Singapore Company Update

Cromwell European REIT

Bloomberg: CERT SP | Reuters: CROM.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

27 Feb 2024

BUY

Last Traded Price (26 Feb 2024): EUR1.43 (**STI :** 3,171.12)
Price Target 12-mth: EUR2.00 (40% upside)

Analysts

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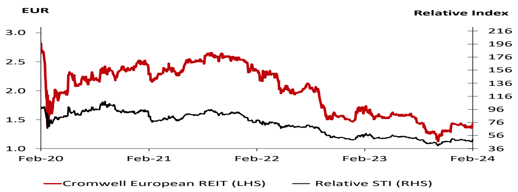
What's New

- FY23 DPU of 15.693 Ects in line with our projections; attractive yield of more than 11%
- Absence of income from the divestments has been partially offset by organic income growth
- Leverage has been maintained relatively well at c.40%, despite revaluation losses
- Maintain BUY with TP unchanged at EUR2.00

Price Relative



Forecasts and Valuation

FY Dec (EURm)	2022A	2023A	2024F	2025F
Gross Revenue	222	216	207	212
Net Property Inc	137	134	133	137
Total Return	39.6	(76.2)	80.3	81.0
Distribution Inc	96.7	88.3	84.4	85.5
EPU (Euro cts.)	7.06	(13.6)	14.3	14.4
EPU Gth (%)	(61)	nm	nm	1
DPU (Euro cts.)	17.2	15.7	15.0	15.2
DPU Gth (%)	1	(9)	(4)	1
NAV per shr (Euro cts.)	242	212	212	212
PE (X)	20.3	nm	10.0	9.9
Distribution Yield (%)	12.0	11.0	10.5	10.6
P/NAV (x)	0.6	0.7	0.7	0.7
Aggregate Leverage (%)	40.2	42.0	42.1	42.3
ROAE (%)	2.9	(6.0)	6.7	6.8
Distn. Inc Chng (%):			(4)	(4)
Consensus DPU (Euro			23.3	23.3
Other Broker Recs:		B: 4	S: 0	H: 0

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

Recalibration to further drive organic income growth

Investment Thesis:

Diversified portfolio in European gateway cities. Cromwell European REIT (CERT) is a fast-growing Pan-European S-REIT with a diversified portfolio of office, industrial, and logistics assets valued at c.EUR2.3bn. The REIT has been an active asset recycler, driving portfolio yields and optimising returns to unitholders. CERT is currently undergoing a portfolio repositioning, pivoting towards lighter industrial/logistics exposure.

Navigating a slowing European economy. CERT has weathered the COVID pandemic well, but we see a new risk emerging with Europe expected to face a period of low growth and high inflation given the ongoing geopolitical crisis. Notwithstanding this, we believe CERT's focus in Italy, France, and the Netherlands – which form c.67% of the portfolio and have relatively better fundamentals – will result in more resilience going forward. The CPI-pegged rental escalations in place for its leases are set to drive steady organic growth in income.

Logistics pivot could drive yield compression. Faced with a slowing economy and weakening EUR, the decline in CERT's share price appears to have been priced in. Yields have expanded to +2SD above average to c.10.0%, which we believe is attractive. The REIT's pivot to focus more on the logistics sector is expected to drive earnings resilience. Thus, we expect a compression in yields, given its improved earnings visibility and growth profile.

Maintain BUY with revised TP of EUR2.00. Our target price of EUR2.00 is based on a DCF valuation with a WACC of 6.4% (risk-free rate of 3.5%). This implies a target yield of c.7.8% over the next three years.

Key Risks

The key risk to our view is lower-than-expected rental income arising from either loss of tenants or a slower upturn in rents/inflation.

