Asia Credit Research

Sabana Shari'ah Compliant Industrial REIT: Credit Update

Thursday, 09 March 2017

More than meets the eye

- **We lowered SSREIT'18s and SSREIT'19s to Underweight on 10 January 2017 on the back of downside price risk given the heightened uncertainty over SSREIT's access to equity capital markets and knock-on effect to financial flexibility.**
- **In January 2017, two groups of dissenting (and uncoordinated) unitholders attempted to seek the removal of the current REIT Manager via an Extraordinary General Meeting ("EGM"). In our view, REITs need to have a functioning REIT Manager at all times to continue as a going concern.**
- **As at 3 March 2017, a new significant unitholder has emerged and we see signs pointing towards our upside case happening. In our upside case, we see new shareholders of SSREIT's REIT Manager to emerge in a friendly M&A deal. SSREIT is currently undergoing a Strategic Review in a bid to enhance unitholder value.**
- **Recommendation:** We are raising SSREIT'18s and SSREIT'19s to Neutral. We may raise these sukuks to Overweight should we see further positive development (eg: entry into discussions, receipt of non-binding proposals). We are keeping our Negative issuer profile on SSREIT due to its relatively high leverage against its closest peers.

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Tel: 6349-1886

GT Institutional Sales
Tel: 6349-1810

OCBC Credit Research
Ezien Hoo, CFA
+65 6722 2215
EzienHoo@ocbc.com

- **Background:** On 10 January 2017, we lowered Sabana Shari'ah Compliant Industrial REIT's ("SSREIT") curve to Underweight on the back of expectations that prices on its sukuks may fall as a knock-on effect of events unfolding in its listed units. Two groups of dissenting (and uncoordinated) unitholders had emerged since January 2017. Subsequently on 7 February 2017, one group had officially sent in a requisition letter asking for an Extraordinary General Meeting ("EGM") to be held, in an attempt to seek removal of the current REIT Manager. The date for the EGM has not been firmed up though the REIT Manager has responded to the Singapore Stock Exchange ("SGX") on 17 February 2017 that an EGM per the requisition request will be convened as soon as practicable and a circular is being prepared. SSREIT is undergoing a review of options available for SSREIT to enhance unitholder value ("Strategic Review"). A Strategic Review Committee comprising 3 directors and a financial advisor has been appointed.

SSREIT, incorporated in Singapore, is listed on the SGX with a market cap of SGD479mn (as at 9 March 2017). SSREIT, sponsored by Vibrant Group is an Industrial REIT in Singapore with total assets of SGD1.0bn. The REIT Manager is 51%-indirectly owned by Vibrant Group. Vibrant Group and its related parties hold ~12% in SSREIT. Mr. Tong Jin Quan is the single largest unitholder with 6.2%. On 3 March 2017, e-Shang Redwood (backed by Warburg Pincus, a global private equity firm) has emerged as the second largest unitholder of SSREIT with a 5.0% stake.

Figure 1: SSREIT Sukuk Outstanding

Issue	Maturity	Outstanding Amount (SGD mn)	Ask Price	Ask YTW (%)	I-Spread	Sukuk Rating
SSREIT 4.0%'18	19 March 2018	90.0	99.55	4.51	308	NR/NR/NR
SSREIT 4.25%'19	03 April 2019	100.0	94.03	7.43	572	NR/NR/NR

Note: (1) Indicative prices as at 9 March 2017
(2) SSREIT 4.5%'17 which is a convertible sukuk and not within our official coverage

- **Situation still unfolding but we see signs of our upside case happening:** An upside case for SSREIT's sukuks would be for new shareholders of SSREIT's REIT Manager to emerge via a friendly M&A deal[1]. While this has yet to happen, we think signs are promising. SSREIT has also retained a financial advisor since 24 February 2017 to assist in the Strategic Review, with the financial advisor reporting to the Strategic Review Committee directly. Possible proposals to unlock unitholder value include a potential sale of units/assets of SSREIT, a sale of the REIT Manager and/or sourcing potential strategic partners. We think major unitholders are highly incentivized to see a co-ordinated resolution to preserve value and would accept reasonable proposals put forward by the Strategic Review Committee, together with their financial advisor.

