

# Singapore Company Update

# Elite Commercial REIT

Bloomberg: ELITE SP | Reuters: ELIE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

3 Mar 2022

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## BUY

Last Traded Price (2 Mar 2022): GBP0.645 (STI : 3,244.40)  
Price Target 12-mth: GBP0.80 (24% upside)

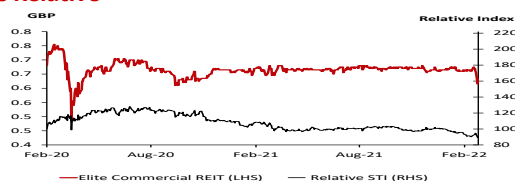
### Analyst

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### What's New

- Markets mispricing positive outcome from recent lease restructuring (critical factor)
- c.79% of total portfolio by GRI now with straight leases through to 2028, offering six years of income visibility, the longest amongst S-REITs
- Committed to invest GBP12.5m in asset enhancement work over three years to drive ESG initiatives
- Maintain BUY and unchanged TP of GBP0.80

### Price Relative



### Forecasts and Valuation

FY Dec (GBPm)	2020A	2021A	2022F	2023F
Gross Revenue	21.0	34.7	36.8	39.0
Net Property Inc	20.4	33.7	35.8	37.9
Total Return	23.4	(4.7)	49.9	23.2
Distribution Inc	14.8	32.9	22.7	24.0
EPU (Pence)	N/A	(1.2)	10.4	4.84
EPU Gth (%)	nm	nm	nm	(54)
DPU (Pence)	4.43	5.43	4.83	5.02
DPU Gth (%)	nm	23	(11)	4
NAV per shr (Pence)	64.9	60.7	66.0	66.1
PE (X)	N/A	nm	6.2	13.3
Distribution Yield (%)	6.9	8.4	7.5	7.8
P/NAV (x)	1.0	1.1	1.0	1.0
Aggregate Leverage (%)	33.7	45.8	40.7	41.0
ROAE (%)	N/A	(1.9)	16.5	7.3

Distn. Inc Chng (%): (12) (14)  
Consensus DPU 5.2 4.8  
Other Broker Recs: B: 4 S: 0 H: 0

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

## Superior income visibility not priced in

### Investment Thesis:

Maintain BUY and TP of GBP0.80, implying a 24% potential upside, with attractive yields of 7.5%/7.8% for FY22F/FY23F. Elite Commercial REIT (ECR)'s portfolio of 155 properties boasts of full occupancy and a long WALE of six years, with over 99% leased to the AA-rated UK Government. As the lease break option in 2023 was removed for almost half of the portfolio, 79% of the portfolio now has straight leases through to 2028 without lease break options. The strong income visibility is a key positive for the REIT.

**Revaluation gains ahead to drive share price re-rating.** We believe that ECR will likely see a lift in valuations with the removal of lease break options for 100 out of 117 properties leased to DWP. The remaining 17 properties have lease break options undecided by DWP as of now, but notice will have to be served by the end of this month, otherwise the leases will continue to run till 2028, generating further upside to valuations. The weighted average lease to break (WALB) is now at its longest ever at c.5 years, which will be a critical factor for the stock to re-rate; historically P/NAV was at 1.2x when WALB was at its longest at c.4.5 years, and the stock is currently trading at just 1x P/NAV with potential revaluation gains ahead.

### Greater incentive for DWP to continue its leases beyond 2028.

With the government's aim to achieve sustainability goals such as net zero carbon emissions by 2050, this sustainability collaboration by ECR and DWP is timely. Achieving higher Energy Performance Certificate (EPC) ratings for the properties in the portfolio can provide a greater incentive for DWP to stay as a tenant beyond 2028, future-proofing the REIT.

### Valuation:

Our target price of GBP0.80 is based on a DCF valuation with a WACC of 5.8% and terminal growth rate of 1.00%.

### Where we differ:

We are slightly more conservative on the inflation-linked rental uplift in 2023.

### Key Risks to Our View:

Tenant risks, country risks, interest rate risks, and regulatory risks

### At A Glance

Issued Capital (m shrs)	477
Mkt. Cap (GBPm/US\$m)	307 / 231
Major Shareholders (%)	
Partner Reinsurance Co Ltd	22.9
Ho Lee Group Trust	7.7
Sunway Re Cap Pte Ltd	5.7
Free Float (%)	63.7
3m Avg. Daily Val (US\$m)	0.20
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	



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## WHAT'S NEW

### Lease regearing and sustainability collaboration with DWP

The removal of lease break options for almost half of the portfolio is a positive development that is not priced in. ECR recently concluded lease re-negotiations with a key tenant, the Department for Work and Pensions (DWP), that occupies 117 properties and contributes 57.3% of revenues. The lease break option has always been an overhang on the stock in our view, given the potential significant impact to earnings if the leases are not renewed. With this positive development, we have newfound confidence that Elite will continue to see much brighter times from 2022 onwards.

We see the following catalysts for the stock:

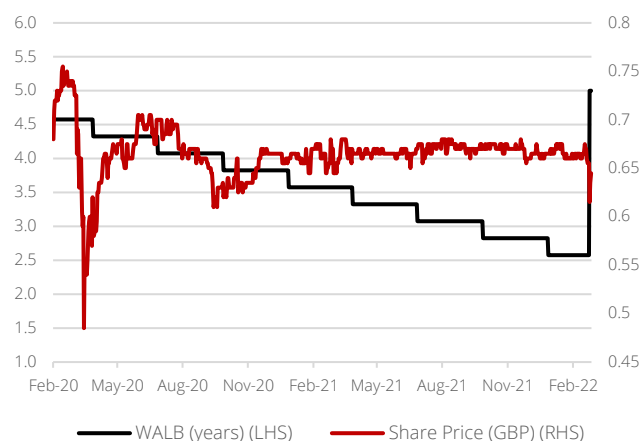
1. Longest ever WALB now at c.5.0 years offers superior earnings visibility, vs. peers.

In the most recent update, the lease break option in March 2023 was removed for 100 of these properties, with 87 properties (41.7% of portfolio by GRI) to enjoy the inflation-linked rental uplift starting April 2023 while 11 properties (5.3% of portfolio by GRI) will have the inflation-linked rental uplift followed by a rent reduction starting April 2023. The details for the remaining 17 properties (10.3% of portfolio by GRI) have yet to be confirmed, but we think that the likelihood for DWP to exercise the break options is fairly low, given that these are assets strategically chosen to provide important social services and serve the local communities, which implies that we are seeing more positives in the coming month.

#### Rent reduction still an overall positive at the portfolio level.

Management shared that these 11 properties with the rent reduction were older and bigger buildings, where DWP has two leases on one property, but they no longer required such a large space. We believe it is more positive for the REIT to take a rent reduction and continue leasing the entire building to the AA-rated UK Government than carving out the property and renting a small portion to another tenant. In addition, these leases will still be subject to the inflation-linked rental escalation, which partially offset the rent reduction.

### WALB (years) vs Share Price (GBP)



Source: DBS Bank Estimates

**Enhanced clarity a unique trait.** The lease break profile of the portfolio has been significantly lengthened. 63.3% of the portfolio had the lease break option in 2023 previously, but it has reduced to 16.3% of the portfolio, while 78.6% of the portfolio now has straight leases through to 2028, providing higher income visibility and stability for the REIT. We believe that this is a critical factor to the re-rating of the stock.

2. Potential uplift in valuations not priced in; P/NAV may drop to 0.93x while gearing falls to 40.7%.

**Revaluation of portfolio in 1H22.** We understand that the Manager will undertake another independent valuation of the entire portfolio in 1H22 for a clearer representation of the REIT's true NAV, which fell by c.8% to £0.61. We believe that valuations may potentially re-rate back higher, given improved income visibility, as most of the properties with the lease break option in 2023 had the option removed, which is more optimistic than the valuers' base case scenario. Assuming the income loss is written back due to an extended WALB, gearing falls to 40.7% while NAV rises to £0.66. Hence, we look forward to higher portfolio valuations and lower gearing on the back of improved cashflows through to 2028.

Elite Commercial REIT

**Sustainability collaboration with DWP.** ECR has committed to invest GBP12.5m over three years towards asset enhancement work on properties leased to DWP, while DWP will be contributing a larger (undisclosed) portion. It will be an ongoing dynamic discussion on the work that needs to be done, not specific to any particular asset.

**Greater incentive for DWP to stay as a tenant beyond 2028.** We see this sustainability collaboration as a positive way to help retain the government tenant. Given that the money can only be spent on a list of pre-approved work, such as lighting systems and initiatives to improve energy efficiency, it should help boost the Energy Performance Certificate (EPC) ratings for the properties, which is important for the buildings that the UK Government leases. As they have also invested in the upkeep of the property, there is now more incentive for DWP to stay.

**Upside in future value of assets.** We also think that this sustainability collaboration is a huge positive for ECR, from a landlord perspective, as the upgraded assets can possibly command higher rentals in the future. Further, with a cap on the amount to be used on one asset, we should see enhancements spread across the portfolio. Hence, there is a likely upside to rentals and value of many properties in the portfolio in the future.

**Decline in distributable income.** The Manager has elected to receive 100% of management fees in cash from FY22 onwards. Hence, DPU falls to 4.83/5.02 pence in FY22F/FY23F, which still translates to attractive yields of 7.5%/7.8%, respectively.

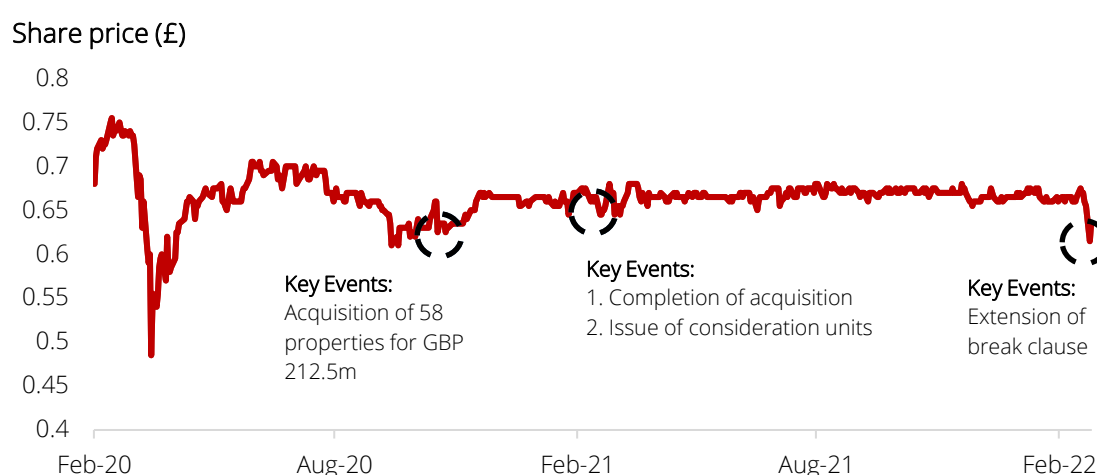
**We maintain our BUY recommendation with an unchanged TP of GBP0.80.**

**Summary of properties occupied by DWP:**

No. of properties	Update	% of portfolio by GRI
87	Lease break option removed; inflation-linked rental uplift starting April 2023	41.7%
11	Lease break option removed; rent reduction implemented followed by inflation-linked rental uplift starting April 2023	5.3%
17	TBD; notice to be served by April 2022, otherwise leases continue till April 2028	10.3%
<b>117</b>		<b>57.3%</b>

Source: Company, DBS Bank

**Historical share price (£)**



Source: Bloomberg Finance L.P., DBS Bank

## Elite Commercial REIT

### Company Background

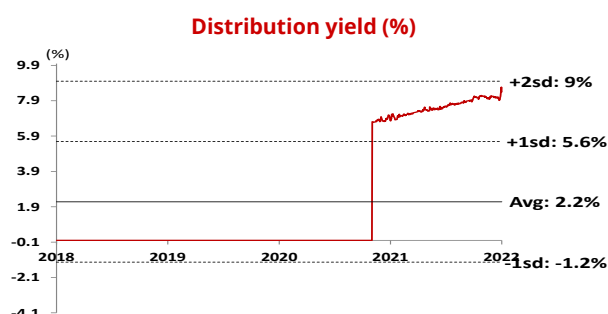
Elite Commercial REIT is the only UK-focused Singapore REIT. It is a Singapore real estate investment trust ("REIT") established with the investment strategy of principally investing, directly or indirectly, in commercial assets and real estate-related assets in the United Kingdom ("UK").

### Interim Income Statement (GBPm)

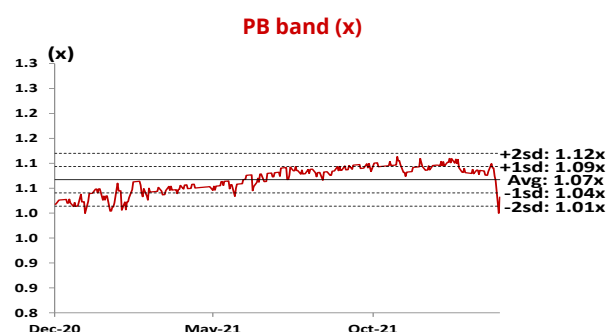
FY Dec	2H2020	1H2021	2H2021	% chg y-o-y	% chg h-o-h
Gross revenue	11.7	15.9	18.8	61.7	18.5
Property expenses	(0.3)	(0.5)	(0.5)	51.1	(3.1)
Net Property Income	11.3	15.4	18.3	62.0	19.2
Other Operating expenses	(1.7)	(2.0)	(2.5)	48.2	27.5
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	(1.3)	(2.2)	(2.2)	(66.8)	(1.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
<b>Net Income</b>	<b>8.29</b>	<b>11.2</b>	<b>13.6</b>	<b>64.1</b>	<b>21.1</b>
Tax	(4.7)	(3.6)	2.19	(146.6)	(161.5)
Minority Interest	0.0	0.0	0.0	-	-
<b>Net Income after Tax</b>	<b>3.59</b>	<b>7.68</b>	<b>15.8</b>	<b>339.6</b>	<b>105.8</b>
Total Return	3.49	3.26	16.2	365.8	399.0
Non-tax deductible Items	0.57	0.85	(12.0)	(2,196.0)	(1,508.0)
Net Inc available for Dist.	4.06	4.11	4.23	4.2	3.0
<b>Ratio (%)</b>					
Net Prop Inc Margin	97.2	96.8	97.4		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

### Historical Dividend yield and PB band



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



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

## Elite Commercial REIT

**Key Assumptions**

FY Dec	2021A	2022F	2023F
Rental growth	0.0	0.0	0.07
Occupancy	1.00	1.00	0.99

**Income Statement (GBPm)**

FY Dec	2020A	2021A	2022F	2023F
Gross revenue	21.0	34.7	36.8	39.0
Property expenses	(0.6)	(1.0)	(1.0)	(1.1)
<b>Net Property Income</b>	<b>20.4</b>	<b>33.7</b>	<b>35.8</b>	<b>37.9</b>
Other Operating expenses	(4.8)	(4.5)	(4.5)	(4.7)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(2.4)	(4.4)	(5.5)	(5.8)
Exceptional Gain/(Loss)	15.9	(28.2)	28.0	0.0
<b>Net Income</b>	<b>29.1</b>	<b>(3.4)</b>	<b>53.7</b>	<b>27.3</b>
Tax	(5.7)	(1.4)	(3.9)	(4.1)
Minority Interest	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0
<b>Net Income After Tax</b>	<b>23.4</b>	<b>(4.7)</b>	<b>49.9</b>	<b>23.2</b>
Total Return	23.4	(4.7)	49.9	23.2
Non-tax deductible Items	(8.5)	29.3	(27.2)	0.82
Net Inc available for Dist.	14.8	32.9	22.7	24.0
<b>Growth &amp; Ratio</b>				
Revenue Gth (%)	N/A	65.7	6.0	5.9
N Property Inc Gth (%)	nm	65.5	6.1	5.9
Net Inc Gth (%)	nm	nm	nm	(53.4)
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	97.2	97.1	97.2	97.2
Net Income Margins (%)	111.4	(13.7)	135.4	59.6
Dist to revenue (%)	70.8	94.6	61.6	61.7
Managers & Trustee's fees	22.9	13.1	12.3	12.2
ROAE (%)	N/A	(1.9)	16.5	7.3
ROA (%)	N/A	(1.1)	9.1	4.1
ROCE (%)	N/A	6.9	5.4	5.1
Int. Cover (x)	6.6	6.7	5.6	5.7

