Singapore Company Guide

IREIT Global

Version 6 | Bloomberg: IREIT SP | Reuters: IREI.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

24 May 2017

HOLD

Last Traded Price (23 May 2017): S$0.755 (**STI :** 3,222.69)
Price Target 12-mth: S$0.75 (-1% downside)

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What's New

- **1Q17 NPI up 3.5%, supported by 10% CPI-linked rental escalation booked at Bonn Campus**
- **1Q17 DPU of 1.44 Scts was down 9% y-o-y on cut in payout ratio to 90%**
- **Expansion of Investment Mandate beyond office to include retail and industrial with new Sponsor on board**

Price Relative

Forecasts and Valuation

FY Dec (EURm)	2015A	2016A	2017F	2018F
Gross Revenue	26.9	34.4	34.9	35.4
Net Property Inc	24.0	30.9	31.3	31.7
Total Return	11.8	30.6	22.5	24.0
Distribution Inc	20.8	25.6	25.9	26.4
EPU (S cts)	3.12	7.70	5.60	5.92
EPU Gth (%)	nm	147	(27)	6
DPU (S cts)	5.24	6.33	5.78	5.77
DPU Gth (%)	nm	21	(9)	0
NAV per shr (S cts)	63.7	64.9	65.2	65.4
PE (X)	24.1	9.8	13.5	12.7
Distribution Yield (%)	6.9	8.4	7.7	7.6
P/NAV (x)	1.2	1.2	1.2	1.2
Aggregate Leverage (%)	42.3	41.4	40.5	39.8
ROAE (%)	5.2	12.0	8.6	9.1
DPU Chng (%):			(9)	(9)
Consensus DPU (S cts):			6.3	6.3
Other Broker Recs:		B: 1	S: 0	H: 1

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

Eyeing Tikehau to pull the trigger

HOLD, TP S$0.75 IREIT Global (IREIT) currently invests in a portfolio of office properties based in Germany. With a weighted average lease expiry (WALE) by gross rental income of around six years, IREIT provides strong cashflow visibility. The strength of its cashflows is also underpinned by its blue chip tenants, such as Allianz, Deutsche Telekom, Deutsche Rentenversicherung Bund and ST Microelectronics. While offering an attractive yield of over 7.5%, uncertainty over the acquisitions to be made by IREIT's new sponsor Tikehau Capital, a European investment manager, will likely cap IREIT's near-term share price performance.

Where we differ. This stock is not widely covered in the market. We are more cautious about IREIT's near-term outlook mainly due to its high gearing of over 40%. Any acquisitions are likely to entail an equity-raising exercise, which may be DPU dilutive in the near term.

Potential for medium term re-rating. With the new mandate for IREIT to invest beyond office sectors to retail and industrial, including logistics, a larger and more diversified portfolio in the medium term may attract more investors resulting in a re-rating of the stock. This re-rating will also gain momentum, once concerns over IREIT's gearing is addressed.

Valuation:

We lowered our payout ratio assumption to 90% from 100%, from FY17F onwards, to reflect Manager's intention to partially pay off debt. Consequently, we cut our FY17-18F DPU forecast by c.10%. TP remains at S$0.75. Maintain HOLD.

Key Risks to Our View:

The key risk to our view is a significant depreciation of EUR versus SGD. For every 0.10 change in the EURSGD FX rate, our DCF valuation changes by 6%. In addition, a weaker-than-expected inflation rate would also delay any increase in rents.

At A Glance

Issued Capital (m shrs)	623
Mkt. Cap (Sm/USm)	470 / 337
Major Shareholders (%)	
Jinquan Tong	55.7
Chap Huat Lim	17.0
Free Float (%)	27.3
3m Avg. Daily Val (US$m)	0.20
ICB Industry : Financials / Real Estate Investment Trusts	

WHAT'S NEW

1Q17 NPI up due to rental uplift at Bonn Campus but DPU dipped

Net property income (NPI) up due to 10% rental escalation booked at Bonn Campus from Dec 2016. 1Q17 Net Property Income (NPI) increased 3.5% y-o-y to €8.8m, mainly attributed to the CPI-linked increase of 10% in the rental income for Bonn campus. Gross revenue declined by 0.4% due to a decrease in service charges income that more than offset the increase in rental income. However, the decrease had no impact on NPI due to a corresponding decrease in recoverable property operating expenses.