- **Potential start of sector consolidation:** On 3 March 2017, e-Shang Redwood emerged as the second largest individual unitholder of SSREIT with a 5.0% stake. e-Shang Redwood is a leading developer, owner and operator of logistics real estate across Asia. The company was formed as a merger of e-Shang Cayman Ltd and Singapore-headquartered Redwood Group. e-Shang Cayman Ltd, headquartered in Shanghai was founded by private equity firm, Warburg Pincus together with 2 entrepreneurs in 2011 while the Redwood Group was founded in 2006 by Mr. Charles de Portes and Mr. Stuart Gibson, veterans of the Asian logistics sector. Since January 2017, e-Shang Redwood has become the second largest unitholder in Cambridge Industrial REIT ("CREIT") with ~12% stake, behind Mr. Tong Jin Quan (18.5%-stake). e-Shang Redwood also holds an 80%-controlling stake in CREIT's REIT Manager having completed the purchase recently in January 2017. In our view, e-Shang Redwood's interest in the Singapore Industrial REIT space is strategic (rather than purely as a financial investment). We see an eventual consolidation among smaller/medium sized Industrial REITs as a credit positive. A hypothetical situation of CREIT[2] and SSREIT combining (without unduly stressing the capital structure) may result in a REIT with total asset base of SGD2.4bn, leading to a positive re-rating of the combined entity's debt in our view. Aside from e-Shang Redwood, we think SSREIT should be able to attract a number of buyers/strategic partners as it provides an immediately tenantable platform of assets (~SGD1.0bn) which is rare in the industrial sector.

Figure 2: Timeline of key events

Key Event	Timeline
Announces 3 new asset acquisitions amounting to SGD82.3mn (including transaction costs)	Between 08 Dec 2016 and 15 Dec 2016
Announces proposed rights issue	20 Dec 2016
Revolting unitholders starts grouping	11 Jan 2017
Close of rights issue	18 Jan 2017
Sponsor and REIT Manager announces that they are undertaking a strategic review	02 Feb 2017
Proceeds from rights issue partially used to pay down debt and costs, pending deployment for acquisitions	06 Feb 2017
Requisition request to convene EGM sent to REIT Manager; letter represents unitholders holding ~0.6% stake in the REIT	06 Feb 2017
Financial advisor appointed to assist in Strategic Review	24 Feb 2017
One Non-Executive Director who has been with the REIT Manager since November 2010 resigns	27 Feb 2017
e-Shang Redwood emerges as significant unitholder with 5.0% stake in SSREIT	03 Mar 2017

- **Acquisitions announced in December 2016:** One of the stated aims for the acquisitions and rights issue was to strengthen SSREIT's balance sheet and reduce aggregate leverage, which management believes will help cater for any future decline in portfolio valuation. In December 2016, SSREIT entered into (i) agreements to acquire 3 light industrial buildings in Singapore for SGD82.3mn (including transaction costs) and (ii) to sell 218 Pandan Loop which should bring cash inflow of SGD14.8mn by 1Q2017. In our view, the new proposed acquisitions

[1] *Industrial REITs: Sector Update published on 24 February 2017*
[2] *Under CREIT's bond documentation, a reconstruction, amalgamation, reorganisation, merger or consolidation to another member of the Group (CREIT and its subsidiaries) where such event is unlikely to have a material adverse effect on the Issuer and Guarantor or on terms approved by Trustee/bondholders does not constitute and Event of Default ("EoD")*

have been fairly aggressive[3] given the overall sector weakness in Singapore and that SSREIT is also facing ~30% of its total debt due within the next 12 months. One of the proposed acquisitions is an asset currently owned by the Sponsor. The EGM to approve this acquisition has not happened yet.