At A Glance

Issued Capital (m shrs)	562
Mkt. Cap (EURm/US$m)	804 / 870
Major Shareholders (%)	
CROMWELL SINGAPORE HOLDINGS PTE	27.4
HILLSBORO CAPITAL LTD	7.3
BlackRock Inc	5.0
Free Float (%)	55.3
3m Avg. Daily Val (US$m)	1.2

GIC Industry : Real Estate / Equity Real Estate Investment (REITs)

ed: BM/ sa: AS, PY, CS

WHAT'S NEW

Recalibration to drive further organic income growth

FY23 revenues and NPI at EUR216.5m and EUR134.3m. FY23 revenues and NPI experienced a decline of 2.5% and 1.8%, respectively, primarily attributable to divestments totaling around EUR237m since FY22. In FY23 alone, EUR196.5m in divestments contributed to this decline. The absence of income from Maxima – which is undergoing redevelopment, the EUR55m project is expected to be completed in FY25 – further impacted results, accounting for an impact of c.EUR2.6m in FY23. However, on a like-for-like basis (excluding divestments), NPI would have seen an increase of approximately 4.1%, driven by improved portfolio occupancies and positive rent reversions.

FY23 DPU of 15.693 Ects is in line with projections. FY23 DPU was in line with our projections, suggesting a current yield exceeding 11.1%. The DPU experienced a y-o-y decline of c.8.7%, attributed to divestments, redevelopments, increased financing costs (up 32.8% y-o-y), and the absence of capital distribution top-ups. Divestments contributed to a 0.65 Ects decrease, while the lack of income from redevelopments resulted in a 0.68 Ects decline. Higher financing costs accounted for a further 1.458 Ects decrease, and the absence of capital distribution top-ups led to a 0.365 Ects decline. Excluding the impact of these disruptions to earnings, the DPU would have only declined by around 4.1%, partially offset by higher rents.

Looking forward, we anticipate that the EUR196.5m in divestments completed in FY23 will have a temporary impact on DPU. Despite the proceeds being primarily allocated to loan repayment and into AEI and rejuvenation projects, the timing differences in the completion of significant rejuvenation projects (e.g., Nervesa 21, Maxima, etc.) are expected to result in a near-term drag on earnings. The completion and stabilisation of these assets are crucial to reversing this impact and contributing positively to the overall earnings trajectory. Our revised projections estimates that DPU will return to growth trajectory in FY25 when the Maxima redevelopment is completed.

Portfolio valuations declined c.1.5% over the past six months. Overall portfolio valuations have decreased by approximately 1.5% since June 2023, with a y-o-y decline of about 3.0%. The Light Industrial & Logistics (L/L) portfolio continues to exhibit a valuation uplift of around 1.4% in 2H23, following a 0.8% increase in the first half, primarily driven by higher rents. Valuations for the L/L portfolio reported an improvement, while only the UK and Germany portfolios saw a slight decline due mainly to the depreciation of the GBP against the EUR, and a c.40bps expansion in cap rates for Germany assets. Valuations of office and the other portfolios reported a decline of 4.6% in the 2H23, adding to the 3.9% decline in the first half. Revaluation losses were primarily attributed to 20-40bps cap rate expansions and more negative views in Poland and Finland.

Overall, CERT's portfolio reported a c.90-100bps expansion in FY23. However, higher rents and the valuers' expectations of further rental growth have helped to partially offset some of the valuation declines, preventing an even wider dip in valuations.

CERT's portfolio valuations held up relatively well, only correcting by c.3.5% over the past 18 months

Movements in LI/Log valuation over the last 18 Months

+/-	LI/Log (+4.8% or €34.5 million overall)
+19.5%	The Czech Republic (▲€12.6 million)
+19.5%	Denmark (▲€18.4 million)
+9.2%	Slovakia (▲€6.0 million)
+4.6%	France (▲€17.1 million)
+2.8%	Italy (▲€4.2 million)
+2.5%	The Netherlands (▲€2.5 million)
-8.7%	Germany (▼€18.0 million)
-16.4%	United Kingdom (▼€8.3 million)

Movements in Office & 'Other' valuation over the last 18 Months

+/-	Country
	Office (-11.6% or €126.2 million overall)
-20.3%	Finland (▼€18.0 million)
-18.5%	Poland (▼€41.2 million)
-14.8%	France (▼€9.7 million)
-9.4%	The Netherlands (▼€47.5 million)
-4.7%	Italy (▼€9.7 million)
	'Others' (-8.7% or €4.4 million overall)
-8.7%	Italy (▼€4.4 million)

