

Singapore Company Update

ESR-REIT

Bloomberg: EREIT SP | Reuters: ESRR.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

21 Jan 2021

BUY

Last Traded Price (20 Jan 2021): S\$0.410 (STI : 2,998.77)
Price Target 12-mth: S\$0.45 (10% upside) (Prev S\$0.43)

Analyst

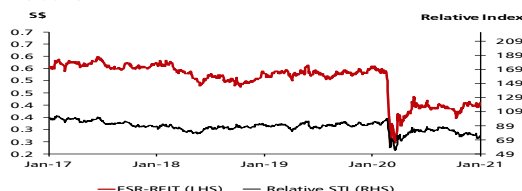
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What's New

- Stabilisation of earnings in 4Q20 led to a 1.9% q-o-q growth in core revenues
- Identified 3-4 properties with AEI opportunities that will generate a c.7% return to drive organic growth
- Targeting to acquire c. S\$1bn of properties from the sponsor's overseas pipeline in the next 3-4 years
- Maintain BUY with a slightly higher TP of S\$0.45

Price Relative



Forecasts and Valuation

| FY Dec (\$m) | 2019A | 2020A | 2021F | 2022F |
|------------------------|-------|-------|-------|-------|
| Gross Revenue | 253 | 230 | 245 | 247 |
| Net Property Inc | 188 | 164 | 178 | 179 |
| Total Return | 0.02 | 0.0 | 104 | 105 |
| Distribution Inc | 133 | 99.1 | 111 | 112 |
| EPU (S cts) | 2.75 | 1.68 | 2.88 | 2.89 |
| EPU Gth (%) | 2,615 | (39) | 71 | 0 |
| DPU (S cts) | 4.01 | 2.80 | 3.08 | 3.09 |
| DPU Gth (%) | 4 | (30) | 10 | 0 |
| NAV per shr (S cts) | 43.0 | 40.3 | 39.9 | 39.5 |
| PE (X) | 14.9 | 24.4 | 14.2 | 14.2 |
| Distribution Yield (%) | 9.8 | 6.8 | 7.5 | 7.5 |
| P/NAV (X) | 1.0 | 1.0 | 1.0 | 1.0 |
| Aggregate Leverage (%) | 43.8 | 44.1 | 44.2 | 44.3 |
| ROAE (%) | 6.1 | 4.0 | 7.2 | 7.3 |

Distn. Inc Chng (%): (1) (2) (2)
Consensus DPU (S cts): 2.90 3.10 3.40
Other Broker Recs: B: 6 S: 0 H: 2

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

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Brain Box

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Next leg of growth lies overseas

Investment Thesis

Stabilisation of earnings and core revenues. With operations stabilising, we expect core revenues to continue their gradual recovery and for FY21 DPU to increase c.10% y-o-y.

Resumption of AEIs to drive organic growth. As the COVID-19 pandemic stabilises, ESR-REIT ("EREIT") has resumed AEI works and embarked on new projects to drive organic growth. AEI plans in FY21 are expected to generate a return of c.7% compared to EREIT's estimated WACC of 5.5%.

Sponsor to provide acquisition pipeline. As EREIT focuses its efforts to acquire accretive assets overseas and to strengthen portfolio lease expiry, its Sponsor's US\$26bn portfolio provides the REIT with a pipeline.

Valuation:

Maintain BUY with TP of S\$0.45. Target price is based on DCF with a WACC of 6.8% (risk-free rate of 2.0%). We have not assumed any acquisitions or the effects of the proposed merger in our estimates.

Where we differ:

Organic growth opportunities within the portfolio. As the COVID-19 situation is stabilising, EREIT has resumed its AEIs and has identified further AEI opportunities to unlock value.

Key Risks to Our View:

Fund-raising. Despite the recent increase in leverage limits to 50%, EREIT's relatively high gearing of (41.6%) puts it at risk of requiring fund-raising to fund major capex expenses.

