TRANSCRIPT

Ascendas Reit's 4Q and Full Year FY17/18 Results Analyst and Media Briefing

Venue & Date: Aperia – Edelweiss Room

23 April 2018, 5:30pm

On the Panel:
Mr William Tay, Chief Executive Officer
Mr Manohar Khiatani, Non-Executive Director
Ms Yeow Kit Peng, Head, Capital Markets & Corporate Development
Ms Koo Lee Sze, Chief Financial Officer

Mr Derek Tan, DBS Group Research: Just two questions from me. I'll be happy to hear management's comments on their outlook organically. If we look at rental reversions for this year, are we expecting things to stabilise, turn more positive or are you still seeing some form of pressure and from which segment would that be?

My second question will be on investment outlook - I think the focus last year was on Australia. Singapore has been a bit quiet. Looking at investment opportunities this year, where are you targeting? Thank you.

Mr William Tay: With regards to your first question on the market outlook, with more than 2.8 million sq m of space completing over the next three years and annual absorption of around one million, we are of the view that the market will still be soft despite the improving manufacturing sector. We will look at customer demand, where they are looking at consolidation or even rightsizing, They are capitalising on the current soft market, to relook at their space requirements that may be due over the next one or two years.

I think that gives us an opportunity to reposition as Singapore embarks on attracting R&D and technology-based companies. We may benefit given our strength in the business park and science park space.

The other sector that we are tracking is co-working, its influence on CBD offices and how it may trickle down into the manufacturing. In our conversation with customers, we understand that some early adopters have incorporated co-work/flexible workspace, for example testing out flexible workspace for their corporate services.

The adoption of new technologies to improve productivity and streamline workflow as well as growth of online services are factors that may potentially reduce space demand.

Taking into consideration these trends, I think Kit Peng has mentioned that we are looking at a slight improvement to our rental reversion this year.

In terms of investment outlook, yes, last year we were more active in Australia. We will continue to scale up in Australia as we see opportunities there. However, there is a lot of capital seeking investment opportunities and yields have tightened, which means that we will have to look harder. We like the eastern seaboard and will continue to explore the opportunities there.

But having said that, we have been looking at new markets as well.

Mr Manohar Khiatani: Just to add on, with regard to investment opportunities in Singapore, it has been challenging because Singapore is a very attractive market and there are many players. But the advantage that we have is a very strong sponsor with a pipeline which will be divested to Ascendas Reit over the next few years. Because of that, we are in a fortunate position.

At the same time, we are actively pursuing built-to-suit opportunities. We are very discipline in our approach. We don't want to win something just for the sake of growing the AUM. It must really be something that is in the best interest of Unitholders and gives us DPU accretive returns.

Mr Donald Chua, Merrill Lynch: A couple of questions, so bear with me. The first question is on the more positive outlook on rental reversion. Are there any specific segments within your portfolio that you think have more opportunities for organic growth? Looking at the business and science park rent reversion for this quarter, it is sequentially a bit lower versus last quarter. But the logistics and other segments are doing nicely, so I just want to hear your views on that.

The second question is on interest rates. From some discussions I had with the other REITs, interest cost is starting to rise for some papers that they have been issuing. Are your bankers quoting you higher spreads and what will we be expecting going forward?

Third question is more strategic. As a new CEO, is there anything that you envision yourself doing differently from the previous CEOs and what are the values you will keep and going forward? How are you going to run the company versus your predecessors? Thanks.

Mr William Tay: I'll leave your second question to Kit Peng and I will take your first and your last questions.

We believe that the growing R&D and technology industry will benefit our business parks as well as the high specifications space. That is where we see some opportunities for positives rental reversions.

For logistics space, we expect an overhang from the oversupply and that will put pressure on rents. Overall, on a portfolio basis, we expect to see a slight improvement in rental reversion.

On your last question, I think a REITs is generally a stable businesses and the focus has always been to generate value and returns. My focus for the next few years will be three-fold, in terms of value management, value creation and value add.