Source: Company, DBS Bank

## Elite Commercial REIT

**Balance Sheet (GBPm)**

<b>FY Dec</b>	<b>2020A</b>	<b>2021A</b>	<b>2022F</b>	<b>2023F</b>
Investment Properties	312	501	536	539
Other LT Assets	0.0	0.51	0.51	0.51
Cash & ST Invt	20.2	19.5	28.3	28.5
Inventory	0.0	0.0	0.0	0.0
Debtors	0.88	12.0	1.55	1.64
Other Current Assets	0.0	0.0	0.0	0.0
<b>Total Assets</b>	<b>333</b>	<b>533</b>	<b>566</b>	<b>569</b>
ST Debt	0.0	6.60	6.60	6.60
Creditor	2.54	5.63	4.46	4.73
Other Current Liab	5.36	9.83	9.83	9.83
LT Debt	102	217	224	227
Other LT Liabilities	5.92	5.04	5.04	5.04
Unitholders' funds	217	289	317	317
Minority Interests	0.0	0.0	0.0	0.0
<b>Total Funds &amp; Liabilities</b>	<b>333</b>	<b>533</b>	<b>566</b>	<b>569</b>
Non-Cash Wkg. Capital	(7.0)	(3.4)	(12.8)	(12.9)
Net Cash/(Debt)	(81.8)	(204)	(202)	(205)
<b>Ratio</b>				
Current Ratio (x)	2.7	1.4	1.4	1.4
Quick Ratio (x)	2.7	1.4	1.4	1.4
Aggregate Leverage (%)	33.7	45.8	40.7	41.0

Source: Company, DBS Bank

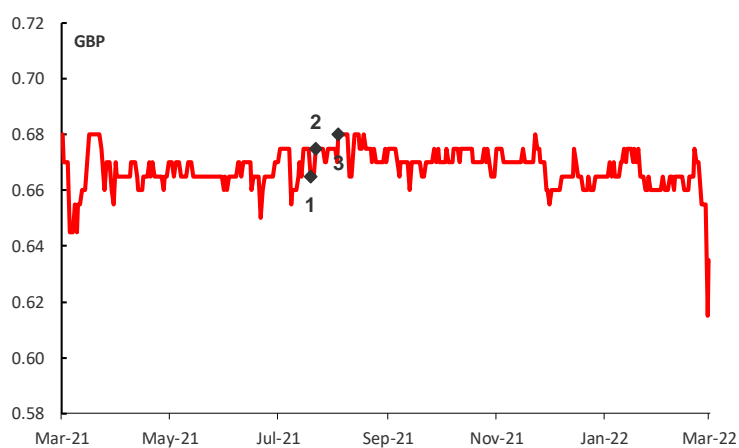
## Elite Commercial REIT

## Cash Flow Statement (GBPm)

FY Dec	2020A	2021A	2022F	2023F
Pre-Tax Income	29.1	(3.4)	53.7	27.3
Dep. & Amort.	0.0	0.0	0.0	0.0
Tax Paid	(2.6)	(2.9)	(3.9)	(4.1)
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0
Chg in Wkg. Cap.	0.06	(6.3)	9.32	0.17
Other Operating CF	(10.1)	35.2	(27.2)	0.82
<b>Net Operating CF</b>	<b>16.5</b>	<b>22.7</b>	<b>32.0</b>	<b>24.2</b>
Net Invnt in Properties	0.0	0.0	(6.3)	(3.1)
Other Invnts (net)	0.0	(9.4)	0.0	0.0
Invnts in Assoc. & JV	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0
Other Investing CF	0.0	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>0.0</b>	<b>(9.4)</b>	<b>(6.3)</b>	<b>(3.1)</b>
Distribution Paid	(16.3)	(17.6)	(23.2)	(24.0)
Chg in Gross Debt	(106)	8.56	6.25	3.13
New units issued	105	0.0	0.0	0.0
Other Financing CF	1.67	(5.1)	0.0	0.0
<b>Net Financing CF</b>	<b>(15.6)</b>	<b>(14.1)</b>	<b>(16.9)</b>	<b>(20.9)</b>
Currency Adjustments	0.0	0.0	0.0	0.0
Chg in Cash	0.83	(0.8)	8.82	0.17
Operating CFPS (Pence)	N/A	7.14	4.74	5.01
Free CFPS (Pence)	N/A	5.59	5.38	4.40

Source: Company, DBS Bank

## Target Price &amp; Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	19 Jul 21	0.67	0.80	BUY
2:	22 Jul 21	0.68	0.80	BUY
3:	04 Aug 21	0.68	0.80	BUY

Source: DBS Bank

Analyst: Singapore Research Team

Dale LAI

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**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

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\*Share price appreciation + dividends

Completed Date: 3 Mar 2022 06:54:50 (SGT)

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