Asia Credit Research

# Earnings Review: Soilbuild Business Space REIT ("SBREIT")

**Issuer Profile: Neutral (4)**

Ticker: **SBREIT**

### Background

Listed in 2013, Soilbuild Business Space REIT ("SBREIT") is an Industrial REIT in Singapore, with total assets of SGD1.23bn as at 5 October 2018. SBREIT currently owns a portfolio of 11 properties in Singapore and 2 properties in Australia. The REIT is Sponsored by Soilbuild Group Holdings Ltd ("Soilbuild") and Soilbuild is wholly owned by Mr. Lim Chap Huat. The Lim family is the REIT's largest unitholder, with a 28.9% stake.

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## Recommendation

- 3Q2018 income was down due to divestment of KTL Offshore and lower contributions from West Park BizCentral and Eightrium though encouragingly, occupancy at Eightrium climbed to 89.3% and we saw positive rental reversion (for renewals as well as blended) this quarter for the first time since 1Q2017. The venture into Australia could also boost portfolio statistics going forward.
- We maintain SBREIT's issuer profile at Neutral (4) given its manageable credit metrics.
- Comparing SBREIT '21s to EREIT '20s, although there is no pick-up in spread we think the latter offers greater value given the shorter tenor of 13 months.
- On the other hand, we prefer SBREIT 6.0%-PERP to EREIT 4.6%-PERP as it offers a 28bps pick-up for a shorter tenor of 14 months. We also have ESR-REIT ("EREIT") at an issuer profile of Neutral (4).

## Relative Value:

| Bond | Maturity | Aggregate leverage | Ask Yield | Spread |
|---|---|---|---|---|
| SBREIT 3.6% '21 | 08/04/2021 | 39.2% | 3.81% | 157bps |
| SBREIT 6% PERP | 27/09/2021 | 39.2% | 6.09% | 379bps |
| EREIT 3.95% '20 | 21/05/2020 | 30.5% | 3.62% | 151bps |
| EREIT 4.6% PERP | 03/11/2022 | 30.5% | 5.89% | 351bps |

*Indicative prices as at 18 October 2018 Source: Bloomberg*
*Aggregate leverage based on latest available quarter*

## Key Considerations

- **Solaris is the key income driver:** In 3Q2018, reported gross revenue and net property income ("NPI") fell 3.6% y/y to SGD19.8mn and 8.8% y/y to SGD16.2mn respectively. This was largely due to the divestment of KTL Offshore, lower contribution from West Park BizCentral and Eightrium though partially offset by higher revenue from the conversion of Solaris into a multi-tenanted property on 15 August 2018. It is worth noting that the conversion also brought about higher property operating expenses of ~SGD1.8mn per annum (NPI margin for master-leased spaces is typically 100% unlike multi-tenanted spaces at ~60-70%). Therefore, even though gross revenue has increased by 5.7% on a quarter-on-quarter basis, NPI still fell by 0.15% q/q. Likewise, EBITDA fell 8.8% y/y to SGD14.9mn. That said, EBITDA/Interest albeit lower remains manageable at 4.08x (3Q2017: 4.3x). Including 50% of perpetual distributions as interest expense, adjusted EBITDA/Interest falls marginally to 4.06x. Solaris accounts for 32% of portfolio income as at 30 September 2018.

- **No clear recovery seen in the industrial space yet:** Portfolio occupancy fell slightly to 87.2% from 87.6% in 2Q2018, with a decline at Tuas Connection to 94.7% from 97.0% as at 30 June 2018. Occupancy was stable at West Park BizCentral at 81.0% while Eightrium saw slight improvement in occupancy to 89.3% from 88.5% in the previous quarter. Furthermore, renewal at Solaris was the sole contributor to the overall positive 2.7% rental reversion in 3Q2018. Otherwise, rental reversion would have kept to its negative trend. As oppose to a downward drift, we expect rents and occupancy to continue to stabilise going forward.

- **Manageable refinancing risk despite higher aggregate leverage:** Following the additional debt taken up to finance parts of the acquisition of two Australian properties, aggregate leverage inched higher to 39.2% (2Q2018: 37.6%). Taking 50% of the perpetual securities issued in September 2018 as debt, adjusted aggregate leverage is ~42%. With just SGD40mn and SGD18.5mn in loans maturing in 2019 and 2020 respectively and SGD868.6mn unencumbered investment properties (post-acquisition) that can be used as collateral if needed, we think refinancing risk is manageable.

- **Maiden expansion into Australia:** SBREIT completed the acquisition of a commercial building in Canberra that is fully leased to Commonwealth Government of Australia ("14 Mort Street") for AUD58.9mn (~SGD58.9mn) and a poultry processing plant in Adelaide ("Inghams Burton") for AUD62.1mn (~SGD62.1mn) on 5 October 2018. These Australian properties are expected to contribute ~10% of the portfolio income and to make up ~9.5% of the portfolio by asset value. We also expect these properties to boost SBREIT's occupancy rate to ~88.2% as well as weighted average lease to expiry ("WALE") to ~3.9 years in the upcoming quarters.

- **New supply at One-North:** Alice@Mediapolis, located 1km away from SBEIT's crown jewel – Solaris, is expected to commence operations in 4Q2018. It is an 11-storey building with a gross floor area of 39,487 sqm (Solaris GFA: ~51,265 sqm). Although Alice caters more to start-ups and fast-growing ventures, both buildings target similar trade sectors such as Science and Engineering. Given Solaris' is currently fully occupied and has seen a high single digit positive rental reversion in 3Q2018, we think Solaris remains attractive to tenants. That being said, we should not discount the possibility of tenants having a higher bargaining power on renewal lease rates on the back of greater rental supply in the area.

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|---|---|
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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

**Positive ("Pos") –** The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

**Neutral ("N") –** The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

**Negative ("Neg") –** The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings ("IPR") into a 7 point Issuer Profile Score ("IPS") scale.

| IPR | Positive | | Neutral | | | Negative | |
|---|---|---|---|---|---|---|---|
| IPS | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

Explanation of Bond Recommendation

**Overweight ("OW") –** The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

**Neutral ("N") –** The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

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Other

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**Analyst Declaration**

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