

Singapore Company Update

ESR-LOGOS REIT

Bloomberg: EREIT SP | Reuters: ESRR.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

14 Oct 2022

BUY

Last Traded Price (13 Oct 2022): S\$0.335 (STI : 3,040.45)
Price Target 12-mth: S\$0.50 (49% upside)

Analysts

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What's New

- Acquisition of Sakura Distribution Centre will be DPU accretive
- The acquisition highlights sponsor's commitment to grow EREIT and transform it into a major industrial S-REIT
- Portfolio rejuvenation addresses some of the major bugbears for EREIT
- Maintain BUY with unchanged TP of S\$0.50

Price Relative



Forecasts and Valuation

FY Dec (S\$m)	2021A	2022F	2023F	2024F
Gross Revenue	241	337	394	407
Net Property Inc	173	248	290	299
Total Return	0.0	162	187	190
Distribution Inc	114	175	204	207
EPU (S cts)	1.02	2.77	2.77	2.81
EPU Gth (%)	(39)	172	0	1
DPU (S cts)	2.99	3.00	3.02	3.05
DPU Gth (%)	7	1	1	1
NAV per shr (S cts)	39.1	41.1	40.8	40.6
PE (X)	32.9	12.1	12.1	11.9
Distribution Yield (%)	8.9	9.0	9.0	9.1
P/NAV (x)	0.9	0.8	0.8	0.8
Aggregate Leverage (%)	42.3	39.7	40.8	40.8
ROAE (%)	2.7	7.4	6.8	6.9

Distn. Inc Chng (%)		0	(1)	(2)
Consensus DPU (S cts):		2.5	2.8	2.8
Other Broker Recs:		B: 8	S: 0	H: 1

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

Portfolio rejuvenation to drive growth

Investment Thesis

Overdue for a re-rating as post-merger synergies unravel. Following a successful merger in April 2022, EREIT is now the fifth largest industrial S-REIT with a total asset base of c.S\$5.5bn, but it is yet to see a re-rating. With a yield of more than 7%, c.200bps higher than its large-cap industrial S-REIT peers, it is attractive. The manager is executing an asset recalibration strategy post-merger, which should be value accretive and drive a re-rating of the share price, in our view.

Portfolio repositioning and rejuvenation underway. On the immediate horizon, EREIT will embark on the repositioning of its portfolio with more than S\$200m in divestments carried out since FY21. EREIT will continue to divest non-core assets and recycle the proceeds into higher yielding opportunities. The rejuvenation of its portfolio entails redevelopment projects and AEs that will drive organic growth in earnings and NAV.

Enviably sponsor pipeline. While its peers find it increasingly challenging to make accretive acquisitions given the negative cap rate spreads in most major markets, EREIT can look to its sponsor's pipeline of c.US\$2.0bn. It has recently announced the acquisition of a modern logistics facility in Japan from its sponsor, which was done at a relatively attractive yield and is projected to generate a c.3% accretion to DPU.

Valuation:

Maintain BUY with TP of S\$0.50. Our target price is based on DCF method with a WACC of 6.6% (risk-free rate of 3.0%). We have not assumed any acquisitions in our estimates.

Where we differ:

Organic growth opportunities within the portfolio. With more headroom for development, we believe EREIT will focus on organic growth opportunities through redevelopments and AEs, even as it continues to hunt for inorganic growth.

Key Risks to Our View:

Fundraising. EREIT's relatively high gearing of c.40% puts it at risk of requiring fundraising to fund major capex, but a revaluation uplift could potentially allay such fears.

At A Glance

Issued Capital (m shrs)	6,673
Mkt. Cap (S\$m/US\$m)	2,235 / 1,557
Major Shareholders (%)	
Tong Jinquan	6.4
E-Shang Infinity Cayman Ltd	5.4
Free Float (%)	88.2
3m Avg. Daily Val (US\$m)	3.0
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	



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WHAT'S NEW

Into the land of the rising sun

Continued transformation of portfolio

Maiden entry into Japan; freehold modern logistics facility.

