Singapore Company Update

Parkway Life REIT

Bloomberg: PREIT SP | Reuters: PWLR.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

15 Jul 2021

BUY

Last Traded Price (14 Jul 2021): S$4.77 (STI : 3,153.15)
Price Target 12-mth: S$5.75 (21% upside) (Prev S$4.50)

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What's New

- A new lease of life secured for the next two decades with c.40% rent increment and 27% rise in NAV
- Staying Singapore-centric with ROFR on Mount Elizabeth Novena Hospital "renewed"
- Better positioned for a new chapter of inorganic growth
- Maintain BUY; raised TP to S$5.75

Price Relative

Forecasts and Valuation

FY Dec (S$m)	2020A	2021F	2022F	2023F
Gross Revenue	121	121	126	126
Net Property Inc	113	113	117	117
Total Return	87.2	84.1	328	87.3
Distribution Inc	86.9	86.1	89.8	89.3
EPU (S cts)	13.2	13.9	14.5	14.4
EPU Gth (%)	(1)	5	4	(1)
DPU (S cts)	13.8	13.8	14.3	14.3
DPU Gth (%)	4	0	4	(1)
NAV per shr (S cts)	196	197	237	237
PE (X)	36.2	34.3	32.9	33.1
Distribution Yield (%)	2.9	2.9	3.0	3.0
P/NAV (x)	2.4	2.4	2.0	2.0
Aggregate Leverage (%)	38.3	39.4	36.1	37.4
ROAE (%)	6.7	7.1	6.7	6.1
Distn. Inc Chng (%):		6	9	(3)
Consensus DPU (S cts):		14.0	14.7	15.7
Other Broker Recs:		B: 3	S: 0	H: 1

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Deal of the decade

Investment Thesis

A new lease of life secured for the next two decades. Parkway Life Real Estate Investment Trust (PREIT) has surpassed expectations with the renewal of the Singapore hospitals' master lease that comes with c.40% rent increment, 27% rise in NAV, and 20-year extension of lease tenure. While trading at a premium of 2.4x P/NAV, we believe PREIT's growth story remains intact with catalysts in the pipeline. BUY!

Staying Singapore-centric with ROFR on Mount Elizabeth Novena Hospital "renewed". The ROFR on Mount Elizabeth Novena Hospital has been "renewed" for 10 years, implying PREIT's intention to remain Singapore-centric and the committed support that its sponsor lends.

Third pillar of growth. PREIT's management believes that it is timely to look at building a third pillar for the company's next growth phase, which we think would be in matured markets.

Valuation:

Maintain BUY, raised TP to S$5.75. We raised our DCF-derived target price (TP) to S$5.75, based on weighted average cost of capital (WACC) of 4.7% and terminal growth of 2.9%. We have factored in upward rental revision and extension of lease tenure with the renewal of the master lease and assumed new acquisitions worth S$25m.

Where we differ:

A new chapter of growth. We believe the rental upliftment from the master lease renewal is just the start of a new chapter of growth. PREIT is now in a better position of focusing on inorganic growth via i) asset-recycling strategies, ii) venturing into a new market (third pillar), and iii) exercising ROFR from its sponsor.

Key Risks to Our View:

Currency risks. PREIT derives c.40% of its earnings from healthcare assets in Japan and is exposed to foreign exchange (forex) volatility.

At A Glance

Issued Capital (m shrs)	605
Mkt. Cap (Sm/USm)	2,886 / 2,133
Major Shareholders (%)	
Parkway Holdings Ltd	35.9
Cohen & Steers Inc	7.4
Free Float (%)	43.3
3m Avg. Daily Val (US$m)	2.2

GIC Industry : Real Estate / Equity Real Estate Investment (REITs)

ed: TH/ sa: YM, PY, CS

WHAT'S NEW

Deal of the decade

A new lease of life secured for the next two decades. PREIT finally revealed the much-anticipated renewal of the master lease for its three Singapore hospitals with the deal of the decade. This secures PREIT's income visibility from its Singapore hospitals for the next two decades, which currently contributes the bulk of its income (c.60% of its NPI). The renewal of the master lease will extend PREIT's WALE from 5.7 years to 16.6 years.