Payout ratio dropped to c.90%. While Distributable Income increased by 1.4% y-o-y to €6.5m, distribution paid declined by 8.7% to €5.9m as payout ratio dropped to c.90% from 100%. A lower payout ratio will be the norm going forward as the Management plans to use earnings to partially pay off its debt. We have lowered our payout assumption from 100% to 90% in our model.

DPU missed our previous forecast: 1Q17 DPU in EUR terms decreased by 10.6% y-o-y to €0.93 due an enlarged unit base as a consequence of paying all management fees in units. DPU in SGD declined by 8.9% to 1.44Scts, thanks to favourable FX hedge rate. 1Q17 DPU missed our previous forecast because we assumed a 100% payout ratio before. As we lowered our payout ratio assumption to 90% (partially offset by slightly higher revenues on better than expected run rate in 1Q17), 1Q17 DPU now represents 25.0% of our FY17 full year forecast. We understand that 100% of expected distributable income for FY17 has been hedged at an average rate of S$1.55 per Euro.

High occupancy but potential near-term vacancy: Portfolio occupancy rate stays stable at 99.8% with long WALE of 5.7 years and no material lease expiries till 2022. Deutsche Telekom (Münster) has vacated one out of six floors it currently occupies from 1 April 2017, the property is being converted into a multi-tenant building with the space released, frictional vacancy will be expected in the next few quarters.

Relatively high gearing: Gearing stays around 42%, higher than S-REITs' average of 35%. The REIT also has relatively short debt maturity of 2.6 years as 49% of debt will be due in 2019. Meanwhile, IREIT's effective cost of debt stands at 2.0% per annum with the proportion of debt on fixed rates remaining at 88%.

New CEO post Tikehau's acquisition of manager Since Tikehau Capital acquired the majority stake in the manager of the REIT, IREIT has been undergoing major senior management movements. New CEO Aymeric Thibord came on board on 15 December 2016 after the previous CEO Itzhak Sella's resignation. Mr. Thibord was nominated by Tikehau and was the deputy director at Tikehau from June 2016 and director in fund management at TH Real Estate from Apr 2014 – March 2016. Following its acquisition, Tikehau Capital announced its plans to broaden IREIT's investment mandate to expand beyond office properties to include retail and industrial properties across Europe. Detailed plans are yet to be announced but we believe some major movements may be in the offering given the new CEO's intention to reduce tenant and property concentration risks.

Maintain HOLD due to limited upside from the current portfolio and uncertainty over how Tikehau intends to grow the REIT. Near-term DPU dilution is possible as new acquisition plans are likely to involve equity fund raising due its gearing being above 40%. Forward yield is still attractive at >7.5%.

Quarterly / Interim Income Statement (EUR'm)

FY Dec	1Q2016	4Q2016	1Q2017	% chg yoy	% chg qoq
Gross revenue	8.80	8.58	8.76	(0.4)	2.0
Property expenses	(1.2)	(0.7)	(0.9)	(26.0)	32.6
Net Property Income	7.61	7.92	7.88	3.5	(0.5)
Other Operating expenses	(0.8)	(2.1)	(0.9)	10.0	(59.5)
Other Non Opg (Exp)/Inc	0.41	0.27	0.56	38.6	112.0
Net Interest (Exp)/Inc	(1.0)	(1.0)	(1.0)	(0.6)	(0.4)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	**6.25**	**5.10**	**6.59**	**5.5**	**29.3**
Tax	(0.3)	(1.0)	(0.5)	35.2	(54.3)
Minority Interest	0.0	0.0	0.0	-	-
Net Income after Tax	**5.91**	**4.08**	**6.13**	**3.8**	**50.2**
Total Return	5.83	7.23	6.04	3.6	(16.5)
Non-tax deductible Items	0.58	(0.8)	0.46	(20.4)	nm
Net Inc available for Dist.	6.41	6.39	6.50	1.4	1.8
Ratio (%)					
Net Prop Inc Margin	86.5	92.3	90.0		
Dist. Payout Ratio	100.0	100.0	89.2		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

