1 September 2022

Property | REITS

ESR-LOGOS REIT (EREIT SP)

Buy (Maintained)

Rise Through The Ranks; Stay BUY

Target Price (Return):	SGD0.53 (+29%)
Price (Market Cap):	SGD0.41 (USD1,963m)
ESG score:	3.10 (out of 4)
Avg Daily Turnover (SGD/USD)	4.16m/2.97m

- **Stay BUY, unchanged TP of SGD0.53 offers 29% upside with c.7% yield.** Post-merger, ESR-LOGOS REIT has emerged stronger, with a well-diversified portfolio largely comprising new-economy assets that put it in a strong position to take on macroeconomic challenges. Its active portfolio recalibration via the divestment of non-core shorter-lease assets and addition of high-quality freehold logistic assets is a step in the right direction. The strong sponsor commitment shown via an increase in its stake and the visible asset injection pipeline is another key positive.
- **Maiden foray into attractive Japan logistics market** with the proposed acquisition of ESR Sakura Distribution Centre, Chiba for JPY17.8bn (SGD183.5m). Its occupancy rate stands at 75%, with the sponsor providing 12-month rent support for vacant space amounting to JPY236.5m (SGD2.4m). With positive demand-supply dynamics for logistics spaces, management is confident of backfilling the entire space in the next one year. The NPI yield is 4.35% (with rental support) and the asset is DPU-accretive, on both a 100% debt-funded basis and 60:40 debt equity mix. With existing rental rates being c.10% below market rates, we see room for rental rate growth when leases are renewed. The acquisition is subject to shareholder approval (at an EGM), and is expected to completed by Oct 2022.
- **Portfolio rebalancing on the right track.** EREIT has been active on the divestment front since early 2021, with four assets divested last year (including ARA Logos assets) and another four announced for 2022. The assets have been divested at a c.8% premium on average to their latest valuations (total divestment value: SGD232m). Additionally the REIT has identified up to SGD450m worth of assets that can be divested in the next 1-2 years. We are upbeat on this, as a key investor concern has also been on the assets with shorter land leases and value erosion from lease decay. In addition, its embarking on five asset enhancement initiatives to boost asset value, with an estimated ROI of 6-8% .
- **Sponsor ESR Group upped its stake by 3% (to 14.4%), at SGD44.7 cents per share** (c.9% premium) in end-July, and became EREIT's biggest equity holder. This was done via an off-market purchase from another major shareholder, Tong Jinquan, whose stake post transaction will be reduced to 3.6%. In addition, the sponsor also acquired another 25% stake in the manager to total 92.3%. ESR Group is the largest player in new-economy assets (portfolio: >USD 59bn) in the Asia-Pacific and has provided the REIT with an initial visible asset pipeline worth USD2bn for potential acquisition across Singapore, Australia and Japan. ESR Group had also demonstrated its commitment in the past via backstopping equity fund-raising.
- **We update FY22-24F numbers to reflect the successful merger.** As our ESG score for the REIT is 3.1 – a notch above the country median – we apply a 2% ESG premium to our intrinsic value to derive our TP.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (SGDm)	230	241	338	409	417
Net property income (SGDm)	164	173	230	296	302
Reported net profit (SGDm)	10	102	(285)	228	233
Total distributable income (SGDm)	106	120	168	219	224
DPS (SGD)	0.03	0.03	0.03	0.03	0.03
DPS growth (%)	(27.1)	7.4	0.6	2.0	1.8
P/B (x)	1.01	0.98	0.88	1.11	1.11
Dividend Yield (%)	6.8	7.3	7.3	7.5	7.6
Return on average equity (%)	0.7	6.7	(14.1)	9.3	9.4
Return on average assets (%)	0.3	3.1	(6.4)	4.1	4.1

Source: Company data, RHB

Analyst

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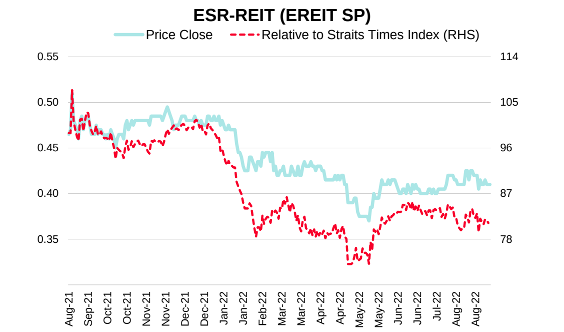
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(14.6)	(2.4)	0.0	(2.4)	(11.8)
Relative	(18.3)	(3.3)	(0.2)	(2.3)	(17.8)
52-wk Price low/high (SGD)					0.37 – 0.51



