

7 January 2020

Property | REITs

## ESR REIT (EREIT SP)

**Buy** (Maintained)

### BUY This Pure-Play Singapore Industrial REIT

Target Price (Return)	SGD0.60 (+11%)
Price:	SGD0.54
Market Cap:	USD1,379m
Avg Daily Turnover (SGD/USD)	2.7m/2.0m

- **BUY, unchanged TP SGD0.60 offers 11% upside plus c.8% FY20F yield.** With the industrial sector showing signs of bottoming out, we believe ESR REIT's well-diversified and sizeable industrial portfolio is better-positioned to tap into any demand growth. Asset enhancements and streamlining operating costs should be near-term catalysts, along with potential acquisitions. Valuations are reasonably attractive, at 1.1x FY20F P/BV.

- **Manufacturing sentiment turned positive in December; industrial rental rates bottoming out.** Singapore's Purchasing Managers' Index (PMI) recorded a marginal expansion of 50.1 pts in December, after seven consecutive months of contraction – which points to a likely bottoming out. Jurong Town Corporation's (JTC) latest (as per 3Q19) also indicates that industrial rental rates edged up 0.1% YoY (flattish QoQ), along with stable occupancy levels.

- **Supply tapering post 2020.** While industrial supply (Figure 5) is expected to jump to 1.9m sqm for 2020 (46% higher than the average supply in 2016-2019), the outlook for business parks and high-tech industrial space – where ESR REIT has the bulk of exposure (44% of AUM) – remains positive. About 7%/17% of leases by rental income are due for renewal in 4Q19/2020, for which we expect flattish rental reversions.

- **Asset enhancement to be the key near-term focus.** ESR REIT is awaiting regulatory approval for partial redevelopment of 7000 Ang Mo Kio Avenue 5. The new industrial space will have a GFA of c.270,000 sqf, with an estimated yield-on-cost of around 9%. Management had earlier guided that the plan is to build a data centre facility, with a back-up option to build a high-tech industrial facility if the necessary approvals are not granted. The site also has an additional 225,000 sqf of unutilised space for future developments.

Besides this, it has also identified six other assets that have a >0.5m sqf of unutilised plot ratio for redevelopment. Rejuvenation plans are also underway for key assets, to strengthen its market positioning. Overall, we are positive on its redevelopment plans and believe it is a cost-efficient way to unlock unitholder value and future-proof assets.

- **Potential to leverage and grow on sponsor's strength.** The REIT's sponsor, ESR Group, is the largest Asia Pacific-focused logistics player that develops and manages logistics assets, with AUM of >USD20bn across six countries. The strong sponsor's expertise should help in terms of operational expertise, and eventually help with overseas market growth at the opportune time. Besides these, the sponsor also has stakes in other industrial S-REITs – which may lead to M&A growth opportunities in the medium term.

- **Key risks.** Tenant defaults and potential escalation in trade tensions crippling industrial demand.

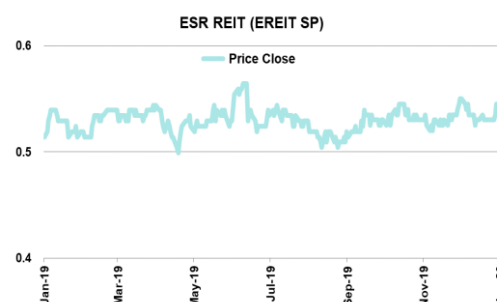
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	3.8	0.0	3.8	3.0	8.0
Relative	4.0	(0.7)	(0.7)	7.4	2.9
52-wk Price low/high (SGD)	0.50 – 0.56				



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (SGDm)	109.7	156.9	265.9	274.2	287.0
Net property income (SGDm)	78.4	112.0	195.6	203.5	212.9
Reported net profit (SGDm)	49.0	72.9	131.8	139.2	148.0
Distributable income (SGDm)	50	74	134	145	148
DPS (SG cents)	3.9	3.9	4.0	4.1	4.2
DPS growth (%)	(7.7)	0.1	4.7	2.5	1.3
P/BV (x)	0.8	1.2	1.1	1.1	1.1
Dividend Yield (%)	7.1	7.1	7.5	7.7	7.8
Return on average equity (%)	0.2	(15.4)	9.8	9.9	10.3
Return on average assets (%)	0.0	(2.4)	1.3	1.3	1.3
Interest coverage (x)	3.4	3.7	3.9	4.0	4.2

