

19 March 2020

Property | REITS

ESR-REIT (EREIT SP)

Buy (Maintained)

Is This The Bottom?

Target Price (Return): SGD0.50 (61.3%)
 Price: SGD0.31
 Market Cap: USD743m
 Avg Daily Turnover (SGD/USD) 5.11m/3.69m

- Maintain BUY with new TP of SGD0.50, from SGD0.60, +61% upside plus 13% yield.** ESR-REIT's share price has tumbled 43% over last one month (vs S-REITs -30%) amidst a global market sell-off. Despite overall market gloom, we see its two key strengths ie pure-play exposure to the Singapore industrial sector (which has remained resilient through market cycles), and supportive/capable sponsor. While near term share price movement remains unpredictable, we see its value emerging at 0.7x P/BV.
- Industrial sector most resilient among various REIT asset class.** Key reasons being the inability to carry out operations remotely for the majority of industrial sectors, lower rental base, and substitution choices for industrial tenants and longer lease tenures (ESR-REIT's WALE – 3.8 years). The manufacturing sector still forms the backbone of Singapore's economy, accounting for 21% of the country's GDP in 2019 and we believe the Government has various policy measures and tools at its disposal to support the industrial sector should the economy enter into a recession.
- A diversified tenant base mitigates potential tenant defaults.** ESR-REIT derives income from 328 tenants across >15 different trade sectors, with logistics (28%), info-comm & technology (13%), and manufacturing (12%) being the largest three. Based on our discussions with management, there has been no tenant default or an increase in late payments so far. Management has also been constantly engaging with its Top 10 tenants (30% of rental income) and is currently monitoring the ongoing developments across various industrial sectors. Hyflux (3% of rental income), one of the Top 10 tenants, has also been paying rent so far.
- High gearing but 100% unencumbered assets.** ESR-REIT's gearing of 41.5% is among the highest in sector. However, asset values need to fall by >SGD 200m or >7% from the current level before a potential breach of the REIT's gearing threshold of 45% occurs. Even in the worst case where such an event occurs, we believe the REIT's sponsor will potentially step in and underwrite any potential equity fund raising. In terms of debt maturity, the REIT has already secured commitments for the SGD160m loan expiring this year at a lower interest cost, which should bring down the overall borrowing costs by 20bps. The next debt maturity is only in 2H21.
- A supportive sponsor.** The REIT's sponsor, ESR Cayman (1821 HK, NR), has a strong pan-Asian industrial sector experience and manages an AUM of >USD20bn across six countries. The sponsor has also been showing its commitment to the REIT by backstopping recent equity fund raisings.
- DPU and valuation changes.** Our FY20F-22F DPU are lowered by 7-9% assuming lower rents and occupancies. We also raise our COE assumptions by 100bps, factoring in higher market risk premiums. Key risks remain a prolonged recession and sharp spike in tenant defaults.

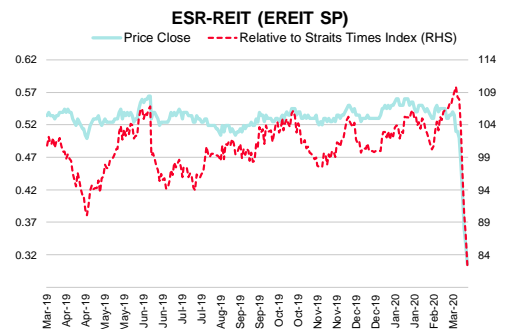
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(42.5)	(42.5)	(42.5)	(41.8)	(43.4)
Relative	(17.8)	(18.4)	(18.1)	(18.4)	(18.9)
52-wk Price low/high (SGD)				0.31	– 0.56



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (SGDm)	157	253	249	263	268
Net property income (SGDm)	112	188	181	192	198
Reported net profit (SGDm)	(233)	6	48	121	141
Total distributable income (SGDm)	75	123	122	130	134
DPS (SGD)	0.02	0.04	0.04	0.04	0.04
DPS growth (%)	(40.1)	61.8	(0.0)	0.7	1.3
P/B (x)	0.65	0.71	0.74	0.73	0.73
Dividend Yield (%)	7.7	12.5	12.5	12.5	12.7
Return on average equity (%)	(20.6)	0.4	3.2	8.3	9.6
Return on average assets (%)	(9.8)	0.2	1.5	3.8	4.4