Source: Bloomberg

Overall ESG Score: 3.10 (out of 4)

E: EXCELLENT

EREIT is sharpening its environmental focus. Six assets currently have solar panels installed on their rooftops, and the REIT is planning to further enhance its solar initiatives. It set a target to reduce energy intensity for multi-tenant buildings by 1% per year. There is also effective tracking of water and waste data. EREIT also aims to upgrade its assets to improve efficiency.

S: GOOD

It recorded an employee satisfaction rate of 80% from respondents. The tenant satisfaction rate improved from 69% in 2018 to 79% in 2020. It also conducted regular disinfection of lifts and common areas (every two hours) to ensure employee safety during the pandemic, and held webinars on workplace safety. The REIT clocked an average of 39.9 hours of training per employee.

G: GOOD

It gives regular updates to keep investors informed on the impact of COVID-19, and has an increased level of disclosure and transparency of data. It has also reviewed and updated internal governance policies.

Financial Exhibits

Asia
Singapore
Property
ESR-LOGOS REIT
EREIT SP
Buy

Valuation basis

DDM

Key drivers

i. Rebound in industrial rental and occupancy rates
ii. Continued yield compression across REITs;
iii. Yield-accretive acquisitions and asset enhancements.

Key risks

i. Prolonged slowdown in the manufacturing sector arising from trade tensions and COVID-19;
ii. Tenant payment defaults;
iii. Selldown by major shareholder.

Company Profile

ESR-LOGOS REIT is an industrial SREIT that is largely focussed on new economy assets such as logistics and business parks in Singapore and Australia. As at 30 June 2022, it holds interests in a diversified portfolio of logistics properties, high-specifications industrial properties, business parks and general industrial properties, with total assets valued at approximately SGD5.5bn. Its portfolio comprises 83 properties (excluding 48 Pandan Road held through a joint venture) located across the developed markets of Singapore (62 assets) and Australia (21 assets), with a total GFA of approximately 2.3m sqm, as well as investments in three property funds in Australia.

Financial summary	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Recurring EPS (SGD)	0.01	0.03	- 0.06	0.03	0.03
EPS (SGD)	0.00	0.03	- 0.05	0.03	0.03
DPS (SGD)	0.03	0.03	0.03	0.03	0.03
BVPS (SGD)	0.40	0.42	0.47	0.37	0.37
Return on average equity (%)	0.7	6.7	(14.1)	9.3	9.4
Weighted avg adjusted shares (m)	3,522.58	3,813.33	5,219.58	6,667.51	6,698.97

Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Recurring P/E (x)	67.96	15.49	na	12.09	11.91
P/E (x)	149.06	15.40	na	11.98	11.81
P/B (x)	1.0	1.0	0.9	1.1	1.1
FCF Yield (%)	11.2	11.0	12.4	10.8	10.7
Dividend Yield (%)	6.8	7.3	7.3	7.5	7.6
EV/EBITDA (x)	- 3.71	- 3.33	- 5.69	- 2.23	- 2.26
EV/EBIT (x)	- 3.71	- 3.33	- 5.69	- 2.23	- 2.26

Income statement (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover	230	241	338	409	417
EBITDA	141	157	207	268	275
Operating profit	141	157	207	268	275
Net interest	(45)	(44)	(56)	(71)	(73)
Income from associates & JVs	3	8	8	12	13
Exceptional income - net	(12)	1	4	2	2
Pre-tax profit	13	108	(271)	246	252
Taxation	(0)	(2)	(9)	(11)	(11)
Minority interests	(3)	(4)	(5)	(7)	(8)
Recurring net profit	21	101	(289)	226	231

Cash flow (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Change in working capital	13	7	46	11	3
Cash flow from operations	161	171	266	295	293
Cash flow from investing activities	(6)	(149)	(10)	(10)	(10)
Dividends paid	(73)	(114)	(156)	(204)	(208)
Cash flow from financing activities	(153)	(16)	(214)	(281)	(277)
Cash at beginning of period	16	18	24	66	70
Net change in cash	2	6	42	4	6
Ending balance cash	18	24	66	70	76

