

21 May 2010

# Industrial REITs

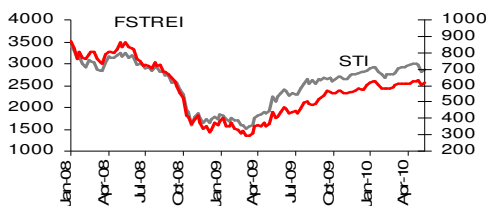
## On stronger footing

**Stronger balance sheets.** The industrial REIT sub-sector is in much a stronger position, in our view, compared to a year ago. REITs including **A-REIT**, **Mapletree Logistics Trust**, **AIMS AMP Capital Industrial REIT** [AAREIT, NOT RATED] and **Cambridge Industrial Trust** [NR] have all raised fresh equity within the past year or so. The sub-sector is on average geared at 33.5% debt-to-assets versus the broader S-REIT average of 30.6%. While the level of debt has decreased generally, there are still pockets of industrial REITs with higher leverage. Leverage levels range from 25% (**Cache Logistics Trust, NR**) to 42.6% (Cambridge).

**Expecting some stability.** The managers for the most part presented a cautiously optimistic outlook going forward - both in terms of a bottoming out of asset values and of rents. This is in line with the expected GDP growth of 7-9% in Singapore this year. Colliers expects the recovery in the exports and manufacturing sector to "support an expansion in demand from manufacturers". This, along with the return of institutional funds, could drive "rents, land and capital values of single-user factories and warehouses [up] to 10 percent in the next 12 months". The demand-supply picture varies by asset type, but we do expect a stable-to-positive year for rents and asset values this year, barring significant shifts in the economic environment

**Big growth plans.** Acquisitions are back on the table with transactions worth S\$1.25b done in the last seven months; we could potentially see MLT, A-REIT and Cache grow their portfolios further. Balance sheet strength and ability to access capital competitively remains the key sticking point. The sub-sector has also indicated a new focus on development projects, which has been A-REIT's domain until now. Asset enhancements and divestments appear to be popular strategies as well.

**Valuation.** In terms of forward yield, industrial REITs trade at a premium of 100 basis points to the broader sector. Interesting, industrial REITs are actually trading at a lower 5% discount-to-book versus 13% for S-REITs on average. There is significant divergence in valuations within the sub-sector: while A-REIT is trading at a 22% premium to book value, on the other extreme, AAREIT trades at a 32% discount to book. We think this is partially because of continued investor caution towards smaller industrial REITs. Nevertheless, if second-tier industrial REITs can present two to three quarters of sustained earnings performance and deliver on their strategic plans, we could see the valuation gap narrow. We have a **NEUTRAL** rating on the broader S-REIT sector.



S-REIT	Analyst	Rating	Fair Value (\$\$)	Current Px (\$\$)
A-REIT	Foo	HOLD	1.85	1.920
MapletreeLog	Kumar	BUY	0.93	0.810
AAREIT		NOT RATED		0.210
Cache		NOT RATED		0.940
Cambridge		NOT RATED		0.500

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At 1Q10 results, we found a few common themes in the guidance given by industrial REIT managers: 1) debt and re-financing; 2) divestments; 3) asset enhancements; 4) acquisitions and 5) development projects. The unifying motivation is how to move forward after a tough year in ways that will both strengthen the REITs and also grow distributable income

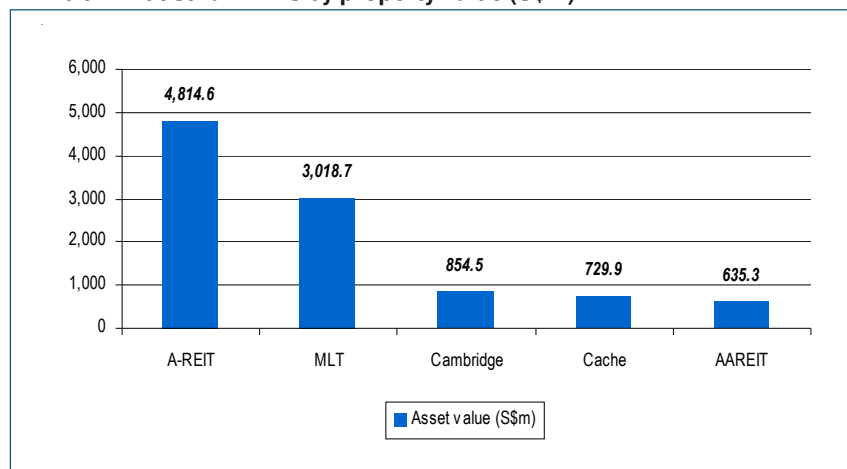
**Exhibit 1: Overview of Industrial REITs**