Source: Cromwell European REIT

Continued positive rental reversions of +5.7% in 4Q23 and FY23. Rental reversions remained healthy, maintaining a positive trend of +5.7% in both 4Q23 and FY23, and remaining unchanged y-o-y. in 2H23, the L/L portfolio reported a smaller increase of +2.3%, largely dragged down by the extension of two large leases in Germany that were extended at passing rents. Although we believe CERT will continue to report robust positive rental reversions for their L/L portfolio, we could see slower rental growth as more new supply is added to the market. For CERT's office portfolio, rental reversions saw another quarter of healthy, positive reversions of +9.4% in 2H23, largely driven by renewals and new leases in the Netherlands.

CERT's overall portfolio occupancy declined from 95.2% to 94.3% q-o-q, primarily due to lower occupancies for the L/L portfolio, which fell from 97.1% to 95.6% q-o-q. This was attributed to the addition of newly completed space in the Czech Republic and Slovakia and lower occupancy for the Denmark assets. With new supply expected to continue growing in the coming quarters, we could see occupancy rates moderating in the near term.

Only 13.5% of portfolio leases due to expire in FY24. Portfolio occupancies are expected to remain relatively stable in the coming year, and the majority of lease expiries in FY24 are anticipated to come from the L/L portfolio. Lease expires in the L/L portfolio primarily stem from one major lease in Denmark, and discussions are currently underway with prospective tenants to fill the expiring space. For the office portfolio, we anticipate the segment to continue seeing further pressure in FY24, particularly for assets located in Poland and Finland, where economic conditions remain challenging.

Aggregate leverage maintained at c.40% despite valuation declines. CERT's aggregate leverage of 40.3% marked a 90bps improvement q-o-q (from 41.2% in 3Q23), despite the decline in portfolio valuations. Conversely, the improvement in gearing was primarily attributed to the completion of divestments that were carried out at healthy discounts to valuations (blended 13.6% premium to most recent valuations). CERT intends to continue divesting approximately EUR200m of non-core assets to further improve its balance sheet.

Borrowing costs experienced a 23bps increase q-o-q, mainly due to the interest rate cap transaction entered during the quarter. We expect borrowing costs to remain stable for the rest of the year, given that ECB rates have peaked and could even decrease during the year. Furthermore, there are no refinancing requirements until November 2025, when EUR450m in bonds will be due. Notably, EUR50m in bonds were repurchased and cancelled in December 2023, resulting in a EUR3.1m gain from the bond buyback. Additionally, 88% of all loans remained hedged to fixed rates, and approximately EUR74m in cash on the balance sheet can be utilised for CAPEX commitments.

2H23 debt ratio (D+P)/A saw a 110 bps improvement (from 1H23) to 42.7%, mainly attributed to the lower outstanding loans. Although portfolio valuations saw a c.1.5% decline h-o-h, the repayment of c.EUR120m in loans led to the improvement in the debt ratio and MAS leverage.

Continued focus on growing earnings organically. The redevelopment of Nervesa 21 has been successfully completed in January 2024, with 70% of the property handed over to Universal Music Group. Negotiations are currently ongoing with other tenants to backfill the remaining 3,000sqm, with expectations to lease out the space in 2Q24. Additionally, the Lovosice ONE refurbishment and expansion have concluded, with approximately 46% of the space already committed. Discussions are also ongoing with another tenant for the remaining vacant space. Lastly, the Nove Mesto ONE expansion has been completed, with DC3 fully committed and DC7 50% committed. Advanced negotiations are underway to lease out the remaining 3,000sqm at DC7. Furthermore, the strip-out works and construction tender for a redevelopment project initiated in 2023 are completed, with the redevelopment anticipated to be finished in FY25.

During the quarter, CERT also identified a new AEI opportunity for Haagse Poort, The Hague. The EUR90m refurbishment of the property includes the addition of two atria, and various other energy reduction measures. We believe that this AEI will allow CERT to command significantly higher rents when leases are due for renewal.

