

# ESR-LOGOS REIT (EREIT SP)

## One step closer

### Execution on divestments; trim TP, maintain BUY

ESR-LOGOS divested 7 non-core assets at a valuation of SGD337m, representing a 4.5% discount to book value. We see the divestment as the first concrete step in its capital recycling plan, following its SGD300m EFR completed in April. While EREIT has another SGD113m worth of assets on its book identified for sale, the divestment lifts its headroom to SGD996m. We expect EREIT to shift its focus from divestment to execution on potential acquisition/redevelopment as rates stabilise. We cut our FY23E DPU by c.2.5% and DDM-based TP by 5% to SGD0.37 to factor in lower earnings due to divestment. Dividend yield is attractive at 8%. Retain BUY.

### Deal at a discount and NPI support

The portfolio of 4 logistics and 1 industrial asset (see Fig 1) was acquired by Intertrust Group, an Amsterdam-based trust management company. According to the manager, EREIT will provide NPI support of SGD4.8m to Intertrust across 36 months. Without NPI support, the portfolio was valued lower at SGD325.4m. The 5 assets contributed aggregate rental income of SGD28.2m in FY22, implying a yield of c.9.0%. We expect the transaction to fully complete by 4Q23. The other two smaller assets were sold at a premium to two separate parties. 22 Chin Bee Drive was acquired by its tenant (Sanli M&E) at a 6.2% premium-to-book, while the freehold warehouse, 51 Musgrave Road, was sold to an unidentified party at a 2.4% premium.

### Execution awaiting

The combined portfolio represents 8% of FY22 income and c.7% of our previous FY23E revenue estimate. Given the income vacuum, we lower our FY23/24E earnings by c.1.4%/7.6% (see fig.2). Management has guided for dilutive impacts on pro forma NAV (-1.1%) and DPU (-4.6%) from the portfolio sale alone. Nonetheless, the divestment is timely amid slowing rate hikes. In our view, EREIT needs to execute on its acquisition/redevelopment pipeline. Potential acquisitions will likely come from redevelopment projects (a cold storage facility) or sponsor pipelines, which include a few modern logistics facilities.

### Balance sheet further de-gear

Assuming all proceeds are used for debt repayment, EREIT's pro-forma gearing will fall to 33.6%, from post-EFR gearing of 38%. With debt headroom of SGD996m (assuming 45% gearing limit), EREIT is better positioned to take on accretive acquisitions and redevelopment projects. In addition, management reiterated during EFR that it has identified up to SGD450m of non-core assets for divestments. If the remaining divestments (SGD113m) are successfully executed, its balance sheet will be further strengthened.

FYE Dec (SGD m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	241	343	392	382	390
Net property income	173	244	282	280	285
Core net profit	114	148	162	163	170
Core EPU (cts)	2.8	1.9	2.1	2.1	2.2
Core EPU growth (%)	11.9	(30.4)	7.3	0.5	4.1
DPU (cts)	3.0	3.0	2.6	2.5	2.6
DPU growth (%)	6.7	0.4	(14.6)	(1.5)	3.0
P/NTA (x)	1.2	1.0	0.9	0.8	0.8
DPU yield (%)	6.2	8.1	8.1	8.0	8.3
ROAE (%)	6.9	6.3	5.9	5.6	5.7
ROAA (%)	3.5	3.3	2.8	2.7	2.8
Debt/Assets (x)	0.42	0.37	0.34	0.34	0.33
Consensus DPU	-	-	2.6	2.7	2.7
MIBG vs. Consensus (%)	-	-	(2.9)	(5.9)	(3.7)

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# BUY

Share Price	SGD 0.32
12m Price Target	SGD 0.37 (+27%)
Previous Price Target	SGD 0.39

### Company Description

ESR-LOGOS REIT operates as a real estate investment trust company, which invests in income-producing industrial properties.