EREIT just received an overwhelming approval (EGM was just held on 12 October 2022) for the proposed acquisition of its ESR Sakura Distribution Centre for S\$183.5m (including rental support) from its sponsor. The property is a five-storey logistics property in Sakura City, Chiba Prefecture in Tokyo, and the purchase consideration is c.21.8% lower than the market comparable in the Chiba Prefecture.

The property has a total NLA of more than 877,300sqft and it currently has an occupancy of 75%. The 25% vacancy was due to a tenant that vacated the property to consolidate its operations into its own built-to-suit facility in May 2022. Prior to this, the property has always been fully occupied over the past five years. Given the strong demand-supply dynamics of the logistics market in the Chiba Prefecture, EREIT is confident of backfilling these vacancies in the near term. We understand that the manager is currently in discussion with prospective tenants to lease the space, and the 12-month rental support from its sponsor will come in handy.

Tackling the two main bugbears

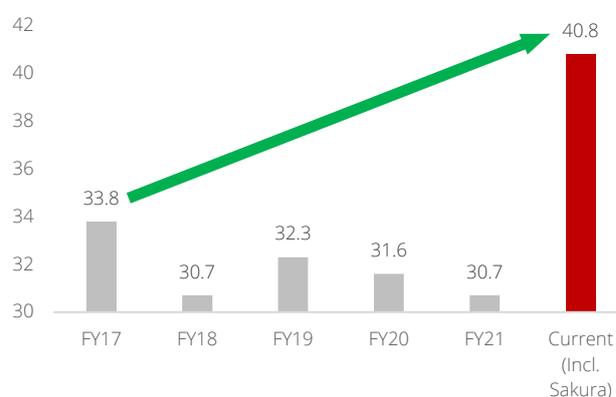
Decaying land tenure of EREIT's portfolio. Previously, EREIT benefitted from being a pureplay industrial S-REIT that appeals to investors looking to gain exposure to Singapore's industrial sector. However, the short land tenures of Singapore industrial properties also meant that its portfolio's land tenure will decay with time. EREIT began addressing this concern back in mid-2021 through the acquisition of stakes in freehold properties in Australia.

With the acquisition of the Sakura Distribution Centre, the proportion of freehold assets in EREIT's portfolio will increase to c.8.2%. The remaining land lease tenure of EREIT's portfolio will also increase by c.6.0% to 40.8 years.

DPU-accretive acquisition. Although EREIT provided two possible scenarios to fund the acquisition, we firmly believe that the manager will fund the acquisition entirely on debt, given its current high cost of capital which makes an equity fund raising scenario to be tough to execute, in our view. Given how the share prices of S-REITs have corrected in recent weeks, we believe EREIT will not proceed with the alternative scenario that requires equity fundraising to raise c.S\$75m and lead to significant NAV dilution.

With the debt-funded option, the acquisition is projected to generate a c.2.9% accretion to DPU. Concurrently, gearing is expected to inch up to c.42%, and we believe that it can be brought down gradually with the future divestment of non-core and lower yielding assets, which will be value accretive to the REIT. Since its successful merger with ARA LOGOS Logistics Trust in April 2022, EREIT has already divested three lower yielding assets to raise more than S\$132m. EREIT has also identified several other non-core assets that they could potentially divest to raise a further S\$400m.

Remaining land lease tenure of 20.8 years; highest in the past five years



Source: EREIT

ESR-LOGOS REIT

Fears of economic slowdown and impact to industrial sector. Market volatility and slowing growth has sparked fears of an economic slowdown, impacting share price for the REIT. Although EREIT will not be insulated from a global economic slowdown, we believe that its rejuvenated portfolio post merger with ARA LOGOS Logistics Trust, will enable the REIT to be better positioned than before. Historically, based on our observation of occupancy rates, we found that logistics properties tend to remain more resilient during economic slowdowns and outperform other industrial property segments.

