

Soilbuild Business Space REIT

NK Ingredients tenancy turns sour



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SINGAPORE | REAL ESTATE (REIT) | UPDATE

9 November 2017

- NK Ingredients fails to top-up insurance guarantee and Trustee has called for the balance of the guarantee
- Negative impact from FY18 onwards
- KTL Offshore could be next to default

What is the news?

The Trustee of Soilbuild Business Space REIT (SBREIT) has called for the \$1.69 mn balance of the NK Ingredients insurance guarantee. The Trustee had previously called for and received \$3.42 mn arising from rental arrears. The tenant then had seven days to top-up the insurance guarantee after it was drawn down on 10 October. The tenant failed to top-up after the Trustee demanded for the top-up on 16 October.

How do we view this?

- **No impact to our FY17e forecast**
The \$1.69 mn balance insurance guarantee is approximately equal to four months of rent and we estimate it to be adequate until January 2018.
- **Likely for the lease to be terminated early**
We believe that to be so, since the Tenant is unable to furnish an insurance guarantee. The existing master lease is actually for 15 years, commencing from the acquisition date on 15 February 2013.
- **Significant impact to portfolio income visibility from FY18e onwards**
On a full year basis, NK Ingredients accounted for 8.9% of portfolio gross rental income (GRI) and 6.8% of net property income (NPI) in FY16. For the most recent 9M17, NK Ingredients contributed 5.9% of portfolio GRI. We believe that marketing of the property at 2 Pioneer Sector 1 will commence soon. Other than impact to the GRI, we expect property expenses to add to the burden for the duration it remains vacant and if the property is converted to a multi-tenancy. We currently assume the property to remain vacant for four months after January 2018. Property valuation at the end of this year could possibly be negatively impacted as well.
- **72 Loyang Way already dragging portfolio down; KTL Offshore could be next**
72 Loyang Way is only 27.0% occupied as at 3Q17, and there is difficulty in back-filling the property. The difficulty arises from not only having to secure a tenant specifically from the Offshore Marine sector, but also requiring up to 148,500 sq ft of space. Meanwhile, KTL Offshore Pte Ltd (tenant at 61 & 71 Tuas Bay Drive), which contributed 5.9%/5.1% of FY16 GRI/NPI, is now in arrears. Its parent company, KTL Global Limited was flagged by its Independent Auditor, doubting the Group's ability to continue as a going concern. More recently, the Group is also reshuffling its top management.

Outlook

The outlook is negative due to multiple tenant defaults in the portfolio – Technics Offshore Engineering, NK Ingredients and KTL Offshore. Income visibility from NK Ingredients has been impaired, and we think there is a high possibility that KTL Offshore could be next.

Maintain Reduce; lower target price of S\$0.61 (previously \$0.64)

No changes to our FY17e estimates, but lowered our FY18e GRI/DPU estimates by 4.4%/7.0% from previous. We would have to make further cuts to our estimates, if a default by KTL Offshore materialises. Our target price represents an implied FY17e P/NAV multiple of 0.86x.

Reduce (Maintain)

LAST CLOSE PRICE	SGD 0.660
FORECAST DIV	SGD 0.056
TARGET PRICE	SGD 0.610
TOTAL RETURN	0.9%

COMPANY DATA

BLOOMBERG CODE:	SBREIT SP
O/S SHARES (MN):	1050
MARKET CAP (USD mn / SGD mn):	509 / 693
52 - WK HI/LO (SGD):	0.74 / 0.63
3M Average Daily T/O (mn):	167

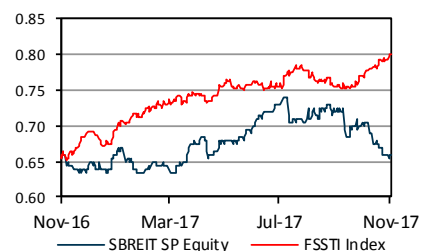
MAJOR SHAREHOLDERS (%)

CHAP HUAT LIM	8.4%
JINQUAN TONG	6.8%
LIM HAN FENG	6.7%
LIM HAN QIN	6.7%
LIM HAN REN	6.7%

PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	(3.8)	(5.2)	9.1
STIRETURN	4.1	3.8	25.4

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY 15	FY 16	FY 17e	FY 18e
Gross Rev. (SGD mn)	79.3	81.1	84.5	79.6
NPI (SGD mn)	67.8	70.7	73.5	66.1
Dist. Inc. (SGD mn)	57.9	60.3	54.8	47.3
P/E (x)	14.1	12.7	13.2	15.5
P/NAV (x)	0.94	0.91	0.93	0.94
DPU (cents)	6.49	6.09	5.59	4.51
Distribution Yield (%)	8.7	9.2	8.5	6.8

Source: Company Data, PSR est.

