

8 August 2022

Property | REITS

Prime US REIT (PRIME SP)

Buy (Maintained)

Market Pessimism Likely Overdone; Stay BUY

Target Price (Return): USD1.00 (+39%)
 Price (Market Cap): USD0.72 (USD841m)
 ESG score: 3.10 (out of 4)
 Avg Daily Turnover (USD/USD) 0.69m/0.69m

- **BUY, new TP of USD1.00 from USD1.02, 39% upside.** We hosted Prime US REIT for a virtual post-results non-deal roadshow. Investor queries were centred on occupancy outlook, interest rate impact and acquisitions. Despite recession concerns, the US job market remains fairly strong – a key driver of office demand. We also do not expect a significant long-term impact on office demand from an increasing hybrid work environment. Its valuation remains undemanding, with a c.10% yield and 15% below book.
- **2H to be slightly weaker.** PRIME posted credible 1H results, with DPU up 5.7% YoY, aided by acquisitions and rental growth. Excluding contributions from recent acquisitions, DPU growth would have been flattish. The known exit of Whitney, Bradley & Brown (ninth largest tenant, c.2.6% of income) in July and the absence of amortised income from WeWork, leases from November are expected to dent 2H22, until these vacancies are backfilled. On a positive note, leasing demand and enquiries for its assets remain healthy and better than our expectations. About 86% of its debts are hedged, with no debt expiry until 2024 (assuming exercise of debt options) and, as such, should be minimally impacted by rising interest rates.
- **Stringing eight quarters of positive rent reversions.** 2Q reversion was at +10.9% (1Q: +3.9%). Leases were signed for c.86k sqf (1.8% of portfolio), with 47% being new leases. Demand was mainly from the finance, professional services and healthcare sectors. Management highlighted that leasing interest varies across markets, and is inversely proportionate to the duration of COVID-19 restrictions. For FY22, rent reversion should stay positive, as asking rates are c.5.3% higher than spot rates. Active leasing discussions are ongoing at Tower I at Emeryville (TE), Village Centre Station I, Tower 909, 222 Main and 171 17th St.
- **In advanced discussions to backfill two-thirds of WeWork space.** A co-working tenant is currently in talks to take up two out of three floors at TE, which should take back occupancy close to 80% levels. The tenant is also looking at moving in on an as-is basis, which should minimise upfront capex and the free rent period. Overall, we expect the portfolio occupancy rate to fluctuate between 88-92% in the next few quarters, but remain comforted by leasing interest.
- **Acquisitions only if the asset is a right fit and price.** Although PRIME is seeing some opportunities in the market, its high trading yield and debt costs have made yield-accretive acquisitions a challenge. As such, it will only selectively consider too-good-to-miss buying opportunities.
- **We trim FY22-24F DPU by 1-2%.** PRIME has an ESG score of 3.1 out of 4.0, based on our proprietary in-house methodology. As this score is one notch above our country median score, we applied a 2% premium to our intrinsic value to derive our TP.

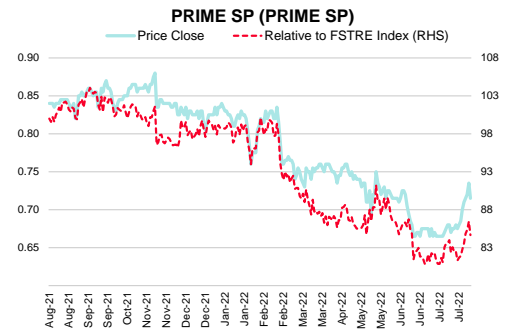
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(14.4)	7.5	(2.7)	(11.7)	(14.9)
Relative	(14.6)	4.0	(1.6)	(14.2)	(15.1)
52-wk Price low/high (USD)					0.67 – 0.88



Source: Bloomberg

Overall ESG Score: 3.10 (out of 4)

E: EXCELLENT

11 out of the 12 properties in PRIME's portfolio are US Green Building Council Leadership in Energy and Environmental Design- (LEED) or Energy Star-certified. It has also undertaken additional long-term energy-saving initiatives across six key assets.

S: GOOD

PRIME enhanced its workplace safety with regards to COVID-19, using technology to ensure social distancing, upgrading air filters and increased cleaning frequency of high-touch areas. To engage with tenants specifically, the property managers at PRIME's properties regularly held events with overall wellbeing in mind, such as ice cream socials, lemonade stands, hot dog events, holiday breakfasts, puppy therapy, Friday popcorn, as well as fitness classes.

