

COMPANY UPDATE

Elite Commercial REIT (ELITE SP)

Break Clauses Becoming A Thing Of The Past

Renegotiation of lease terms with sovereign tenant DWP has led to break clauses being removed from 108 leases, of which rents for 97 leases were maintained while rents for 11 leases were reduced. The properties have rent reviews every five years benchmarked against UK CPI, and rental escalation of 15.4% is expected to kick in in Apr 23. Exor NV is the largest shareholder with a 23% stake. ELITE is a recession-resistant counter-cyclical yield play. Maintain BUY. Target price: £0.87.

WHAT'S NEW

- Elite Commercial REIT (ELITE) has embarked on renegotiation of lease terms with sovereign occupier Department for Work and Pensions (DWP) since Feb 22. DWP occupies 146 out of ELITE's 155 commercial properties.
- Majority of 136 DWP leases have no break clauses (83.8% of total contractual rent). 27 of the DWP leases are straight leases without break clauses. Break clauses were removed from 108 leases, of which rents for 97 leases were maintained while rents for 11 leases were reduced. The reduction in rents for the 11 commercial properties is estimated at 36% (before positive impact of rental escalation). DWP also signed a new five-year lease for one commercial property at East Street, Epsom.
- Break options for 10 leases were exercised (7.2% of total contractual rent). DWP has exercised break options for nine leases. It will vacate from one building in Mar 22 and another eight buildings in Mar 23. HM Revenue & Customs has also exercised the break option for Sidlaw House at Dundee and will vacate the building in Jun 22. ELITE will consider three options for these 10 commercial properties: a) re-let to other potential new tenants, b) divestment with vacant possession or following re-letting, or c) seek alternative uses, such as conversion or redevelopment.

RENTAL CONTRIBUTION AFTER RENEGOTIATION OF LEASE TERMS WITH DWP

Type of Leases	Number of Properties	Contractual Rent for 2022 (£)	Contractual Rent for 2023 (£)	% Change
Straight Leases	27	11,783	13,597	+15.4
<u>Leases with break options removed</u>				
- Without rent reduction	97	17,284	19,926	+15.4
- With rent reduction	11	1,976	1,457	-26.3
New five-year lease for East Street, Epsom	1	143	160	+11.9
<u>Leases with break options exercised</u>				
- Vacated on 31 Mar 22	1	35	n.a.	n.a.
- To vacate by 31 Mar 23	8	1,758	n.a.	n.a.
Lease pending an outcome	1	390	n.a.	n.a.
Total	146	33,370	35,140#	+5.3%#

Source: ELITE #Assuming no income from the 10 commercial properties with break options exercised or pending outcome.

KEY FINANCIALS

Year to 31 Dec (GBPm)	2020*	2021	2022F	2023F	2024F
Net turnover	21	35	37	37	39
EBITDA	16	29	30	31	31
Operating profit	16	29	30	31	31
Net profit (rep./act.)	7	23	21	20	21
Net profit (adj.)	7	23	21	20	21
EPU (GBP pence)	2.2	5.2	4.4	4.3	4.4
DPU (GBP pence)	4.4	5.4	5.1	5.0	5.3
PE (x)	28.6	12.3	14.6	14.9	14.4
P/B (x)	1.0	1.0	1.2	1.2	1.2
DPU Yld (%)	6.9	8.5	7.9	7.8	8.3
Net margin (%)	35.6	66.1	55.2	54.8	54.0
Net debt/(cash) to equity (%)	37.6	70.7	89.8	92.3	94.9
Interest cover (x)	6.6	6.0	5.5	5.2	5.4
ROE (%)	n.a.	9.1	7.5	7.9	8.4
Consensus DPU (GBP pence)	n.a.	n.a.	4.9	5.1	5.5
UOBKH/Consensus (x)	-	-	1.03	0.97	0.96

*Period from 6 Feb 20 to 31 Dec 20.

Source: Elite Commercial REIT, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	£0.64
Target Price	£0.87
Upside	+35.9%
(Previous TP)	£0.95)

COMPANY DESCRIPTION

Elite is the first UK-focused S-REIT listed on the SGX. It principally invests in commercial real estate in the UK.