### Statistics

52w high/low (SGD)	0.42/0.31
3m avg turnover (USDm)	2.2
Free float (%)	83.0
Issued shares (m)	7,660
Market capitalisation	SGD2.4B
	USD1.8B

### Major shareholders:

Tong Jin Quan	10.4%
Esr Singapore Pte Ltd.	5.0%
Tong Yulou	3.3%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	(6)	(3)	(23)
Relative to index (%)	(6)	(2)	(25)

Source: FactSet

### Abbreviations explained

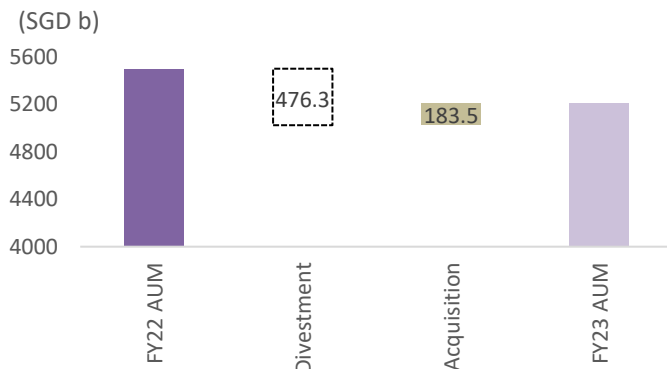
NPI: Net property income  
EFR: Equity fund raising  
DPU: Distributions per unit

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Tear Sheet Insert

## Value Proposition

- Singapore industrial REIT underpinned by AUM growth and 8.0% dividend yield, with upside potential for its share price.
- Material portfolio exposure to logistics/warehousing (44% of FY22 revenue) and high-spec (14%) assets, set to capitalize on the sector’s buoyant demand.
- Diversified footprint in Australia and sizeable portfolio (SGD726m in FY22) to benefit from Australian logistics/warehousing market.
- Management sticks to AEI strategy, upgrading general industrial assets into higher-value high-spec space.

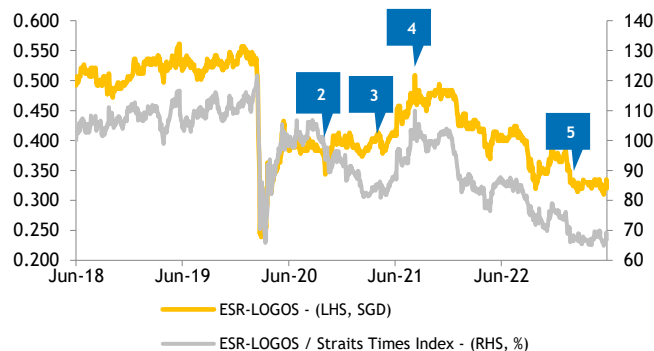
### EREIT’s capital recycling since merger



Source: Company

## Price Drivers

### Historical share price trend



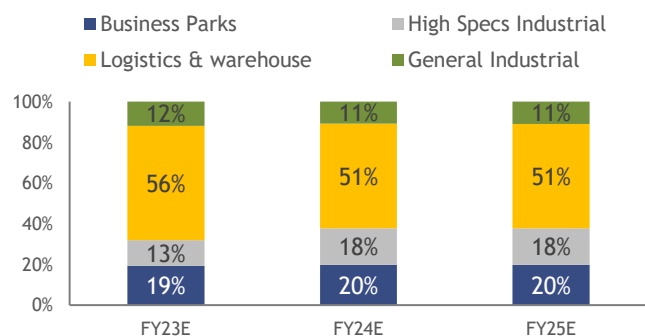
Source: Company, Maybank IBG Research

1. May-18: Announced merger with Viva Industrial Trust (VIT) at SGD0.96/VIT unit.
2. Dec-20: Merger proposal with Sabana REIT (SBREIT) via share swap (0.94x exchange ratio) was rejected by SBREIT unitholders.
3. May-21: Acquired 10% stake in ESR Australia logistics portfolio for AUD60.5m, fully funded via debt. Raised SGD100m via private placement (SGD0.372/unit) for acquisition of new logistics asset (46A Tanjong Penjuru)..
4. Aug-21: Announced merger with ARA LOGOS REIT via way of trust scheme of arrangement, at an implied gross exchange ratio of 1.970x.
5. Feb-23: Proposed EFR of SGD300m via preferential offering and private placement.

## Financial Metrics

- Dividend yield is attractive at 8%, and strong rental reversions within its logistics/warehouse and general industrial segment (FY22: +15.7%). Expect occupancies to remain steady around 90%.
- Further DPU growth to be driven by more accretive acquisitions and AEI in logistics and high-spec segments
- SGD50m of debt is due for refinancing in FY23 with new WADE of 2.7 years.

### NPI forecast



Source: Company

## Swing Factors

### Upside

- Accretive acquisitions.
- Sooner than expected completion of AEI assets and/or stronger leasing demand.
- Further increase in overall leasing demand, driving improvements in both occupancy and rental reversions.
- Signing of new tenants to drive up occupancy at under-leased properties.