All eyes on New Sponsor Tikehau Capital to pull the trigger

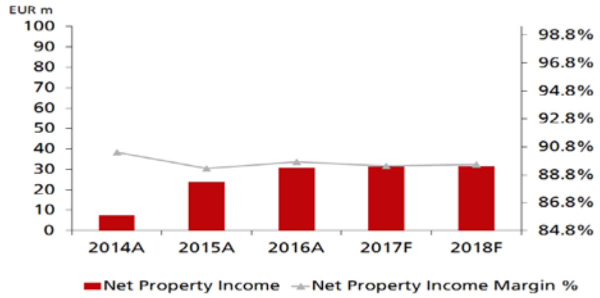
Broadened investment mandate. Post an EGM held on 20 Apr 2017, unitholders of IREIT approved the Manager's proposed investment mandate to grow its portfolio beyond the office sector, into the retail and industrial (including logistics) market segments in Europe. The previous 'ABBA' strategy in office sector investment will no longer apply, instead, the REIT will have the flexibility to explore and investment in more opportunities in other real estate sectors amidst rising competition in the office sector, which will lead to asset and tenant base diversification for the REIT to enhance long-term stable income and ultimately distribution to unitholders.

Healthy real estate market in Europe. The European real estate market remains very strong, reaching €251bn of investment volume in 2016, according to data collected by CBRE, up 5% from 2015 (excluding UK) (Table 1, Chart 1, Appendix). The three core asset classes (office, retail and industrial) in the new investment mandate accounted for about 74% of the total investment volume (Chart 2, Appendix).

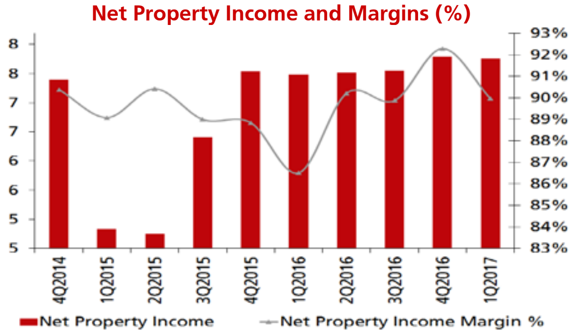
New Sponsor Tikehau Capital signals alignment of interest. Tikehau has a 2.7% stake in IREIT, albeit not significant, it still signals its alignment of interest with unitholders. Tikehau Capital is a pan-European asset management and investment firm who has over €9.9bn in asset under management, out of which, 18% of €1.7bn is invested in real estate that comprises assets across France, Germany and Italy. Its shareholding includes Tamesek's 3.0% stake, the rest of the shareholders are mostly French institutions.

We are cautiously optimistic about the near-term outlook. While expansion is on the horizon, we are cautious because 1) acquisition is likely to result in equity fund raising given the high leverage ratio of 42%, this may lead to DPU dilution, 2) potential cap rate expansion when entering into the industrial space which has been trading on a wider cap rate than office in Europe, which will have a negative impact on valuation, 3) we sense the imminent goal for the new management is diversification and a more holistic focus on total return of a property rather than purely yield, hence the new acquisitions may not be immediately yield accretive, and 4) unlike the Sponsor of most of the other S-REITs, Tikehau Capital is not a property developer. This means in the long run there may not be a readily available ROFR pipeline from the Sponsor to the REIT. Instead, expansion will be relied on acquisitions and the leverage will be on the investment expertise of the Sponsor in deal selections. At the same time, we are optimistic about the fact of the expansion of the investment mandate which will inject new blood to an otherwise very stable portfolio lacking growth potential.

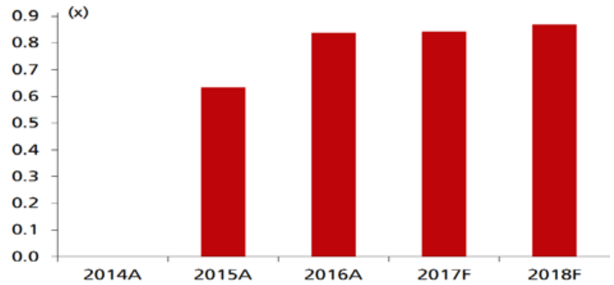
Net Property Income and Margins (%)



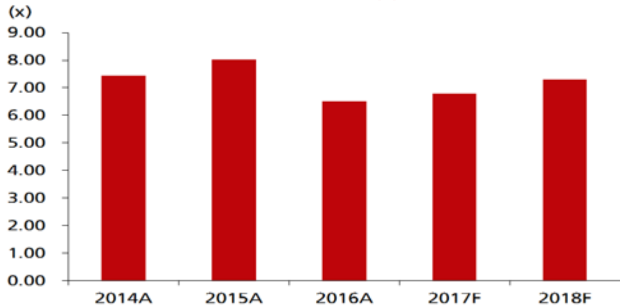
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

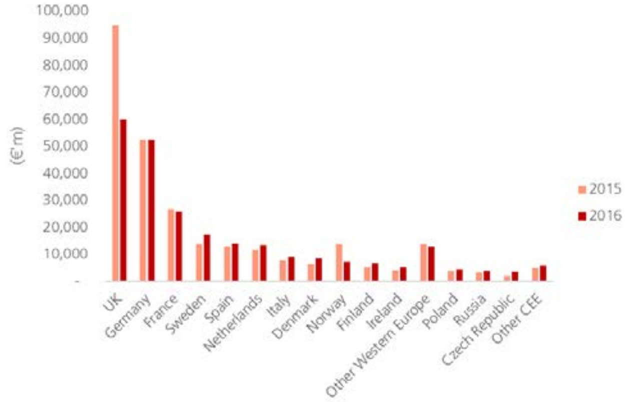
Appendix: EUROPEAN COMMERCIAL REAL ESTATE INVESTMENT MAREKT IN 2016

Table 1: Commercial Real Estate Investment in Europe

	2015	2016	Change
	Investment (€'m)		
UK	94,792	60,170	-37%
Germany	52,580	52,500	0%
France	26,785	25,728	-4%
Sweden	13,662	17,438	28%
Spain	12,899	13,892	8%
Netherlands	11,590	13,544	17%
Italy	8,025	9,087	13%
Denmark	6,387	8,395	31%
Norway	13,702	7,468	-45%
Finland	5,191	6,777	31%
Ireland	4,217	5,269	25%
Other Western Europe	13,755	12,878	-6%
Poland	3,785	4,482	18%
Russia	3,190	3,794	19%
Czech Republic	1,987	3,697	86%
Other CEE	4,903	5,873	20%
Other	2	99	n.m
Europe (excl. UK)	182,660	190,921	5%
Europe	277,452	251,092	-10%

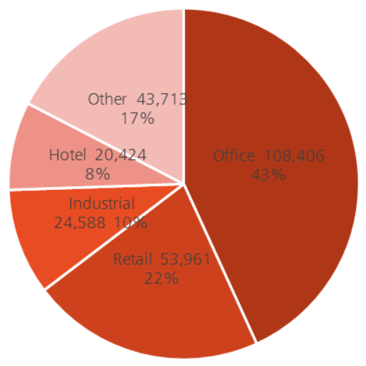
Source: CBRE Research, Q4 2016

Chart 1: Commercial Real Estate Investment in Europe: flat to marginal growth, except in the UK



Source: Company, DBS Bank

Chart 2: Commercial Real Estate Investment in Europe in 2016 – by Sector (€'m)



Source: Company, DBS Bank

Balance Sheet:

Naturally hedged portfolio. IREIT's aggregate gearing stands at around 42%. While its gearing is higher than other S-REITs, this risk is mitigated by the fact that all of IREIT's borrowings are in EUR which is generally lower than SGD-based debt, and acts as a natural hedge to the REIT's assets. In addition, interest rate risk is managed by having c.88% of its borrowings on fixed interest rates.