STOCK DATA

GICS sector	Real Estate
Bloomberg ticker:	ELITE SP
Shares issued (m):	478.9
Market cap (GBPm):	306.5
Market cap (US\$m):	381.8
3-mth avg daily t'over (US\$m):	0.4

Price Performance (%)

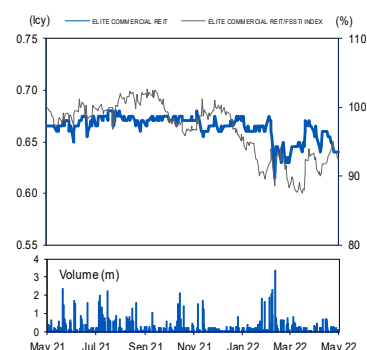
52-week high/low GBP0.680/GBP0.615

1mth	3mth	6mth	1yr	YTD
(3.8)	(3.0)	(4.5)	(3.8)	(3.8)

Major Shareholders

	%
Exor Nederland	22.9
Ho Lee Group Trust	7.7
Sunway RE Capital	5.8
FY22 NAV/Share (GBP)	0.55
FY22 Net Debt/Share (GBP)	0.49

PRICE CHART



Source: Bloomberg

ANALYST(S)

Jonathan Koh, CFA
 +65 6590 6620
 jonathankoh@uobkayhian.com

- **Only three leases with outstanding break options (3.9% of total contractual rent).** DWP has only one remaining lease with a break clause that occurs in Mar 23. DWP has not decided on whether to exercise the break option for this building. Two other leases with National Records of Scotland and Natural Resource Wales also have break options that occur in Jan 23 and Aug 23 respectively.
- **Mid-year valuation.** ELITE plans to conduct a mid-year valuation exercise to update the valuations of its properties post the renegotiation of lease terms.
- **Rental rates are affordable for the UK government.** The average rental rate for ELITE's 155 commercial properties is low at £9.60psf per year in 2021. The average valuation of its commercial properties is £130psf, which is below the current construction cost of £190-250psf in the UK.
- **Income stability with long WALE.** ELITE has a long WALE of 5.5 years as of Mar 22 post renegotiation of lease terms.
- **Benefitting from higher inflation.** The leases with the UK government are full repairing and insuring triple net leases that provide high NPI margin of 97.1% in 2021. Thus, ELITE is sheltered from the negative impact from higher cost of electricity. The leases have rent reviews every five years benchmarked against the UK Consumer Price Index (CPI). The built-in rental escalation is subject to an annual minimum increase of 1% and maximum of 5%. Based on consensus estimate of 7.5% for the UK's CPI in 2022, we estimate the step-up in rents at 15.4% for Apr 23.

STOCK IMPACT

- **Recession-resistant counter-cyclical yield play.** ELITE benefits from recession-resistant and counter-cyclical cash flows from its sovereign tenants. The UK government is rated AA by S&P and Aa3 by Moody's. Rent collection in advance for 2Q22 was 100% within seven days of due date.
- **Covea to become the largest shareholder.** PartnerRE, the largest investor of Elite UK Commercial Fund II, has increased its stake in ELITE from 1% to 23% post ELITE's acquisition of 58 commercial properties located across the UK for £212.5m in Mar 21. PartnerRE is a top-5 reinsurer on a worldwide basis. Excor NV, the Dutch holding company for Italy's Agnelli family, has sold PartnerRE to French insurer Covea Cooperations for US\$9b in Oct 21.

EARNINGS REVISION/RISK

- **Gradually deleveraging through DRP.** ELITE's aggregate leverage was 42.8% as of Mar 22. Its Distribution Reinvestment Plan (DRP) serves to allow ELITE to deleverage gradually. Its average cost of debt is 2.1%. 63% of its total borrowings are hedged to fixed interest rates. Assuming that Bank of England hikes Repo Rate to 1.25% by end-22, we estimate that cost of debt would increase to 2.3% in 2023.
- We have trimmed our 2022 and 2023 DPU by 6% and 15% respectively due to the renegotiation of lease terms and higher interest rates. We have conservatively assumed that: a) break options for the remaining three leases with break options were exercised, and b) a worst-case scenario that commercial properties with break options exercised are vacant for nine months and rental income is halved after securing replacement tenants.