At A Glance

| | |
|--|---------------|
| Issued Capital (m shrs) | 3,576 |
| Mkt. Cap (\$m/US\$m) | 1,466 / 1,103 |
| Major Shareholders (%) | |
| Tong Jinquan | 23.4 |
| E-Shang Infinity Cayman Ltd | 7.9 |
| ESR Funds Management | 6.0 |
| Free Float (%) | 62.7 |
| 3m Avg. Daily Val (US\$m) | 1.8 |
| GIC Industry : Real Estate / Equity Real Estate Investment (REITs) | |



Live more, Bank less

ESR-REIT

WHAT'S NEW

Next leg of growth lies overseas

| Key operational data | 4Q2020 | 3Q2020 | %q-o-q | 4Q2019 | % y-o-y |
|-------------------------|--------|--------|----------|--------|----------|
| Revenue | 59 | 57 | 4.1% | 63 | -5.1% |
| NPI | 44 | 40 | 8.0% | 46 | -5.6% |
| DI | 27 | 25 | 6.9% | 29 | -8.9% |
| DPU (Scts) | 0.84 | 0.80 | 5.3% | 1.00 | -16.0% |
| Portfolio occupancies | 91.0% | 90.8% | 0.9 ppt. | 90.5% | 2.3 ppt. |
| WALE (years) | 3.0 | 3.0 | - 0.2 | 3.8 | 1.7 |
| Rental reversion | -0.6% | -0.2% | N.A. | 0.0% | N.A. |
| Aggregate leverage | 41.6% | 41.6% | 0.2 ppt. | 41.5% | - |
| Interest Coverage Ratio | 3.5 | 3.6 | 0.2x | 3.7 | - 0.1x |

Source: ESR REIT

Key details of 4Q20 results:

- Core revenue of S\$59.3m and NPI of S\$43.6m were a 4.2% and 7.9% q-o-q improvement respectively
- 4Q20 DPU of 0.84 Scts comprises core DPU of 0.741 Scts, and 0.099 Scts from retained income
- Portfolio occupancy inched up slightly to 91.0% with c.1.1m sqft of leases signed and renewed in 4Q20
- Rental reversions posted a slight 0.6% decline in 4Q20
- Gearing was maintained at 41.6% and all-in cost of debt was reduced to 3.54%

Our thoughts

(+ Quick recovery and stabilisation of core revenue

- Given the stability in operations and cashflow in 4Q20, EREIT has distributed the remaining income (0.099 Scts) that was retained earlier in the year
- Core earnings of S\$59.3m was a 4.2% q-o-q improvement; it does not expect to provide any significant rental relief or restructuring in FY21
- Core DPU of 0.741 Scts was up 5.9% q-o-q

(-) FY20 core DPU was down 20.7% mainly due to rental rebates as a result of COVID-19 pandemic

- Rental rebates provided for SMEs and retail tenants; c.S\$8.0m of rebates had been utilised in FY20
- Negative rental reversions and lease restructuring
- Non-renewal at several single-tenanted properties and the subsequent conversion of five single-tenanted buildings to multi-tenanted buildings

(+ Healthy occupancy rate a testament of quality portfolio and proactive lease management

- Despite the slowdown in leasing activities, occupancy rate remained healthy at 91.0%
- 3.8m sqft of leases signed and renewed in FY20; signed 1.6m sqft of new leases in FY20
- High tenant retention rate of c.85%

(+ AEI plans expected to generate a c.7.0% return on investment

- Plans to proceed with the development of a multi-tenanted high-spec addition at 7000 Ang Mo Kio Avenue 5
- Identified another two or three properties for AEI in FY21; estimated cost of S\$60-70m
- Ongoing AEI at UE BizHub EAST and 19 Tai Seng Avenue on track for completion in 1Q21 and 3Q21 respectively

(+ Expansion overseas to support portfolio land tenure, supported by pipeline assets from Sponsor

- Focusing on overseas acquisitions in FY21 by tapping on Sponsor's pipeline
- Will consider both income-producing assets as well as development projects (JV with Sponsor)
- Acquisitions will include both direct purchase and investments in private funds
- EREIT's current WACC is estimated to be c.5.5%
- Targeting to acquire c.S\$1.0bn over the next 3-4 years

ESR-REIT

(-) Pressure on rental reversions in FY21

- c.20.1% of leases due to expire in FY21; 18.0% from multi-tenanted buildings and 2.1% from single-tenanted buildings
- Spike in new supply in FY21 will likely put pressure on rents at general/light industrial properties
- Expect rental reversions to remain flat or slightly negative

(+) Expect further savings in borrowing costs

- All-in borrowing costs improved slightly to 3.54%
- In negotiations to early refinance the S\$191m of loans expiring in August and October 2021
- Further savings in finance costs expected, but will only gradually see the savings towards second half of FY21; all-in costs could go down to c.3.1% by year-end

Despite a y-o-y decline in core revenues, we believe that EREIT's 4Q20 earnings have stabilised and will continue to recover gradually going forward. The completion of the two ongoing AEIs during the year may provide further upside, and the c.S\$59m remaining in capital gains will be utilised to support any void in income from further AEIs.

