

22 March 2022

Property | REITS

ESR-REIT (EREIT SP)

Buy (Maintained)

Unitholders Approve Merger; Stay BUY

- **Maintain BUY and TP of SGD0.53, 26% upside with c.7% yield.** ESR-REIT's proposed merger with ARA LOGOS Logistics Trust (ALLT SP, TAKE PROFIT, TP: SGD0.95) has received the green light from unitholders from both sides – paving the way for merger completion by end-1H22. We expect the combined REIT to execute its strategy of portfolio optimisation and asset enhancements, which should lead to a rerating. With a strong and supportive sponsor and a healthy pipeline of assets, we see good growth potential. Valuations are attractive, at 1.1x P/BV.
- **Overwhelming approval to revised offer.** More than 98% of ESR-REIT's unitholders by value voted in favour of resolutions for the merger and issue of shares, as part of the merger with ALLT (see our [24 Jan](#) note for further merger details). For ALLT, the scheme consideration was approved by 94.8% of unitholders by value and 62.9% (representing 92.5% in value) by the unitholders present voting by proxy at the scheme meeting. This is well above the threshold requirement of >50%. Following this, the court hearing of the application to sanction the scheme is expected to be held on 11 Apr and, if successful, unitholders are expected to receive units and cash consideration by end-April – with the delisting of ALLT expected on 5 May. Post-merger sponsor ESR Cayman will remain as a key shareholder (11.2% of combined entity) and the REIT manager.
- **Recap of merger merits.** The merger will result in a combined ESR-LOGOS REIT asset size of SGD5.4bn (from ESR REIT's SGD3.4bn). This will make it one of the top 10-SREITs by free float market cap. New economy assets (high-technology and logistics warehouses) will account for 66% of portfolio rental income, vs 47% presently. We like the merger for three key reasons: i) A sizeable new-economy and well diversified portfolio reduces concentration risks and, more importantly, resolves the conflict of interest from overlapping acquisition mandates with the sponsor, ii) it lowers the cost of capital, with the interest cost alone expected to fall by c.100bps post-merger, and iii) there are opportunities to transform its portfolio, by accelerating the divestment of its older, shorter-tenure assets and reinvesting the proceeds into modern new economy assets in the Asia-Pacific, with a visible c.USD2bn worth of sponsor pipeline assets.
- **Our forecasts currently do not include merger effects** which should contribute positively to DPU. Based on our proprietary methodology we derive an ESG score to 3.1 (out of 4) for the REIT. As this score is one notch above the country median, we have applied a 2% ESG premium to our DDM-derived intrinsic value to derive our TP.

Target Price (Return): SGD0.53 (+26%)
 Price (Market Cap): SGD0.42 (USD1,249m)
 ESG score: 3.10 (out of 4)
 Avg Daily Turnover (SGD/USD) 2.97m/2.20m

Analysts

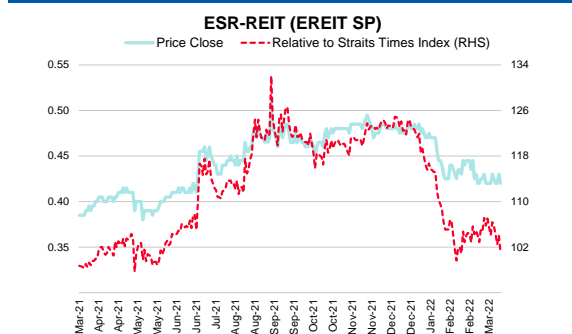
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(12.5)	(5.6)	(13.4)	(11.6)	7.7
Relative	(19.1)	(2.7)	(20.4)	(20.0)	1.5
52-wk Price low/high (SGD)	0.38 – 0.51				



Source: Bloomberg

Overall ESG Score: 3.10 (out of 4)

E: EXCELLENT

ESR-REIT is sharpening its environmental focus, with six assets equipped with rooftop solar panels. The REIT is also planning to further enhance its solar initiatives. It targets to reduce energy intensity for multi-tenanted buildings by 1% per year. It also has effective tracking of water and waste data, and aims upgrade assets to improve efficiency.

S: GOOD

It has an employee satisfaction rate of 80% from respondents. Tenant satisfaction rate improved from 69% in 2018 to 79% in 2020. There is regular disinfection of lifts and common areas (every two hours) to ensure employee safety during the pandemic, and holds webinars on workplace safety – clocking an average of 39.9 hours of training per employee.

