

24 January 2020

Property | REITs

ESR REIT (EREIT SP)

Buy (Maintained)

Cautiously Optimistic On 2020; BUY

Target Price (Return) SGD0.60 (+7%)
 Price: SGD0.56
 Market Cap: USD1,447m
 Avg Daily Turnover (SGD/USD) 1.9m/1.4m

- **Maintain BUY, SGD0.60 TP**, 7% upside. ESR REIT's 4Q19/FY19 results met our and Street estimates. With the industrial sector stabilising, we believe its well-diversified and Singapore-centric portfolio is well-equipped to tap into any demand uptick. Management emphasised its near-term strategy of asset recycling and extracting value via asset enhancements. One concern, however, is the sizeable SGD81m revaluation loss recorded in FY19. Valuations are reasonably attractive, at 1.3x P/BV with a 7.3% dividend yield.
- **Expecting a slightly better FY20.** Management noted that sentiment across industrial tenants have improved, with some sectors looking for expansion although the broader theme is still on consolidation. This is also reflected in recent Purchasing Managers' Index (PMI) data, with Singapore's PMI expanding marginally to 50.1 in Dec 2019, after seven consecutive months of contraction. Overall, management expects to see some improvement in portfolio occupancy, and guided for a flattish to slight positive rental outlook.
- **Hyflux update.** Hyflux currently occupies about 30% of the total space in 8 Tuas South Lane, for which it has been paying rental. Management has found tenants for another 26% of the space, bringing the current occupancy rate to 56%. ESR REIT is seeing good demand from tenants for the remaining space and expects to ramp up the occupancy rate to 80% in the coming quarters. It has also fully utilised the rental guarantee provided by Hyflux to cover the rental shortfall.
- **Asset enhancement plans awaiting final approval.** For 7000 Ang Mo Kio Avenue 5, it has signed an MoU with a prospective data centre tenant to redevelop the space (c.270,000 sqf), as mentioned in past reports. However, there has been some delay with the tenant getting approvals from the authorities. Management noted that it is likely to wait until 1H20 to get the approvals. If the green light is not granted, it has alternative plans to develop the space into a high-specification industrial building – for which it has already received a lot of enquiries. The site also has an additional 225,000 sqf of unutilised space for future developments. Besides this, it has also identified six other assets with >0.5m sqf of unutilised plot ratio for redevelopment.
- **Plan to grow and leverage on sponsor's strength.** In terms of strategy, management plans to divest 2-3 non-core assets (short land tenures with minimal asset enhancement potential), and recycle the capital on asset enhancements and acquisitions. The REIT also plans to expand its portfolio overseas, leveraging on sponsor ESR Group, which manages logistics assets with an AUM of >USD20bn across six countries. Its potential target markets include Australia, China and Japan. In Singapore, it will continue to look for quality acquisitions with the possibility of M&A-led growth in the medium term.
- **DPU changes and risks.** We trim our FY20-21F DPU by 1-2%. Tenant defaults and escalating global trade tensions remain as key risks.

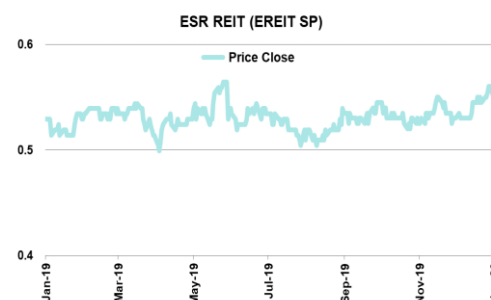
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	5.7	4.7	3.7	4.8	5.8
Relative	5.3	4.0	0.8	8.9	3.8
52-wk Price low/high (SGD)	0.50 – 0.56				



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (SGDm)	156.9	253.0	270.2	283.0	286.8
Net property income (SGDm)	112.0	187.9	196.5	205.9	211.7
Reported net profit (SGDm)	72.9	108.5	130.6	139.2	143.7
Distributable income (SGDm)	74	133	143	146	148
DPS (SG cents)	3.9	4.0	4.1	4.2	4.2
DPS growth (%)	0.1	4.0	2.0	1.5	0.4
P/BV (x)	1.2	1.3	1.3	1.3	1.3
Dividend Yield (%)	6.9	7.2	7.3	7.4	7.4
Return on average equity (%)	(15.4)	0.7	8.5	9.7	9.9
Return on average assets (%)	(2.4)	0.1	1.0	1.2	1.2
Interest coverage (x)	3.7	3.1	3.7	3.9	3.9

Source: Company data, RHB

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Financial Exhibits

Asia		Financial summary	Dec 18	Dec 19	Dec 20F	Dec 21F	Dec 22F
Singapore		Recurring EPS (SGD)	0.02	0.03	0.04	0.04	0.04
REITs		EPS (SGD)	(0.07)	0.00	0.04	0.04	0.04
ESR-REIT		DPS (SGD)	0.04	0.04	0.04	0.04	0.04
		BVPS (SGD)	0.47	0.43	0.43	0.44	0.44
		Weighted avg adjusted shares (m)	3170	3487	3508	3528	3549
Major shareholders (%)		Valuation metrics	Dec 18	Dec 19	Dec 20F	Dec 21F	Dec 22F
Tong Jinquan	30.8	Recurring P/E (x)	24.3	18.0	15.0	14.2	13.8
E-Shang Infinity Cayman	7.7	P/E (x)	(7.8)	196.8	15.1	13.1	12.8
Vanguard Group Inc	2.2	P/B (x)	1.2	1.3	1.3	1.3	1.3
Valuation basis		FCF Yield (%)	(2.1)	8.2	8.7	8.9	8.8
DDM methodology:		Dividend Yield (%)	6.9	7.2	7.3	7.4	7.4
i. CoE of 7.8%;		EV/EBITDA (x)	25.8	16.3	14.5	13.8	13.4
ii. 1% long-term growth.		EV/EBIT (x)	25.8	16.3	14.5	13.8	13.4
Key drivers		Income statement (SGDm)	Dec 18	Dec 19	Dec 20F	Dec 21F	Dec 22F
i. Rebound in industrial rental and occupancy rates;		Total turnover	157	253	270	283	287
ii. Continued yield compression across REITs;		Gross profit	112	188	197	206	212
iii. Yield-accretive acquisitions and asset enhancements.		EBITDA	100	160	178	188	193
		Depreciation and amortisation	0	0	0	0	1
Key risks		Operating profit	100	160	178	188	193
i. Prolonged slowdown in the manufacturing sector due to trade tensions;		Net interest	(27)	(51)	(48)	(48)	(50)
ii. Tenant defaults;		Income from associates & JVs	0	0	0	0	0
iii. Sell-down by major shareholder.		Exceptional income - net	0	0	0	0	1
		Pre-tax profit	(228)	10	134	155	160
Company Profile		Taxation	(0)	(0)	(4)	(5)	(5)
ESR-REIT is a leading industrial REIT and as at 31 Dec 2019 holds interest in a diversified portfolio of 57 properties located across Singapore, with a total gross floor area of approximately 15.1m sqf and an aggregate property value of SGD 3.04bn		Minority interests	0	0	0	0	1
The properties are in the following business sectors: General Industrial, Light Industrial, Logistics/Warehouse, Hi-Specs Industrial, and Business Park, and are located close to major transportation hubs and key industrial zones island-wide.		Recurring net profit (adj)	73	108	131	139	144
		Cash flow (SGDm)	Dec 18	Dec 19	Dec 20F	Dec 21F	Dec 22F
		Change in working capital	(31)	(1)	9	4	(1)
		Cash flow from operations	68	178	192	195	195
		Capex	(106)	(18)	(20)	(20)	(20)
		Cash flow from investing activities	(149)	(55)	(10)	(10)	(10)
		Dividends paid	(56)	(125)	(143)	(146)	(148)
		Cash flow from financing activities	88	(125)	(173)	(187)	(189)
		Cash at beginning of period	12	18	16	24	23
		Net change in cash	6	(2)	9	(2)	(4)
		Ending balance cash	18	16	24	23	18
		Balance sheet (SGDm)	Dec 18	Dec 19	Dec 20F	Dec 21F	Dec 22F
		Total cash and equivalents	18	16	24	23	18
		Tangible fixed assets	3016	3162	3166	3182	3197
		Intangible assets	0	0	0	0	0
		Total investments	3016	3202	3206	3221	3237
		Total other assets	35	28	51	51	47
		Total assets	3051	3230	3257	3272	3284
		Short-term debt	282	160	0	0	0
		Total long-term debt	986	1031	1193	1183	1183
		Other liabilities	152	379	387	393	390
		Total liabilities	1420	1570	1580	1576	1573
		Shareholders' equity	1480	1509	1525	1545	1560
		Minority interests	151	151	151	151	151
		Total equity	1631	1660	1676	1696	1712
		Net debt	1175	1169	1160	1165	1167
		Total liabilities & equity	3051	3230	3257	3272	3284
		Key metrics	Dec 18	Dec 19	Dec 20F	Dec 21F	Dec 22F
		Revenue growth (%)	43.0	61.3	6.8	4.7	1.3
		Recurrent EPS growth (%)	(38.3)	35.2	19.7	5.9	2.6
		Gross margin (%)	71.4	74.3	72.7	72.8	73.8
		Operating EBITDA margin (%)	64.0	63.1	66.0	66.3	67.4
		Net profit margin (%)	(145.6)	3.9	48.2	53.1	54.0
		Dividend payout ratio (%)	100.0	100.0	100.0	100.0	100.0
		Capex/sales (%)	67.3	7.3	7.4	7.1	7.0
		Interest cover (x)	3.7	3.1	3.7	3.9	3.9

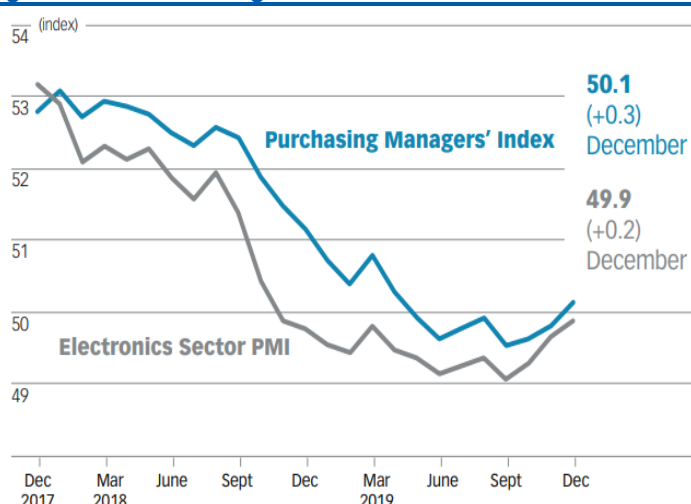
Source: Company data, RHB

Figure 1: DDM valuation

	FY20F	FY21F	FY22F	FY23F	FY24F	Terminal Value
DPU (SGD cents)	4.09	4.15	4.17	4.17	4.19	62.7
Fair value (SGD)	0.60					
Current price (SGD)	0.56					
Price upside (%)	6.8%					
Distribution yield (%)	7.3%					
Total Returns (%)	14.1%					
Assumptions:						
Risk-free rate (%)	2.8					
Beta	0.9					
Cost of equity (%)	7.8					
Terminal growth (%)	1.0					

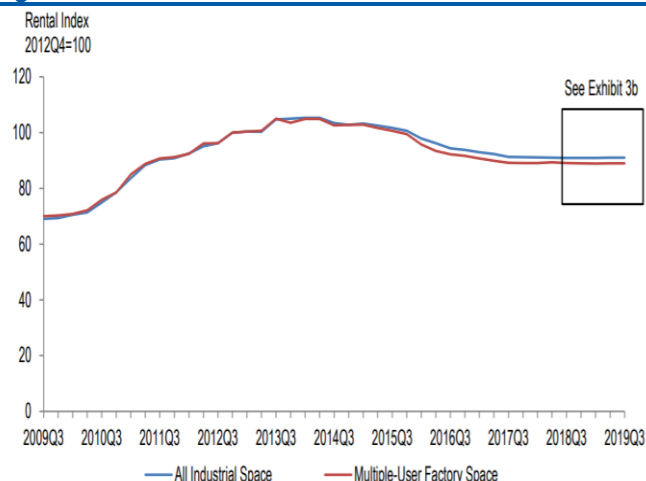
Source: Company data, RHB

Figure 2: Manufacturing & Electronics PMI Index



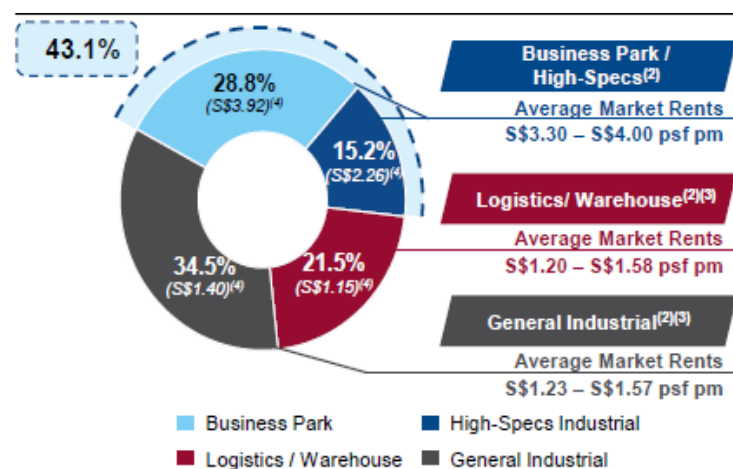
Source: SIPMM, The Business Times

Figure 3: SG Industrial Rental Index



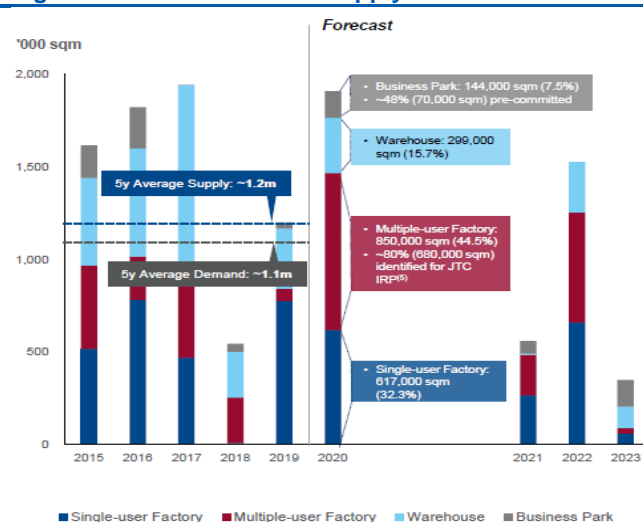
Source: JTC

Figure 4: ESR REIT – breakdown of asset classes



Source: Company

Figure 5: Industrial market supply



Source: JTC, Company

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Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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