Value management is where we want to uphold and improve the franchise value that we have created over the years. By way of proactive asset management, as well as sound leasing strategies and enhancing our customer experience to improve our competitiveness. We will also conduct hold-sell analysis to determine if and when to divest properties to recycle the capital.

On value creation, we believe that there are untapped value in our portfolio that we can unlock. On an asset basis, we will look at how we can transform our properties to suit customers' requirements. There are also opportunities where we can look at redeveloping some of the buildings, incorporate smart technologies and making them future-ready.

On value add, we want to scale up in Singapore. As Mano mentioned, there are still opportunities from the sponsor. At the right time, and if they are yield accretive, we will acquire from the sponsor. We will also scale up in Australia as I mentioned just now and are actively look at new markets. In the past, we only had one or two persons looking at international markets but we have reorganised our investment department into specific teams focusing on Europe and the US. We will be prudent and discipline and consider deals that are yield accretive.

We will be working closely with the sponsor. The sponsor's footprint is currently in Asia Pacific, so there is a common interest to look at new markets.

Ms Yeow Kit Peng: On your question about the interest rate environment, while we were issuing the seven-year bond recently, the market condition was very volatile. We have to negotiate very hard on the spreads and strategise to capture the right moment to issue. We managed to issue the seven-year bond at 70 basis points spread.

Subsequently, the spreads continued to increase. Some indicated spreads of about 85 basis point if we were to issue another seven-year bond.

One strategy is to keep the issue size small, so that when the investors know there is a limited amount of bonds that will be issued, the spread can be tightened. In any case, 72% of our debt is on fixed rates and will help to mitigate the overall increase in interest rates.

Mr Manohar Khiatani: I think William gave a very good vision of his strategy. I just want to add on the final point about working closely with the sponsor. When Ascendas Reit made its foray into Australia two and a half years ago, it was a portfolio of about S$1 billion and it was a very attractive portfolio. Ascendas Reit worked very closely with the sponsor, and it was only because of that that the acquisition was made possible. The sponsor put in about $60 million and it has turned out to be a very good move as you all can see. Now with the Australian portfolio growing and stabilising, I believe it gives us the confidence to look at other new opportunities that may arise. As William has mentioned, we will be very discipline and we will only invest if it is in the long-term interest of the REIT.

Mr David Lum, Daiwa Capital Markets Singapore: Two questions. First, can you explain again the 19% negative rental reversion in the high specs space? You mentioned something about a showroom, and if you exclude that lease, rental reversion would have been positive 2.4% (total portfolio full year). Can you give us an idea of how much showroom space was renewed?

The second question is, to what extend did the weaker Australian dollar affect your DPU?

Mr William Tay: You are right, the showroom space is about 40% of the renewed space in the high-specs segment during the fourth quarter. On full year portfolio basis, it is only about 3% of area renewed. Generally, retail space is under some pressure and the showroom space is quite similar to retail. The rental that we signed is actually much higher than surrounding comparables. If you strip that lease out, the high-specs segment will show a 1.3% positive rental reversion in the 4th quarter.

Ms Koo Lee Sze: With regards to the exchange rate, we forward hedge our Australian distribution, so there is not much impact.

Mr David Lum, Daiwa Capital Markets Singapore: Will there be an impact this year?

Ms Yeow Kit Peng: Currently, the Australian dollar to Singapore dollar is hovering at around A$1:S$1.01 to S$1.02. We will continue to hedge our cash flow one year forward to smoothen currency volatility, if any.

Ms Tan Xuan, CLSA: Two questions as well. Firstly on new markets, can you share what are some of the markets that you are looking at more closely? And also, for William, on the 3 key focus areas that you mentioned, can you provide some quantitative KPIs that you will be looking at to assess how you are doing in each area? Thank you.

Mr William Tay: We are looking at Europe and US markets. The interest would probably be more towards Europe at this point. But this is not conclusive until we conduct more in-depth study into the opportunities available in those markets. We see that US has depth in the market and there are much more deals. But we like Europe given that it has a similar risk profile, and also the returns are generally similar to the investments we have made so far.

