

Singapore Company Update

Digital Core REIT

Bloomberg: DCREIT SP | Reuters: DIGT.SI

Refer to important disclosures at the end of this report

28 Jul 2023

BUY

Last Traded Price (27 Jul 2023): US\$0.520 (STI : 3,337.42)

Price Target 12-mth: US\$0.90 (73% upside)

Analysts

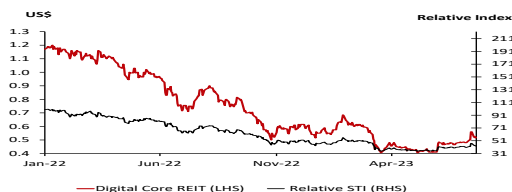
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What's New

- 1H23 DPU of 1.92 UScts was flat h-o-h; in line with our FY23 DPU forecasts
- Healthy gearing of only 34.2%; ample debt headroom for future acquisitions and further share buybacks
- Trading at a very attractive yield of more than 7.1%, with potential index inclusion as an additional catalyst
- Maintain BUY with a TP of US\$0.90

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2022A	2023F	2024F	2025F
Gross Revenue	108	116	117	118
Net Property Inc	69.4	73.3	74.2	74.6
Total Return	(1.3)	29.6	29.6	29.7
Distribution Inc	44.8	42.0	42.4	43.0
EPU (US cts.)	2.43	2.60	2.60	2.59
EPU Gth (%)	(25)	7	0	0
DPU (US cts.)	3.98	3.70	3.72	3.75
DPU Gth (%)	(3)	(7)	0	1
NAV per shr (US cts.)	82.7	81.8	81.3	80.4
PE (X)	21.4	20.0	20.0	20.1
Distribution Yield (%)	7.7	7.1	7.1	7.2
P/NAV (x)	0.6	0.6	0.6	0.6
Aggregate Leverage (%)	34.8	35.0	35.3	35.6
ROAE (%)	2.9	3.2	3.2	3.2

Distn. Inc Chng (%)		0	0	0
Consensus DPU (US cts.)		4.90	4.90	5.10
Other Broker Recs:		B: 6	S: 0	H: 0

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

Attractive valuations and near-term catalysts

Investment Thesis:

Pure-play data centre REIT riding on structural tailwinds. Demand for data centres in key markets remains robust with the lack of available capacity. DCREIT's presence in some of these key markets throughout the US, Canada, and Europe means it continues to benefit from such robust demand. Moreover, the long WALE for its assets ensures income stability in the foreseeable future. In the event of any availability, DCREIT should be able to quickly backfill the space, given the healthy demand dynamics in those markets.

Recent acquisition of Frankfurt DC to drive earnings. DCREIT has recently completed the acquisition of a 25% stake in the Frankfurt DC, which is expected to drive an accretion of c.2.0%. DCREIT has the option to increase its stake in the Frankfurt DC, as well as other pipeline assets from its sponsor, which will further drive earnings. The large pipeline of assets from its sponsor will enable DCREIT to continue acquiring accretive data centre assets going forward.

Pipeline assets from sponsor valued at more than US\$15bn.

DCREIT has been granted an ROFR by its sponsor for data centre assets in its pipeline valued at up to c.US\$15bn. This allows DCREIT to potentially grow into the largest pure-play data centre S-REIT. Its healthy debt headroom provides it the financial flexibility to embark on further accretive acquisitions. We believe that once markets become more conducive for further acquisitions, DCREIT will be able to grow further.

Maintain BUY with TP of US\$0.90. Our TP of US\$0.90 is based on a DCF valuation with a WACC of 6.2% (risk-free rate of 3.5%). This implies a normalised target yield of 4.2% in the next two years.

Key Risks

Key risks include a slowdown in demand for data centres or a decline in rents in North America where the bulk of DCREIT's portfolio is located.