The renewal of the lease will be presented for unitholders' approval in an EGM expected to be called by 3Q21, after which completion is expected by the end of 3Q21.

New lease exceeds expectations. With the strategic collaboration and support from its sponsor, IHH Healthcare, to ensure business continuity and sustained growth for both sponsor and PREIT, the new master lease agreements have exceeded expectations on all fronts.

- **Extension of lease tenure by another five years**, securing the master lease for 20 years (to expire on 31 Dec 2042) instead of 15 years as previously expected (the initial master lease was for 15+15 years), providing a longer term of income certainty and stability. The new master lease includes an option to renew for a further term of 10 years from 1 Jan 2043 to 31 Dec 2052.

- **Higher-than-expected S$150m of asset enhancement works driving c.40% rental upliftment in FY26.** There will be a rental increase of c.40%, an estimated total rental of S$99m in Year 4 (FY26), post the completion of S$150m asset enhancement works to which PREIT has committed. The asset enhancement works will be targeted to improve efficiency, utilisation and productivity that will drive the income generation capabilities of the underlying hospital operations.

  The rental upliftment was c.11% above our forecasts on a higher committed amount of capex works of S$150m vs our assumption of S$100m (please refer to our previous report published on 20 April 2021 titled "*Capitalise on this once-in-15 years opportunity*").

- **Guaranteed rental step-up of 2-3% during downtime from AEI.** Although the rental boost will not be seen immediately upon the renewal, PREIT has again delivered "no downside risks" even during the downtime from AEI. Instead, it provides guaranteed rental step-up of 2-3% during the 3-year AEI period, in line with the historical average of rental growth per annum from its annual rent review mechanism calculated from CPI+1% formula.

- **Immediate NAV upside of c.20% upon renewal and a total of c.40% increment in asset value post AEI.** Based on pro forma figures, the value of the assets is expected to increase by c.40% post AEI. Assuming that capex will be fully funded by borrowings, PREIT's NAV is expected to increase by c.20% upon renewal of the master lease following the renewal and rental uplift. NAV is expected to rise by a total of c.27% upon completion of the AEI in Year 4, FY26.

  As such, gearing is expected to reduce to 34.5% from 38.5% as at Dec 2020, providing sufficient debt headroom to fund the capex works and/or potential future acquisition. Based on pro forma figures and assuming the S$150m is fully debt-funded, PREIT's gearing will increase to 37.3% upon completion of the AEI.

- **Maintain its CPI-linked lease structure favoured by investors while keeping the option to ride on potential upside from the asset.** The lease structure's annual rent review is still calculated based on the higher of i) CPI+1% formula, which is highly favoured by investors, or ii) base + variable rent formula, which allows investors to participate in potential upside from the hospital operations.

ROFR on Mount Elizabeth Novena Hospital "renewed" for 10 years, reinforces PREIT's intention to stay Singapore-centric. The rights of first refusal (ROFR) on Mount Elizabeth Novena Hospital was granted by the sponsor during the IPO had expired in 2012. As such, the sponsor continues to show its strong support and intention by granting a "new" ROFR on the hospital to PREIT for a period of 10 years. This further solidifies the continued collaboration of PREIT and its sponsor for the long term and reinforces PREIT's intention to stay Singapore-centric and its interest to acquire (though timing remains uncertain) Mount Elizabeth Novena Hospital when the opportunity arises.