Source: Company data, RHB

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## Financial Exhibits

Asia		<b>Financial summary</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
Singapore		Recurring EPS (SGD)	0.04	0.02	0.04	0.04	0.04
REITs		EPS (SGD)	0.00	(0.07)	0.05	0.05	0.05
<b>ESR-REIT</b>		DPS (SGD)	0.04	0.04	0.04	0.04	0.04
		BVPS (SGD)	0.71	0.47	0.47	0.48	0.48
		Weighted avg adjusted shares (m)	1314	3170	3483	3504	3524
<b>Major shareholders (%)</b>		<b>Valuation metrics</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
Tong Jinquan	30.9	Recurring P/E (x)	14.5	23.5	14.3	13.6	12.9
E-Shang Infinity Cayman	7.7	P/E (x)	508.1	(7.5)	11.6	11.4	10.9
Vanguard Group	2.1	P/B (x)	0.8	1.2	1.1	1.1	1.1
<b>Valuation basis</b>		FCF Yield (%)	(7.2)	(2.2)	7.0	8.3	8.9
DDM methodology:		Dividend Yield (%)	7.1	7.1	7.5	7.7	7.8
i. CoE of 7.8%;		EV/EBITDA (x)	33.8	25.2	14.1	13.6	13.0
ii. 1% long-term growth.		EV/EBIT (x)	33.8	25.2	14.1	13.6	13.0
<b>Key drivers</b>		<b>Income statement (SGDm)</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
i. Rebound in industrial rental and occupancy rates;		Total turnover	110	157	266	274	287
ii. Continued yield compression across REITs;		Gross profit	78	112	196	203	213
iii. Yield-accretive acquisitions and asset enhancements.		EBITDA	69	100	178	185	194
		Depreciation and amortisation	0	0	0	0	0
<b>Key risks</b>		Operating profit	69	100	178	185	194
i. Prolonged slowdown in the manufacturing sector arising from trade tensions;		Net interest	(20)	(27)	(46)	(46)	(46)
ii. Tenant defaults;		Income from associates & JVs	0	0	0	0	0
iii. Sell-down by major shareholders.		Exceptional income - net	0	0	0	0	0
		Pre-tax profit	1	(228)	168	171	180
<b>Company Profile</b>		Taxation	0	(0)	(5)	(5)	(5)
ESR REIT invests in quality income-producing industrial properties and, as at 30 Sep 2019, has a diversified portfolio of 57 properties located across Singapore, with total GFA of ~15.1m sqf and a property value of SGD3.13bn.		Minority interests	0	0	0	0	0
The properties are in the following business sectors: general industrial, light industrial, logistics/warehouse, hi-specs industrial, and business parks, and are located close to major transportation hubs and key industrial zones island-wide.		Recurring net profit (adj)	49	73	132	139	148
		<b>Cash flow (SGDm)</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
		Change in working capital	(0)	(31)	34	1	4
		Cash flow from operations	69	68	222	197	209
		Capex	(120)	(106)	(90)	(40)	(40)
		Cash flow from investing activities	(304)	(149)	(194)	(40)	(40)
		Dividends paid	(46)	(56)	(134)	(145)	(148)
		Cash flow from financing activities	243	88	(6)	(168)	(178)
		Cash at beginning of period	4	12	18	39	28
		Net change in cash	8	6	21	(11)	(9)
		Ending balance cash	12	18	39	28	20
		<b>Balance sheet (SGDm)</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
		Total cash and equivalents	12	18	39	28	20
		Tangible fixed assets	1652	3016	3162	3194	3226
		Intangible assets	0	0	3	3	3
		Total investments	1652	3016	3165	3197	3229
		Total other assets	44	35	71	61	54
		Total assets	1696	3051	3236	3258	3283
		Short-term debt	155	282	0	0	0
		Total long-term debt	515	986	1298	1298	1291
		Other liabilities	96	152	135	135	141
		Total liabilities	766	1420	1433	1433	1432
		Shareholders' equity	779	1480	1653	1674	1700
		Minority interests	151	151	151	151	151
		Total equity	930	1631	1804	1825	1851
		Net debt	436	466	471	476	481
		Total liabilities & equity	1696	3051	3236	3258	3283
		<b>Key metrics</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
		Revenue growth (%)	(2.1)	43.0	69.5	3.1	4.7
		Recurrent EPS growth (%)	(7.0)	(38.3)	64.5	5.0	5.7
		Gross margin (%)	71.5	71.4	73.5	74.2	74.2
		Operating EBITDA margin (%)	63.3	64.0	66.8	67.5	67.7
		Net profit margin (%)	1.3	(145.6)	61.2	60.4	60.8
		Dividend payout ratio (%)	100.0	100.0	100.0	100.0	100.0
		Capex/sales (%)	109.6	67.3	33.8	14.6	13.9
		Interest cover (x)	3.4	3.7	3.9	4.0	4.2