G: GOOD

It holds regular investor updates to keep the latter informed about the impact of the pandemic on business. There has also been an increased level of disclosure and transparency of data. The REIT manager has also reviewed and updated its internal governance policies.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (SGDm)	230	241	243	245	248
Net property income (SGDm)	164	173	176	177	178
Reported net profit (SGDm)	10	102	132	132	133
Total distributable income (SGDm)	106	120	127	129	130
DPS (SGD)	0.03	0.03	0.03	0.03	0.03
DPS growth (%)	(27.1)	7.4	0.9	0.8	0.5
P/B (x)	1.04	1.00	1.07	1.06	1.05
Dividend Yield (%)	6.6	7.1	7.2	7.2	7.3
Return on average equity (%)	0.7	6.7	8.3	8.3	8.3
Return on average assets (%)	0.3	3.1	3.9	3.9	3.9

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Singapore	Recurring EPS (SGD)	0.01	0.03	0.03	0.03	0.03
Property	EPS (SGD)	0.00	0.03	0.03	0.03	0.03
ESR-REIT	DPS (SGD)	0.03	0.03	0.03	0.03	0.03
EREIT SP	BVPS (SGD)	0.40	0.42	0.39	0.40	0.40
Buy	Return on average equity (%)	0.7	6.7	8.3	8.3	8.3
	Weighted avg adjusted shares (m)	3,522.58	3,813.33	4,009.72	4,029.29	4,048.97
Valuation basis	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
DDM	Recurring P/E (x)	69.61	15.87	12.80	12.81	12.76
	P/E (x)	152.70	15.78	12.80	12.81	12.76
	P/B (x)	1.0	1.0	1.1	1.1	1.0
	FCF Yield (%)	10.9	10.7	10.0	10.1	10.1
	Dividend Yield (%)	6.6	7.1	7.2	7.2	7.3
	EV/EBITDA (x)	- 3.46	- 3.09	- 2.59	- 2.70	- 2.75
	EV/EBIT (x)	- 3.46	- 3.09	- 2.59	- 2.70	- 2.75
Key drivers	Income statement (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Rebound in industrial rental and occupancy rates;	Total turnover	230	241	243	245	248
ii. Continued yield compression across S-REITs;	EBITDA	141	157	159	159	161
iii. Yield-accretive acquisitions and asset enhancements.	Operating profit	141	157	159	159	161
	Net interest	(45)	(44)	(40)	(40)	(40)
	Income from associates & JVs	3	8	4	4	5
	Exceptional income - net	(12)	1	0	0	0
	Pre-tax profit	13	108	138	139	141
	Taxation	(0)	(2)	(2)	(2)	(2)
	Minority interests	(3)	(4)	(4)	(5)	(5)
	Recurring net profit	21	101	132	132	133
Key risks	Cash flow (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Prolonged slowdown in the manufacturing sector arising from trade tensions and COVID-19;	Change in working capital	13	7	(0)	2	1
ii. Tenant lease defaults;	Cash flow from operations	161	171	168	170	171
iii. Sell-down by its major shareholder.	Cash flow from investing activities	(6)	(149)	(10)	(10)	(10)
	Dividends paid	(73)	(114)	(120)	(122)	(123)
	Cash flow from financing activities	(153)	(16)	(148)	(154)	(155)
	Cash at beginning of period	16	18	24	34	40
	Net change in cash	2	6	10	6	6
	Ending balance cash	18	24	34	40	46
Company Profile	Balance sheet (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
ESR-REIT is a leading industrial REIT with a diversified portfolio of 58 properties located across Singapore, with a total gross floor area of approximately 15.6m sqf and an aggregate property value of SGD3.2bn. It also holds a 10.0% interest in ESR Australia Logistics Partnership, a private fund comprising 37 predominantly freehold logistics properties in Australia.	Total cash and equivalents	18	24	34	40	46
	Total investments	3,157	3,253	3,269	3,285	3,301
	Total assets	3,187	3,330	3,357	3,379	3,401
	Short-term debt	190	209	20	20	20
	Total long-term debt	988	981	1,188	1,183	1,183
	Total liabilities	1,589	1,581	1,632	1,629	1,630
	Shareholders' equity	1,447	1,598	1,574	1,599	1,620
	Total equity	1,598	1,749	1,725	1,750	1,771
	Net debt	1,161	1,167	1,174	1,163	1,157
	Total liabilities & equity	3,187	3,330	3,357	3,379	3,401
	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Revenue growth (%)	(9.1)	4.9	0.8	0.9	0.9
	Recurrent EPS growth (%)	18.7	338.6	24.0	(0.1)	0.4
	Operating EBITDA margin (%)	61.3	65.1	65.3	65.0	65.0
	Net profit margin (%)	4.2	42.1	54.1	53.8	53.8
	Dividend payout ratio (%)	1023.1	111.9	91.6	92.4	92.5
	Interest cover (x)	3.11	3.58	3.93	3.96	4.00

