Singapore Industry Focus

Industrial S-REITs

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DBS Group Research . Equity

15 Mar 2021

A buyer on recent dips

- Good opportunity to accumulate large cap Industrial S-REITs as recent correction of c.18% is close to 21% peak-to-trough drop in 2013 led by taper tantrum
- Misconception of "lack of growth"; Industrial S-REITs to deliver acquisition-led 7% y-o-y growth in FY21F DPU, 2.5% above pre-pandemic level
- Well plugged into future structural trends with significant exposure in "new economy" assets
- Picks are A-REIT, FLCT and MLT

Time to accumulate. The large cap industrial S-REITs have corrected by 18% from its recent peak due to a spike in 10-year yields and rotational interest into the more cyclical retail/office subsectors. That said, we see value emerging as the recent price decline mirrors closely to that seen in 2013's taper tantrum days (c.21% peak-to-trough decline) but fundamentals are stronger now. While investors were rightly worried about a spike in yields impacting returns, we believe this is priced in at current levels. We are buyers on dips given (i) FY21F DPU growth to accelerate to c7.%, and A-REIT and FLCT offer good value with yield spreads of c.4.1%, wider than pre-pandemic levels. We also like MLT for its Asia Pacific footprint and pivot into the Indian logistics space.

Misconception that industrial S-REITs lack "growth", ability to deliver pre-pandemic DPUs in FY21 not priced in . While investors lament on the lack of "growth" for the industrial S-REITs in 2021, we would like to correct this misconception. Income disruption in 2020 (COVID) was the least compared to other real estate subsectors. In fact, the industrial subsector is projected to deliver c.2.5% higher DPUs compared to FY19 (pre-pandemic) while delivering an acquisition fueled DPU growth of c.7% in FY21. The large cap industrial S-REITs trade at a FY21 yield of 4.9% (spread of c.3.3%), in line with pre-pandemic days. Among the large caps, A-REIT trades a yield spread that is even wider when compared to its 3-yr/5-yr mean and 2013 taper tantrum days, offering very good value.

Best plugged into post COVID-19 structural growth trends. We believe that large cap industrial S-REITs remain in a virtuous cycle of acquisition growth, with the ability to deliver on accretive deals to drive upside to our c.7% growth in DPU estimate. The sector's earnings resilience is now stronger with the pivot to more new economy assets (Business Parks, Logistics and Data-centers) which formed c.77% of assets in 2020 from c.60% in 2013.

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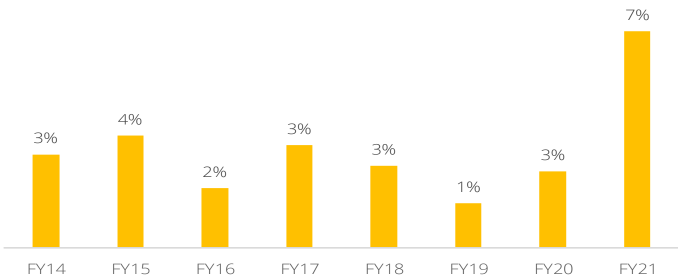
STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
Ascendas REIT	2.91	8,700	4.00	(0.7)	(12.4)	BUY
Mapletree Logistics Trust	1.80	5,535	2.35	(5.3)	(4.3)	BUY
Mapletree Industrial Trust	2.59	4,528	3.25	(7.5)	(11.3)	BUY
Frasers Logistics & Commercial Trust	1.39	3,544	1.85	0.7	13.0	BUY
Keppel DC REIT	2.56	3,109	2.80	(6.6)	9.4	HOLD

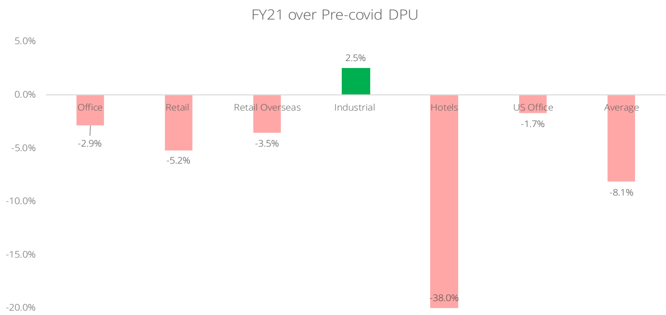
Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 12 Mar 2021