Our views

As anticipated, CERT's strategic divestments have significantly bolstered its balance sheet, albeit with a notable impact on earnings and DPU. The ongoing redevelopment projects, while temporarily affecting income, are expected to contribute positively once they are completed and generate rental income (completion of Maxima in FY25).

The c.3.0% decline in portfolio valuations in FY23 aligns with earlier estimates, showcasing CERT's proactive portfolio management efforts that have shielded it from more substantial valuation decreases. On the capital management front, gearing remained relatively stable at 40.3%, again due to CERT's strategic recalibration of its portfolio and divestment of non-core assets at premiums. While financing costs saw a slight increase in 4Q23, stability is anticipated as ECB rates appear to have peaked, and CERT faces no refinancing requirements until November 2025.

In the short term, FY24 DPU is expected to decline by c.4%, mainly due to the significant absence of income resulting from the EUR196.5m in divestments. Although positive rental reversions and financing cost savings are likely to offset part of this absence in income, we anticipate that DPUs will only return to growth trajectory in FY25 when the redevelopment of Maxima is completed. Even though CERT retains the option to leverage capital gains distributions as a tool to buffer for DPU stability, we believe that they will unlikely do so in the near term as maintaining gearing and cash balances remain priority this year.

Despite the slight downward revision in DPU estimates in the near-term, the current attractive valuation that implies a forward yield of c.10.5%, and expectations for a rebound in earnings in the next 12-24 months, we maintain our **BUY** recommendation with an unchanged TP of **EUR2.00**.

Areas to watch: (i) Operating metrics (occupancy rates and rental reversions), (ii) impact of peaking interest rates but increasingly uncertain economic conditions on property valuations, and (iii) lease expiries in FY24 (especially for the office portfolio), (iv) ability to lease out newly completed redevelopment properties and rents achieved.

Company Background

Cromwell European REIT (CERT) is a Singaporean REIT with the principal investment strategy of investing, directly or indirectly, in a diversified portfolio of income-producing real estate assets in Europe that are used primarily for office, light industrial/logistics, and retail purposes. CERT owns a portfolio of 110 properties in, or close to, major gateway cities in the Netherlands, Italy, France, Poland, Germany, Finland, Denmark, the Czech Republic, Slovakia, and the UK, and it has been pivoting towards logistics assets. CERT is managed by Cromwell EREIT Management Pte. Ltd., a wholly owned subsidiary of CERT's sponsor, Cromwell Property Group. Cromwell is a real estate investor and manager with operations in 14 countries and is listed on the ASX.

Interim Income Statement (EURm)

FY Dec	2H2022	1H2023	2H2023	% chg yoy	% chg hoh
Gross revenue	115	108	108	(5.7)	(0.2)
Property expenses	(45.2)	(39.8)	(42.4)	(6.3)	6.5
Net Property Income	69.5	68.5	65.8	(5.3)	(4.1)
Other Operating expenses	(7.8)	(4.6)	(6.6)	(15.8)	44.3
Other Non Opg (Exp)/Inc	9.50	(1.0)	(7.8)	nm	696.6
Associates & JV Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	(14.0)	(15.7)	(16.7)	(19.5)	(6.0)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	57.2	47.3	34.7	(39.3)	(26.6)
Tax	(3.9)	2.29	(17.8)	359.8	nm
Minority Interest	(1.2)	(1.2)	(1.2)	0	1.4
Net Income after Tax	52.1	48.4	15.7	(69.8)	(67.5)
Total Return	(12.4)	(16.7)	(59.5)	(381.4)	256.0
Non-tax deductible Items	60.1	60.5	104	72.9	71.8
Net Inc available for Dist.	47.8	44.0	44.5	(7.0)	1.0
Ratio (%)					
Net Prop Inc Margin	60.6	63.3	60.8		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank Ltd

Historical Distribution Yield and PB band

Distribution yield (%)

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

PB band (x)

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

Income Statement (EURm)