VALUATION METHOD

DDM (Cost of Equity: 7.9%; Terminal g: 0.5%)

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Relative valuation

SBREIT is relatively undervalued to the peer average P/NAV multiple, and has a higher yield compared to the peer average. We believe the higher yield compared to peers is a reflection of the risk of the portfolio going forward.

Peer relative data (arranged by Mkt. Cap.)

	Mkt. Cap. (S\$ mn)	Price (S\$)	Trailing P/NAV (x)	12M-trailing yield (%)
Ascendas REIT	7,676	2.66	1.25	5.9
Mapletree Industrial Trust	3,723	1.975	1.40	6.4
Viva Industrial Trust	936	0.965	1.23	7.5
AIMS AMP Capital Industrial REIT	906	1.415	1.04	7.5
ESR-REIT	726	0.555	0.88	7.1
Soilbuild Business Space REIT	693	0.660	0.92	8.9
Sabana Shari'ah Compliant REIT	484	0.460	0.81	7.3
Average			1.08	7.2

Source: Bloomberg (Updated: 9 November 2017)

Financials

Statement of Total Return and Distribution Statement

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
Gross revenue	68.1	79.3	81.1	84.5	79.6
Property expenses	(10.8)	(11.6)	(10.5)	(11.0)	(13.5)
Net property income	57.4	67.8	70.7	73.5	66.1
Net Finance (Expense)/Inc.	(9.7)	(12.8)	(13.1)	(14.1)	(15.2)
Manager's fees	(5.5)	(6.4)	(6.0)	(5.9)	(4.7)
Other items	(1.1)	(1.4)	(1.2)	(1.3)	(1.4)
Exceptional items	-	-	-	-	-
Net income	41.2	47.1	50.3	52.2	44.7
FV change, Invmnt. properties	0.9	4.5	(50.9)	-	-
Total Return Before Tax	42.1	51.7	(0.6)	52.2	44.7
Taxation	-	-	-	-	-
Total Return After Tax	42.1	51.7	(0.6)	52.2	44.7
Distribution adjustments	8.1	6.2	60.8	2.6	2.6
Income available for distribution	50.2	57.9	60.3	54.8	47.3
Income distributed	50.2	57.9	60.3	54.8	47.3

Per share data (cents)

Y/E Dec	FY14	FY15	FY16	FY17e	FY18e
NAV	80.0	79.8	72.1	70.7	70.3
EPU	5.09	5.28	5.21	4.99	4.26
DPU	6.19	6.49	6.09	5.59	4.51

Cash Flow

Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
CFO					
Net income	41.2	47.1	50.3	52.2	44.7
Adjustments	16.7	21.8	22.6	15.8	16.1
WC changes	3.4	(0.5)	10.1	1.3	(1.9)
Cash generated from ops	61.3	68.4	83.9	69.4	58.9
Others	(7.4)	(11.4)	(12.6)	(15.8)	(16.1)
Cashflow from ops	53.9	57.1	71.3	53.5	42.8
CFI					
CAPEX, net	(0.2)	(25.5)	(31.9)	(0.5)	(0.5)
Purchase of Inv. Propty.	(94.6)	(98.1)	(103.9)	-	-
Others	-	-	0.0	-	-
Cashflow from investments	(94.8)	(123.6)	(135.7)	(0.5)	(0.5)
CFF					
Share issuance, net	(0.1)	88.6	59.1	-	-
Loans, net of repayments	91.5	29.3	73.3	-	-
Dividends	(49.4)	(55.7)	(58.9)	(61.7)	(48.5)
Others	-	-	-	-	-
Cashflow from financing	41.9	62.3	73.4	(61.7)	(48.5)
Net change in cash	1.0	(4.2)	9.0	(8.7)	(6.2)
Effects of exchange rate	-	-	-	-	-
Ending cash	21.0	16.8	25.7	17.0	10.8