At A Glance

Issued Capital (m shrs)	1,123
Mkt. Cap (US\$m/US\$m)	584 / 584
Major Shareholders (%)	
DIGITAL CR SINGAPOREP	33.6
Sumitomo Mitsui Financial Group Inc	7.0
APG Asset Management N.V.	6.9
Free Float (%)	47.4
3m Avg. Daily Val (US\$m)	1.4
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	

WHAT'S NEW

Attractive valuations and near-term catalysts

1H23 revenues were slightly lower h-o-h, but NPI increased 3.5%

- 1H23 revenues were c.2.7% lower as compared to 2H22
- However, property expenses were also lower, leading to the c.3.5% increase in NPI h-o-h
- Although occupancy at the Toronto DC is currently at 67.4%, two-thirds of the absence in income from the previous Sungard lease has already been backfilled

1H23 DPU of 1.92 UScts in line with previous six months

- 1H23 DPU of 1.92 UScts is similar to DPU of 2H22
- It is in line with our projections, forming c.52% of our FY23 DPU projections
- Despite the higher financing costs, income contribution from the acquisition of the 25% stake in the Frankfurt DC helped to maintain Distributable Income (DI) and DPU

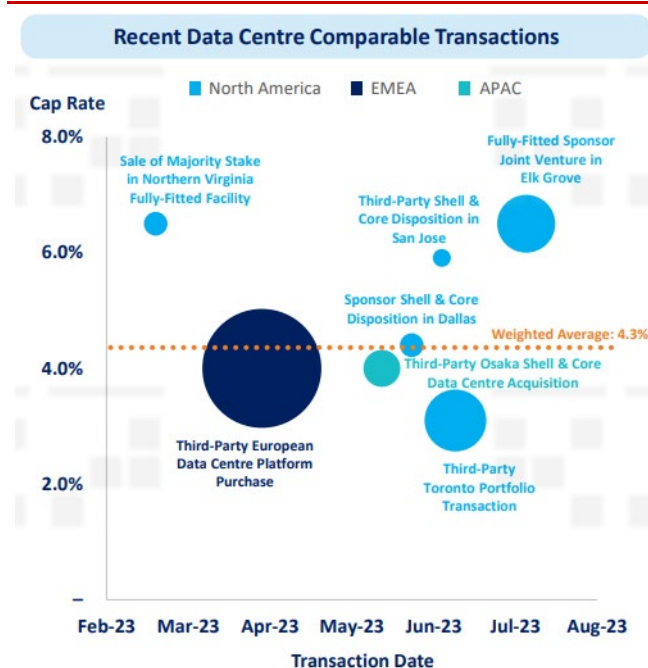
Leasing activity slowed in Toronto, but picked up in Frankfurt

- Overall portfolio occupancy declined marginally from 96.9% to 96.7% q-o-q
 - This was due to the slight decline of 2.1% in occupancy at the Toronto DC
 - Although rents continue to rise in Toronto and supply remains tight, leasing activity seems to have slowed down
- Leasing activity in Frankfurt remains robust and we hope to see an improvement in the Frankfurt DC's occupancy rate in the next quarter
- There were no new leases signed or leases renewed in 2Q23
 - 2% of DCREIT's portfolio leases (by rent) remains to expire in FY23

Cap rates of data centres have widened across markets and property types

- Transactions involving data centres remained limited in the past six months
- Based on the few transactions done, cap rates range between c.3% to 7%
 - It depends on the market in which the transaction took place, as well as the data centre type (i.e., fully fitted, shell & core, etc.)
 - The weighted average cap rate is c.4.3%
- As the bulk of DCREIT's assets are shell & core data centres located in North America, the cap rates of the recent transactions are in line with DCREIT's portfolio cap rates
 - These are around 4.5%
- As interest rates remain high and continue to creep up, DCREIT's portfolio cap rates could see a marginal expansion by the year-end

Recent transactions support DCREIT's portfolio valuations



Source: Digital Core REIT

Financing costs increased 60bps q-o-q

- DCREIT's borrowing costs increased 60bps q-o-q to 4.7% currently
 - This was due to the re-contracting of an interest rate swap during the quarter
 - No loans were refinanced in 1H23, and borrowings hedged to fixed rates remain at 72%
 - The average duration of interest rate hedging is c.2.5 years
- No refinancing is required until FY25
- YTD average cost of debt is c.4.4% as at 1H23
 - The REIT does not expect any further significant movements in borrowing costs in FY23
 - This is in line with management's previous guidance of maintaining borrowing costs at 4.5%-5.0% in FY23
- Gearing remains healthy at 34.2%, with ample debt headroom for future acquisitions or further share buybacks
 - DCREIT carried out c.US\$2.1m in share buybacks in 1H23