Share Price Drivers:

Uncertainty arising from IREIT's new sponsor. Tikehau Capital, a European investment manager, recently completed the acquisition of an 80% stake in IREIT's manager and announced plans to broaden IREIT's investment mandate beyond European offices to include retail and industrial properties. Given the lack of details over which asset classes Tikehau Capital plans to focus on and how it intends to grow the REIT given IREIT's already high gearing, we believe IREIT's share price performance will be capped in the near term.

Boost to capital values from negative interest rates. As negative interest rates in Europe incentivise investors to invest in riskier assets, we believe this will lead to further cap rate compression of European properties. As a German property REIT, IREIT is well positioned to capture the expected increase in property values.

Key Risks:

Deflation risk. Should Germany experience another bout of deflation, this may cause a delay a potential rise in rents in the future. This would negatively impact projected distributions going forward.

Interest rates risks. Any increase in interest rates will result in higher interest payments and reduce the income available for distribution, which will result in lower distribution per unit (DPU) for unitholders.

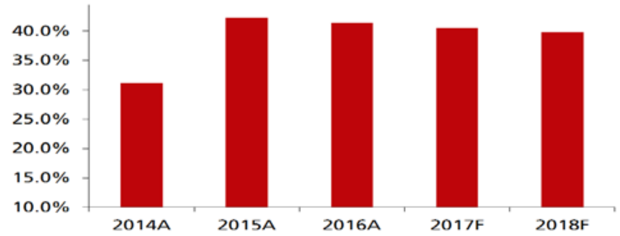
Single-tenant leases. IREIT is reliant on GMG, a wholly owned subsidiary of Deutsche Telekom for c. 60% of gross rental income (GRI). Non-performance by GMG will negatively impact distributions to unitholders.

Changes in tax regime. Any changes in the tax regime could negatively impact IREIT's distributions.

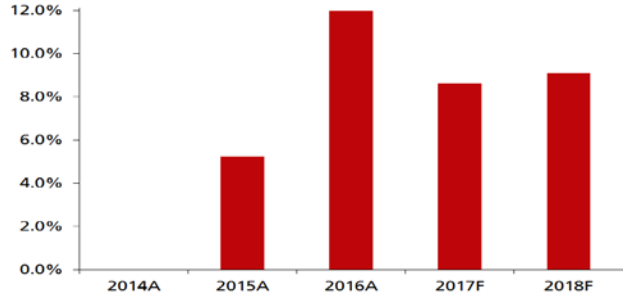
Company Background

IREIT is a Singapore listed REIT established with the investment strategy of principally investing, directly or indirectly, in a portfolio of income-producing real estate in Europe which is used primarily for office, retail and industrial (including logistics) purposes, as well as real estate-related assets.

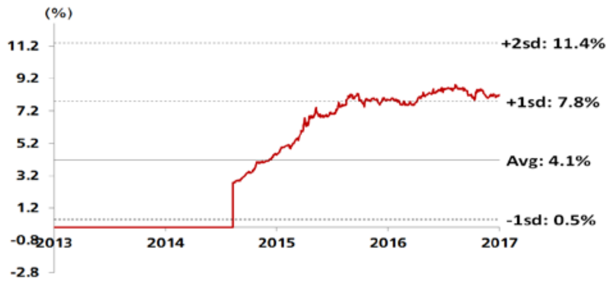
Aggregate Leverage (%)



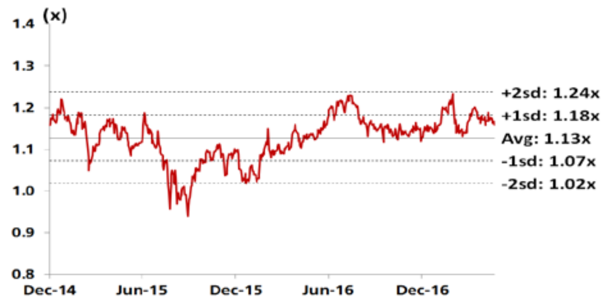
ROE (%)



Distribution Yield (%)



PB Band (x)



