Asia Credit Research

Earnings Review: VIVA Industrial Trust ("VIT")

Issuer Profile: Neutral (5)

Ticker: **VITSP**

Background

VIVA Industrial Trust ("VIT") is an Industrial REIT in Singapore, with total assets of SGD1.3bn as at 31 March 2018. It currently owns a portfolio of ten properties (inclusive of the hotel at UE BizHub East). VIT is in exclusive negotiations with ESR-REIT ("EREIT") with regards to a proposed merger. EREIT is a separate listed Industrial REIT in Singapore with total assets of SGD1.7bn as at 31 March 2018.

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Recommendation

- VIT posted an increase in gross revenue in 1Q2018, driven by growth from existing properties and full quarter contribution from an acquired property in January 2017. VIT is in the midst of exclusive discussions with its peer, ESR-REIT ("EREIT") on a proposed merger. We think a deal, if it happens, would have a manageable impact to VIT's sole bond (it matures in September 2018). We maintain VIT's issuer profile at Neutral (5).
- We prefer the short-dated VITSP 4.15% '18 over the EREIT 3.5% '18 as it allows a spread pick up of 60 bps and matures two months earlier. In our view, the spread differential more than compensates for the differential in issuer profile. We hold ESR-REIT at an issuer profile of Neutral (4).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage (%)	Ask Yield	Spread
VITSP 4.15% '18	19/09/2018	40.6	2.90%	131
EREIT 3.5% '18	05/11/2018	30.0	2.39%	74

Indicative prices as at 17 May 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter

Key Considerations

- **Increase in gross revenue in 1Q2018:** VIT announced their results for the first quarter 2018. Gross revenue increased 4.8% y/y to SGD28.7mn driven by higher rental contribution from 6 Chin Bee Avenue as well as higher revenue at VIVA Business Park and UE BizHub (both hotel and business park components). These partly offset decline in rents at Jackson Square. Net property income however only increased 3.5% y/y to SGD21.1mn as property expenses at UE BizHub and Jackson Square rose. VIT has a relatively concentrated tenant profile, reflecting that six of its properties and the hotel component of UE BizHub are held under Master Lease agreements. 42% of VIT's gross rental income is attributable to its top 10 tenants. The lease on the hotel component at UE BizHub, which contributes 8.1% to 1Q2018 revenue, is due to expire in November 2018. Nonetheless, per VIT, the Master Lessee is obliged to renew the lease for a second five year term. The renewed lease rates will be on SGD9.7mn p.a (from SGD8.6mn p.a now), representing a 13% increase in lease rates.

- **Interest coverage relatively stable:** EBITDA (based on our calculation which does not include rental support income) was up 3.8% y/y to SGD19.2mn in 1Q2018 while finance expense was 5.8% higher at SGD5.2mn, resulting in a slightly lower EBITDA/interest coverage of 3.67x against 3.74x in 1Q2017. The higher finance expense was driven by a small increase in debt taken to help fund asset enhancement at VIVA Business Park and the acquisition of 6 Chin Bee.

- **Aggregate leverage above median:** As at 31 March 2018, aggregate leverage was 40.6%, slightly higher than the 39.8% as at end-2017. Short term debt relates to the SGD100mn in VIT's sole bond due in September 2018 while cash balance was SGD11.3mn (excluding pledged deposits). With secured debt making up 34% of investment properties, VIT still has some financial flexibility to raise more secured debt if need be and we see refinancing risk as manageable at VIT.

- **Certain properties have short underlying land lease:** At 31 March 2018, investment properties were valued at SGD1.28bn, unchanged from end-2017. Excluding 6 Chin Bee which was purchased in January 2017, the portfolio would have been valued at SGD1.19bn against SGD1.20bn as at 31 December 2016. Among which, revaluation losses were taken at Jackson Square and VIVA Business Park, we think in part due to acceleration of time decay in the underlying land lease (11 years left for Jackson Square and 13 years left for VIVA Business Park). Nonetheless, as at 31 March 2018, VIT's portfolio occupancy was relatively healthy at 91.5% (end-2017: 90.6%) and we saw Jackson Square's occupancy improved to 90% after dipping to 86% in end-2017 as a significant tenant had moved out. Portfolio occupancy had significantly increased from 70.1% at time of IPO in November 2013.

- **Looming lease expiries:** As at 31 March 2018, only 10% of leases by gross rental income at VIT would come due by end-2018. This includes committed leases, assumes that renewal options are not exercise and excludes the impending expiry on the master lease of the hotel portion at UE BizHub. In 1Q2018, VIT managed to renew 61,400 sq ft of space at a positive rental reversion of 2.6%. While this only represents 10% of the space up for renewal in 2018, it is an encouraging sign. While the remaining lease expiries in 2018 looks manageable, 2019 though will see VIT facing large lease expiries (representing 31% of total gross rental income) and 45% of these would come from VIVA Business Park.

- **Proposed merger on-going:** On the proposed merger with ESR-REIT, the exclusivity had been extended to the earlier of (1) execution of definitive agreements or (2) 31 May 2018. An independent financial adviser has also been appointed to advise the independent directors on the proposed transaction. Notwithstanding the successive time extension in exclusivity, we see the probability of deal completion as high and the proposed merger as a credit positive for both VIT and EREIT.

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<tr><th colspan="2"><u>OCBC Global Treasury</u></th></tr>
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Explanation of Issuer Profile Rating / Issuer Profile Score

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 into a 7 point Issuer Profile Score 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.

Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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