DPU growth profile for large cap industrial S-REITs



Source: DBS Bank

Industrial S-REITs DPU (FY21 vs pre-pandemic)



Source: DBS Bank

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ed: JS/ sa: PY, CS

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Price declines have mirrored pre-pandemic days

10-year yields have spiked recently on inflation fears. Investors are justifiably nervous given the recent correction in S-REITs' stock prices as market focus turned to inflation fears driving a sharp spike in 10-year yields in recent weeks. Expectations of higher inflation have brought US 10-yr yields higher to 1.5%, representing 85bps rise over 3 months since the bottom in Nov 2020.

This had also pulled the SG 10-year yield by close to 75bps to c.1.55% (10 March 2021) over the same period. We however note that most of the spike in the 10-year yields happened in Feb 2021 (55 bps points for the US 10-yr yield and c.40 bps points for SG 10-year yield). Generally, we have seen S-REITs underperform the STI when the 10-yr yield spikes up rather than a gradual rise as the latter represents steady economic recovery which would drive rentals and occupancy rates. With most the spike in yields largely done (according to our interest rate strategists), we believe that a period of share price stability will return.

Large cap industrial S-REITs have underperformed year-to-date. S-REITs started the year brightly in 2021 but performance reversed in Feb and early Mar with the spike in the 10-year yields, and share prices have declined by c.4% year to date (YTD) or c.9% from the peak in Jan 2021. The large cap industrial S-REITs have come under pressure of late, with A-REIT, MINT, MLT, FLCT and KDCREIT underperforming the broad index (FSTREI), down 18% from the recent peak (vs 8% decline in the FSTREI) as of 10 March 2021.

The share price drop in the industrial subsector is largely expected given the ongoing rotational interest to the cyclical subsectors (i.e. retail, office and hospitality) in recent times. At current levels, we believe the correction for the larger cap S-RETIs is largely done, especially when the price decline (peak-to-trough) closely mirrors that seen during the 2013 taper tantrums.

Time to buy the dip. When compared against the peak-to-trough performance of the top 10 S-REITs back in 2013, we note that industrial S-REITs have now dropped close to the c.21% fall that we saw in 2013. We thus see value and would take the opportunity to re-enter selected industrial S-REITs. Large cap industrial S-REITs are poised to deliver c.7% y-o-y growth in DPU in FY21 on the back of earnings recovery and acquisitions.

Summary of share price performance (top 10 S-REITs by market cap)

	Sector	Price 10th Mar	% Chg Beg 2021	% Chg Beg 2020	% Chg Covid-Low	% Chg Recent Peak	2013 Taper tantrum Peak-Trough
AREIT	Industrial	2.85	-5%	-5%	20%	-24%	-24%
MLT	Industrial	1.78	-13%	3%	30%	-14%	-21%
MINT	Industrial	2.55	-13%	-2%	25%	-15%	-18%
FLT	Industrial	1.35	-7%	8%	50%	-16%	n.a.
KDC	Industrial	2.54	-11%	17%	31%	-19%	n.a.
Average industrial (large cap)		-	-10%	4%	31%	-18%	-21%
CICT	Commercial	2.08	-4%	-18%	27%	-13%	-20%
KREIT	Commercial	1.14	3%	-8%	29%	-7%	-26%
FCT	Retail	2.39	-3%	-18%	32%	-10%	-24%
MCT	Commercial	2.01	-6%	-19%	25%	-11%	-25%
Suntec	Commercial	1.52	0%	-22%	28%	-5%	-23%
FSTREI		817.75	-4%	-13%	28%	-9%	-21%
STI		3,108.50	8%	-4%	28%	0%	-12%

Source: Bloomberg Finance L.P., DBS Bank

Well positioned for the future

Yields reflect the industrial S-REIT pivot to "new economy" assets. From a yield perspective, the recent correction has brought yields for the large cap industrial S-REITs to c.4.9% on average (ranging c.3.8% to 5.6%), which is at its 2-year average and close to pre-pandemic levels. The exception is A-REIT which currently trades at c.5.6% forward yield, highest when compared to the past few years and close to yields in the taper tantrum days in 2013.