As for your next question on KPIs, we have started to look at 7 buildings where we see opportunities for redevelopment and repositioning. I hope that address the questions you have. The value adding focus has been covered under the key markets that we want to enter.

Mr Tan Cheng Wee from SooChow CSSD Capital Markets: Just a follow-up question on new markets. William, given you have a strong track record in Southeast

Asia, will that also be a new market that you are looking to enter? And, regarding redevelopment, what proportion of the portfolio do you think has redevelopment opportunity?

And a specific question on 108 Wickham Street. I notice that the acquisition yield is tighter than the earlier suburban office acquisition. Can we understand more on the transaction? Thank you.

Mr William Tay: Yes, I have experience in South East Asia, but the risk profiles are very different from what Ascendas Reit is looking at. So for now, I don't think we will look at South East Asia.

I do not have the answer to the size of the redevelopment opportunities in the portfolio. But these are assets that are in good locations. Today their specifications may not do so well in capturing the new demand, so we are looking at redeveloping such assets. For example, in logistics, where there's an opportunity, we will look at increasing plot ratio and creating ramp up facilities. We can also look at repositioning some assets located near the MRT, to align with the new master plan and Singapore's landscape.

Mr Manohar Khiatani: If you look at Science Park, for example DNV/DSO was acquired by Ascendas Reit last year from the sponsor. Those were redeveloped assets. After redevelopment, the value has gone up. These are the kind of opportunities William was referring to.

Mr William Tay: You mentioned that the yield is tighter for 108 Wickham Street compared to 100 Wickham Street. I would say that the team had very good foresight then. Soon after we entered the Brisbane suburban market with the acquisition of 100 Wickham Street, the yield tightened further as seen in the yield for 108 Wickham Street.

Ms Goola Warden, The Edge: Just a couple of questions. One is how can incorporating smart technology and future proofing your buildings lead back to an increase in DPU? The second one is about the trend of cap rates versus the trend of rising interest rates. How do you think that would feed back to your cap rates or your discount rates when you value your properties?

Mr William Tay: Incorporating technology is part and parcel of our redevelopment plans. Our buildings can be rejuvenated, incorporating new technologies to create value for customers as well as riding on new technologies in PropTech, where we can look at lowering operation expenses (opex).

In fact, this weekend we are hosting a Hackathon in Science Park 2, where there are Singapore and regional teams coming to pitch their solutions to property related problems. The sponsor has an innovation fund that we can tap on if we invest into some of these ideas. We have also allowed the use of Science Park 2 as a pilot site for testing of new ideas. These are areas in which we can look at technologies, both on a new build and opex sides.

Ms Yeow Kit Peng: On interest rates vs. capitalisation rates. In Australia, we noticed there are some compression in the cap rates that the valuers adopted for this round of valuation. It is roughly 25 basis points. In Singapore, it is not so apparent and it could be because we change valuers every two years. What we are able to observe is that better occupancies and rental rates resulted in higher valuations for some of our buildings.

Mr Manohar Khiatani: Certainly interest rates play a part in how the valuer determine the cap rates. Normally if interest rates go up, the cap rate should go up. But it is not a linear co-relation.

Mr Yeo Zhi Bin, CIMB: Three questions from me. First, about 14% of rental income will be due for expiry, could you give a split between Singapore and Australia? Second question, I noticed that a lot of Brisbane leases are coming up for renewal in the next 12 months, and that the rental index in Brisbane has been coming down. Could we expect some rather sharp negative rental reversion from these leases? And the third question, just wondering in the next 12 months, could we see the diversification into the new markets which you spoke of? Or is this is a 2-3 years kind of a mid-term plan. Thanks.

Mr William Tay: Singapore is about 84% and Australia is about 6% out of that 14% due for renewal. Yes, a number of leases are up for renewal in Brisbane, but there are good demand drivers. Firstly coming from inter-state migration, second is the improving state economy. In the worst case scenario, assuming that we can't renew all the Brisbane leases, the impact is about 2-3% of Australia gross revenue.

On your next question, I won't give a specific time line. We hope to deliver something within the next 12-18 months but, don't hold me to that. We will look at the deals prudently and make sure that it's actually yield accretive to the Trust.

Mr Manohar Khiatani: The board has not set any timeline for going into new markets. I reiterate, that we will only want to do deals that make sense and which is in a longer term interest. There is absolutely no pressure on the team. We only do it if it make sense and I wanted to make that point quite clear.

Mr Nicholas Teh, Credit Suisse: Can you remind us if you have any ROI target in terms of the redevelopment? Also, just looking at one of the newer AEI that you announced, is this a trend where more tenants are demanding services and amenities like the gym, for example. When you do things like that, are you trying to bring up occupancy or is there a certain uplift in rents that you can achieve?

Mr William Tay: What we have achieved in the past is above 7% and we hope to achieve this when we look at redevelopment. When we embark on AEIs, one of the areas we look at it to provide an environment that is attractive to our customers so that they will stay with us. Whilst post AEI occupancy has generally been holding up well, we don't see so much impact on rents. Rents is more dependent on the market.

Mr Donald Chua, Merrill Lynch: Can we understand more on the guiding principle of going to overseas? Is it more strategic or more opportunistic? i.e. are you going to buy a platform if you go overseas, or are you willing to do piecemeal deals as well. You were mentioning about your sponsor a lot just now. Will these deals be sponsor led or will you invest without involving the sponsor? And is there a capital allocation target between Singapore and overseas for the next 5 years? Thanks.

Mr William Tay: For new markets, we want to look at sizable portfolios. One key criteria we are looking at is scalability. We must be able to scale up in the location that we've picked. Just like in Australia, we first entered via a $1 billion portfolio acquisition and we have scaled up to $1.5 billion within two years. Similarly in new markets, we do not want to do just one portfolio deal and just stop.

Yes, we are definitely looking at platforms but I guess all of us know the platform deals may not necessary be very attractive. One possibility is for the sponsor to take a stake in the platform, build up a pipeline of properties and grow together with us in the same market. It is almost similar to the Singapore market where the sponsor has been able to support us with pipeline since our IPO.

On your next question on capital allocation, we still want to be a Singapore-focused REIT so overseas allocation will probably be around 30% – 40%.

Mr Andy Wong, OCBC: A couple of questions. Firstly, in terms of Europe and US, what kind of acquisition cap rates would be meaningful to you? Secondly, do you have a rough sense, in terms of industrial investment in Australia, what is the breakdown between local and overseas companies? Just want to get a sense of how much the locals have invested in the market last year. Thanks.

Mr William Tay: In the US, suburban office cap rates are similar to Singapore and Australia. Yields for other asset classes have compressed quite a fair bit. In Europe, there are more opportunities in different assets classes and logistics, suburban office and business park sectors remain attractive to us. In Australia over the past year, there were more transactions by local players but the share of offshore buyers has been increasing.

Mr Manohar Khiatani: Maybe we can take have the last few questions?

Mr Vijay Natarajan, RHB: Considering the continual capital rate compression as well as large amounts of capital chasing in this market, would you be considering being more active in divestments going forward? What kind of divestment target do you have for the next few years? Also can you provide a target on acquisition investment for the next one to two years?

Mr William Tay: We will assess the performance of our assets in our portfolio and we will not divest just because of the cap rate compression. Considerations include how these assets fit into the portfolio as well as whether the underlying asset has longer term opportunity for growth or whether land tenure is running low. On your second question, as I mentioned just now, we still have a billion dollars of debt headroom and that's fairly big for us right now.

Mr William Tay: Any last question?

Ms Tan Xuan, CLSA: Hi I just have a very quick question on yield accretion. Should we be expecting that on the first year of acquisition? Or are you looking at a longer term say 3 years view.

Mr William Tay: Generally it will have to make sense to the portfolio. We are looking at longer term benefits to the Trust.

Thank you so much for coming.

\- END -