G: GOOD

PRIME has been improving its stakeholder engagement since its listing. It gives greater detail about its earnings quality, as well as market outlook and update disclosures. There is a clear delineation of roles between the Board and management.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (USDm)	144	157	165	170	177
Net property income (USDm)	95	101	105	108	113
Reported net profit (USDm)	23.2	68.2	65.6	79.0	80.9
Total distributable income (USDm)	72.1	75.6	81.8	83.9	86.2
DPS (USD)	0.07	0.07	0.07	0.07	0.07
DPS growth (%)	119.8	(2.0)	2.0	1.8	1.9
P/B (x)	0.82	0.80	0.86	0.86	0.87
Dividend Yield (%)	9.7	9.5	9.7	9.9	10.1
Return on average equity (%)	2.7	7.2	6.7	8.0	8.2
Return on average assets (%)	1.7	4.4	3.9	4.6	4.7

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Singapore	Recurring EPS (USD)	0.02	0.06	0.06	0.07	0.07
Property	EPS (USD)	0.02	0.06	0.06	0.07	0.07
Prime US REIT	DPS (USD)	0.07	0.07	0.07	0.07	0.07
PRIME SP	BVPS (USD)	0.87	0.89	0.83	0.83	0.82
Buy	Return on average equity (%)	2.7	7.2	6.7	8.0	8.2
	Weighted avg adjusted shares (m)	1,039.00	1,111.62	1,179.57	1,188.98	1,198.65
Valuation basis						
DDM	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Recurring P/E (x)	32.01	11.66	12.85	10.76	10.59
	P/E (x)	32.01	11.66	12.85	10.76	10.59
	P/B (x)	0.8	0.8	0.9	0.9	0.9
	FCF Yield (%)	11.8	11.3	11.0	10.7	11.7
	Dividend Yield (%)	9.7	9.5	9.7	9.9	10.1
	EV/EBITDA (x)	- 2.57	- 2.69	- 2.10	- 2.05	- 1.99
	EV/EBIT (x)	- 2.57	- 2.69	- 2.10	- 2.05	- 1.99
Key drivers						
i. Under-rented portfolio in growth markets with a diverse tenant base;						
ii. Inbuilt rental rate escalations providing organic growth;						
Inorganic growth potential via acquisitions.						
Key risks						
i. US economy faltering into a deep recession;						
ii. Pick-up in work-from-home trends resulting in a structural decline in office space demand;						
iii. Regulatory changes and changes to the tax-efficient structure.						
Company Profile						
Prime US REIT is a diversified Singapore REIT with a focus on stabilised income-producing office assets in the US. It offers investors a unique exposure to a high-quality portfolio of 14 prime and freehold office properties, that are strategically located in ten primary markets in the US.						
	Income statement (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Total turnover	144	157	165	170	177
	EBITDA	85	91	94	97	101
	Operating profit	85	91	94	97	101
	Net interest	(15)	(17)	(19)	(20)	(22)
	Pre-tax profit	25	73	66	84	86
	Taxation	(2)	(5)	0	(5)	(5)
	Recurring net profit	23	68	66	79	81
	Cash flow (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Change in working capital	4	2	9	1	2
	Cash flow from operations	90	96	109	108	118
	Capex	(2)	(6)	(17)	(17)	(17)
	Cash flow from investing activities	(176)	(260)	(17)	(17)	(17)
	Dividends paid	(65)	(69)	(82)	(84)	(86)
	Cash flow from financing activities	86	141	(86)	(82)	(87)
	Cash at beginning of period	38	37	14	17	16
	Net change in cash	(0)	(24)	7	9	13
	Ending balance cash	37	14	17	16	14
	Balance sheet (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Total cash and equivalents	37	14	17	16	14
	Total investments	1,405	1,655	1,670	1,703	1,737
	Total assets	1,447	1,673	1,691	1,724	1,756
	Total long-term debt	480	629	646	669	692
	Total liabilities	539	682	708	738	768
	Shareholders' equity	908	991	983	985	988
	Total equity	908	991	983	985	988
	Net debt	443	615	629	653	678
	Total liabilities & equity	1,447	1,673	1,691	1,724	1,756
	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Revenue growth (%)	136.7	9.2	5.1	3.3	3.8
	Recurrent EPS growth (%)	(38.7)	174.6	(9.3)	19.4	1.6
	Operating EBITDA margin (%)	59.5	58.0	57.1	57.2	57.3
	Net profit margin (%)	16.2	43.5	39.8	46.4	45.8
	Dividend payout ratio (%)	310.6	110.9	124.6	106.2	106.5
	Capex/sales (%)	1.7	3.5	10.0	9.8	9.6
	Interest cover (x)	5.74	5.35	5.02	4.85	4.64