Following the merger with ARA LOGOS Logistics Trust earlier in the year, EREIT's exposure to logistics facilities doubled. Its concentration of logistics facilities will be further enhanced with the acquisition of the Sakura Distribution Centre. Post the acquisition, c.51.8% of EREIT's portfolio will consist of logistics facilities. The support from its sponsor on this deal and further possible pipeline opportunities also demonstrates its commitment to EREIT and opens the doors for further access to a c.US\$2.0bn portfolio of logistics facilities in the pipeline.

Diversifying its footprint into one of the largest logistics markets in APAC, EREIT has the opportunity to ride on the strong fundamentals of the logistics sector in Japan. The strong supply and demand dynamics are expected to drive

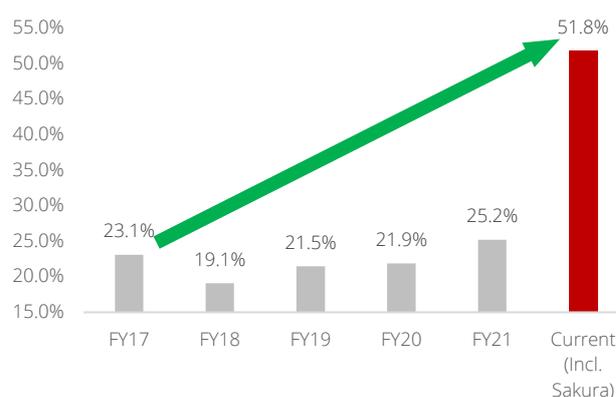
Do current valuations capture EREIT's transformation?

Over the past few weeks, S-REITs have undergone a correction owing to rising interest rates impacting its returns. Currently, EREIT trades at a **P/NAV multiple of c.0.96x**, and at a forward dividend yield of more than 8.5%. Looking at its historical trading performance, such levels may not be unheard of, especially during major economic crises such as the Global Financial Crisis, Euro Debt Crisis, Flash Crash in 2015, and most recently, the initial outbreak of COVID-19, we believe that there are key differences this time round, which warrant a higher valuation multiple.

Firstly, given EREIT's rejuvenated portfolio and transition into a larger-cap industrial REIT, we believe it is currently trading at a **very attractive level**, especially given its portfolio's **outsized exposure to logistics facilities** and potential for further **growth through its sponsor's pipeline**. Even when compared to the Taper Tantrum period in 2013, EREIT was still trading just above NAV. Although EREIT's gearing may seem relatively high at c.42.0%, its capital management metrics are better than before. Its entire portfolio is unencumbered, and c.70% of its portfolio is hedged to fixed

positive rental growth in the near to medium term. Gross rents in Greater Tokyo continue to be driven by a tighter market environment and low vacancy rates, especially in Chiba Bay, where the Sakura Distribution Centre is located. With Japan having a very limited stock of modern logistics facilities (only c.13% of total supply), modern assets with superior specifications such as the Sakura Distribution Centre increasingly stand out and appeal to tenants.

