int. Cover (x)	5.1	4.3	4.4	4.7	4.6

Source: Company, DBS Bank

Driven by acquisitions

Quarterly / Interim Income Statement (S$m)

FY Dec	1Q2019	2Q2019	3Q2019	4Q2019	1Q2020
Gross revenue	225	230	230	240	521
Property expenses	(61.6)	(52.2)	(51.7)	(57.5)	(133)
Net Property Income	163	177	178	182	388
Other Operating expenses	(15.2)	(16.2)	(16.3)	(17.8)	(38.5)
Other Non Opg (Exp)/Inc	3.27	17.2	(0.7)	(33.6)	19.3
Associates & JV Inc	0	0	6	6	6
Net Interest (Exp)/Inc	(30.2)	(38.3)	(37.3)	(37.8)	(83.1)
Exceptional Gain/(Loss)	0.0	0.0	3.22	0.0	5.39
Net Income	**121**	**140**	**127**	**93.3**	**294**
Tax	(6.6)	(2.5)	(3.9)	(14.3)	(14.7)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	**115**	**138**	**123**	**79.0**	**279**
Total Return	144	138	123	127	279
Non-tax deductible Items	(31.0)	(29.0)	(16.1)	(20.1)	(15.9)
Net Inc available for Dist.	113	109	107	107	263
Growth & Ratio					
Revenue Gth (%)	(1)	2	0	4	117
N Property Inc Gth (%)	(3)	9	0	2	113
Net Inc Gth (%)	(11)	20	(11)	(36)	253
Net Prop Inc Margin (%)	72.6	77.3	77.5	76.0	74.4
Dist. Payout Ratio (%)	114.2	114.6	115.8	118.7	100.0

Balance Sheet (S$m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Investment Properties	11,236	13,543	13,653	14,183	14,213
Other LT Assets	82.2	69.4	75.5	81.6	87.7
Cash & ST Invts	52.3	95.7	47.3	45.7	42.5
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	39.6	36.3	47.9	48.9	49.7
Other Current Assets	4.11	119	119	119	119
Total Assets	**11,414**	**13,864**	**13,943**	**14,479**	**14,513**
ST Debt	612	614	754	784	814
Creditor	158	256	191	195	198
Other Current Liab	54.8	109	112	113	113
LT Debt	3,486	4,615	4,615	4,815	4,815
Other LT Liabilities	157	159	180	200	221
Unit holders' funds	6,946	8,111	8,092	8,371	8,351
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**11,414**	**13,864**	**13,943**	**14,479**	**14,513**
Non-Cash Wkg. Capital	(169)	(209)	(136)	(140)	(143)
Net Cash/(Debt)	(4,045)	(5,134)	(5,322)	(5,554)	(5,587)
Ratio					
Current Ratio (x)	0.1	0.3	0.2	0.2	0.2
Quick Ratio (x)	0.1	0.1	0.1	0.1	0.1
Aggregate Leverage (%)	36.5	38.6	39.3	39.5	39.6
Z-Score (X)	1.5	1.2	1.4	1.4	1.4

Gearing to remain stable

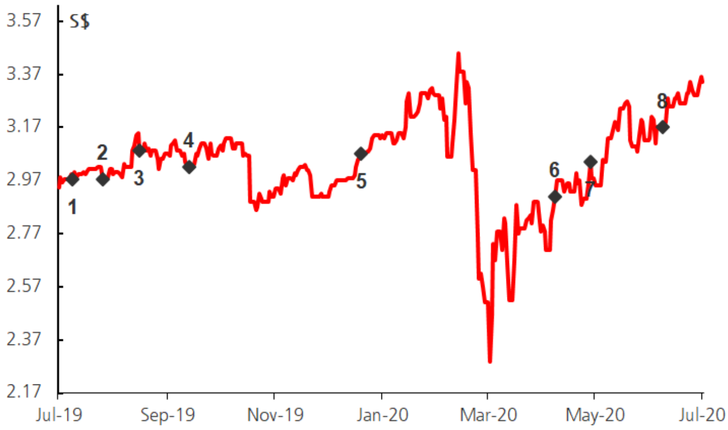
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2018A	2019A	2020F	2021F	2022F
Pre-Tax Income	488	360	546	610	615
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(5.7)	(3.6)	(9.1)	(12.1)	(13.1)
Associates &JV Inc/(Loss)	(0.5)	(0.4)	(6.1)	(6.1)	(6.1)
Chg in Wkg.Cap.	19.7	96.7	(76.1)	2.99	2.20
Other Operating CF	111	136	(10.7)	(10.7)	(10.7)
Net Operating CF	**612**	**589**	**444**	**584**	**588**
Net Invt in Properties	0.0	0.0	0.0	0.0	0.0
Other Invts (net)	(1,053)	(1,746)	(110)	(530)	(30.0)
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.51	0.36	0.0	0.0	0.0
Other Investing CF	24.4	20.6	20.6	20.6	20.6
Net Investing CF	**(1,028)**	**(1,725)**	**(89.5)**	**(509)**	**(9.5)**
Distribution Paid	(463)	(502)	(543)	(606)	(611)
Chg in Gross Debt	610	539	140	230	30.0
New units issued	448	1,298	0.0	300	0.0
Other Financing CF	(150)	(149)	0.0	0.0	0.0
Net Financing CF	**444**	**1,186**	**(403)**	**(75.9)**	**(581)**
Currency Adjustments	(1.2)	(0.6)	0.0	0.0	0.0
Chg in Cash	27.9	49.6	(48.4)	(1.6)	(3.2)
Operating CFPS (S cts)	19.6	14.6	14.4	15.8	15.7
Free CFPS (S cts)	20.3	17.5	12.3	15.9	15.7

Source: Company, DBS Bank

Target Price & Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	30 Jul 19	2.97	3.33	BUY
2:	16 Aug 19	2.97	3.33	BUY
3:	06 Sep 19	3.08	3.33	BUY
4:	04 Oct 19	3.02	3.33	BUY
5:	10 Jan 20	3.07	3.45	BUY
6:	29 Apr 20	2.91	3.45	BUY
7:	19 May 20	3.04	3.45	BUY
8:	29 Jun 20	3.17	3.45	BUY

Source: DBS Bank

Analyst: Derek TAN

Dale LAI

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: 24 Jul 2020 08:17:31 (SGT)
Dissemination Date: 24 Jul 2020 08:45:21 (SGT)

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

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