AEI to upgrade assets for higher asset utilisation and towards "green" and sustainability features. The asset enhancement plans will largely be on Mount Elizabeth Hospital, the largest of the three hospitals in PREIT's Singapore portfolio. It will focus on upgrading the quality

of the assets, and drive asset efficiency and utilisation to derive future growth. The capex works will largely focus on:

- future proofing through improvement works on safety features and utility infrastructure,
- enhancing building performance with eco-friendly and sustainability features through Green Mark certification and technological advances such as building management system, and
- refreshing the aesthetics and the ambience of the property, as well as addressing patient demand and evolving healthcare trends through the upgrade and reconfiguration of the hospital space and functions.

Capex works are expected to start by 1 Jan 2023 and expected to take three years (completion by FY26). All renewal capex works is expected to be completed no later than 31 Mar 2028.

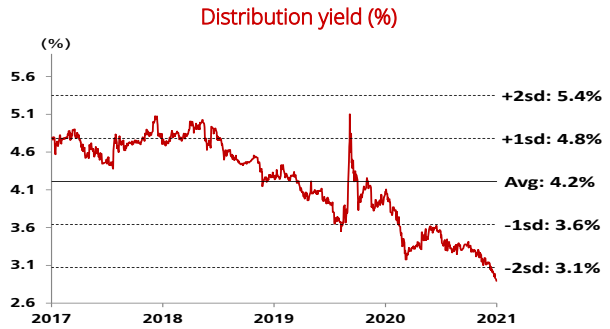
Staying on course with potential acquisitions and opportunity to recapitalise capital structure. PREIT stays on course in growing its assets via potential accretive acquisitions either in Japan or a new third market for the next phase of growth. While the timing of potential acquisitions remains uncertain, a sizeable acquisition would not only offer inorganic growth but an opportunity to recapitalise its capital structure.

Maintain BUY; raise TP to S$5.75. We maintain our BUY rating and raise our TP to S$5.75 from S$4.50 to price in the master lease renewal and the accompanying rental uplift. We revised our FY21F-FY22F DPU estimates by 6-9% based on the higher-than-expected rental increment. We believe the renewal of the master lease is not the end but just a start of a new chapter of growth for PREIT. With a bigger asset size and improved debt headroom, PREIT is now better positioned to grow its portfolio size via potential acquisitions either in its existing Japan market or a new third market for long-term visibility.

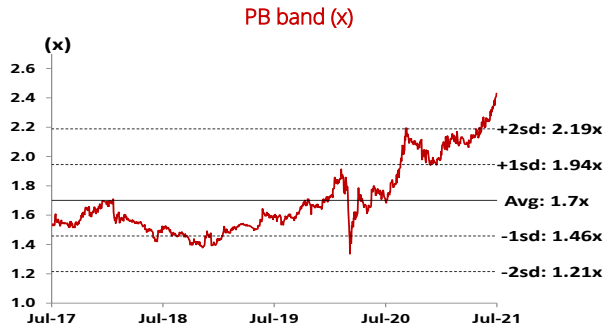
Company Background

Parkway Life REIT (PREIT) is one of Asia's largest listed healthcare REITs. It invests in income-producing real estate and real estate-related assets used primarily for healthcare and healthcare-related purposes.

Historical Dividend yield and PB band



Source: Bloomberg Finance L.P., DBS Bank estimates



Source: Bloomberg Finance L.P., DBS Bank estimates

Segmental Breakdown

FY Dec	2019A	2020A	2021F	2022F	2023F
Revenues (S$m)					
Singapore	68.5	69.5	70.4	72.0	74.2
Japan Nursing homes	46.4	51.1	50.1	53.3	51.2
Malaysia	0.37	0.31	0.54	0.54	0.55
Total	115	121	121	126	126
NPI (S$m) (S$m)					
Singapore	65.4	66.3	67.1	68.7	70.8
Japan Nursing homes	42.6	46.1	45.1	48.0	46.1
Malaysia	0.22	0.16	0.37	0.37	0.38
Total	108	113	113	117	117
NPI (S$m) Margins (%)					
Singapore	95.4	95.5	95.4	95.4	95.4
Japan Nursing homes	91.9	90.1	90.0	90.0	90.0
Malaysia	60.4	51.1	69.0	69.0	69.0
Total	93.9	93.1	93.0	93.0	93.1

Income Statement (S$m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Gross revenue	115	121	121	126	126
Property expenses	(7.0)	(8.4)	(8.4)	(8.8)	(8.7)
Net Property Income	108	113	113	117	117
Other Operating expenses	(15.1)	(17.5)	(14.6)	(14.9)	(15.8)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(6.6)	(5.2)	(4.7)	(5.0)	(4.9)
Exceptional Gain/(Loss)	2.44	(0.8)	0.0	0.0	0.0
Net Income	89.0	89.0	93.2	97.1	96.6
Tax	(8.6)	(9.2)	(9.1)	(9.3)	(9.3)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	80.4	79.8	84.1	87.8	87.3
Total Return	123	87.2	84.1	328	87.3
Non-tax deductible Items	(40.6)	(0.3)	2.00	(238)	2.00
Net Inc available for Dist.	82.8	86.9	86.1	89.8	89.3
Growth & Ratio					
Revenue Gth (%)	2.1	4.9	0.1	4.0	0.1
N Property Inc Gth (%)	2.7	4.0	0.0	4.0	0.2
Net Inc Gth (%)	8.6	(0.7)	5.4	4.4	(0.5)
Dist. Payout Ratio (%)	96.4	96.0	97.1	96.7	96.6
Net Prop Inc Margins (%)	93.9	93.1	93.0	93.0	93.1
Net Income Margins (%)	69.8	66.0	69.5	69.7	69.3
Dist to revenue (%)	71.9	71.9	71.1	71.3	70.9
Managers & Trustee's fees	13.1	14.5	12.1	11.9	12.5
ROAE (%)	6.9	6.7	7.1	6.7	6.1
ROA (%)	4.1	3.9	4.0	3.9	3.6
ROCE (%)	4.4	4.2	4.3	4.1	3.8
Int. Cover (x)	14.1	18.2	20.7	20.3	20.8

Source: Company, DBS Bank

Quarterly Income Statement (S$m)

FY Dec	1Q2020	2Q2020	3Q2020	4Q2020	1Q2021
Gross revenue	29.9	30.3	30.2	30.6	30.0
Property expenses	(2.1)	(2.1)	(2.1)	(2.1)	(2.0)
Net Property Income	27.8	28.2	28.1	28.5	28.0
Other Operating	(4.3)	(4.5)	(3.9)	(4.9)	(3.8)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(1.5)	(1.2)	(1.2)	(1.4)	(1.1)
Exceptional Gain/(Loss)	(4.4)	2.83	(0.4)	1.13	3.20
Net Income	**17.5**	**25.4**	**22.7**	**23.4**	**26.4**
Tax	(1.9)	(2.1)	(1.9)	(3.3)	(2.8)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	**15.6**	**23.3**	**20.8**	**20.1**	**23.6**
Total Return	15.6	23.3	20.8	27.5	28.7
Non-tax deductible Items	6.07	(1.7)	1.37	(6.1)	(6.3)
Net Inc available for Dist.	21.7	21.6	22.1	21.4	22.3
Growth & Ratio					
Revenue Gth (%)	7	1	0	1	(2)
N Property Inc Gth (%)	2	2	0	1	(2)
Net Inc Gth (%)	(32)	49	(11)	(3)	17
Net Prop Inc Margin (%)	92.9	93.2	93.1	93.1	93.4
Dist. Payout Ratio (%)	92.6	94.1	96.6	100.7	96.6

Balance Sheet (S$m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Investment Properties	1,966	1,991	2,014	2,284	2,339
Other LT Assets	3.02	4.36	4.36	4.36	4.36
Cash & ST Invts	21.9	22.7	69.7	66.8	62.4
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	12.0	18.1	12.6	13.1	13.1
Other Current Assets	0.0	30.9	30.9	30.9	30.9
Total Assets	**2,003**	**2,067**	**2,132**	**2,399**	**2,450**
ST Debt	77.8	163	163	163	163
Creditor	21.9	26.9	26.4	27.7	27.3
Other Current Liab	3.21	2.89	12.0	12.2	12.2
LT Debt	662	629	678	703	753
Other LT Liabilities	56.0	62.1	62.1	62.1	62.1
Unit holders' funds	1,182	1,184	1,190	1,432	1,433
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**2,003**	**2,067**	**2,132**	**2,399**	**2,450**
Non-Cash Wkg. Capital	(13.2)	19.2	5.00	4.07	4.46
Net Cash/(Debt)	(718)	(769)	(771)	(799)	(854)
Ratio					
Current Ratio (x)	0.3	0.4	0.6	0.5	0.5
Quick Ratio (x)	0.3	0.2	0.4	0.4	0.4
Aggregate Leverage (%)	36.9	38.3	39.4	36.1	37.4
Z-Score (X)	2.2	2.1	2.1	2.1	2.1

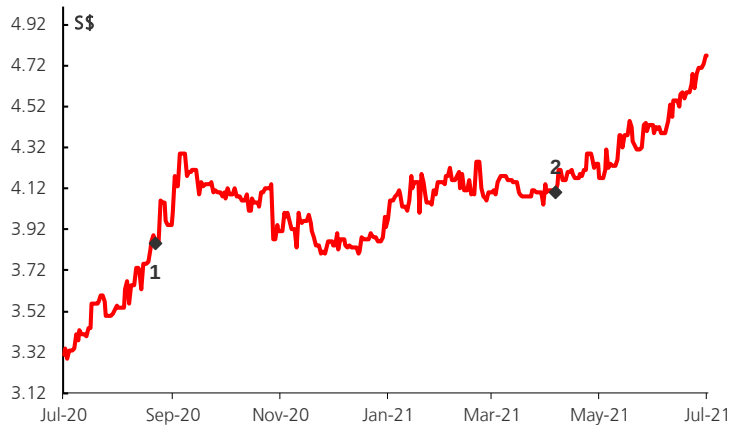
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2019A	2020A	2021F	2022F	2023F
Pre-Tax Income	89.0	96.4	93.2	97.1	96.6
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(5.0)	(5.1)	0.0	(9.1)	(9.3)
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	1.29	0.62	5.04	0.75	(0.3)
Other Operating CF	3.92	(1.6)	0.0	0.0	0.0
Net Operating CF	**89.3**	**90.3**	**98.3**	**88.7**	**86.9**
Net Invt in Properties	(9.6)	(4.6)	(54.2)	(29.9)	(55.0)
Other Invts (net)	(51.5)	(24.0)	37.1	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.01	0.01	0.0	0.0	0.0
Net Investing CF	**(61.1)**	**(28.6)**	**(17.1)**	**(29.9)**	**(55.0)**
Distribution Paid	(79.4)	(82.0)	(83.6)	(86.8)	(86.3)
Chg in Gross Debt	56.4	25.7	49.5	25.0	50.0
New units issued	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(5.4)	(5.1)	0.0	0.0	0.0
Net Financing CF	**(28.4)**	**(61.5)**	**(34.1)**	**(61.8)**	**(36.3)**
Currency Adjustments	0.11	0.52	0.0	0.0	0.0
Chg in Cash	(0.2)	0.79	47.1	(2.9)	(4.4)
Operating CFPS (S cts)	14.5	14.8	15.4	14.5	14.4
Free CFPS (S cts)	13.2	14.2	7.29	9.72	5.27

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	04 Sep 20	3.85	4.00	BUY
2:	19 Apr 21	4.10	4.50	BUY

Note *: Share price and Target price are adjusted for corporate actions.*

Source: DBS Bank

Analyst: Rachel TAN

Derek TAN

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 15 Jul 2021 08:04:56 (SGT)
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