More than 50% of EREIT's portfolio consists of logistics facilities



Source: EREIT

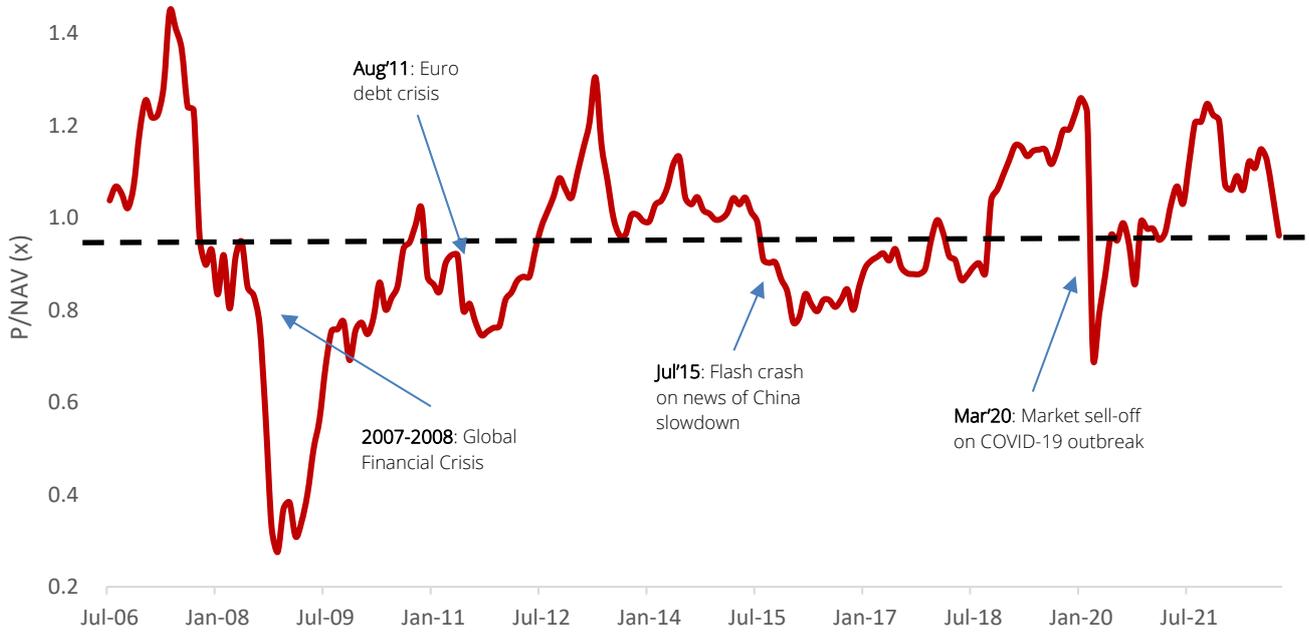
rates. Based on our estimates, EREIT also currently has a very healthy ICR of approximately 3x.

We have refreshed our projections to assume that the divestment of 49 Pandan Road and 2 Jalan Kilang Barat will be completed by the end of FY22, and the acquisition of the Sakura Distribution Centre will only begin contributing income in the beginning of FY23. We have also taken the opportunity to assume that EREIT's all-in cost of financing will creep up by c.55bps over the next three years.

Despite the adjustments and revised estimates, we believe EREIT offers a very attractive yield at the current levels and that there is room for some earnings growth over the next few years, even with higher financing costs. As such, we will be maintaining our **BUY** recommendation with an unchanged TP of **S\$0.50**.

ESR-LOGOS REIT

EREIT previously traded below NAV during major economic crises



Source: Bloomberg L.P., DBS Bank

Company Background

Following the successful merger with ARA LOGOS Logistics Trust (ALOG) on 28 April 2022, ESR REIT has been renamed ESR-LOGOS REIT (EREIT). Including the c.S\$2.0bn ALOG portfolio, EREIT’s total assets are valued at c.S\$5.5bn. Its portfolio consists of 83 properties in Singapore and Australia, as well as investments in three property funds which make up c.7.8% of EREIT’s AUM (EREIT’s stake in the funds is valued at c.A\$377.8m).