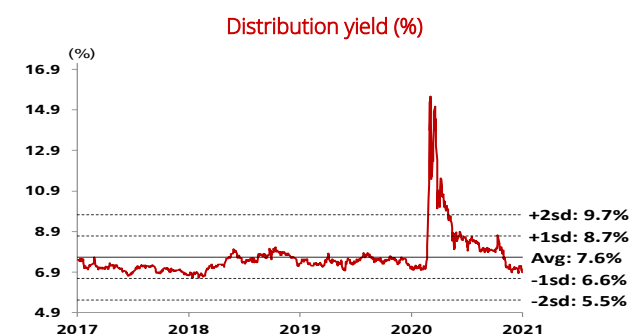
Given the current tightening in cap rates globally, EREIT's first overseas foray is likely to be in Australia. For accretive acquisitions, we believe EREIT will rely on a combination of income-producing assets as well as development projects (via JV or investment in private funds). Its Sponsor's sizeable pipeline, valued at more than US\$26bn, provides EREIT with ample opportunities to foray overseas.

We maintain our **BUY** recommendation on EREIT with a slightly higher TP of **S\$0.45**.

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.

Historical Dividend yield and PB band



Source: Bloomberg Finance L.P., DBS Bank estimates



Source: Bloomberg Finance L.P., DBS Bank estimates

ESR-REIT

Income Statement (\$m)

| FY Dec | 2018A | 2019A | 2020A | 2021F | 2022F |
|-----------------------------|--------------|-------------|-------------|------------|------------|
| Gross revenue | 157 | 253 | 230 | 245 | 247 |
| Property expenses | (44.9) | (65.1) | (65.7) | (67.3) | (67.8) |
| Net Property Income | 112 | 188 | 164 | 178 | 179 |
| Other Operating expenses | (11.7) | (17.5) | (23.3) | (23.3) | (23.5) |
| Other Non Opg (Exp)/Inc | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Associates & JV Inc | 0.0 | (1.5) | 3.01 | 3.04 | 3.07 |
| Net Interest (Exp)/Inc | (27.4) | (61.9) | (56.8) | (44.8) | (45.0) |
| Exceptional Gain/(Loss) | (299) | (5.4) | (14.7) | 0.0 | 0.0 |
| Net Income | (226) | 102 | 72.4 | 113 | 114 |
| Tax | (0.1) | 0.0 | 0.0 | 0.0 | 0.0 |
| Minority Interest | (4.2) | (3.8) | (3.0) | (2.0) | (2.1) |
| Preference Dividend | 233 | (6.1) | (9.7) | (7.0) | (7.0) |
| Net Income After Tax | 1.95 | 91.6 | 59.7 | 104 | 105 |
| Total Return | 0.0 | 0.02 | 0.0 | 104 | 105 |
| Non-tax deductible Items | 308 | 117 | 96.4 | 7.00 | 7.00 |
| Net Inc available for Dist. | 74.5 | 133 | 99.1 | 111 | 112 |
| Growth & Ratio | | | | | |
| Revenue Gth (%) | 43.0 | 61.3 | (9.1) | 6.6 | 0.8 |
| N Property Inc Gth (%) | 42.8 | 67.7 | (12.6) | 8.3 | 0.8 |
| Net Inc Gth (%) | (95.9) | 4,589.4 | (34.8) | 73.8 | 0.9 |
| Dist. Payout Ratio (%) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Net Prop Inc Margins (%) | 71.4 | 74.3 | 71.4 | 72.6 | 72.5 |
| Net Income Margins (%) | 1.2 | 36.2 | 26.0 | 42.3 | 42.4 |
| Dist to revenue (%) | 47.5 | 52.4 | 43.1 | 45.2 | 45.2 |
| Managers & Trustee's fees | 7.5 | 6.9 | 10.1 | 9.5 | 9.5 |
| ROAE (%) | 0.2 | 6.1 | 4.0 | 7.2 | 7.3 |
| ROA (%) | 0.1 | 2.9 | 1.9 | 3.3 | 3.3 |
| ROCE (%) | 4.4 | 5.6 | 4.6 | 5.1 | 5.1 |
| Int. Cover (x) | 3.7 | 2.8 | 2.5 | 3.4 | 3.5 |

Recovery in core revenues with the absence of further rental rebates and reliefs.