### Downside

- Slowdown in economic activity or structural changes in supply chain norm in Singapore or Australia, reducing demand for L&W assets.
- Termination of long-term leases causing loss of income.
- Weaker-than-expected leasing demand for business parks and general industrial assets, resulting in falling occupancy and rents.
- Prolonged high interest rates environment could increase the average all-in cost of debt and reduce distributable income.

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Risk Rating & Score <sup>1</sup>	na
Score Momentum <sup>2</sup>	na
Last Updated	4 Oct 2022
Controversy Score <sup>3</sup>	na

## Business Model & Industry Issues

- EREIT draws on its available pool of funds to invest in industrial real estate, carry out asset enhancements and redevelop properties to optimise value for its unitholders. Its activities relating to permissible investments, leverage limits, and annual reporting requirements are regulated by the MAS under Singapore's code on collective investment schemes. The manager successfully maintained employee and tenant satisfaction at 78%/81% respectively despite the pandemic, whilst maintaining zero Covid-19 cases or work-related injuries and staying in compliance with social-economic laws and regulations.

### Material E issues

- Implemented Environmental Policy and Green Procurement Policy in FY2021. The former outlines the manager's sustainability focuses.
- Reduced grid electricity consumption and consumption intensity by 5.5% YoY and 9.7% respectively in FY20.
- Installed rooftop solar panels on 12 properties under ELOG Solar Harvesting Programme. Targets 50% increase target in solar power generation by 2025 (from base year 2019).
- Targets net zero carbon for certain Singapore properties by 2030. 30/32 multi-tenanted buildings were "Water Efficiency Building" certified, up from 22 as of 2019, with water intensity also reduced by 6%.
- Targets GMC for all buildings undergoing AEI from 2019 onwards. Targets for GRESB benchmark through continued submission. Obtained ISO14001:2015 on Environmental Management System certification. No incidents of non-compliance with environmental regulations and laws.

### Material S issues

- Zero Covid-19 cases or work-related injuries amongst employees by applying strict workplace safety measures.
- Zero material incidents of non-compliance with socio economic laws and regulations.
- Employee satisfaction at 81% with a response rate of 94%.
- Transition to bi-weekly online activities such as workout classes and health talks helped cure social disconnect.
- Manager purchased cash vouchers from F&B tenants to help provide a boost in sales under COVID-19 Care Initiative.
- Grew tenant satisfaction from 69% in 2018 to 78% in 2021.
- 69% of employees are female, including Chairperson Ms. Stefanie Yuen Thio.

### Key G metrics and issues

- Sponsor ESR Cayman (~13.9% stake) provides a strong and visible pipeline of assets and support, particularly for the REIT's growth ambitions outside of Singapore.
- Board comprises 8 directors (seven men; one woman), a CEO and executive director (Adrian Chui), three independent non-executives and three non-executives.
- Independent Chairman Stephanie Yuen Thio and other independent directors are unrelated to any members of management.
- Remuneration committee comprises 3 non-executive directors, mostly independent except for Mr. Jeffrey Perlman, whom is also Chairman of ESR Cayman.
- Audit Committee is mostly independent, comprising 3 non-executives.
- Management fee structure is in line with peers, with 0.5% base fee of deposited properties, 25% performance fee based on DPU growth (subject to high watermark), 0.5% divestment and 1% acquisition fee. Pay-out ratio averaged -98.2% since listing, consistently above the 90% minimum threshold.

<sup>1</sup>**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. <sup>2</sup>**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. <sup>3</sup>**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Quantitative Parameters (Score:32)						
	Particulars	Unit	2019	2020	2021	MLT SP (2021)
E	Scope 1 GHG emissions	tCO2e	N/A	N/A	N/A	1341
	Scope 2 GHG emissions	tCO2e	17,747	16,239	15,344	11003
	<b>Total</b>	tCO2e	17,747	16,239	15,344	12344
	Scope 3 GHG emissions	tCO2e	N/A	N/A	N/A	N/A
	<b>Total</b>	tCO2e	17747	16239	15344	12344
	GHG intensity	kgCO2e/m2	141	122	110	2.37
	Energy intensity (grid electricity consumption)	kWh/sqm	345	298	269	6.2
	Renewable energy generated as % consumption	%	5.5	4.9	5.0	63
	Water intensity	m3/m2	3.5	3.2	3.0	0.102
	Waste recycled	%	15.5	19.2	15.6	N/A
Cases of environmental non-compliance	number	0	0	0	18.3	
Green financing as a % of total borrowing	%	N/A	N/A	N/A	0	
Green certified properties	number	6	4	8	16.1	
S	% of women in workforce	%	68	67	69	59
	% of women in management roles	%	N/A	N/A	N/A	N/A
	Number of accidents	number	2	1	2	0
	Recordable work injury rate	%	N/A	1.17	2.18	0
G	MD/CEO salary as % of reported net profit	%	N/A	N/A	N/A	N/A
	Board salary as % of reported net profit	%	0.7	0.72	0.56	0.16
	Independent directors on the Board	%	50	50	40	58.3
	Female directors on the Board	%	10	10	10	33

Qualitative Parameters (Score: 50)	
a)	is there an ESG policy in place and is there is a standalone ESG committee or is it part of a risk committee? <i>Yes - it has a Sustainability Committee led by the CEO, responsible for the execution and monitoring of ESG policies, complementing ESR Group's environmental considerations.</i>
b)	is the senior management salary linked to fulfilling ESG targets? <i>No - as of FY21, sustainability KPIs were not part of the performance appraisals.</i>
c)	Does the company follow the task force of climate related disclosures framework for ESG reporting? <i>Yes</i>
d)	Does the company do green leasing or has plans to start green leasing or participate in GRESB real estate assessment? <i>Yes - in 2021, the company submitted its first GRESB Real Estate Assessment.</i>
e)	What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company? <i>(1) It implemented a new target on solar energy to achieve its goal of lower carbon emissions. (2) The manager conducted an environmental risk management assessment in line with the Monetary Authority of Singapore's guidelines and an assessment of climate-related risks, in line with the TCFD framework. (3) Providing additional e-waste recycling bins on a voluntary basis for tenants and the general public since 2019, and working closely with e-waste vendors.</i>
g)	Does carbon offset form part of the net zero/carbon neutrality target of the company? <i>No</i>

Target (Score: 100)			
Particulars		Target	Achieved
Reduce energy consumption for MTBs in 2023 vs 2019 baseline		5%	13%
Annual reduction of energy intensity for MBTs		1%	14%
Increase solar power generation by 2025 vs 2019 baseline		50%	N/A
Annual reduction of water intensity for MTBs vs 2019 baseline		2%	9%
Obtain Water Efficiency Building (WEB) certifications for MTBs by 2023		100%	93.8%
Obtain new WEB for MTBs per year		10%	25%
No incidents of non-compliance with environmental regulations and laws		Maintain	Maintained
<b>Impact</b>			
NA			
<b>Overall Score: 53</b>			
As per our ESG matrix, ESR-LOGOS REIT (ELOG) has an overall score of 53.			

ESG score	Weights	Scores	Final Score
Quantitative	50%	32	16
Qualitative	25%	50	13
Target	25%	100	25
<b>Total</b>			<b>53</b>

ESR has attained an above-average score of 53 based on our aggregated quantitative/qualitative/target-based approach, and we see room for improvements in its ESG metrics, such as GHG emission, "S" and "G" metrics. Further disclosure could be a plus. We also encourage ESR to review and set more ambitious targets given its stellar achievements in FY21.

Fig 1: Description of divested assets

	3 Pioneer Sector 3	4 & 6 Clementi Loop	6 Chin Bee Avenue	21 Changi North Way	30 Toh Guan Road	22 Chin Bee Drive	51 Musgrave Road, Australia
Building type	Warehouse	Warehouse	Warehouse	Ramp-up warehouse	Industrial	Industrial	Warehouse
Occupancy (%)	100	85.9	100	100	97.3	100	86.3
Origin	ESR portfolio	ESR portfolio	ESR portfolio	A-LOG portfolio	ESR portfolio	ESR portfolio	A-LOG portfolio
Buyer	Intertrust Group					Sanli M&E (current tenant)	Undisclosed
FY22 Rental Income (SGD m)	7.3	3.8	7.9	3.7	5.5	N/A	0.6
Valuation (SGD m)	100	39.6	98.3	31.7	60.8	13	9.5
Sale consideration (SGD m)	95	37.6	93	30.1	57.8	13.8	9.7
Premium / (Discount) to Valuation (%)	(5.0)	(5.1)	(5.4)	(5.0)	(4.9)	6.2	2.1
Implied NPI yield (%)	7.7	10.1	8.5	12.3	9.5	na	6.2
Purchase price (SGD m)	93.4	63.4	93.3	34.6	35	5.8	9.2