	A-REIT	AAREIT	Cache	Cambridge	MLT
<b>Affiliation / sponsor</b>	Ascendas	AMP Capital / AIMS Financial	ARA / CWT Ltd	nabInvest / Oxley / Mitsui	Mapletree
<b>Type of assets</b>	Mixed industrial	Mixed industrial	Warehouse / logistics	Mixed industrial	Warehouse / logistics
<b>Number of properties</b>	93 properties	26 properties	6 properties	42 properties	84 properties
<b>Asset value (\$m)</b>	4,814.6	635.3	729.9	854.5	3,018.7
<b>Geography</b>	SG only	SG / JP	SG only	SG only	Pan-Asian (SK, HK, JP, MY, CN, SG)
<b>Exposure to Singapore</b>	100.0%	98.0%	100.0%	100.0%	52.0%
<b>% MTB</b>	54.0%	13.8%	0.0%	5.0%	40.0%
<b>% STB</b>	46.0%	86.2%	100.0%	95.0%	60.0%
<b>Development projects</b>	✓	✗	✗	✗	✗

STB - Single tenanted (inc sale & leaseback / master lease), MTB - Multi tenanted

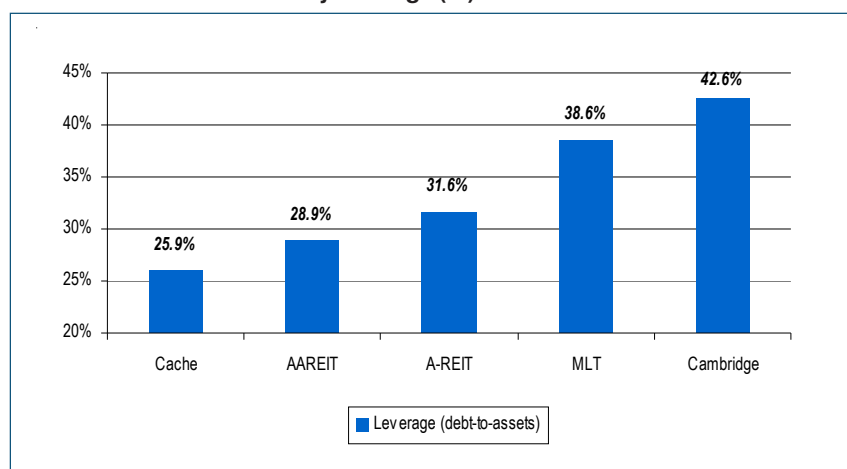
Source: S-REITs, OIR

**Debt and re-financing.** Attitudes on gearing differ based on the size and strength of the REIT: Temasek-backed MLT has stated it is comfortable with its current leverage of 38.6% debt-to-assets and in fact, was one of the REITs to retain a medium term target of 45%. In contrast, the majority of the S-REIT sector has indicated a target range of 30-35% through the cycle. In fact, some of the smaller REITs like Cambridge are still de-leveraging their balance sheets. REITs have been de-leveraging through both equity fundraising and increasingly via asset divestments. Some REITs have also indicated an interest in proactively re-financing loans both to term out loan tenors and also to take advantage of an easing credit environment. With lower margins and a low interest rate environment, there is a potential opportunity to increase distributable income simply by bringing down interest expense.

**Exhibit 2: Industrial REITs by property value (S\$m)**

Source: S-REITs, OIR

**Divestments.** Divestments have become an important part of REIT strategy, both to de-leverage and also to 'refresh the portfolio'. In an effort to bring down its leverage level, Cambridge has fully divested *16 Tuas Avenue 18A* and part of 48 Toh Guan Road, Enterprise Hub (38 out of the 120 strata units) as at 31 March 2010. AAREIT has also signaled its intention to divest some assets, both as a strategic exit out of Japan (where it has only one property) and to refresh its portfolio (it wants to exit a couple of Singapore assets that it believes may under-perform in the medium-to-long term).

**Exhibit 3: Industrial REITs by leverage (%)**

Source: S-REITs, OIR

Note: After funding for acquisition of DBS Asia Hub, A-REIT's leverage will rise to 34%

**Asset enhancements.** The industrial REITs managers also indicated asset enhancement initiatives are being planned. A-REIT has already revealed asset works plans for two of its assets *1 Senoko Avenue* and *10 Toh Guan Road*. Cambridge is also considering asset works and AAREIT indicated that this is a strategy it is considering in the medium term. The primary motivation is to maximize plot ratio, increasing the efficiency of the portfolio (and ultimately, distributable income). Other motivations include redeveloping the property for a different use or catering to specific customer needs.

**Acquisitions.** Cache has sufficient debt headroom to acquire more properties in the next twelve months. A-REIT is also fairly comfortably leveraged (at 34% debt-to-assets after accounting for the *DBS Hub* acquisition). It could also make further acquisitions in the near-term. Cambridge and AAREIT could potentially employ proceeds from asset divestments towards acquisitions, but Cambridge's first priority is likely to be reducing the level of debt on its balance sheet. AAREIT also has a right of first refusal on a Penjurong Lane property owned by AMP Capital.