Source: Company, DBS Bank

Income Statement (EURm)

FY Dec	2014A	2015A	2016A	2017F	2018F
Gross revenue	8.33	26.9	34.4	34.9	35.4
Property expenses	(0.8)	(2.9)	(3.5)	(3.7)	(3.7)
Net Property Income	**7.53**	**24.0**	**30.9**	**31.3**	**31.7**
Other Operating expenses	(1.6)	(3.0)	(4.8)	(4.9)	(3.9)
Other Non Opg (Exp)/Inc	0.0	(1.0)	0.96	0.0	0.0
Net Interest (Exp)/Inc	(0.8)	(2.6)	(4.0)	(3.9)	(3.8)
Exceptional Gain/(Loss)	(12.4)	(5.2)	11.1	0.0	0.0
Net Income	**(7.3)**	**12.2**	**34.1**	**22.5**	**24.0**
Tax	1.16	(0.4)	(3.5)	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	**(6.2)**	**11.8**	**30.6**	**22.5**	**24.0**
Total Return	(6.2)	11.8	30.6	22.5	24.0
Non-tax deductible Items	0.16	3.72	6.01	3.40	2.40
Net Inc available for Dist.	6.42	20.8	25.6	25.9	26.4
Growth & Ratio					
Revenue Gth (%)	N/A	223.4	27.8	1.6	1.2
N Property Inc Gth (%)	nm	219.3	28.4	1.3	1.3
Net Inc Gth (%)	nm	nm	159.0	(26.5)	6.6
Dist. Payout Ratio (%)	100.0	100.0	100.0	90.0	90.0
Net Prop Inc Margins (%)	90.4	89.2	89.7	89.4	89.5
Net Income Margins (%)	(74.2)	43.9	89.1	64.4	67.9
Dist to revenue (%)	77.1	77.2	74.3	74.1	74.7
Managers & Trustee's fees	19.6	11.1	14.0	13.9	10.9
ROAE (%)	(6.2)	5.2	12.0	8.6	9.1
ROA (%)	(4.0)	3.1	6.5	4.7	5.0
ROCE (%)	4.2	5.8	5.4	6.0	6.4
Int. Cover (x)	7.4	8.0	6.5	6.8	7.3

Source: Company, DBS Bank

Increase in NPI from the acquisition of Berlin Campus and 10% CPI-linked rental escalation at Bonn Campus

Quarterly / Interim Income Statement (EURm)

FY Dec	1Q2016	2Q2016	3Q2016	4Q2016	1Q2017
Gross revenue	8.80	8.48	8.54	8.58	8.76
Property expenses	(1.2)	(0.8)	(0.9)	(0.7)	(0.9)
Net Property Income	7.61	7.65	7.68	7.92	7.88
Other Operating expenses	(0.8)	(0.8)	(1.1)	(2.1)	(0.9)
Other Non Opg (Exp)/Inc	0.41	0.71	(0.4)	0.27	0.56
Net Interest (Exp)/Inc	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	**6.25**	**6.54**	**5.12**	**5.10**	**6.59**
Tax	(0.3)	(1.7)	(0.4)	(1.0)	(0.5)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	**5.91**	**4.85**	**4.70**	**4.08**	**6.13**
Total Return	5.83	13.0	4.60	7.23	6.04
Non-tax deductible Items	0.58	(6.6)	1.74	(0.8)	0.46
Net Inc available for Dist.	6.41	6.41	6.34	6.39	6.50
Growth & Ratio					
Revenue Gth (%)	2	(4)	1	0	2
N Property Inc Gth (%)	(1)	0	0	3	(1)
Net Inc Gth (%)	15	(18)	(3)	(13)	50
Net Prop Inc Margin (%)	86.5	90.2	89.9	92.3	90.0
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	89.2

Balance Sheet (EURm)

