Asia Credit Research

Earnings Review: Sabana Shari'ah Compliant Industrial REIT ("SSREIT")

Issuer Profile: Neutral (5)

Ticker: **SSREIT**

Background

Sabana Shari'ah Compliant Industrial REIT ("SSREIT") is an industrial REIT in Singapore, with total assets of ~SGD938mn and a portfolio of 19 properties in Singapore as at 30 September 2018. Vibrant Group and its related parties hold ~10.4% in SSREIT, followed by the e-Shang Redwood Group ("ESR", also the second largest unitholder of ESR-REIT), holding 7.9%.

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Recommendation

- SSREIT's rental income was somewhat weaker q/q, though notably the REIT continues to make good progress in asset divestments which would help reduce aggregate leverage and provide a buffer from asset value corrosion.
- We see 17.5% of rental income at SSREIT's "at-risk" though in our downside scenario, SSREIT's still meets our parameters of Neutral (5) and we are comfortable maintaining it as such. We are Overweight the SSREIT 4.25% '19s (matures in April 2019) and think the pick-up against Hong Fok Corporation's HFCSP 4.75% '19s and Banyan Tree's 4.875% '19s more than compensates for SSREIT's additional risk. We also hold HFCSP and BTHSP at an issuer profile of Neutral (5).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield-to-call/YTM	Spread
SSREIT 4.25% '19s	03/04/2019	38.6%	5.30%	342bps
HFCSP 4.75% '19s	22/03/2019	33.1%	3.48%	161bps
BTHSP 4.875% '19s	03/06/2019	67.7%	4.26%	231bps

Indicative prices as at 19 November 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter
Net gearing for Banyan Tree and Hong Fok

Key Considerations

- **Somewhat weaker q/q:** Gross revenue was down 4.8% y/y to SGD19.9mn in 3Q2018 on the back of lower contribution from certain multi-tenanted properties, negative rental reversions on certain master leases (including Sponsor-related Master Leases) though these were partly offset by higher contribution from 10 Changi South Street 2, 39 Ubi Road 1 and 15 Jalan Kilang Barat. Net property income though saw a larger y/y decrease of 5.7% to SGD12.6mn following higher utilities expenses incurred on multi-tenanted properties which was insufficient to offset the lower impairment losses on trade receivables on the previous master tenants of 1 Tuas Avenue 4 and 6 Woodlands Loop and lower property expenses elsewhere. On a q/q basis though, gross revenue and net property income would have declined 1.1% and 0.5% respectively. We think this is due to the absence of rental from 21 Joo Koon Crescent which has become vacant as at 30 September 2018 (was occupied as at 30 June 2018). In September 2018, SSREIT reached a settlement and has received SGD2.2mn in outstanding rental arrears and late payment charges from its tenant at 10 Changi South Street 2 (6.5% gross revenue contribution in 2Q2018). Going by its receivable days, SSREIT did not face further collection issues in 3Q218 in our view.

- **Financial flexibility lower than Industrial peers though short term refinancing risk is manageable:** As at 30 September 2018, aggregate leverage was 38.6%, slightly higher versus 30 June 2018's aggregate leverage of 38.2%. There are no refinancing due until the SGD100mn SSREIT 4.25% '19s come due in April 2019. While SSREIT's financial flexibility is lower versus other Industrial REITs under our coverage, we note SSREIT's considerable progress in divesting assets where proceeds have been used to reduce debt. Additionally, SSREIT still maintains access to bank debt markets (eg: SSREIT '18s which matured in March 2018 was redeemed by existing bank facilities). While secured debt as a percentage of total debt has increased, as at 30 September 2018, unencumbered assets still stood at SGD239mn, which can go towards raising more secured financing, if need be. Assuming a loan-to-value ratio of 70%, SSREIT can raise ~SGD167mn from these assets.

- **Rejigging of portfolio likely to reduce aggregate leverage:** SSREIT is in the midst of selling another two properties (1 Tuas Avenue 4 and 9 Tai Seng Drive) for SGD110.8mn and the properties have been reclassified as assets held for sale. The sale of 1 Tuas Avenue 4 is below book (revaluation loss of SGD12.3mn recorded in 3Q2018) though SSREIT is expected to record a SGD60mn gain from the sale of 9 Tai Seng Drive, reportedly to Ascendas-Singbridge. The net proceeds from the sale of 9 Tai Seng Drive of SGD98.1mn is targeted to be used for debt repayment while the proceeds from the sale of 1 Tuas Avenue 4 may be used for debt repayment or growth. Assuming SGD98.1mn is used to reduce debt, aggregate leverage may reduce to ~29%.

- **Negative rental reversion from Sponsor Master Leases:** In October 2018, SSREIT had renewed the Master Leases for three of its properties with subsidiaries of Vibrant Group (unrated), its Sponsor. 51 Penjuru Road has been renewed for two years while the other two properties were renewed for one year each. In aggregate, rents on the leases would be SGD11.5mn. When all three Master Leases were renewed last year for a year, the aggregate rent was SGD8.8mn. The renewed leases were signed with a negative rental reversion of 3-4% from last year's rates per company. As at 30 September 2018, by net lettable area, SSREIT faced 25.4% of leases coming due in end-2018. With the signing of the Master Leases with Sponsor (albeit at lower rates), SSREIT is left with only 6.5%, all from multi-tenanted properties, for the rest of the year. We estimate that Sponsor makes up about 11% of SSREIT's rental income. Sponsor is a high yield bond issuer who reported net loss of SGD93.1mn for the financial year ended April 2018. It is also undergoing a special audit at a group of subsidiaries in China.

- **Downside scenario:** EBITDA (based on our calculation which does not include other income and other expenses) was down 5.8% y/y to SGD11.4mn though finance cost had declined even more at SGD3.7mn (down 8.2% y/y). Resultant EBITDA/Interest coverage was held steady at 3.0x versus 3Q2017 despite the fall in EBITDA. On a q/q basis, EBITDA had fallen 0.6%, in line with the q/q fall in net property income. Removing 17.5% of SSREIT's rental income which we deemed to be "at-risk", we find adjusted EBITDA/Interest at 2.5x in the downside scenario. In this scenario, SSREIT's asset base will also take a hit (eg: from the reduction in rents), aggregate leverage may rise back to 35%, factoring in proceeds from asset sales used to repay debt.

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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.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform 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.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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