VALUATION/RECOMMENDATION

- **Maintain BUY.** Our target price for ELITE of £0.87 is based on DDM (COE: 6.75%, terminal growth: 1.0%).

SHARE PRICE CATALYST

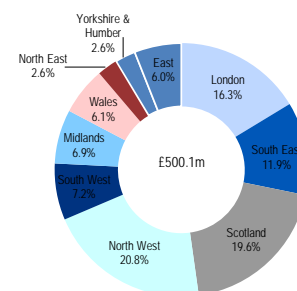
- Recession-resistant counter-cyclical yield play sheltered from uncertainties created by heightened geopolitical tension and the Russia-Ukraine war.
- Accretive acquisitions of government offices and commercial buildings in the UK.

KEY OPERATING METRICS

		1Q21	2Q21	3Q21	4Q21	1Q22	yoy	qoq
DPU	pence	1.22	1.41	1.48	1.32	1.28	4.9%	-3.0%
Occupancy	%	100.0%	100.0%	100.0%	100.0%	100.0%	0ppt	0ppt
Aggregate Leverage	%	42.1%	42.1%	42.1%	42.4%	42.8%	0.7ppt	0.4ppt
Average Cost of Debt	%	1.90%	1.90%	1.90%	2.00%	2.10%	0.2ppt	0.1ppt
Weighted Average Lease Expiry (WALE)	year	7.4	6.6	6.4	6.0	5.5	-1.9yrs	-0.5yrs
Weighted Debt Maturity	year	2.8	2.5	2.3	2.1	1.8	-1yrs	-0.3yrs
% Borrowing In Fixed Rates	%	63%	63%	63%	63%	63%	0.0%	0.0%

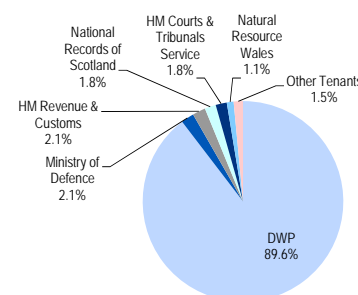
Source: ELITE, UOB Kay Hian

VALUATION BY GEOGRAPHY



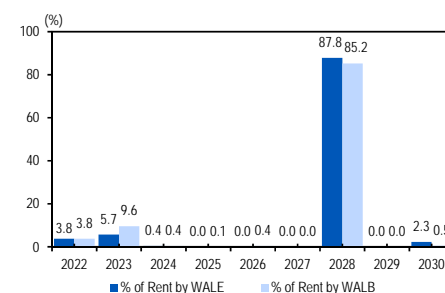
Source: Elite

TENANT BY GROSS RENTAL INCOME



Source: Elite

LEASE EXPIRY PROFILE (MAR 22)



Source: Elite

CONSUMER PRICE INDEX - UK



Source: CEIC

PROFIT & LOSS

Year to 31 Dec (GBPm)	2021	2022F	2023F	2024F
Net turnover	34.7	37.3	37.4	39.4
EBITDA	29.2	30.4	30.5	31.5
Deprec. & amort.	0.0	0.0	0.0	0.0
EBIT	29.2	30.4	30.5	31.5
Net interest income/(expense)	(4.9)	(5.5)	(5.8)	(5.8)
Pre-tax profit	24.3	24.9	24.7	25.7
Tax	(1.4)	(4.2)	(4.2)	(4.4)
Net profit	23.0	20.6	20.5	21.3
Net profit (adj.)	23.0	20.6	20.5	21.3

BALANCE SHEET

Year to 31 Dec (GBPm)	2021	2022F	2023F	2024F
Fixed assets	501.3	501.3	501.3	501.3
Other LT assets	0.5	0.5	0.5	0.5
Cash/ST investment	19.5	23.2	24.9	21.3
Other current assets	12.0	12.3	12.3	13.0
Total assets	533.4	537.4	539.0	536.1
ST debt	6.6	6.6	6.6	6.6
Other current liabilities	15.4	16.0	16.0	16.3
LT debt	217.3	250.0	255.0	255.0
Other LT liabilities	5.0	5.0	5.0	5.0
Shareholders' equity	289.0	259.8	256.4	253.2
Total liabilities & equity	533.4	537.4	539.0	536.1