FY Dec	2021A	2022A	2023F	2024F	2025F
Gross revenue	200	222	216	207	212
Property expenses	(70.0)	(85.3)	(82.2)	(73.3)	(75.0)
Net Property Income	130	137	134	133	137
Other Operating expenses	(11.0)	(14.3)	(11.1)	(10.5)	(11.6)
Other Non Opg (Exp)/Inc	0.83	16.3	(8.8)	5.00	5.00
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(21.7)	(24.4)	(32.4)	(34.1)	(35.3)
Exceptional Gain/(Loss)	26.7	(58.7)	(140)	0.0	0.0
Net Income	125	55.7	(58.4)	93.8	94.9
Tax	(28.3)	(13.8)	(15.5)	(10.7)	(11.0)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	(0.2)	(2.3)	(2.3)	(2.8)	(2.8)
Net Income After Tax	96.4	39.6	(76.2)	80.3	81.0
Total Return	96.4	39.6	(76.2)	80.3	81.0
Non-tax deductible Items	(2.7)	57.0	164	4.03	4.43
Net Inc available for Dist.	93.6	96.7	88.3	84.4	85.5
Growth & Ratio					
Revenue Gth (%)	7.0	11.0	(2.5)	(4.5)	2.4
N Property Inc Gth (%)	10.9	5.1	(1.8)	(0.6)	2.4
Net Inc Gth (%)	21.4	(58.9)	nm	nm	0.9
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	65.0	61.6	62.0	64.5	64.6
Net Income Margins (%)	48.2	17.8	(35.2)	38.8	38.3
Dist to revenue (%)	46.8	43.5	40.8	40.8	40.4
Managers & Trustee's fees	5.5	6.4	5.1	5.1	5.5
ROAE (%)	7.1	2.9	(6.0)	6.7	6.8
ROA (%)	4.0	1.5	(3.1)	3.4	3.5
ROCE (%)	4.0	3.7	5.1	4.8	4.8
Int. Cover (x)	5.5	5.0	3.8	3.6	3.5

Decline in revenues due to EUR237m in divestments carried out since FY22.

Source: Company, DBS Bank Ltd

Interim Income Statement (EURm)

FY Dec	2H2021	1H2022	2H2022	1H2023	2H2023
Gross revenue	101	107	115	108	108
Property expenses	(35.3)	(40.1)	(45.2)	(39.8)	(42.4)
Net Property Income	65.8	67.3	69.5	68.5	65.8
Other Operating	(5.6)	(6.5)	(7.8)	(4.6)	(6.6)
Other Non Opg (Exp)/Inc	0.84	6.84	9.50	(1.0)	(7.8)
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(10.4)	(10.4)	(14.0)	(15.7)	(16.7)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	50.6	57.2	57.2	47.3	34.7
Tax	(13.4)	(9.9)	(3.9)	2.29	(17.8)
Minority Interest	0.0	(1.2)	(1.2)	(1.2)	(1.2)
Net Income after Tax	37.2	46.2	52.1	48.4	15.7
Total Return	36.1	52.0	(12.4)	(16.7)	(59.5)
Non-tax deductible Items	11.6	(3.1)	60.1	60.5	104
Net Inc available for Dist.	47.5	49.1	47.8	44.0	44.5
Growth & Ratio					
Revenue Gth (%)	2	6	7	(6)	0
N Property Inc Gth (%)	2	2	3	(1)	(4)
Net Inc Gth (%)	15	24	13	(7)	(68)
Net Prop Inc Margin (%)	65.1	62.7	60.6	63.3	60.8
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

EUR196.5m in divestments completed in FY23 alone. Proceeds have mainly been used to repay debt.

Source: Company, DBS Bank Ltd

Balance Sheet (EURm)