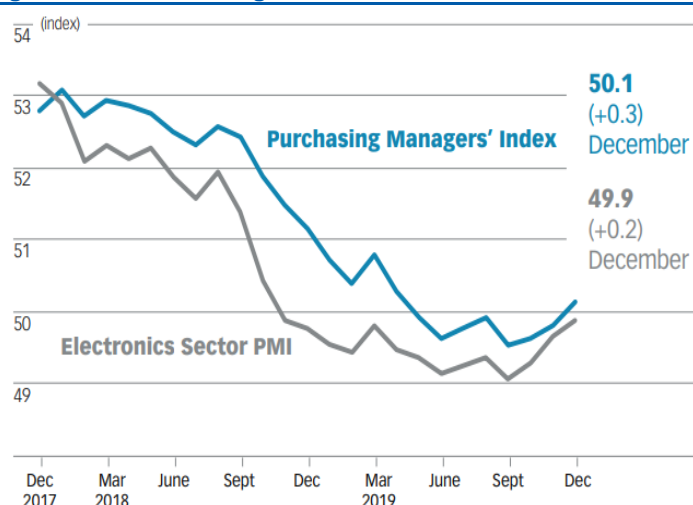
Source: Company data, RHB

Figure 1: DDM valuation

	FY19F	FY20F	FY21F	FY22F	FY23F	Terminal Value
DPU (SGD cents)	4.04	4.14	4.19	4.21	4.26	62.9
<b>Fair value (SGD)</b>	<b>0.60</b>					
Current price (SGD)	0.54					
Price upside (%)	10.8%					
Distribution yield (%)	7.5%					
Total Returns (%)	18.3%					
<b>Assumptions:</b>						
Risk-free rate (%)	2.8					
Beta	0.9					
Cost of equity (%)	7.8					
Terminal growth (%)	1.0					

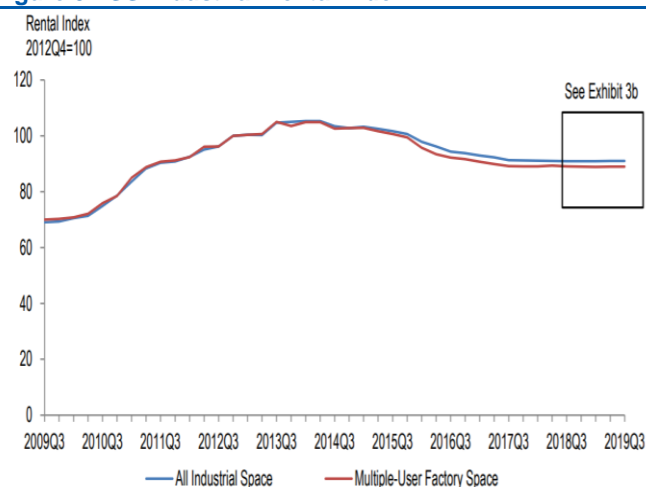
Source: Company data, RHB

Figure 2: Manufacturing & Electronics PMI



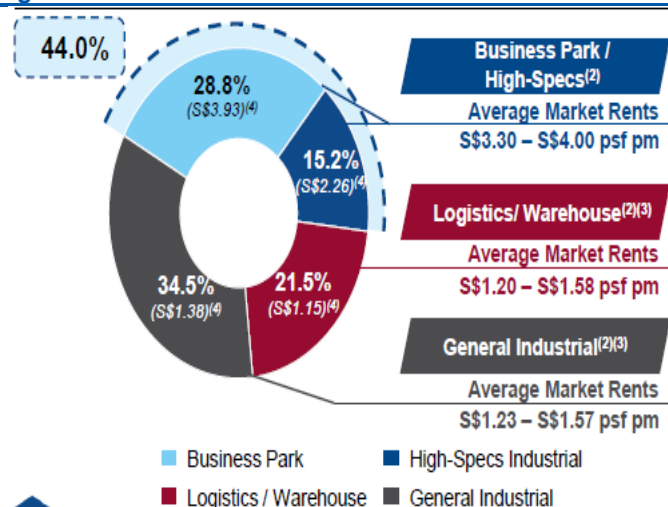
Source: Singapore Institute of Purchasing and Materials Management (SIPMM), The Business Times of Singapore

Figure 3: SG Industrial Rental Index



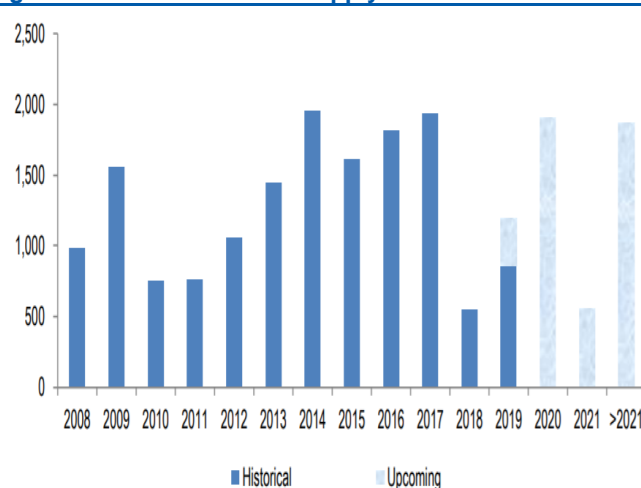
Source: JTC

Figure 4: ESR REIT – breakdown of asset classes



Source: Company data

Figure 5: Industrial market supply



Source: JTC

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