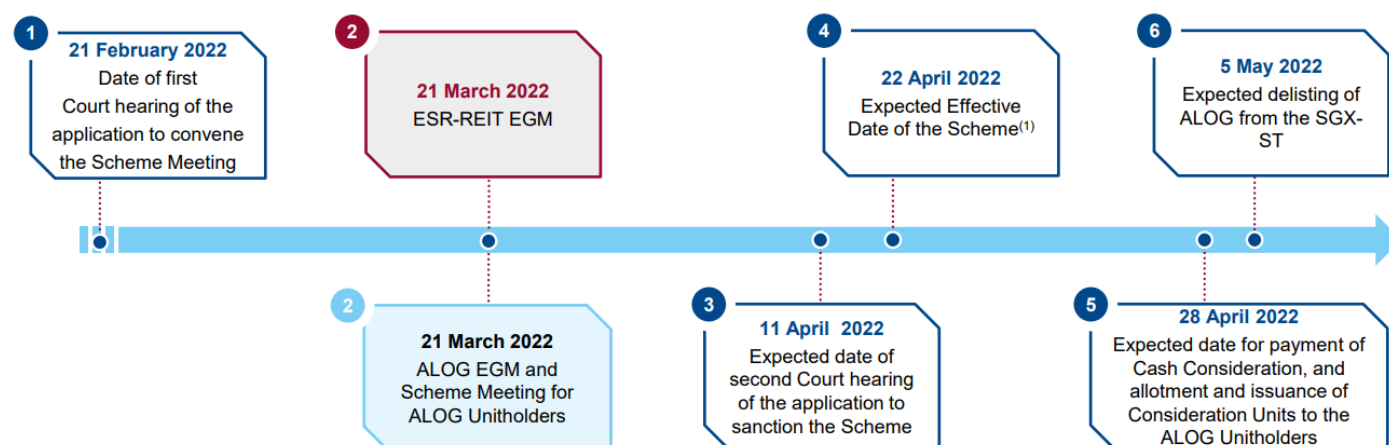
Source: Company data, RHB

Figure 1: DDM valuation

	FY22F	FY23F	FY24F	FY25F	Terminal Value
DPU (SG cents)	3.00	3.03	3.05	3.10	3.16
Fair value (SGD)	0.52				
ESG Prem./(disc.) (SGD)	0.01				
Target Price (SGD)	0.53				
Current price (SGD)	0.42				
Price upside (%)	26.2%				
Distribution yield (%)	7.2%				
Total Returns (%)	33.4%				
Assumptions:					
Risk-free rate (%)	2.8				
Beta	0.8				
Cost of equity (%)	6.9				
Terminal growth (%)	1.0				

Source: RHB

Figure 2: Indicative timeline of the merger



▪ The above timeline is indicative and subject to change. Please refer to future SGXNET announcement(s) by the ESR-REIT Manager and / or the ALOG Manager for the exact dates of these events

Source: Company

Recommendation Chart

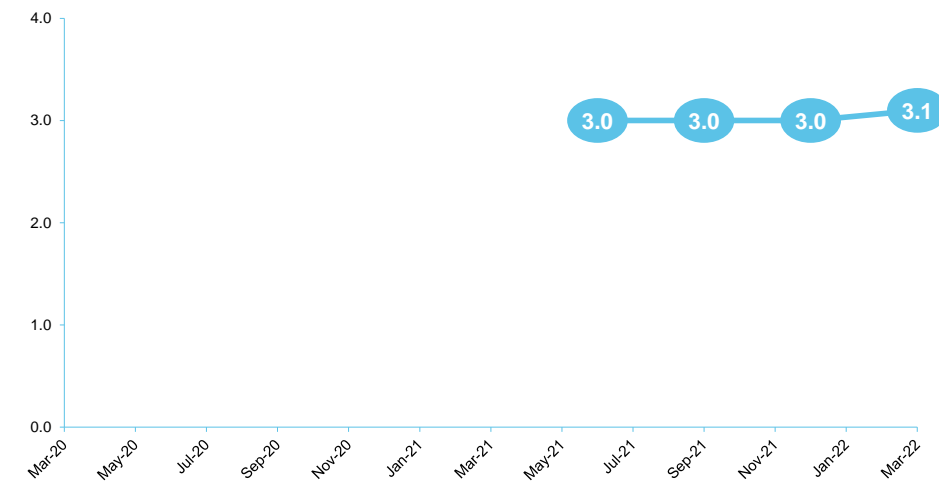


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-03-08	Buy	0.53	0.42
2021-09-09	Buy	0.54	0.48
2021-01-21	Buy	0.48	0.42
2020-03-18	Buy	0.50	0.31
2019-10-29	Buy	0.60	0.54
2019-02-12	Buy	0.61	0.51

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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