Source: Company, DBS Bank

ESR-REIT

Balance Sheet (\$m)

| FY Dec | 2018A | 2019A | 2020A | 2021F | 2022F |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Investment Properties | 3,016 | 2,934 | 2,889 | 2,892 | 2,895 |
| Other LT Assets | 0.0 | 267 | 268 | 271 | 274 |
| Cash & ST Invt | 17.7 | 15.7 | 18.1 | 9.72 | 4.10 |
| Inventory | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debtors | 11.1 | 12.1 | 12.2 | 18.7 | 18.8 |
| Other Current Assets | 5.70 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total Assets | 3,051 | 3,230 | 3,187 | 3,192 | 3,192 |
| ST Debt | 282 | 160 | 190 | 190 | 190 |
| Creditor | 58.2 | 47.8 | 62.3 | 66.4 | 67.0 |
| Other Current Liab | 61.1 | 63.7 | 66.4 | 66.4 | 66.4 |
| LT Debt | 986 | 1,031 | 988 | 993 | 998 |
| Other LT Liabilities | 32.4 | 267 | 282 | 282 | 282 |
| Unit holders' funds | 1,631 | 1,660 | 1,598 | 1,591 | 1,584 |
| Minority Interests | 0.0 | 0.0 | 0.0 | 2.05 | 4.14 |
| Total Funds & Liabilities | 3,051 | 3,230 | 3,187 | 3,192 | 3,192 |
| Non-Cash Wkg. Capital | (102) | (99.4) | (116) | (114) | (114) |
| Net Cash/(Debt) | (1,251) | (1,175) | (1,161) | (1,174) | (1,185) |
| Ratio | | | | | |
| Current Ratio (x) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Quick Ratio (x) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Aggregate Leverage (%) | 41.6 | 43.8 | 44.1 | 44.2 | 44.3 |
| Z-Score (X) | 0.3 | 0.6 | 0.6 | 0.6 | 0.6 |

Source: Company, DBS Bank

ESR-REIT

Cash Flow Statement (\$m)

| FY Dec | 2018A | 2019A | 2020A | 2021F | 2022F |
|----------------------------|--------------|---------------|--------------|--------------|--------------|
| Pre-Tax Income | 6.22 | 95.5 | 62.8 | 106 | 107 |
| 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 | 1.50 | (3.0) | (3.0) | (3.1) |
| Chg in Wkg.Cap. | (35.1) | (1.2) | 13.2 | (2.4) | 0.36 |
| Other Operating CF | 96.7 | 83.8 | 85.5 | 0.0 | 0.0 |
| Net Operating CF | 67.8 | 180 | 158 | 100 | 104 |
| Net Invnt in Properties | (149) | (12.6) | (10.9) | (3.0) | (3.0) |
| Other Invnts (net) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Invnts in Assoc. & JV | 0.0 | (44.6) | 0.0 | 0.0 | 0.0 |
| Div from Assoc. & JVs | 0.0 | 1.86 | 4.80 | 0.0 | 0.0 |
| Other Investing CF | 0.05 | 0.02 | 0.02 | 0.0 | 0.0 |
| Net Investing CF | (149) | (55.4) | (6.1) | (3.0) | (3.0) |
| Distribution Paid | (59.0) | (128) | (76.9) | (111) | (112) |
| Chg in Gross Debt | 43.5 | (77.6) | (14.0) | 5.00 | 5.00 |
| New units issued | 141 | 147 | (0.4) | 0.0 | 0.0 |
| Other Financing CF | (37.7) | (66.3) | (61.6) | 0.0 | 0.0 |
| Net Financing CF | 87.6 | (125) | (153) | (106) | (107) |
| Currency Adjustments | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Chg in Cash | 6.01 | (0.5) | (0.6) | (8.4) | (5.6) |
| Operating CFPS (S cts) | 5.34 | 5.43 | 4.09 | 2.85 | 2.87 |
| Free CFPS (S cts) | (4.2) | 5.02 | 4.15 | 2.70 | 2.79 |

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 |
| 3: | 24 Apr 20 | 0.32 | 0.43 | BUY |
| 4: | 30 Oct 20 | 0.35 | 0.43 | BUY |

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

Source: DBS Bank

Analyst: Dale LAI

Derek TAN

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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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