**Exhibit 4: Recent acquisitions by Industrial REITs**

REIT	Assets	Location	Type	Cost ('000 000)	Vendor	Funding
<b>AAREIT</b>	i) 1A Int'l Business Park ii) 23 Tai Seng Drive iii) 3 Toh Tuck Link iv) 56 Serangoon North Ave 4 v) 30/32 Tuas West Road	Singapore	Mixed industrial	S\$158.8	Sponsor / Third-party	Nov '09 placement proceeds, Dec '09 rights issue proceeds, units & debt
<b>Mapletree</b>	i) 7 Penjurong Close ii) 15 Changi South Street 2 iii) Shonan Centre	Singapore / Japan	Warehouse	S\$145.0	Third-party	Proceeds from Nov '09 private placement & debt
<b>A-REIT</b>	i) DBS Asia Hub at Changi Business Park ii) Light industrial building at Joo Koon iii) Jurong property completed in 2011/ 2012	Singapore	Mixed industrial	S\$228.5	Sponsor / Third-party	Proceeds from Aug '09 private placement (for first two pptys)
<b>Cache</b>	i) CWT Commodity Hub ii) CWT Cold Hub iii) Schenker Megahub iv) C&P Changi Districentre v) Hi-Speed Logistics Centre vi) C&P Changi Districentre 2	Singapore	Warehouse	S\$713.2	Sponsor / Sponsor-affiliated parties	Apr '10 IPO proceeds, units & debt

Source: S-REITs, OIR

Meanwhile, S\$300m worth of assets in Mapletree Logistics Trust's sponsor pipeline are at or nearing completion and the manager indicated that we could expect more acquisition announcements in the coming months. In addition, MLT's sponsor and Itochu Corp (vendor of the recent Japan acquisition) plan to develop logistics projects of approximately US\$300m to US\$500m over the next three to five years. These will also be offered to MLT on a right of first refusal basis. MLT has limited debt headroom (it had hit 45% with less than S\$200m additional debt) and, in our opinion, is likely to employ a debt-equity strategy much as it did with the November placement-cum-acquisitions (which was accretive to unitholders).

**Development projects.** Currently, A-REIT is the only industrial REIT<sup>1</sup> with development projects. S-REITs are allowed to engage in development activities of up to 10% of their asset value. There has been a marked shift in guidance and now MLT, Cambridge, and AAREIT have also expressed an interest in development projects. Development projects carry higher risk but also offer higher returns - they also allow the REIT to create its own pipeline for future acquisitions and to cater to specific client needs. This is likely more of a medium-term goal because of the difficulty in finding the right project and partner. The 10% regulatory limit also requires the REIT to be of sufficient scale to make any project viable. AAREIT and Cambridge would probably have to partner with a developer party (potentially an existing tenant or business partner).

**Exhibit 5: Valuation snapshot**

(S\$)	Last price	Leverage (%)	BVPU 31-Mar	Price to book (x)	FY-1F DPU	YoY %	FY-2F DPU	YoY %	FY-1F yield	FY-2F yield
A-REIT	1.920	31.6%	1.58	1.22	0.138	5.3%	0.145	5.1%	7.2%	7.6%
AAREIT	0.210	28.9%	0.31	0.68	0.020	-61.0%	0.020	0.0%	9.5%	9.5%
Cache	0.940	25.9%	0.87	1.08	0.050	n/a	0.090	35.0%	7.1%	9.6%
Cambridge	0.500	42.6%	0.59	0.85	0.050	-7.4%	0.050	0.0%	10.0%	10.0%
MapletreeLog	0.810	38.6%	0.87	0.93	0.064	6.7%	0.064	0.0%	7.9%	7.9%
<b>Indus Avg</b>		<b>33.5%</b>		<b>0.95</b>		<b>-14.1%</b>		<b>8.0%</b>	<b>8.3%</b>	<b>8.9%</b>
<b>SREIT Avg</b>		<b>30.6%</b>		<b>0.87</b>		<b>-7.0%</b>		<b>7.5%</b>	<b>7.3%</b>	<b>7.7%</b>

We use OIR estimates for A-REIT and MLT, and consensus estimates for rest

After funding for acquisition of DBS Asia Hub, A-REIT's leverage will rise to 34%

Dividend growth and yield estimates are annualized for Cache FY-1

FY-1F is current financial year; FY-2F is next financial year

Source: S-REITs, Bloomberg, OIR and consensus estimates

<sup>1</sup> We exclude Ascendas India Trust [NR] for the purposes of this discussion

**SHAREHOLDING DECLARATION:**

Meenal Kumar's immediate family owns units in:

- Ascott Residence Trust
- Ascendas India Trust
- Indiabulls Properties Invt Trust
- AIMS AMP Cap Industrial REIT
- Saizen REIT

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