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Balance Sheet

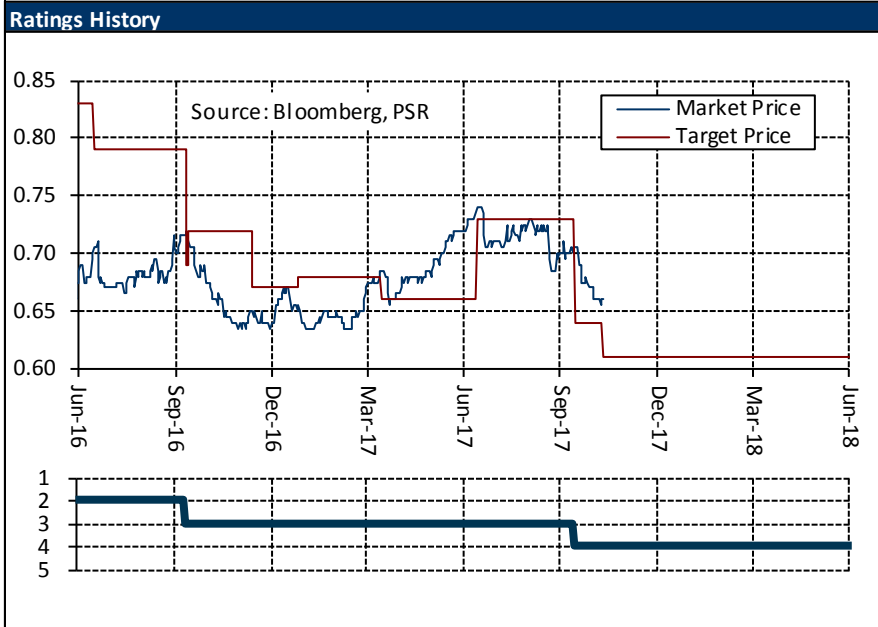
Y/E Dec, SGD mn	FY14	FY15	FY16	FY17e	FY18e
ASSETS					
Investment properties	1,031	1,191	1,244	1,244	1,245
Inv. Propty. Under Devmnt.	-	-	-	-	-
Others	1.0	3.4	0.9	0.9	0.9
Total non-current assets	1,032	1,194	1,245	1,245	1,246
Cash	21.0	16.8	25.7	17.0	10.8
Trade receivables	0.8	2.4	4.3	4.4	4.2
Others	0.5	1.2	0.9	0.9	0.9
Total current assets	22.3	20.4	30.9	22.4	15.9
Total Assets	1,054	1,215	1,275	1,267	1,262
LIABILITIES					
Trade payables	8.7	10.1	12.0	12.4	11.8
Borrowings	95	-	-	145	98
Rental deposits	2.5	2.7	5.4	5.4	5.4
Others	0.1	-	0.2	0.2	0.2
Total current liabilities	106	13	18	163	115
Borrowings	274	399	472	327	375
Rental deposits	23	24	33	34	32
Others	-	33	1	1	1
Total non-current liabilities	297	456	506	362	408
Total Liabilities	403	469	524	525	523
Net assets	651	746	752	742	738
Represented by:					
Unitholders' funds	651	746	752	742	738

Valuation Ratios

Y/E Dec	FY14	FY15	FY16	FY17e	FY18e
P/NAV (x)	0.99	0.94	0.91	0.93	0.94
P/DPU (x)	12.7	11.5	10.8	11.8	14.6
Distribution Yield (%)	7.9	8.7	9.2	8.5	6.8
NPI yield (%)	5.6	6.1	5.8	5.9	5.3

Growth & Margins (%)

	FY14	FY15	FY16	FY17e	FY18e
Growth					
Revenue	16.4%	2.3%	4.2%	-5.8%	
Net property income (NPI)	18.2%	4.3%	4.0%	-10.1%	
Distributable income	15.3%	4.1%	-9.1%	-13.6%	
DPU	4.7%	-6.1%	-8.3%	-19.3%	
Margins					
NPI margin	84.2%	85.4%	87.1%	86.9%	83.0%
Key Ratios					
Net Debt or (Net Cash)	348.0	381.8	446.6	455.3	461.5
Aggregate Leverage	35.0%	32.8%	37.0%	37.3%	37.4%



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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