Balance sheet (SGDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total cash and equivalents	18	24	66	70	76
Total investments	3,157	3,253	5,433	5,472	5,510
Total assets	3,187	3,330	5,563	5,613	5,657
Short-term debt	190	209	20	50	50
Total long-term debt	988	981	2,160	2,160	2,170
Total liabilities	1,589	1,581	2,722	2,750	2,774
Shareholders' equity	1,447	1,598	2,440	2,463	2,483
Total equity	1,598	1,749	2,840	2,863	2,883
Net debt	1,161	1,167	2,114	2,140	2,144
Total liabilities & equity	3,187	3,330	5,563	5,613	5,657

Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Revenue growth (%)	(9.1)	4.9	40.2	20.8	2.1
Recurrent EPS growth (%)	18.7	338.6	(308.9)	0.0	1.5
Operating EBITDA margin (%)	61.3	65.1	61.3	65.6	65.8
Net profit margin (%)	4.2	42.1	(84.2)	55.8	55.7
Dividend payout ratio (%)	1023.1	111.9	(54.9)	89.3	89.6
Interest cover (x)	3.11	3.58	3.69	3.76	3.78

Source: Company data, RHB

Operating metrics moving in the right direction. EREIT's portfolio achieved a positive rental reversion of 11.4% in 1H22, with a stronger 14.3% reversion seen in 2Q. All segments saw positive rental reversions, with the highest coming from the logistics (+15.4%) and general industrial (+13.1%) segments. We expect overall rental reversions to remain strong in 2H22, within the 5-10% range. Meanwhile, its portfolio occupancy rate for 1H22 improved to 94.1% (1Q22: 91.5%), mainly on the back of the successful merger with ARA Logos Logistics Trust, whose assets had near-full occupancy rates.

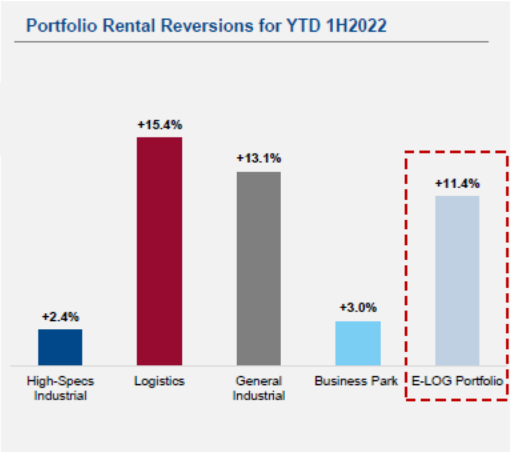
Figure 1: Breakdown of rental reversions (1H)

Portfolio Rental Reversions by Asset Class

	2Q2022	YTD 1H2022
High-Specs Industrial	+3.2%	+2.4%
Logistics	+22.4%	+15.4%
General Industrial	+18.1%	+13.1%
Business Park	+1.3%	+3.0%
Portfolio	+14.3%	+11.4%

Portfolio Rental Reversions by Geography

	2Q2022	YTD 1H2022
Singapore	+14.3%	+11.4%
Australia(1)	-	-
Portfolio	+14.3%	+11.4%



Source: Company data

Plans to raise service charges by 15%. The REIT was impacted by rising utility charges in 2Q22, which compressed its NPI margin by c.4ppt. This has now been mitigated by the majority of portfolio utilities being successfully converted to SP tariff rates. From 2Q22 onwards, more than 90% of the portfolio's utilities expense have also been moved to a pass-through cost recovery basis. As such, margins are expected to recover from 2H22 onwards. With regards to mitigating inflationary pressures, management is exploring bulk procurement for economies of scale and leveraging on strong partnerships with suppliers. EREIT will also be progressively rolling out service charge increases at an average of 15% for selected assets from later this year.