CASH FLOW

Year to 31 Dec (GBPm)	2021	2022F	2023F	2024F
Operating	22.7	0.5	26.2	26.8
Pre-tax profit	(3.4)	24.9	24.7	25.7
Tax	(2.9)	(4.2)	(4.2)	(4.4)
Working capital changes	(6.3)	0.3	(0.0)	(0.3)
Non-cash items	30.7	2.7	2.5	3.6
Other operating cashflows	4.6	(23.1)	3.2	2.3
Investing	(9.4)	0.0	0.0	0.0
Capex (growth)	(9.4)	0.0	0.0	0.0
Capex (maintenance)	0.0	0.0	0.0	0.0
Financing	(14.1)	3.2	(24.5)	(30.4)
Distribution to unitholders	(17.6)	(24.0)	(23.7)	(25.6)
Issue of shares	0.0	0.0	0.0	0.0
Proceeds from borrowings	8.6	32.7	5.0	0.0
Others/interest paid	(5.1)	(5.5)	(5.8)	(4.8)
Net cash inflow (outflow)	(0.8)	3.7	1.6	(3.6)
Beginning cash & cash equivalent	20.2	19.5	23.2	24.9
Changes due to forex impact	0.1	0.0	0.0	0.0
Ending cash & cash equivalent	19.5	23.2	24.9	21.3

KEY METRICS

Year to 31 Dec (%)	2021	2022F	2023F	2024F
Profitability				
EBITDA margin	84.1	81.3	81.7	79.9
Pre-tax margin	70.1	66.6	66.1	65.1
Net margin	66.1	55.2	54.8	54.0
ROA	5.3	3.9	3.8	4.0
ROE	9.1	7.5	7.9	8.4
Growth				
Turnover	65.7	7.5	0.0	5.6
EBITDA	87.5	4.0	0.5	3.2
Pre-tax profit	84.2	2.1	(0.7)	4.0
Net profit	207.5	(10.2)	(0.7)	4.0
Net profit (adj.)	207.5	(10.2)	(0.7)	4.0
EPU	131.5	(15.7)	(1.6)	3.1
Leverage				
Debt to total capital	43.6	49.7	50.5	50.8
Debt to equity	77.5	98.8	102.0	103.3
Net debt/(cash) to equity	70.7	89.8	92.3	94.9
Interest cover (x)	6.0	5.5	5.2	5.4

Disclosures/Disclaimers

This report is prepared by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser in Singapore.

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities.

This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. Advice should be sought from a financial adviser regarding the suitability of the investment product, taking into account the specific investment objectives, financial situation or particular needs of any person in receipt of the recommendation, before the person makes a commitment to purchase the investment product.

This report is confidential. This report may not be published, circulated, reproduced or distributed in whole or in part by any recipient of this report to any other person without the prior written consent of UOBKH. This report is not directed to or intended for distribution to or use by any person or any entity who is a citizen or resident of or located in any locality, state, country or any other jurisdiction as UOBKH may determine in its absolute discretion, where the distribution, publication, availability or use of this report would be contrary to applicable law or would subject UOBKH and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by UOBKH to be reliable. However, UOBKH makes no representation as to the accuracy or completeness of such sources or the Information and UOBKH accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. UOBKH and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of UOBKH and its connected persons are subject to change without notice. UOBKH reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) UOBKH, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) UOBKH, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; (3) the officers, employees and representatives of UOBKH may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business"); and (4) UOBKH may otherwise have an interest (including a proprietary interest) in the subject corporation(s) referred to in this report.

As of the date of this report, no analyst responsible for any of the content in this report has any proprietary position or material interest in the securities of the corporation(s) which are referred to in the content they respectively author or are otherwise responsible for.