From a yield spread perspective (yields compared to the 10-yr SG yields), the sector is already trading at its pre-pandemic valuation levels with A-REIT a standout at 4.1% (vs 3.3% in pre-pandemic FY19 and 4.0% in taper tantrum days). Despite the tighter spreads for the other industrial S-REITs, we believe that investors are ignoring the large cap industrial S-REITs strong DPU growth of c.7.0% in FY21 and pivot towards the more specialized industrial real estate class (or new economy assets), which should accelerate their growth prospects with lower earnings risk.

As such, see ample buffers. Catalysts that would bring flows back to the S-REITs are (i) stability in the 10-year yields, and (ii) increased confidence on their earnings growth trajectory (by 1Q21 in our view) and acquisitions. Our strategy is to take advantage of the correction to accumulate, as per our earlier report: Singapore REITs: Beating the odds.

Yields and Yield spreads (vs 10-year yields over time)

	AREIT	MINT	MLT	FLCT	KDCREIT	Average
Asset focused:	BP/Log/DC	BP/DC	Log	Log	DC	
	Yield (%)	Yield (%)	Yield (%)	Yield (%)	Yield (%)	Yield (%)
5yr avg.	5.8%	5.7%	5.8%	6.4%	4.9%	5.7%
3yr avg.	5.4%	5.2%	5.2%	6.2%	4.4%	5.3%
2yr avg.	5.1%	4.8%	4.7%	5.9%	4.0%	4.9%
Current	**5.6%**	**4.7%**	**4.6%**	**5.7%**	**3.8%**	**4.9%**
Avg. Pre-pandemic (2019)	5.2%	5.4%	5.2%	5.9%	4.5%	5.2%
High Covid-19 (2020)	5.2%	5.0%	5.2%	8.0%	4.1%	5.5%
Avg. Taper Tantrum (2013)	6.1%	7.1%	6.4%	n.a.	n.a.	6.5%
	Spread (%)	Spread (%)	Spread (%)	Spread (%)	Spread (%)	Spread (%)
5yr avg.	3.9%	3.8%	4.0%	4.5%	3.0%	3.8%
3yr avg.	3.7%	3.5%	3.4%	4.4%	2.7%	3.5%
2yr avg.	3.6%	3.3%	3.3%	4.4%	2.5%	3.4%
Current	**4.1%**	**3.1%**	**3.0%**	**4.1%**	**2.3%**	**3.3%**
Avg. Pre-pandemic (2019)	3.3%	3.5%	3.3%	3.9%	2.5%	3.3%
High Covid-19 (2020)	4.3%	3.8%	3.9%	6.8%	3.0%	4.3%
Avg. Taper Tantrum (2013)	4.0%	5.0%	4.4%	n.a.	n.a.	4.5%

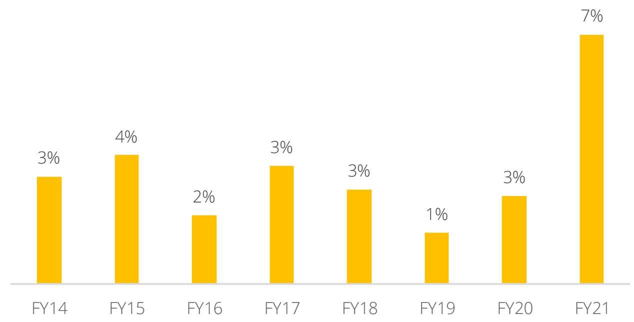
** BP: Business Park, Log: Logistics; DC: Datacenter*
Source: company, DBS Bank

Positioned to capture future growth prospects

The 5 large cap industrial REITs' asset under management (AUM) have grown by almost 3x in size and expanded outside of Singapore in order to bring diversity and growth to unitholders. The REITs (through mandates) have now pivoted towards more specialised industrial assets (i.e. business parks/suburban offices or logistics and data-centers) which have more resilient demand and expected to continue growing in a post COVID-19 world.