Source: Company data, RHB

Figure 1: DDM valuation

	FY22F	FY23F	FY24F	FY25F	FY26F	Terminal value
DPU (US cents)	6.94	7.06	7.19	7.26	7.32	106.2
Intrinsic Value (USD)	0.98					
ESG Premium/(discount)	0.02					
Target Price (USD)	1.00					
Current Price (USD)	0.72					
Price Upside (%)	38.9%					
Distribution Yield FY19F (%)	9.7%					
Total Return (%)	48.6%					
Assumptions						
Risk-free rate (%)	3%					
Beta	1.0					
Cost of equity (%)	9.0%					
Terminal growth (%)	2%					

Source: RHB

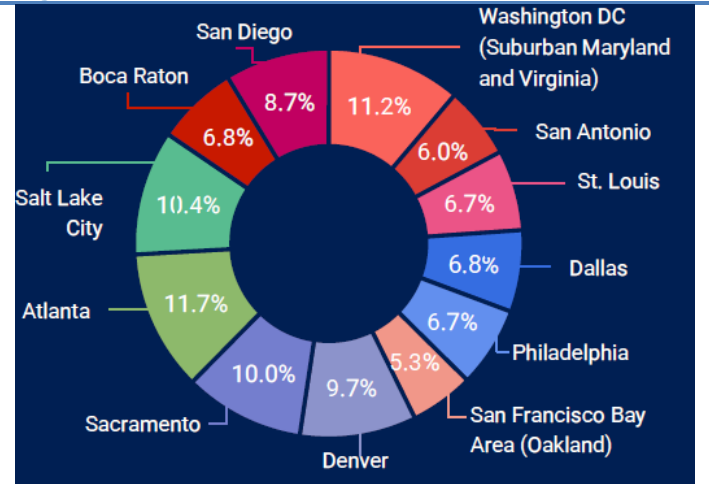
Figure 2: Average rental rates are 5% below asking rental rates

Name of Property	Annual In Place Rent (US\$)	Annual Asking Rent (US\$)	Potential Rental Reversion	WALE	Occupancy	Lease expiry through 2022 by CRI ^[1]
Tower I at Emeryville	\$55.74	\$55.80	0.1%	2.1	58.9%	0.2%
222 Main	\$39.30	\$37.30	-5.1%	4.3	95.4%	0.1%
Village Center Station I	\$23.77	\$23.50	-1.1%	1.7	69.9%	0.0%
Village Center Station II	\$24.70	\$24.00	-2.8%	6.0	100.0%	0.0%
101 South Hanley	\$29.06	\$31.50	8.4%	3.6	90.3%	0.1%
Tower 909	\$29.48	\$33.20	12.6%	3.7	84.1%	0.2%
Promenade I & II	\$28.28	\$28.50	0.8%	2.4	98.6%	0.0%
CrossPoint	\$34.45	\$41.00	19.0%	3.1	100.0%	1.6%
One Washingtonian Center	\$36.21	\$36.50	0.8%	2.5	81.2%	0.2%
Reston Square	\$43.81	\$37.00	-15.6%	1.6	100.0%	2.7%
171 17th Street	\$29.08	\$28.00	-3.7%	5.7	91.9%	0.6%
Park Tower	\$33.29	\$40.50	21.7%	3.9	87.2%	0.4%
One Town Center	\$34.46	\$37.00	7.4%	5.4	98.4%	0.0%
Sorrento Towers	\$40.56	\$47.57	17.3%	5.7	97.0%	0.3%
Total / Weighted Average	\$33.41	\$35.19	5.3%	4.0	89.6%	6.5%

[1] Lease expiry excludes month to month leases accounting for 2.4% of CRI.