- **Rights issue crystalizes unitholders revolt:** Among the matters unitholders were concerned about was a fall in share price since the IPO in November 2010 (IPO price of SGD1.05/unit), though SSREIT's rights issue sparked heightened concern. On 20 December 2016, SSREIT announced that it was undertaking a renounceable and underwritten rights issue to raise gross proceeds of ~SGD80.2mn. Net proceeds from the equity raising was intended to partially fund the proposed asset acquisitions by SSREIT. Vibrant Group Limited (the Sponsor), Singapore Enterprises Private Limited (the Sponsor's wholly-owned subsidiary of the Sponsor), the REIT Manager and two controlling shareholders of the Sponsor undertook to fully take up their pro-rata entitlement aggregating ~12.1% of the rights issue. In addition, the Sponsor also committed to subscribe for up to 25.9mn in excess rights units (~8.35% of the total rights issue). Mr. Tong and his related entities did not subscribe to the rights issue, as far as we could observe.

- **Large discount:** The rights issue was offered on the basis of 42 rights units for every 100 existing units (implying a 42% shareholding dilution) for unitholders who did not exercise any of their rights[4]. The rights issue allowed existing unitholders to subscribe for their pro-rata entitlement at an issue price of SGD0.258 per rights unit. The price represented:
  - A discount of ~48.9% to the closing price per unit of SGD0.505 on 19 December 2016
  - A discount of ~40.3% to the theoretical ex-rights price of SGD0.432 per unit

- **Existing unitholders and potential new equity holders would want to preserve value:** As part of the sukuk documentation for SSREIT 4.0%'18s and SSREIT 4.25%'19s, any change in the REIT Manager done in accordance to the Trust Deed (this is a fairly standard clause in Singapore REIT bond documentations)[5] is unlikely to trigger a Dissolution Event. Our base case is that the majority of SSREIT unitholders (by percentage holding) would vote in a manner that preserves the highest valuation for their stake versus putting the REIT into disarray during the eventual EGM. We think it is far likelier for an EGM to happen in conjunction with a proposal put to the table. Per The Edge, the REIT Manager has 60 days to schedule the EGM from the requisition date.[6] We also think that new equity holders are likely to take into consideration the interest of debt holders given the structural reliance of REITs on both the bank debt and debt capital markets. Short term debt due was SGD130.2mn per unaudited financials. This includes a SGD42.4mn outstanding convertible instrument (SSREIT 4.5%'17s). The conversion price of SGD0.8389 makes the instrument highly unlikely to be converted. These would need to be redeemed come September 2017 (unless earlier redeemed due to CoC[7]). As at 31 December 2016, SSREIT has SGD54.7mn in undrawn revolver facilities.

- **Asset coverage sufficient in worst case scenario:** In our worst case scenario, an M&A event leads to SSREIT performing large scale asset sales/ceasing operations/delisting from the SGX without a consent solicitation to seek approval from sukuk holders. Such moves constitute a Dissolution Event and sukuk holders would have to wait for a resolution under a workout situation. The REIT Manager has disclosed that the Sponsor contributes ~17% to net property income ("NPI") as at 31 December 2016. Under a worst case scenario where Sponsor reneges on such rental income (eg: in an unlikely event the situation turns hostile), we infer that up to 20% of SSREIT's asset value may be put at risk. However, this is supported by a large equity buffer (~SGD633mn taking into account of the rights issue and

[3] *For the avoidance of doubt and in so far this credit update is concerned, we are not opining on the valuation of the properties nor the terms of the proposed transactions. We understand that independent valuation reports were prepared in conjunction with the proposed transactions*

[4] *The rights though are renounceable and could be sold during the rights entitlement trading period*

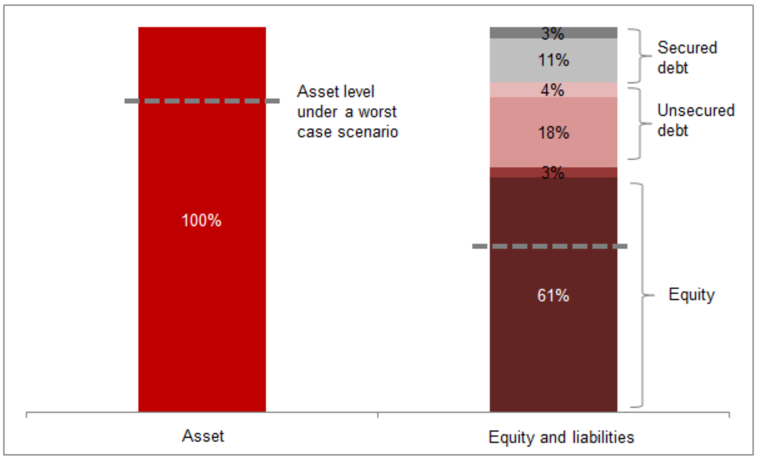
[5] *In the case of bonds, an Event of Default*