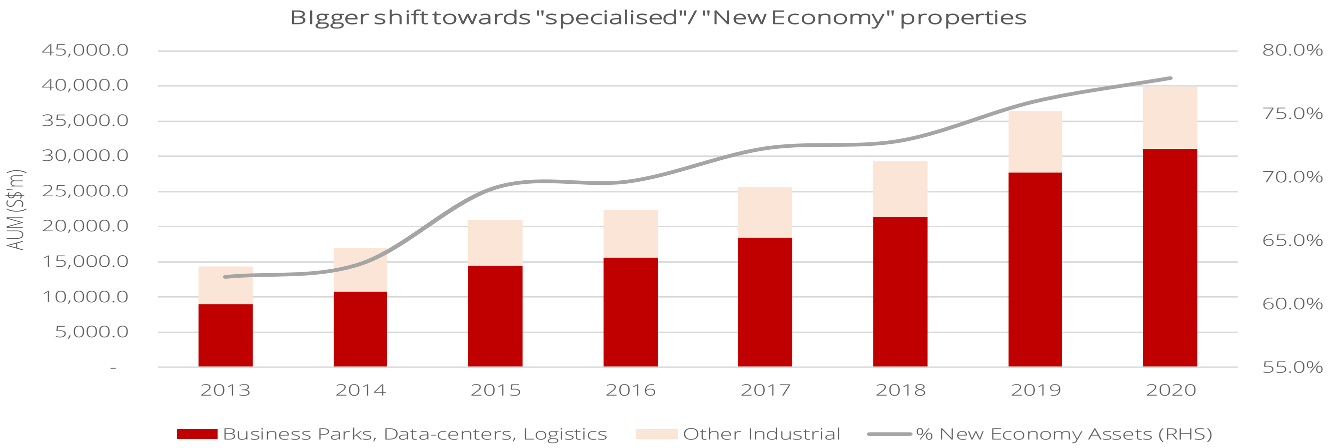
As a percentage of assets, the large cap industrial S-REITs have close to 77% in the above mentioned "new-economy" asset classes compared to c.60% back in 2013. This significant shift should offer investors comfort that earnings and DPU are on a growth track.

DPU growth profile (large cap industrial S-REITs)



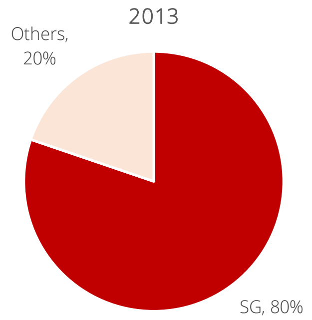
Source: Companies, DBS Bank

Positioned towards more "specialized" industrial or "new-economy" assets - now at c.77% of asset base



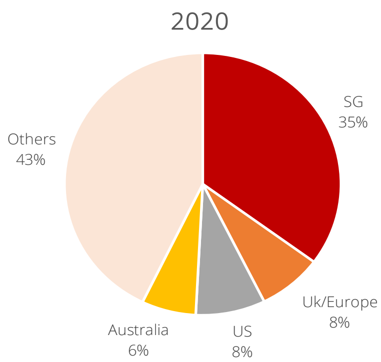
Source: Companies, DBS Bank

Geographical breakdown (2013)



Source: Companies, DBS Bank

Geographical breakdown (2020)



Source: Companies, DBS Bank

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Ability to deliver pre-pandemic DPUs this year is not priced in

Industrial S-REITs ability to deliver pre-pandemic DPU not priced in. The DPU growth for the industrial subsector is projected to grow at c.7% in FY21, but this is lower compared other subsectors which range between +c.3.0% to +c.43%. That said, the lower growth rate is due to limited income disruption seen in FY20. Recall that due to the circuit breaker in Singapore in Apr-May 2020, and mandatory shutdowns across the globe, landlords in general had to provide rental incentives to tenants. Retail landlords were impacted the most with industrial and office landlords seeing lesser impact as their tenants remained in operation.