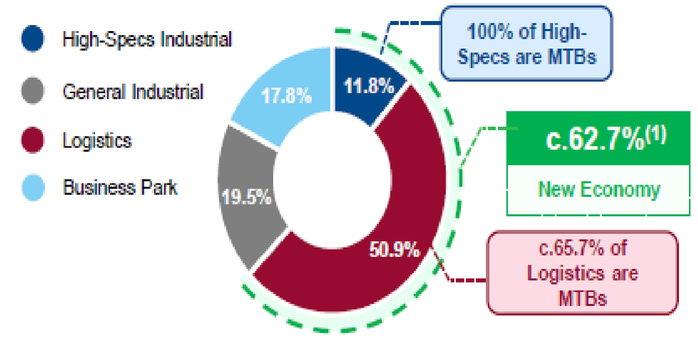
DDM valuation. Our 5-year DDM-based TP is derived from a cost of equity (COE) of 7% (risk-free rate: 2.75%, terminal growth: 1%). We have assumed a 100% payout ratio, taking into consideration the REIT's near-term capex requirements and 50% of the management fees being paid in units.

Figure 2: ESR-REIT's DDM valuation

	FY22F	FY23F	FY24F	FY25F	FY26F	Terminal Value
DPU (SG cents)	3.00	3.06	3.11	3.20	3.26	55.1
Fair value (SGD)	0.52					
ESG Prem./(disc.) (SGD)	0.01					
Target Price (SGD)	**0.53**					
Current price (SGD)	0.41					
Price upside (%)	29.4%					
Distribution yield (%)	7.3%					
Total Returns (%)	36.7%					
Assumptions:						
Risk-free rate (%)	2.8					
Beta	0.8					
Cost of equity (%)	7.0					
Terminal growth (%)	1.0					

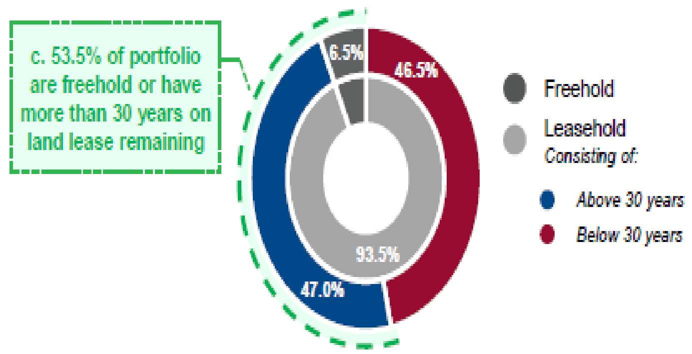
Source: RHB

Figure 3: Portfolio breakdown by segment



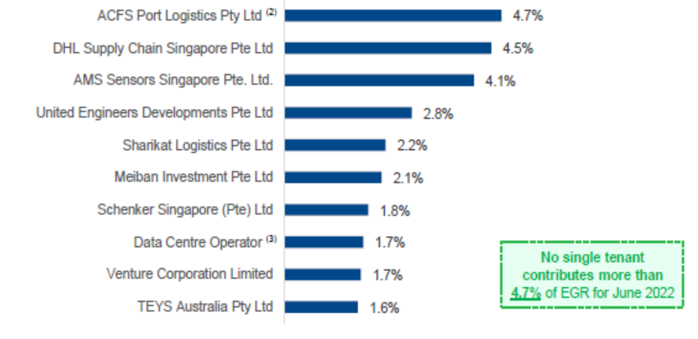
Source: Company data

Figure 4: Portfolio breakdown by lease tenure



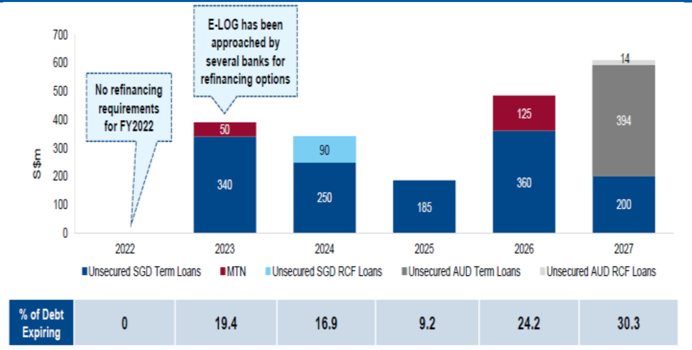
Source: Company data

Figure 5: Top 10 tenants by rental income (1H22)