[6] *The Edge "New substantial unitholder appears at Sabana REIT" dated 3 March 2017*

[7] *CoC may be triggered should there be a change of shareholding at the REIT Manager or a change in the REIT Manager itself such that Blackwood Investment Pte Ltd ("Blackwood") is no longer the largest shareholder of the REIT Manager and any larger shareholder than Blackwood has more appointed representatives on the board than Blackwood. We do not cover SSREIT 4.5%'17s. There are no Change of Control ("CoC") provisions for the SSREIT4.0%18s and SSREIT4.25%'19s.*

debt paid down in February 2017). Secured debt only makes up 14% of total assets based on our estimation, leaving sufficient asset coverage to unsecured debt holders.

Figure 3: Proforma Capital Structure



Source: OCBC Credit Research updated from FY2016 unaudited financial statements
Note: (1) Adjusted for rights proceeds used to pay down SGD60mn of debt

- **Recommendation:** We are raising SSREIT'18s and SSREIT'19s to Neutral. We may raise these to Overweight should we see further positive development (eg: entry into discussions, receipt of non-binding proposals). We are keeping our Negative issuer profile on SSREIT due to its relatively high leverage against its closest peers.

We have considered the following:

A) Viva Industrial Trust's VITSP'18s are trading at an Ask YTM of 4.09% (spread of 250bps). We think a spread differential between the VITSP'18s and the SSREIT'18s is justified given there is still uncertainty with regards to an outcome from the Strategic Review and to compensate for the lower liquidity of the SSREIT curve
B) SSREIT'19s has the widest spreads compared to bonds issued by Singapore REITs of a similar tenure. We think this would tighten by around 260bps to be in line with SSREIT'18s.