FY Dec	2014A	2015A	2016A	2017F	2018F
Investment Properties	291	441	453	454	455
Other LT Assets	1.67	2.30	2.25	2.25	2.25
Cash & ST Invts	12.3	21.2	20.8	19.1	16.6
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	1.97	1.56	1.44	2.33	2.36
Other Current Assets	0.0	0.0	0.09	0.09	0.09
Total Assets	**307**	**466**	**478**	**478**	**476**
ST Debt	0.0	0.0	23.6	23.6	23.6
Creditor	4.53	3.90	2.96	4.62	4.63
Other Current Liab	6.42	12.5	13.0	13.0	13.0
LT Debt	95.4	197	174	170	166
Other LT Liabilities	0.24	1.66	4.07	4.07	4.07
Unit holders' funds	200	251	260	262	265
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**307**	**466**	**478**	**478**	**476**
Non-Cash Wkg. Capital	(9.0)	(14.8)	(14.4)	(15.2)	(15.1)
Net Cash/(Debt)	(83.1)	(176)	(177)	(175)	(173)
Ratio					
Current Ratio (x)	1.3	1.4	0.6	0.5	0.5
Quick Ratio (x)	1.3	1.4	0.6	0.5	0.5
Aggregate Leverage (%)	31.1	42.3	41.4	40.5	39.8
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS Bank

Increase in gearing due to acquisition of Berlin Campus

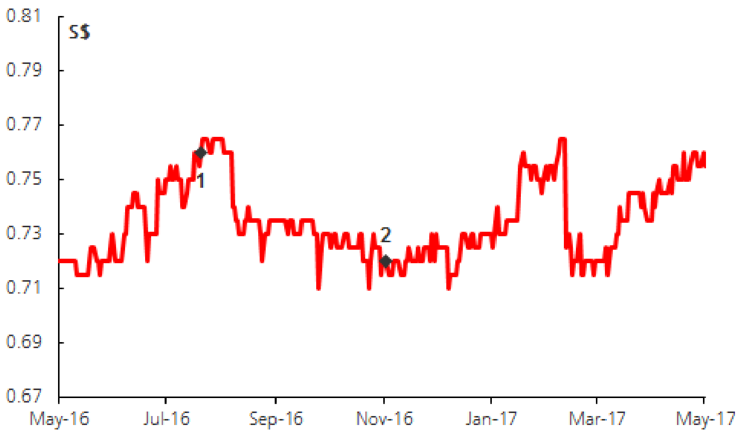
Cash Flow Statement (EURm)

FY Dec	2014A	2015A	2016A	2017F	2018F
Pre-Tax Income	5.10	17.4	23.0	22.5	24.0
Dep. & Amort.	0.0	1.00	1.00	1.00	1.00
Tax Paid	1.16	(0.4)	(3.5)	0.0	0.0
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	7.90	(0.2)	(0.7)	0.76	0.0
Other Operating CF	(6.1)	6.06	9.81	3.40	2.40
Net Operating CF	**8.02**	**23.9**	**29.7**	**27.7**	**27.4**
Net Invt in Properties	(303)	(156)	(0.5)	(1.0)	(1.0)
Other Invts (net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.0	0.0	0.0	0.0	0.0
Net Investing CF	**(303)**	**(156)**	**(0.5)**	**(1.0)**	**(1.0)**
Distribution Paid	0.0	(15.1)	(24.9)	(23.3)	(23.8)
Chg in Gross Debt	95.4	101	0.0	(4.1)	(4.1)
New units issued	212	58.0	0.0	0.0	0.0
Other Financing CF	0.0	(2.2)	(3.7)	0.0	0.0
Net Financing CF	**307**	**142**	**(28.6)**	**(27.4)**	**(27.9)**
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	12.3	9.94	0.59	(0.7)	(1.5)
Operating CFPS (S cts)	0.04	6.36	7.63	6.69	6.76
Free CFPS (S cts)	(95.2)	(34.9)	7.33	6.63	6.51

Acquisition of Berlin Campus

Source: Company, DBS Bank

Target Price & Ratings History



***Note**: Share price and Target price are adjusted for corporate actions.*

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	11 Aug 16	0.76	0.77	HOLD
2:	24 Nov 16	0.72	0.75	HOLD

Source: DBS Bank

Analyst: Singapore Research Team
Mervin SONG CFA

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BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 24 May 2017 10:00:44 (SGT)
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