Source: Company data

Figure 6: Debt maturity profile



Source: Company data

Figure 7: Details of ESR Sakura Distribution Centre

Proposed Acquisition	▪ Acquisition of 100% of the Trust Beneficiary Interest in ESR Sakura DC, a 5-storey modern logistics facility located in Chiba Prefecture, Tokyo, Japan (the "**Japan Acquisition**")		
Independent Valuation(1)		CBRE	Colliers
	▪ **With Rental Support:**	JPY18,000m (c.S$185.6m)	JPY18,030m (c.S$185.9m)
	▪ **Without Rental Support:**	JPY17,800m (c.S$183.5m)	JPY17,730m (c.S$182.8m)
Japan Purchase Consideration	▪ JPY17,800m (c.S$183.5m) with 12 months of Rental Support		
Total Acquisition Costs	▪ c.S$187.0m(2)		
Method of Financing	▪ The Manager intends to finance the Total Acquisition Outlay (save for the Acquisition Fee) with an **optimal combination of internal sources of funds, external bank borrowings, and/or equity capital market issuances**(3) ▪ For the avoidance of doubt, the Manager **has secured sufficient financing to fund the Japan Acquisition**(4)		
Pro forma Financial Effects	*FOR ILLUSTRATIVE PURPOSES ONLY NOT A FORWARD-LOOKING PROJECTION* **Scenario A:** ▪ **(100% Debt)** – **DPU Accretion:** 2.9% – **Gearing:** 42.0%	**Scenario B:** ▪ **(60% Debt / 40% Equity)** – **DPU Accretion:** 0.5% – **Gearing:** 40.6%	

Source: Company

Figure 8: Divestments since 2021

Divestments	Asset Type	Divestment Price (SGD m)	Valuation (SGD m)	Premium/ (loss)	Completion Date
Kidman Park	Logistics	42.6	41.1	3.6%	31-May-21
ALOG Changi Districentre 2	Logistics	16.7	15.5	7.7%	30-Jun-21
11 Serangoon North Avenue 5	General Industrial	53	20	5.0%	30-Nov-21
3C Toh Guan Road East	Logistics		30.5		30-Nov-21
28 Senoko Drive	General Industrial	12	13.1	-8.4%	14-Jan-22
45 Changi South Avenue 2	General Industrial	11.1	10.3	7.8%	14-Mar-22
3 Sanitarium Drive, Berkeley Vale	Logistics	53.4	45.1	18.4%	22-Jul-22
Pandan Logisitcs Hub	Logistics	43.5	37.8	15.1%	4Q22
Total (SGD m)		**232.3**			

Source: Company data, RHB

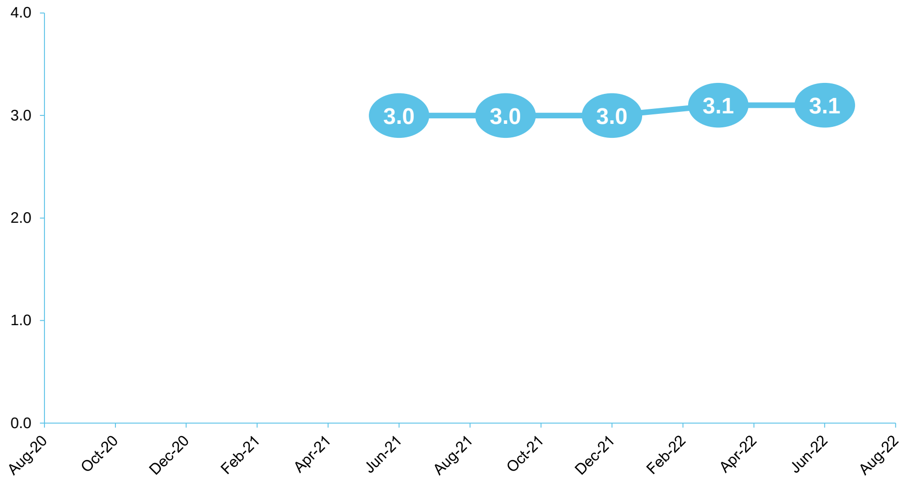
Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-03-08	Buy	0.53	0.42
2021-12-28	Buy	0.54	0.48
2021-09-09	Buy	0.54	0.48
2021-01-21	Buy	0.48	0.42
2020-03-18	Buy	0.50	0.31
2020-01-24	Buy	0.60	0.56
2020-01-07	Buy	0.60	0.55
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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