No further updates on Cyxtera's Chapter 11 proceedings

- Courts are still in the process of evaluating letters of intent at this point
 - Expect to receive an outcome or some updates before the October 2023 deadline

Digital Core REIT

- There could still be a chance that the new owners may reject some of its leases with the landlords
 - We previously thought that there will be no further lease rejections since the letters of intent have already been finalised
 - Despite this, we believe that only the two DCs in LA face the risk of lease rejections, as Cyxtera's occupancies there are only c.57%
 - Rentals at both assets in LA are c.10%-15% below market rents and provide upside potential in the event a replacement tenant is needed
- Cyxtera has paid all rents due in July, but rentals for June remain in arrears
 - This is mostly attributable to a timing issue, as that was the time Cyxtera filed for Chapter 11
 - DCREIT is confident that the rentals for June will be paid in due course
 - Moreover, rental payments in July have resumed in full

Our thoughts

Despite the continued uncertainty surrounding Cyxtera, we are more optimistic that a resolution will be announced in the coming months. Although there is no guarantee that the new owner will affirm all its leases with DCREIT, we are confident that it will affirm the majority of the leases, and the risk of lease rejections will mainly surround the two LA data centres (c.7% of DCREIT's annual revenue). Moreover, in the event of a lease rejection at the LA properties, there is potential for DCREIT to increase rents by 10%-15% at the assets.

Operationally, DCREIT's **performance remains stable** with only two vacancies within its portfolio (Toronto and Frankfurt). Although leasing momentum seems to have slowed down in Toronto, we believe the increased enquiries in Frankfurt will help pick up the slack. Moreover, supply in Toronto remains tight and rents have been holding out. Although the 60bps increase in borrowing costs this quarter will have an impact, we believe that financing costs will hover around current levels, as there are **no refinancing requirements until FY25**, and the **majority of loans remain on fixed rates**.

As such, we will maintain our **BUY** recommendation with a TP of **US\$0.90**. We believe DCREIT is currently trading at a **very attractive yield of more than 7.1%** and at a **P/B multiple of 0.65x**, which is almost unheard of for a pure-play data centre REIT. Despite the ongoing uncertainties surrounding its leases with Cyxtera, we believe a resolution will soon be reached and the DCREIT will be able to deliver our projected earnings. Also, DCREIT's share price has recovered over the past month, and it could potentially be **included in the FTSE NAREIT Developed Asia Index** as soon as September 2023.

Company Background

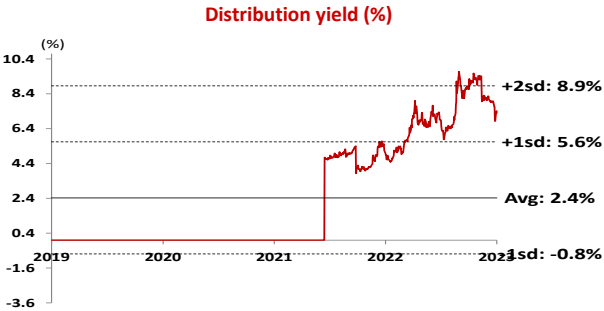
DCREIT is a real estate investment trust that primarily invests in stable income-producing data centres as well as assets necessary to support the digital economy globally. Its portfolio currently comprises of 13 properties located in major data centre markets throughout the US, Canada, and Germany.

Interim Income Statement (US\$m)