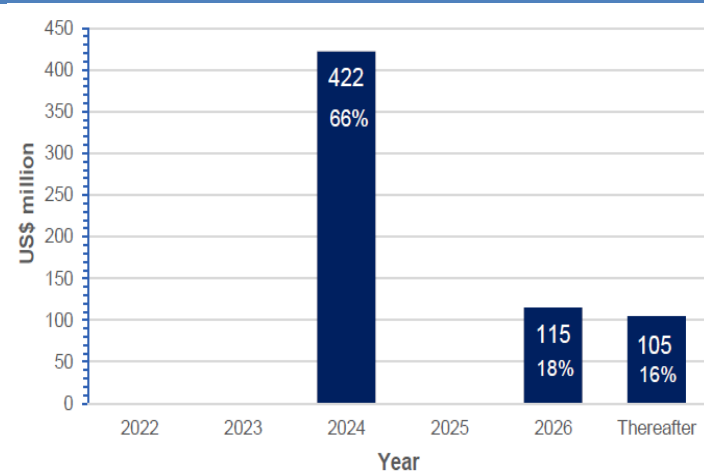
Source: Company data

Figure 3: No market accounts for >12% of rental income



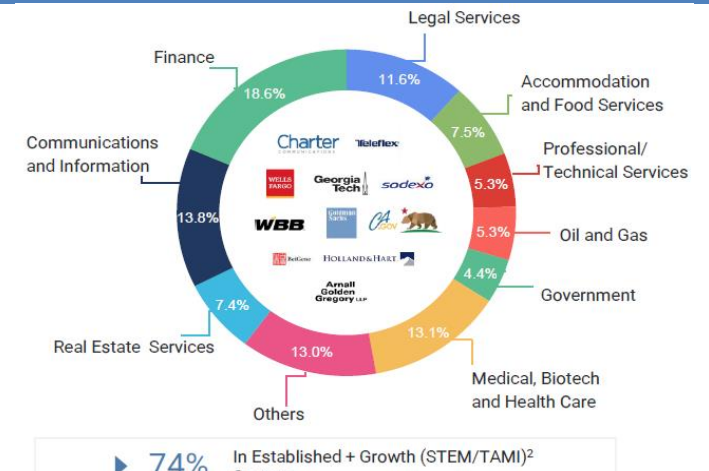
Source: Company data

Figure 4: PRIME has a weighted debt maturity of 3.2 years (post extension options)



Source: Company data

Figure 5: No tenant sector accounts for >20% of PRIME's income



Source: Company data

Recommendation Chart

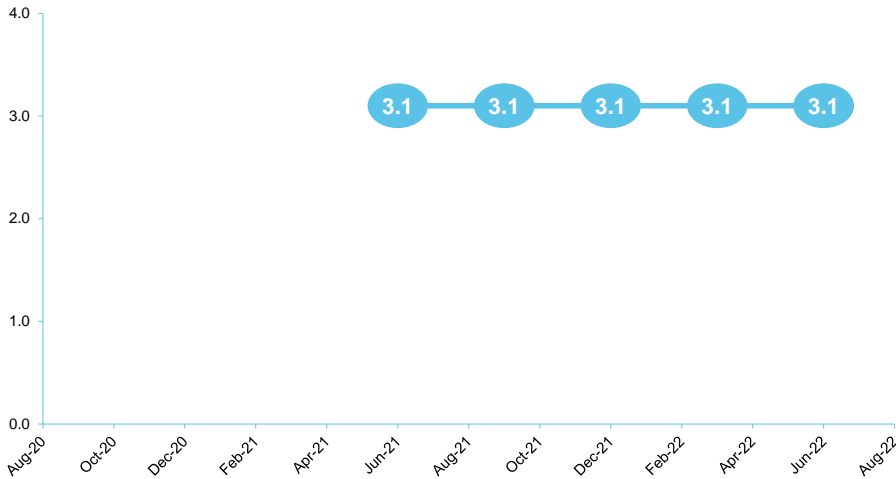


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-02-17	Buy	1.02	0.82
2021-11-07	Buy	1.04	0.88
2021-08-04	Buy	1.03	0.83
2021-06-24	Buy	1.03	0.88
2021-02-18	Buy	1.00	0.83
2020-12-03	Buy	1.00	0.77

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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