Sabana Shari'ah Compliant Industrial Trust

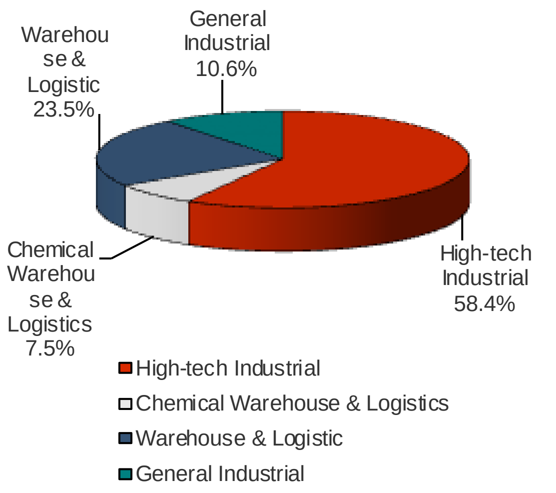
Table 1: Summary Financials

Year Ended 31st Dec	FY2014	FY2015	FY2016
Income Statement (SGD'mn)			
Revenue	100.3	100.8	91.8
EBITDA	66.3	64.8	51.2
EBIT	64.9	64.4	51.2
Gross interest expense	24.6	21.5	21.1
Profit Before Tax	36.9	-73.4	-62.5
Net profit	36.9	-73.4	-62.5
Balance Sheet (SGD'mn)			
Cash and bank deposits	12.3	10.4	9.2
Total assets	1,281.7	1,165.4	1,022.9
Gross debt	478.8	481.1	437.9
Net debt	466.6	470.6	428.7
Shareholders' equity	772.6	653.7	556.8
Total capitalization	1,251.4	1,134.8	994.7
Net capitalization	1,239.1	1,124.4	985.5
Cash Flow (SGD'mn)			
Funds from operations (FFO)	38.3	-73.0	-62.5
* CFO	68.4	70.0	48.7
Capex	1.2	1.5	1.8
Acquisitions	32.5	0.0	0.0
Disposals	0.0	0.0	54.6
Dividends	48.1	50.4	38.7
Free Cash Flow (FCF)	67.2	68.5	46.8
* FCF Adjusted	-13.4	18.2	62.7
Key Ratios			
EBITDA margin (%)	66.0	64.3	55.7
Net margin (%)	36.8	-72.8	-68.0
Gross debt to EBITDA (x)	7.2	7.4	8.6
Net debt to EBITDA (x)	7.0	7.3	8.4
Gross Debt to Equity (x)	0.62	0.74	0.79
Net Debt to Equity (x)	0.60	0.72	0.77
Gross debt/total capitalisation (%)	38.3	42.4	44.0
Net debt/net capitalisation (%)	37.7	41.9	43.5
Cash/current borrowings (x)	0.1	0.1	0.1
EBITDA/Total Interest (x)	2.7	3.0	2.4

Source: Company, OCBC estimates

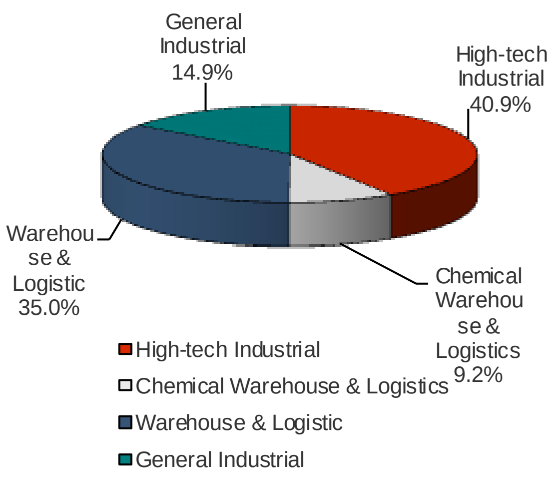
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO before deducting interest expense*

Figure 1: Revenue breakdown by Segment - FY2016



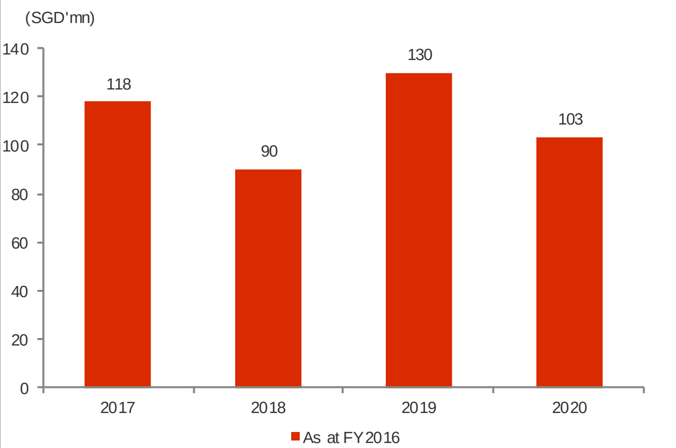
Source: Company

Figure 2: Asset breakdown by Segment - FY2016



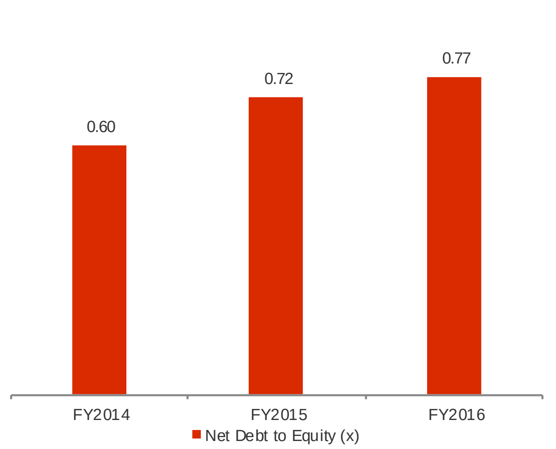
Source: Company

Figure 3: Debt Maturity Profile



*Source: Company | *Excludes transaction expense*

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates