Issuer Profile:
Neutral (4)

Ticker:
EREIT

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ESR-REIT ("EREIT")

Recommendation

- **EREIT saw q/q revenue decrease by 1.6% to SGD63.8mn. Y/y revenue growth is not comparable given that EREIT combined with VIVA Industrial Trust in October 2018. Interest coverage had declined to 3.3x.**
- **Reported aggregate leverage had declined to 39% as at 30 June 2019 (42% as at 31 March 2019) although we expect this to tilt back up to ~41% following its asset enhancement initiatives and purchase of a logistics facility in Singapore via a joint venture.**
- **While EREIT had completed an equity raise and another SGD50mn more to come, this only covers a portion of total funding required. Of note, the joint venture will be assuming debt to acquire the logistics facility. While off-balance sheet, this debt would be counted towards EREIT's reported aggregate leverage.**
- **While 2Q2019 saw an uptick in overall Singapore industrial space sector, we are less positive over the 2H2019 outlook, in particular for the Singapore warehouse sub-segment.**
- **We see Cache Logistics Trust ("CACHE") as EREIT's closest comparable, despite EREIT's larger asset size. We are Overweight the EREIT 3.95% '20s which is trading at an ask yield to maturity of 3.18% (154bps spread) and among the highest yielding short dated high grade bond in the SGD space. We are however, Underweight the EREIT 4.6%-PERP as we see the risk of non-call as higher relative to CACHE 5.5%-PERP, notwithstanding the ~20bps pick-up on a YTC basis. We hold both EREIT and CACHE's issuer profile at Neutral (4).**

Relative Value:

Bond	Maturity / Call date	Aggregate leverage	Ask YTC	Ask YTM	Spread to call
EREIT 3.95% '20	21/05/2020	39.0%	-	3.18%	154bps
EREIT 4.6%-PERP	03/11/2022	39.0%	5.31%	4.50%	376bps
CACHE 5.5%-PERP	01/02/2023	37.9%	5.09%	5.35%	354bps

Indicative prices as at 7 August 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter

Background

- EREIT which invest primarily in industrial assets completed its combination with its peer, VIVA Industrial Trust ("VIVA") in October 2018. VIVA is now held as a sub-trust by EREIT. As at 30 June 2019, EREIT's total asset was SGD3.3bn and is now the fourth largest industrial REIT listed on the Singapore Stock Exchange. All properties are located in Singapore.
- Mr. Tong Jinquan is now EREIT's largest unitholder with a ~32%-stake while ESR, the Sponsor of EREIT is the second largest unitholder with a ~9%- stake. The EREIT REIT Manager is now owned by ESR (67.3%), Mr. Tong (including deemed interests) (25.0%) and Mitsui & Co., Ltd (7.7%).
- ESR currently controls the REIT Manager of Sabana Shari'ah Compliant Industrial REIT ("SSREIT", Issuer profile: Unrated) and is also the single largest unitholder in SSREIT holding a ~20%-stake. Back in 2017, both REITs were in talks though no transaction transpired at that time. As yet though, SSREIT is still a separate REIT to EREIT though we expect further sector consolidation in time.

Key Considerations

- **Q/q fall in revenue:** Given that EREIT had combined with its peer VIVA Industrial Trust ("VIVA") in October 2018, we think y/y comparison is less meaningful. Gross revenue for 2Q2019 was down 1.6% q/q to SGD63.8mn. We think this was driven by lower overall occupancies of 91% in 2Q2019 versus 92% in 1Q2019 (though still above the overall industrial space occupancies of 89.3%) and lower lease rates as indicated by the FY2018 negative rental reversion of -2.9%. While a small property, 31 Kian Teck Way was sold, the sale only occurred on 28 June 2019 and we think the property was sold vacant which should have had a very minimal impact on q/q revenue change. There was no other asset movement q/q. Net property income ("NPI") by 1.7% q/q to SGD63.8mn.

- **Weaker EBITDA/Interest coverage:** EBITDA (based on our calculation which does not include other income and other expenses) was SGD43.3mn in 2Q2019, down 2.6% q/q while interest expense (excluding lease liabilities) was up 2.6% q/q to SGD13.2mn, resulting in a lower EBITDA/Interest coverage of 3.3x (1Q2019: 3.5x). EREIT had SGD150mn in perpetual outstanding as at 30 June 2019. Assuming EREIT pays out distribution in full, this would be SGD6.9mn per year (SGD1.7mn per quarter), taking 50% of this as interest payments, we find EBITDA/(Interest plus 50% distribution) at 3.1x, weakening from 3.2x in 1Q2019. As at 30 June 2019, Hyflux Membrane Manufacturing (S) Pte Ltd ("Hyflux Membrane", a subsidiary of troubled Hyflux Ltd) was still the third largest tenant contributing 3.6% of rental income. While Hyflux Membrane has not defaulted on its rental payment as of March 2019, we consider this income stream "at risk". Removing the contribution from Hyflux, EREIT's EBITDA/Interest coverage ratio will drop to 3.2x.

- **Proposing to buy PTC Logistics Hub in Singapore via a joint venture:** In June 2019, EREIT entered into a partnership with Poh Tiong Choon ("PTC"), a third party logistics. As part of this partnership, EREIT has also entered into a joint venture with PTC to buy PTC Logistic Hub, a ramp-up warehouse located on 48 Pandan Road. EREIT will be holding 49%-stake in the joint venture with PTC holding the remaining 51%. The total acquisition cost which EREIT needs to bear comprising of the equity share, stamp duties and transaction costs is SGD44.4mn, though the joint venture is expected to fund SGD146.2mn of the acquisition with debt assumed at that level. With a 49%-stake, we think EREIT's proportionate debt and asset that will be reflected in reported aggregate leverage would amount to SGD72mn and SGD110mn respectively (65% debt-to-asset funding structure at the joint venture level).

- **Equity fund raising went in part to pay down debt:** In June 2019, EREIT announced its proposed equity fund raising exercise to raise SGD150mn in total via (1) Equity private placement and (2) Non-renounceable preferential offering. Of the total expected gross proceeds of SGD150mn, SGD44.4mn was targeted to fund the 49%-stake in PTC Logistics Hub, SGD45.7mn for asset enhancement initiatives at 7000 Ang Mo Kio Avenue 5 and UE BizHub East, SGD56.8mn to fund the repayment of existing debt with the rest set aside of transaction expenses. On 18 June 2019, EREIT raised SGD100mn via the equity private placement at a relatively large discount of 8.3% to the volume weighted average price on 14 June 2019 although during the quarter a larger amount of debt (net of new borrowings) of SGD86mn was paid down.

- **Aggregate leverage reduced q/q:** Following the debt repayment, as at 30 June 2019, reported aggregate leverage was 39.0%, declining from the 42.0% as at 31 March 2019. Including 50% of the perpetuals as debt, we estimate adjusted aggregate leverage at 41% at 30 June 2019, reducing from the 44% as at 31 March 2019. Short term debt as at 30 June 2019 amounted to SGD178.2mn, including two tranches of SGD bonds coming due in May and April 2020 respectively (collectively SGD160mn), with the remaining relates to a revolver. With short term debt representing only 15% of total debt and all properties remaining unencumbered, we see the refinancing risk as manageable.

- **......though expect this to tilt back up with many moving parts:** Given that the new units from the equity private placement were only issued in end June 2019, we assume that the asset enhancement initiatives ("AEI") have not been paid for while PTC Logistics Hub acquisition had not reached completion. In total, we think EREIT's outstanding obligations were SGD90.1mn as at 30 June 2019 versus cash balance of SGD24.7mn. As of writing, details and timing for the preferential offering has not been provided, though we assume EREIT can successfully raise SGD50mn, being SGD150mn in proposed total equity funding less the SGD100mn raised in the June 2019 equity private placement tranche. Even with

SGD50mn from the preferential offering and increased in asset from the joint venture and AEI, we think EREIT's reported aggregate leverage will tilt back up to ~41%, on the high side within our REIT coverage.

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

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

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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