Source: Maybank IBG Research

Fig 2: Estimate changes

	FY23E (old)	FY24E (old)	FY23E (New)	FY24E (New)	FY23E (% change)	FY24E (% change)
Revenue (SGDm)	397.8	413.3	392.2	381.9	(1.4)	(7.6)
NPI (SGDm)	286.4	306.4	281.7	279.5	(1.6)	(8.8)
Distribution to unitholders	199.9	210.0	194.4	195.8	(2.8)	(6.8)
DPU (SG cts)	2.63	2.67	2.56	2.53	(2.5)	(5.4)

Source: Maybank IBG Research

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Key Metrics</b>					
Price/DPU(x)	16.0	12.3	12.3	12.5	12.1
P/BV (x)	1.2	1.0	0.9	0.8	0.8
P/NTA (x)	1.2	1.0	0.9	0.8	0.8
DPU yield (%)	6.2	8.1	8.1	8.0	8.3
FCF yield (%)	8.4	9.2	13.9	11.2	11.2
<b>INCOME STATEMENT (SGD m)</b>					
Revenue	241.3	343.2	392.2	381.9	389.7
<b>Net property income</b>	<b>173.3</b>	<b>244.2</b>	<b>281.7</b>	<b>279.5</b>	<b>284.9</b>
Management and trustee fees	(17.6)	(26.4)	(30.8)	(31.4)	(32.1)
Net financing costs	(51.4)	(80.5)	(91.4)	(84.5)	(81.0)
Associates & JV	7.7	5.9	5.9	6.2	6.6
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income/expenses	0.0	0.6	0.6	0.6	0.6
<b>Pretax profit</b>	<b>112.0</b>	<b>143.9</b>	<b>166.0</b>	<b>170.4</b>	<b>179.0</b>
Income tax	(2.2)	(9.5)	(3.2)	(3.3)	(3.5)
Minorities	(6.9)	(12.0)	(18.2)	(18.2)	(18.2)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
<b>Total return avail to unitholders</b>	<b>105.5</b>	<b>128.3</b>	<b>156.7</b>	<b>161.0</b>	<b>169.4</b>
Core net profit	113.6	147.6	162.0	163.2	169.9
Distributable inc to unitholders	114.4	177.1	194.4	195.8	203.9
<b>BALANCE SHEET (SGD m)</b>					
Cash & Short Term Investments	24.2	45.6	360.4	345.9	330.9
Accounts receivable	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	0.0	0.0	0.0	0.0	0.0
Investment properties	3,146.0	5,103.4	5,205.5	5,309.6	5,415.8
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	40.7	41.2	42.1	42.1	43.3
Other assets	118.9	463.9	418.9	418.9	418.9
<b>Total assets</b>	<b>3,329.8</b>	<b>5,654.2</b>	<b>6,026.8</b>	<b>6,116.5</b>	<b>6,208.9</b>
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	64.3	91.6	91.6	91.6	91.6
LT interest bearing debt	1,409.4	2,076.1	2,062.7	2,062.7	2,062.7
Other liabilities	106.9	637.5	637.5	637.5	637.5
<b>Total Liabilities</b>	<b>1,580.7</b>	<b>2,805.1</b>	<b>2,791.7</b>	<b>2,791.7</b>	<b>2,791.7</b>
Shareholders Equity	1,598.0	2,444.7	2,830.7	2,920.3	3,012.7
Minority Interest	151.1	404.4	404.4	404.4	404.4
<b>Total shareholder equity</b>	<b>1,749.1</b>	<b>2,849.1</b>	<b>3,235.1</b>	<b>3,324.7</b>	<b>3,417.1</b>
<b>Total liabilities and equity</b>	<b>3,329.8</b>	<b>5,654.2</b>	<b>6,026.8</b>	<b>6,116.5</b>	<b>6,208.9</b>
<b>CASH FLOW (SGD m)</b>					
<b>Cash flow from operations</b>	<b>152.8</b>	<b>226.8</b>	<b>331.7</b>	<b>274.0</b>	<b>277.2</b>
Capex	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Acquisitions & investments	(149.3)	(267.6)	0.0	0.0	0.0
Disposal of FA & investments	0.0	0.0	0.0	0.0	0.0
Dividend income from associates	0.0	0.0	0.0	0.0	0.0
Other investing cash flow	0.0	0.6	0.6	0.6	0.6
<b>CF from investing activities</b>	<b>(149.3)</b>	<b>(267.0)</b>	<b>0.6</b>	<b>0.6</b>	<b>0.6</b>
Dividends paid	40.5	(99.4)	98.6	(195.8)	(203.1)
Interest expense	(52.4)	(84.3)	(91.4)	(84.5)	(81.0)
Change in debt	16.6	13.1	(13.4)	0.0	0.0
Equity raised / (purchased)	0.0	(2.4)	0.0	0.0	0.0
Other financial activities	(2.1)	138.1	(7.8)	(7.8)	(7.8)
<b>CF from financing activities</b>	<b>2.6</b>	<b>(34.9)</b>	<b>(13.9)</b>	<b>(288.1)</b>	<b>(291.9)</b>
<b>Effect of exchange rate changes</b>	<b>(0.0)</b>	<b>(1.0)</b>	<b>(1.0)</b>	<b>(1.0)</b>	<b>(1.0)</b>
<b>Net cash flow</b>	<b>6.1</b>	<b>(76.1)</b>	<b>317.4</b>	<b>(14.5)</b>	<b>(15.0)</b>