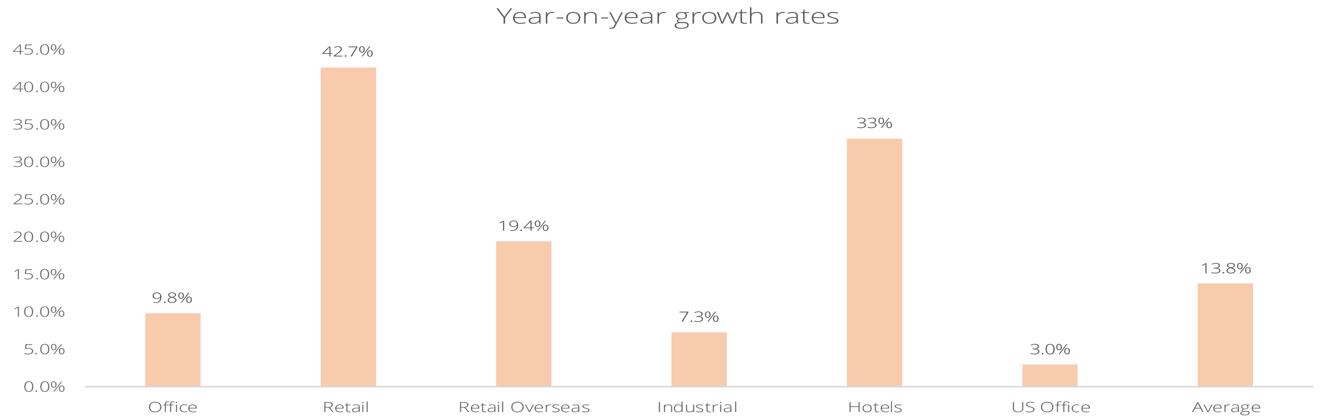
Among the industrial S-REITs, we estimate that DPUs of industrial large cap S-REITs is projected to grow by an average of c7% y-o-y in FY21, and projected to deliver c.2.5% higher DPU on average than pre-pandemic DPU (FY19).

DPU growth profiles for the top 5 market cap industrial REITs

	FY21F (% Chg y-o-y)	FY21F vs FY19F (%)
AREIT	9.6%	0.6%
MINT	8.5%	6.0%
MLT	3.8%	4.4%
FLT	7.7%	5.5%
KDC REIT	9.2%	28.1%
Industrial Average	7.3%	2.5%

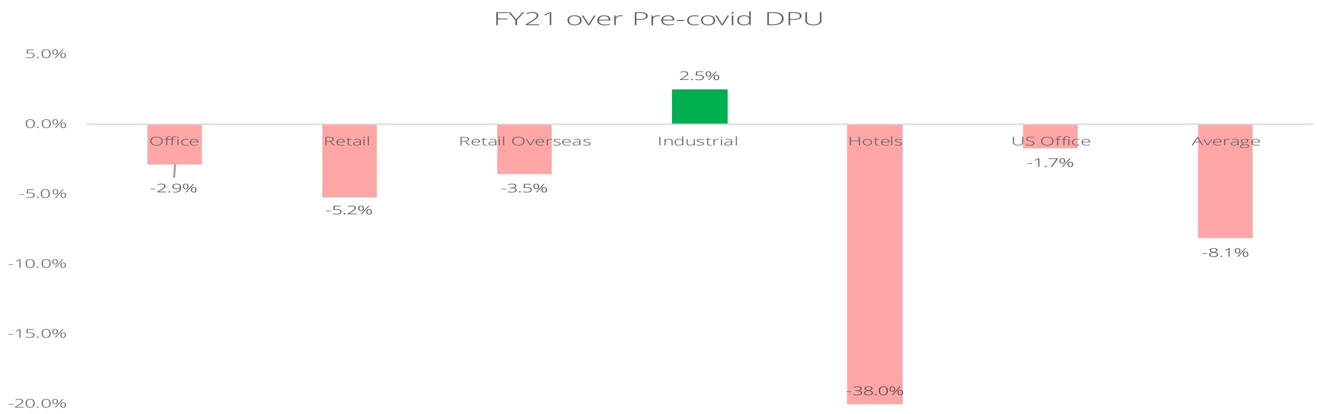
Source: company, DBS Bank

Summary of DPU growth profile in FY21F



Source: company, DBS Bank

DPU growth in FY21F compared to pre-pandemic levels



Source: company, DBS Bank

Ability to acquire is a key catalyst

Not resting on their laurels. Scanning the global landscape for opportunities, either through third parties or from their respective sponsors, is one of the key reasons why the industrial S-REITs, especially large cap REITs, are able to grow through acquisitions.

Even after the recent share price correction, the 5 large cap industrial S-REITs continue to remain within the virtuous cycle of growth where the implied WACC is lower than their target yields of potential acquisitions that the managers might be looking at.

Significant pipelines to tap on. In addition, based on our estimates, we estimate that AREIT, MINT, MLT, FLT and KDCREIT continue to enjoy access to their sponsors for acquisition opportunities, which can be executed upon. This access and ability to acquire is a valued trait which should drive a re-rating in these S-REITs when it happens. Based on our estimates, FLT, KDC REIT and MLT have the highest percentage of pipeline assets to its current AUM at 79%, 33% and 25% respectively, implying significant inorganic growth opportunity to tap on. AREIT and MINT have potential pipelines that may result in a c.15% expansion of their respectively portfolios if executed on.

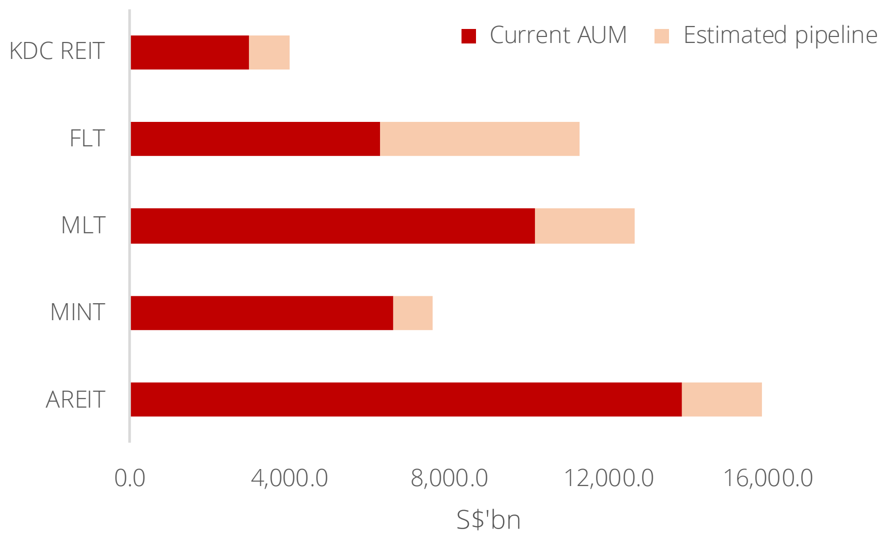
Implied WACC still conducive for acquisitions

	Cost of Equity (%)	Cost of debt (%)	Implied WACC (%)*	Gearing (%)	Target yield (%)	Location	Accretive (Y/N)
AREIT	5.6%	2.7%	4.4%	32.8%	5.0%-6.0%	SG, UK, AU	Yes
MINT	5.0%	2.9%	4.2%	37.3%	5.5%-6.0%	SG, US	Yes
MLT	4.7%	2.2%	3.7%	36.8%	5.0%-8.0%	SG, CN, KR, VN, IN	Yes
FLT	5.5%	1.9%	4.0%	36.2%	5.0%-6.0%	AU, UK, EUR	Yes
KDC REIT	3.7%	1.6%	2.8%	36.2%	4.5%-6.0%	SG, AU, EUR	Yes

**assumed at 60% equity and 40% debt cost*

Source: company, DBS Bank

Pipeline as a percentage



Source: company, DBS Bank

Observation:

The pipeline available from the respective sponsors is expected to increase the REIT's AUM by c.23% to 79%.

FLT, KDC and MLT's pipeline as a % of AUM is the highest at 79%, 33% and 25% respectively.

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: 15 Mar 2021 06:42:49 (SGT)
Dissemination Date: 15 Mar 2021 06:53:57 (SGT)

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