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS (SGD)	-	0.07	0.01	0.01	0.03
Property	EPS (SGD)	-	0.07	0.00	0.01	0.04
ESR-REIT	DPS (SGD)		0.02	0.04	0.04	0.04
EREIT SP	BVPS (SGD)		0.47	0.43	0.41	0.42
Buy	Return on average equity (%)		(20.6)	0.4	3.2	8.3
	Weighted avg adjusted shares (m)		3,170.17	3,305.06	3,507.23	3,527.24
						3,547.38
Valuation basis						
DDM Methodology						
Key drivers	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. Rebound in industrial rents and occupancy;	Recurring P/E (x)	na	59.99	22.46	8.87	7.66
ii. Continued yield compression across REITs;	P/E (x)	na	165.80	22.46	8.87	7.66
iii. Accretive acquisitions and asset enhancements.	P/B (x)	0.7	0.7	0.7	0.7	0.7
	FCF Yield (%)	7.0	17.7	16.0	17.0	16.9
	Dividend Yield (%)	7.7	12.5	12.5	12.5	12.7
	EV/EBITDA (x)	-	8.02	-	5.44	-
	EV/EBIT (x)	-	8.02	-	5.44	-
						5.03
						5.03
Key risks	Income statement (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. Prolonged slowdown in the manufacturing sector arising from trade tensions and COVID-19;	Total turnover	157	253	249	263	268
ii. Tenant defaults;	EBITDA	100	170	163	174	180
iii. Sell down by major shareholder.	Operating profit	100	170	163	174	180
	Net interest	(27)	(51)	(48)	(49)	(50)
	Exceptional income - net	0	(11)	0	0	0
	Pre-tax profit	(228)	10	49	125	146
	Taxation	(0)	(0)	(1)	(4)	(4)
	Minority interests	(4)	(4)	0	0	0
	Recurring net profit	(233)	17	48	121	141
Company Profile	Cash flow (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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	Change in working capital	(31)	(1)	2	5	(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.	Cash flow from operations	68	178	171	183	183
	Cash flow from investing activities	(149)	(55)	(10)	(10)	(10)
	Dividends paid	(56)	(125)	(133)	(135)	(138)
	Cash flow from financing activities	88	(125)	(153)	(171)	(174)
	Cash at beginning of period	12	18	16	24	26
	Net change in cash	6	(2)	8	2	(2)
	Ending balance cash	18	16	24	26	24
	Balance sheet (SGDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	23	16	24	26	24
	Total investments	3,016	3,202	3,136	3,136	3,151
	Total assets	3,051	3,230	3,185	3,188	3,203
	Short-term debt	282	160	0	0	0
	Total long-term debt	986	1,031	1,203	1,188	1,188
	Total liabilities	1,420	1,570	1,581	1,572	1,570
	Shareholders' equity	1,480	1,509	1,453	1,465	1,482
	Total equity	1,631	1,660	1,604	1,616	1,633
	Net debt	1,245	1,175	1,179	1,162	1,164
	Total liabilities & equity	3,051	3,230	3,185	3,188	3,203
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	43.0	61.3	(1.8)	5.9	1.9
	Recurrent EPS growth (%)	(24634.3)	0.0	167.2	153.2	15.8
	Operating EBITDA margin (%)	63.9	67.4	65.6	66.0	67.2
	Net profit margin (%)	(148.2)	2.4	19.2	46.1	52.7
	Dividend payout ratio (%)	(32.0)	2180.4	279.7	111.2	97.3
	Interest cover (x)	3.66	3.33	3.39	3.57	3.61

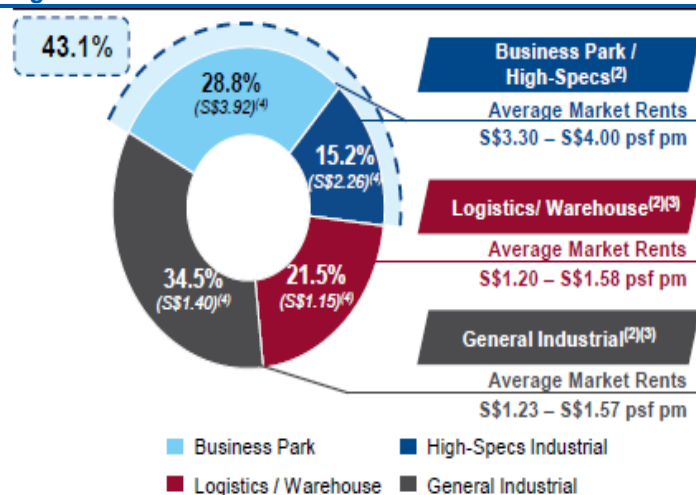
Source: Company data, RHB

Figure 1: DDM valuation

(FYE Dec)	FY20F	FY21F	FY22F	FY23F	FY24F	Terminal Value
DPU (SGD cents)	3.80	3.83	3.88	4.01	4.08	53.4
Fair value (SGD)	0.50					
Current price (SGD)	0.31					
Price upside (%)	65.3%					
Distribution yield (%)	12.5%					
Total Returns (%)	77.8%					
Assumptions:						
Risk-free rate (%)	2.8					
Beta	0.9					
Cost of equity (%)	8.7					
Terminal growth (%)	1.0					

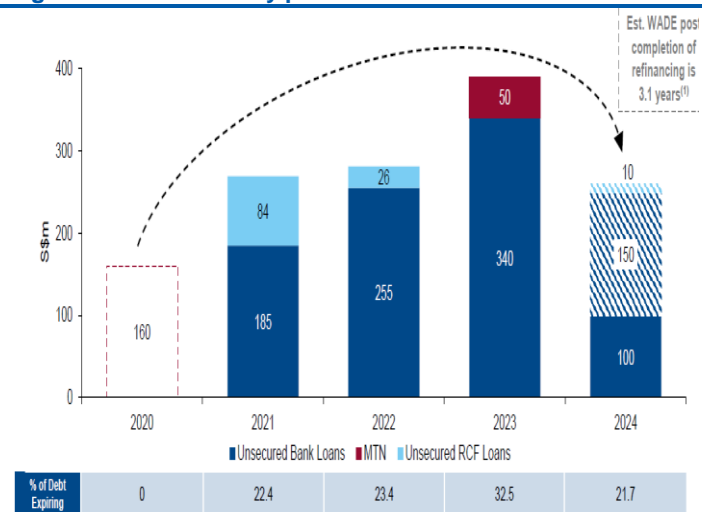
Source: Company data, RHB

Figure 2: ESR REIT - asset class breakdown



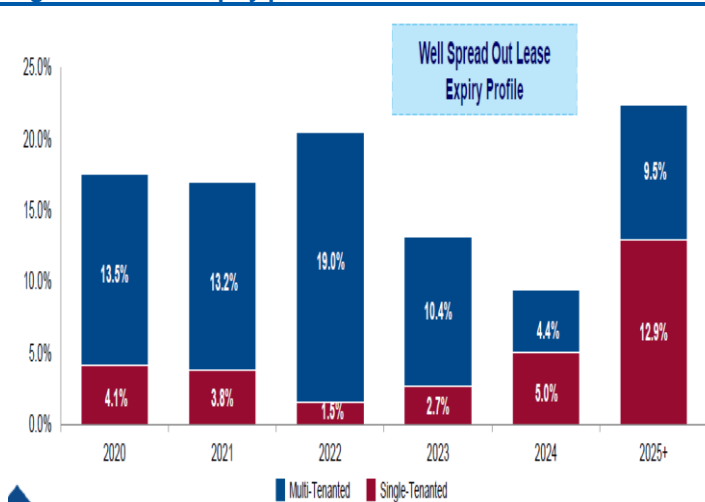
Source: Company data

Figure 3: Debt maturity profile



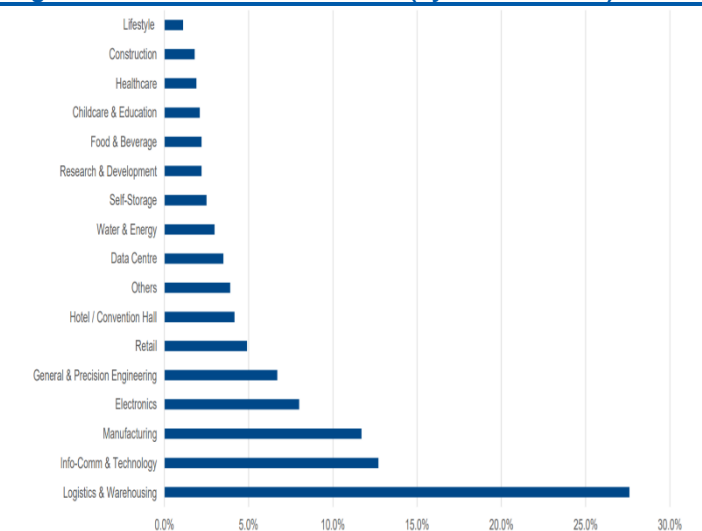
Source: Company data

Figure 4: Lease expiry profile



Source: Company data

Figure 5: Trade sector breakdown (by rental income)



Source: Company data

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-01-24	Buy	0.60	0.56
2020-01-07	Buy	0.60	0.55
2019-10-29	Buy	0.60	0.54

Source: RHB, Bloomberg

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