ESR-LOGOS REIT

Interim Income Statement (S\$m)

FY Dec	1H2021	2H2021	1H2022	% chg yoy	% chg hoh
Gross revenue	120	121	148	23.2	21.6
Property expenses	(32.9)	(35.2)	(44.9)	36.6	27.7
Net Property Income	87.0	86.3	103	18.2	19.1
Other Operating expenses	(8.6)	(9.0)	(12.1)	40.6	33.4
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	3.22	4.48	3.13	(3.0)	(30.2)
Net Interest (Exp)/Inc	(27.5)	(28.2)	(33.9)	(23.2)	(20.2)
Exceptional Gain/(Loss)	(4.8)	15.0	(439)	nm	nm
Net Income	68.8	70.1	(374)	nm	nm
Tax	0.05	(2.2)	(11.9)	nm	435.9
Minority Interest	(2.0)	(2.1)	(2.5)	(28.6)	19.4
Net Income after Tax	66.9	65.7	(389)	nm	(691.2)
Total Return	62.0	39.5	(346)	nm	(976.1)
Non-tax deductible Items	(1.8)	20.8	411	nm	1,880.0
Net Inc available for Dist.	63.6	63.7	68.9	8.3	8.1
Ratio (%)					
Net Prop Inc Margin	72.6	71.1	69.6		
Dist. Payout Ratio	300.0	300.0	300.0		

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

ESR-LOGOS REIT

Income Statement (\$m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Gross revenue	230	241	337	394	407
Property expenses	(65.7)	(68.0)	(89.1)	(104)	(107)
Net Property Income	164	173	248	290	299
Other Operating expenses	(23.3)	(16.1)	(23.6)	(26.9)	(28.1)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	3.01	7.70	14.9	18.4	18.8
Net Interest (Exp)/Inc	(56.8)	(55.7)	(60.4)	(77.2)	(82.5)
Exceptional Gain/(Loss)	(14.7)	39.0	0.0	0.0	0.0
Net Income	72.4	148	179	204	208
Tax	0.0	(2.2)	0.0	0.0	0.0
Minority Interest	(3.0)	(4.1)	(2.0)	(2.3)	(2.3)
Preference Dividend	(9.7)	(102)	(15.2)	(15.2)	(15.2)
Net Income After Tax	59.7	40.4	162	187	190
Total Return	0.0	0.0	162	187	190
Non-tax deductible Items	96.4	18.9	13.5	16.8	16.4
Net Inc available for Dist.	99.1	114	175	204	207
Growth & Ratio					
Revenue Gth (%)	(9.1)	4.9	39.8	16.9	3.2
N Property Inc Gth (%)	(12.6)	5.5	43.2	16.9	3.3
Net Inc Gth (%)	(34.8)	(32.4)	301.0	15.4	1.7
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	71.4	71.8	73.6	73.6	73.6
Net Income Margins (%)	26.0	16.7	48.0	47.4	46.8
Dist to revenue (%)	43.1	47.1	52.0	51.7	50.8
Managers & Trustee's fees	10.1	6.7	7.0	6.8	6.9
ROAE (%)	4.0	2.7	7.4	6.8	6.9
ROA (%)	1.9	1.2	3.7	3.4	3.4
ROCE (%)	4.6	5.0	5.3	5.0	5.1
Int. Cover (x)	2.5	2.8	3.7	3.4	3.3

Contribution from Sakura Distribution Centre to only begin in FY23.

Source: Company, DBS Bank

ESR-LOGOS REIT

Interim Income Statement (S\$m)

FY Dec	1H2020	2H2020	1H2021	2H2021	1H2022
Gross revenue	114	116	120	121	148
Property expenses	(33.5)	(32.2)	(32.9)	(35.2)	(44.9)
Net Property Income	80.2	84.0	87.0	86.3	103
Other Operating	(8.9)	(14.4)	(8.6)	(9.0)	(12.1)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.84	2.18	3.22	4.48	3.13
Net Interest (Exp)/Inc	(29.2)	(21.8)	(27.5)	(28.2)	(33.9)
Exceptional Gain/(Loss)	(21.9)	7.24	(4.8)	15.0	(439)
Net Income	21.1	51.3	68.8	70.1	(374)
Tax	0.0	0.0	0.05	(2.2)	(11.9)
Minority Interest	(1.1)	(2.0)	(2.0)	(2.1)	(2.5)
Net Income after Tax	20.0	30.7	66.9	65.7	(389)
Total Return	(26.6)	36.3	62.0	39.5	(346)
Non-tax deductible Items	77.9	18.4	(1.8)	20.8	411
Net Inc available for Dist.	54.7	58.3	63.6	63.7	68.9
Growth & Ratio					
Revenue Gth (%)	N/A	2	3	1	22
N Property Inc Gth (%)	nm	5	4	(1)	19
Net Inc Gth (%)	nm	146	35	(2)	(691)
Net Prop Inc Margin (%)	70.5	72.3	72.6	71.1	69.6
Dist. Payout Ratio (%)	200.0	300.0	300.0	300.0	300.0