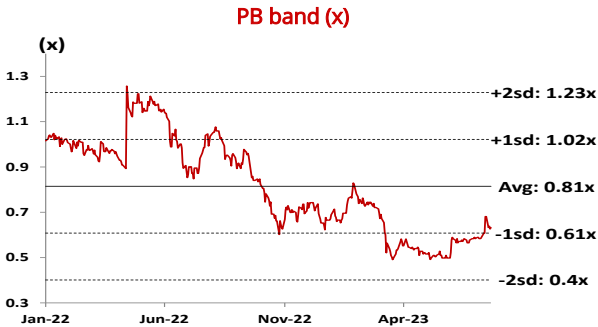
FY Dec	1H2022	2H2022	1H2023	% chg yoy	% chg hoh
Gross revenue	52.8	54.9	53.4	1.1	(2.7)
Property expenses	(17.4)	(20.9)	(18.2)	4.7	(12.8)
Net Property Income	35.4	34.0	35.2	(0.7)	3.5
Other Operating expenses	(6.2)	(7.5)	(6.0)	(3.2)	(20.1)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	0.0	(0.5)	2.08	nm	(549.8)
Net Interest (Exp)/Inc	(3.5)	(6.7)	(9.2)	(165.8)	(37.4)
Exceptional Gain/(Loss)	0.0	0.0	(2.9)	nm	nm
Net Income	25.8	19.3	19.2	(25.6)	(0.9)
Tax	(3.3)	(9.4)	(6.9)	107.9	(26.4)
Minority Interest	(3.0)	(2.0)	(3.2)	(8.3)	63.2
Net Income after Tax	19.5	8.02	9.07	(53.4)	13.1
Total Return	19.5	(20.8)	9.07	(53.4)	(143.7)
Non-tax deductible Items	3.75	42.3	12.4	231.2	(70.7)
Net Inc available for Dist.	23.2	21.5	21.5	(7.5)	(0.2)
Ratio (%)					
Net Prop Inc Margin	67.0	61.9	65.8		
Dist. Payout Ratio	100.0	100.8	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

Digital Core REIT

Income Statement (US\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Gross revenue	105	108	116	117	118
Property expenses	(38.6)	(38.3)	(42.4)	(42.8)	(43.0)
Net Property Income	66.1	69.4	73.3	74.2	74.6
Other Operating expenses	(12.0)	(15.1)	(10.9)	(11.0)	(11.0)
Other Non Opg (Exp)/Inc	0.0	1.42	0.0	0.0	0.0
Associates & JV Inc	0.0	(0.5)	(0.5)	(0.5)	(0.5)
Net Interest (Exp)/Inc	(4.4)	(10.2)	(20.0)	(20.7)	(20.9)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	49.6	45.1	41.9	42.1	42.2
Tax	(7.1)	(12.7)	(5.6)	(5.6)	(5.6)
Minority Interest	(5.9)	(4.9)	(6.8)	(6.9)	(6.9)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	36.7	27.5	29.6	29.6	29.7
Total Return	36.7	(1.3)	29.6	29.6	29.7
Non-tax deductible Items	9.51	46.1	12.4	12.8	13.3
Net Inc available for Dist.	46.2	44.8	42.0	42.4	43.0
Growth & Ratio					
Revenue Gth (%)		3.0	7.4	1.1	0.5
N Property Inc Gth (%)		5.0	5.7	1.2	0.5
Net Inc Gth (%)		(25.0)	7.4	0.2	0.1
Dist. Payout Ratio (%)		100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)		64.4	63.4	63.4	63.4
Net Income Margins (%)		25.5	25.6	25.3	25.2
Dist to revenue (%)		41.6	36.3	36.3	36.6
Managers & Trustee's fees		14.0	9.4	9.4	9.4
ROAE (%)		2.9	3.2	3.2	3.2
ROA (%)		1.8	1.8	1.8	1.8
ROCE (%)		2.6	3.4	3.4	3.4
Int. Cover (x)		5.3	3.1	3.1	3.0

DI supported by backfilling at Toronto and income contribution from Frankfurt DC.

Source: Company, DBS Bank

Digital Core REIT

Interim Income Statement (US\$m)