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	4.9	42.3	14.3	(2.6)	2.0
Net property income growth	5.5	41.0	15.3	(0.8)	1.9
Core net profit growth	14.6	29.9	9.8	0.7	4.1
Distributable income growth	15.6	54.8	9.8	0.7	4.1
<b>Profitability ratios (%)</b>					
Net property income margin	71.8	71.2	71.8	73.2	73.1
Core net profit margin	47.1	43.0	41.3	42.7	43.6
Payout ratio	108.0	155.9	124.1	121.6	120.3
<b>DuPont analysis</b>					
Total return margin (%)	43.7	37.4	40.0	42.1	43.5
Gross revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	2.1	2.3	2.1	2.1	2.1
ROAE (%)	6.9	6.3	5.9	5.6	5.7
ROAA (%)	3.5	3.3	2.8	2.7	2.8
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	2.1	2.0	2.2	2.2	2.2
Net gearing (%) (excl. perps)	79.2	71.3	52.6	51.6	50.7
Net interest cover (x)	3.0	2.7	2.7	2.9	3.1
Debt/EBITDA (x)	9.1	9.5	8.2	8.3	8.2
Capex/revenue (%)	0.0	0.0	0.0	0.0	0.0
Net debt/ (net cash)	1,385.3	2,030.5	1,702.3	1,716.8	1,731.8
Debt/Assets (x)	0.42	0.37	0.34	0.34	0.33

Source: Company; Maybank IBG Research



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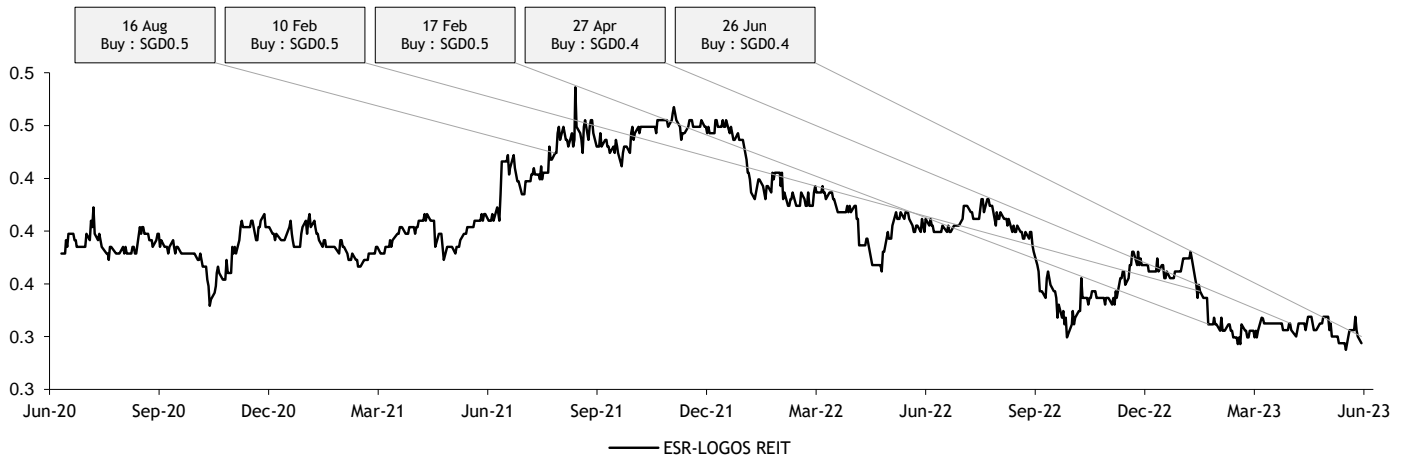
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