IMPORTANT DISCLOSURES FOR U.S. PERSONS

This research report was prepared by UOBKH, a company authorized, as noted above, to engage in securities activities in Singapore. UOBKH is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution by UOBKH (whether directly or through its US registered broker dealer affiliate named below) to "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"). All US persons that receive this document by way of distribution from or which they regard as being from UOBKH by their acceptance thereof represent and agree that they are a major institutional investor and understand the risks involved in executing transactions in securities.

Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through UOB Kay Hian (U.S.) Inc ("UOBKHUS"), a registered broker-dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through UOBKH.

UOBKHUS accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to and intended to be received by a U.S. person other than a major U.S. institutional investor.

The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and may not be an associated person of UOBKHUS and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

Analyst Certification/Regulation AC

Each research analyst of UOBKH who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of UOBKH or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including UOBKH's total revenues, a portion of which are generated from UOBKH's business of dealing in securities.

Reports are distributed in the respective countries by the respective entities and are subject to the additional restrictions listed in the following table.

General	This report is not intended for distribution, publication to or use by any person or entity who is a citizen or resident of or located in any country or jurisdiction where the distribution, publication or use of this report would be contrary to applicable law or regulation.
Hong Kong	This report is distributed in Hong Kong by UOB Kay Hian (Hong Kong) Limited ("UOBKHHK"), which is regulated by the Securities and Futures Commission of Hong Kong. Neither the analyst(s) preparing this report nor his associate, has trading and financial interest and relevant relationship specified under Para. 16.4 of Code of Conduct in the listed corporation covered in this report. UOBKHHK does not have financial interests and business relationship specified under Para. 16.5 of Code of Conduct with the listed corporation covered in this report. Where the report is distributed in Hong Kong and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKHHK (and not the relevant foreign research house) in Hong Kong in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Hong Kong who is not a professional investor, or institutional investor, UOBKHHK accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Indonesia	This report is distributed in Indonesia by PT UOB Kay Hian Sekuritas, which is regulated by Financial Services Authority of Indonesia ("OJK"). Where the report is distributed in Indonesia and contains research analyses or reports from a foreign research house, please note recipients of the analyses or reports are to contact PT UOBKH (and not the relevant foreign research house) in Indonesia in respect of any matters arising from, or in connection with, the analysis or report.
Malaysia	Where the report is distributed in Malaysia and contains research analyses or reports from a foreign research house, the recipients of the analyses or reports are to contact UOBKHM (and not the relevant foreign research house) in Malaysia, at +603-21471988, in respect of any matters arising from, or in connection with, the analysis or report as UOBKHM is the registered person under CMSA to distribute any research analyses in Malaysia.
Singapore	This report is distributed in Singapore by UOB Kay Hian Private Limited ("UOBKH"), which is a holder of a capital markets services licence and an exempt financial adviser regulated by the Monetary Authority of Singapore. Where the report is distributed in Singapore and contains research analyses or reports from a foreign research house, please note: (i) recipients of the analyses or reports are to contact UOBKH (and not the relevant foreign research house) in Singapore in respect of any matters arising from, or in connection with, the analysis or report; and (ii) to the extent that the analyses or reports are delivered to and intended to be received by any person in Singapore who is not an accredited investor, expert investor or institutional investor, UOBKH accepts legal responsibility for the contents of the analyses or reports only to the extent required by law.
Thailand	This report is distributed in Thailand by UOB Kay Hian Securities (Thailand) Public Company Limited, which is regulated by the Securities and Exchange Commission of Thailand.
United Kingdom	This report is being distributed in the UK by UOB Kay Hian (U.K.) Limited, which is an authorised person in the meaning of the Financial Services and Markets Act and is regulated by The Financial Conduct Authority. Research distributed in the UK is intended only for institutional clients.
United States of America ('U.S.')	This report cannot be distributed into the U.S. or to any U.S. person or entity except in compliance with applicable U.S. laws and regulations. It is being distributed in the U.S. by UOB Kay Hian (US) Inc, which accepts responsibility for its contents. Any U.S. person or entity receiving this report and wishing to effect transactions in any securities referred to in the report should contact UOB Kay Hian (US) Inc. directly.

Copyright 2022, UOB Kay Hian Pte Ltd. All rights reserved.

<http://research.uobkayhian.com>

RCB Regn. No. 197000447W