Balance Sheet (S\$m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Investment Properties	2,889	3,146	4,929	5,037	5,037
Other LT Assets	268	107	397	397	397
Cash & ST Invt	18.1	24.2	27.0	45.1	54.8
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	12.2	23.1	25.7	30.1	31.0
Other Current Assets	0.0	29.3	29.3	29.3	29.3
Total Assets	3,187	3,330	5,408	5,539	5,549
ST Debt	190	209	209	209	209
Creditor	62.3	64.3	91.5	107	110
Other Current Liab	66.4	74.8	74.8	74.8	74.8
LT Debt	988	981	1,718	1,831	1,836
Other LT Liabilities	282	251	251	251	251
Unit holders' funds	1,598	1,749	3,061	3,061	3,061
Minority Interests	0.0	0.0	1.98	4.24	6.53
Total Funds & Liabilities	3,187	3,330	5,408	5,539	5,549
Non-Cash Wkg. Capital	(116)	(86.8)	(111)	(122)	(125)
Net Cash/(Debt)	(1,161)	(1,167)	(1,901)	(1,995)	(1,991)
Ratio					
Current Ratio (x)	0.1	0.2	0.2	0.3	0.3
Quick Ratio (x)	0.1	0.1	0.1	0.2	0.2
Aggregate Leverage (%)	44.1	42.3	39.7	40.8	40.8
Z-Score (X)	0.6	0.6	0.6	0.6	0.6

Acquisition of Sakura Distribution Centre to be funded entirely by debt.

Source: Company, DBS Bank

ESR-LOGOS REIT

Cash Flow Statement (\$m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Pre-Tax Income	62.8	46.6	164	189	192
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc/(Loss)	(3.0)	(7.7)	(14.9)	(18.4)	(18.8)
Chg in Wkg.Cap.	13.2	6.80	24.5	11.1	2.46
Other Operating CF	85.5	118	(107)	16.8	16.4
Net Operating CF	158	164	66.2	199	193
Net Invnt in Properties	(10.9)	(28.5)	(1,783)	(108)	0.0
Other Invnts (net)	0.0	(71.3)	0.0	0.0	0.0
Invnts in Assoc. & JV	0.0	0.0	(290)	0.0	0.0
Div from Assoc. & JVs	4.80	5.00	14.9	18.4	18.8
Other Investing CF	0.02	(54.6)	0.0	0.0	0.0
Net Investing CF	(6.1)	(149)	(2,058)	(89.9)	18.8
Distribution Paid	(76.9)	(118)	(175)	(204)	(207)
Chg in Gross Debt	(14.0)	16.6	886	113	5.00
New units issued	(0.4)	146	1,284	0.0	0.0
Other Financing CF	(61.6)	(60.2)	0.0	0.0	0.0
Net Financing CF	(153)	(16.0)	1,994	(90.7)	(202)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	(0.6)	(1.6)	2.87	18.0	9.75
Operating CFPS (S cts)	4.07	3.95	0.71	2.78	2.80
Free CFPS (S cts)	4.14	3.41	(29.4)	1.34	2.84

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	04 Jul 22	0.40	0.50	BUY
2:	28 Jul 22	0.42	0.50	BUY

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

Source: DBS Bank

Analyst: Dale LAI

Derek TAN

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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

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