FY Dec	2021A	2022A	2023F	2024F	2025F
Investment Properties	2,449	2,509	2,242	2,248	2,254
Other LT Assets	6.90	27.9	12.7	12.7	12.7
Cash	59.3	35.4	73.8	40.5	40.3
ST Investment	0.0	0.0	0.0	0.0	0.0
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	18.5	16.3	14.5	13.0	13.3
Net Intangibles Assets	0.0	0.0	0.0	0.0	0.0
Other Current Assets	0.87	0.96	25.0	25.0	25.0
Total Assets	2,535	2,590	2,367	2,339	2,345
ST Debt	23.0	50.6	0.0	0.0	0.0
Creditor	35.7	42.4	42.1	7.25	7.42
Other Current Liab	32.5	36.3	40.2	40.2	40.2
LT Debt	900	964	948	954	960
Other LT Liabilities	66.3	73.5	82.5	82.5	82.5
Unit holders' funds	1,477	1,423	1,255	1,255	1,255
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	2,535	2,590	2,367	2,339	2,345
Non-Cash Wkg. Capital	(48.8)	(61.4)	(42.8)	(9.5)	(9.3)
Net Cash/(Debt)	(863)	(979)	(874)	(913)	(920)
Perpetuals	64.2	64.2	64.2	64.2	64.2
Ratio					
Current Ratio (x)	0.9	0.4	1.4	1.7	1.7
Quick Ratio (x)	0.9	0.4	1.1	1.1	1.1
Aggregate Leverage (%)	37.4	40.2	42.0	42.1	42.3

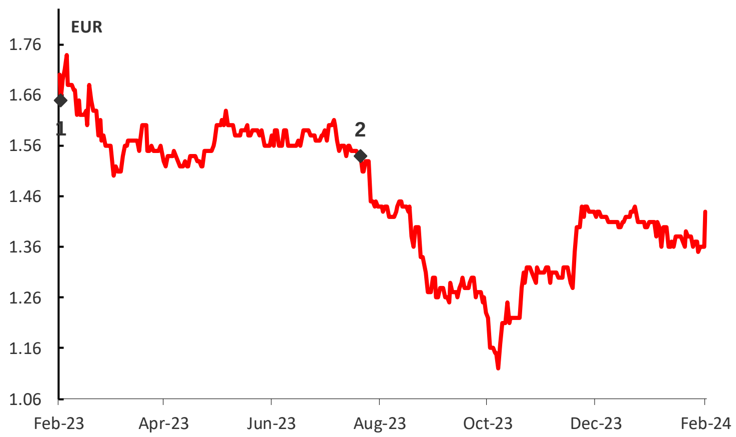
Source: Company, DBS Bank Ltd

Cash Flow Statement (EURm)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Income	96.4	39.6	(76.2)	80.3	81.0
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(5.1)	(8.1)	(7.9)	0.0	0.0
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(18.5)	(20.1)	(28.8)	(33.3)	(0.1)
Other Operating CF	24.1	80.9	202	4.03	4.43
Net Operating CF	96.9	92.4	89.1	51.0	85.3
Net Invt in Properties	(22.6)	(38.9)	(83.1)	(6.2)	(6.4)
Other Invts (net)	(72.2)	(76.4)	197	0.0	0.0
Invts in Assoc. & JV	(125)	16.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	(12.9)	(7.0)	(1.9)	0.0	0.0
Net Investing CF	(233)	(106)	112	(6.2)	(6.4)
Distribution Paid	(83.2)	(93.3)	(91.6)	(84.4)	(85.5)
Chg in Gross Debt	75.6	92.5	(62.6)	6.20	6.35
New units issued	97.7	(0.1)	0.0	0.0	0.0
Other Financing CF	61.3	(8.9)	(8.2)	0.0	0.0
Net Financing CF	151	(9.8)	(162)	(78.2)	(79.1)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	15.7	(23.8)	38.4	(33.3)	(0.1)
Operating CFPS (Euro cts.)	21.5	20.0	21.0	15.0	15.2
Free CFPS (Euro cts.)	13.8	9.52	1.08	7.97	14.0

Source: Company, DBS Bank Ltd

Target Price & Ratings 12-mth History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	27 Feb 23	1.65	2.10	BUY
2:	15 Aug 23	1.54	2.00	BUY

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

Source: DBS Bank Ltd

Analysts: Dale LAI

Derek TAN

DBS Group Research 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*

Completed Date: 27 Feb 2024 07:18:43 (SGT)
Dissemination Date: 27 Feb 2024 08:34:01 (SGT)

Sources for all charts and tables are DBS Bank Ltd unless otherwise specified.

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