FY Dec	1H2022	2H2022	1H2023		
Gross revenue	52.8	54.9	53.4		
Property expenses	(17.4)	(20.9)	(18.2)		
Net Property Income	35.4	34.0	35.2		
Other Operating	(6.2)	(7.5)	(6.0)		
Other Non Opg (Exp)/Inc	0.0	0.0	0.0		
Associates & JV Inc	0.0	(0.5)	2.08		
Net Interest (Exp)/Inc	(3.5)	(6.7)	(9.2)		
Exceptional Gain/(Loss)	0.0	0.0	(2.9)		
Net Income	25.8	19.3	19.2		
Tax	(3.3)	(9.4)	(6.9)		
Minority Interest	(3.0)	(2.0)	(3.2)		
Net Income after Tax	19.5	8.02	9.07		
Total Return	19.5	(20.8)	9.07		
Non-tax deductible Items	3.75	42.3	12.4		
Net Inc available for Dist.	23.2	21.5	21.5		
Growth & Ratio					
Revenue Gth (%)	N/A	N/A	N/A	4	(3)
N Property Inc Gth (%)	nm	nm	nm	(4)	3
Net Inc Gth (%)	nm	nm	nm	(59)	13
Net Prop Inc Margin (%)	N/A	N/A	67.0	61.9	65.8
Dist. Payout Ratio (%)	N/A	N/A	100.0	100.8	100.0

Income contribution from Frankfurt DC.

Balance Sheet (US\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Investment Properties	1,441	1,424	1,430	1,435	1,441
Other LT Assets	1.14	154	154	154	154
Cash & ST Invt	20.1	25.2	23.8	27.8	31.3
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	3.49	7.14	3.86	3.90	3.92
Other Current Assets	4.09	2.16	2.16	2.16	2.16
Total Assets	1,469	1,613	1,614	1,624	1,633
ST Debt	0.0	0.0	0.0	0.0	0.0
Creditor	10.5	20.6	11.6	11.7	11.8
Other Current Liab	7.05	5.34	5.57	5.60	5.61
LT Debt	341	495	501	507	513
Other LT Liabilities	3.40	14.6	14.6	14.6	14.6
Unit holders' funds	957	935	932	929	926
Minority Interests	150	142	149	156	163
Total Funds & Liabilities	1,469	1,613	1,614	1,624	1,633
Non-Cash Wkg. Capital	(9.9)	(16.6)	(11.1)	(11.2)	(11.3)
Net Cash/(Debt)	(321)	(470)	(477)	(479)	(481)
Ratio					
Current Ratio (x)	1.6	1.3	1.7	2.0	2.1
Quick Ratio (x)	1.3	1.2	1.6	1.8	2.0
Aggregate Leverage (%)	23.7	34.8	35.0	35.3	35.6

Weighted average debt maturity of c.3.4 years.

Source: Company, DBS Bank

Digital Core REIT

Cash Flow Statement (US\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Income	49.6	45.1	41.9	42.1	42.2
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	0.0	0.0	0.0	(5.6)	(5.6)
Associates & JV Inc/(Loss)	0.0	0.46	0.46	0.46	0.46
Chg in Wkg.Cap.	2.10	3.64	(11.1)	0.09	0.04
Other Operating CF	9.51	(14.4)	9.71	9.77	9.82
Net Operating CF	61.2	34.8	41.0	46.8	46.9
Net Invt in Properties	0.0	0.0	(5.8)	(5.9)	(5.9)
Other Invts (net)	0.0	(2.2)	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	(68.9)	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	(0.5)	(0.5)	(0.5)
Other Investing CF	0.0	(86.1)	0.0	0.0	0.0
Net Investing CF	0.0	(157)	(6.3)	(6.3)	(6.3)
Distribution Paid	(46.2)	(26.7)	(42.0)	(42.4)	(43.0)
Chg in Gross Debt	0.0	1.48	5.78	5.85	5.88
New units issued	0.0	1.15	0.0	0.0	0.0
Other Financing CF	0.0	(5.7)	0.0	0.0	0.0
Net Financing CF	(46.2)	116	(36.2)	(36.6)	(37.1)
Currency Adjustments	0.0	0.01	0.0	0.0	0.0
Chg in Cash	15.1	(6.1)	(1.4)	3.97	3.45
Operating CFPS (US cts.)	5.25	2.76	4.59	4.10	4.08
Free CFPS (US cts.)	5.44	3.08	3.10	3.59	3.57

Source: Company, DBS Bank

Target Price & Ratings 12-mth 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:	29 Jul 22	0.87	1.15	BUY
2:	23 Sep 22	0.77	1.15	BUY
3:	27 Oct 22	0.55	0.90	BUY
4:	21 Nov 22	0.58	0.90	BUY
5:	03 Feb 23	0.68	0.90	BUY

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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