TRANSCRIPT

Ascendas Reit's 2Q FY2019 Results Analyst and Media Briefing

Venue & Date: Big Picture Auditorium, Capital Tower, Singapore
1 November 2019, Friday

On the Panel:
Mr William Tay, Chief Executive Officer
Ms Yeow Kit Peng, Head, Capital Markets & Investor Relations
Mr Lawden Tan, Head, Investment and Business Development
Ms Koo Lee Sze, Chief Financial Officer

Mr Mervin Song, JP Morgan: Just curious why you take the rights issue route rather than placement this year. In terms of the occupancy, I noticed some of the US properties are running quite low this year, what's the reason for that and how quickly you can improve the occupancy from here? That's it from me for now.

Mr William Tay: Thanks Mervin. Thetarget equity fund raisingis S$1.3 billion. It is not a small size, and it's likely to be the largest in the S-REITs space. We also wanted to take this opportunity to thank the unitholders who have supported us all these time. So which is why we are opening this opportunity to all existing unitholders. In terms of pricing of the rights, it is a 17% discount to last close price and 15% discount to TERP (theoretical ex-right price). This is really quite a good price for any unitholder who think they would like to continue with us in this journey.

The other point about occupancy. If you look at the market vacancies across the three cities, we are either in line, or lower than the market. Construction costs is quite high in the US, which is why there is a preference towards build-to-suit or pre-committed space requirement. Which means that speculative space supply will be limited. We are confident that we can lease out more space because now we actually have a team on the ground. In fact, when Ascendas-Singbridge bought over the portfolio, they have already done very well in terms of proactive asset management. They have completed some AEI and also have moved some tenants to create space for new demands.

We will be proactive asset managers and will continuously enhance the asset performance.

Mr Derek Tan, DBS Vickers: Just a follow-up question to understand the US portfolio a bit more. Could you give us a sense of how the performance been since Ascendas-Singbridge bought over the portfolio. Apart from rental escalations, what kind of reversions have you been able to achieve. Going forward, what are your in-place rents vs. the market?

Mr William Tay: More than 80% of the leases have a built-in fixed escalation of 2.5% to 4%, so the existing leases would have had a 2.5% to 4% increase in rentals from last year till now. This is a very healthy cash flow visibility for us. Most of the properties in our markets have market rents that are much higher than the passing rent, so we believe we can benefit from higher rents at renewals.

Mr Derek Tan: And could you also give us some comfort on the major tenants in the US? I think it will be in the top ten right? How long is the lease for that particular tenant? And in the event that they decide to scale back on space, what are your back-up plans for that?

Mr Lawden Tan: Our largest tenant is CareFusion. If you look at it as a portfolio per se, the lease expiry profile is pretty evenly spread out. I think that is more important, so we are not so concerned about CareFusion's lease. Coupled with fact that many of tenants are signed at rents below market rent, there is potential for positive rental uplift.

Mr William Tay: Just to add on, CareFusion will become one of our top ten at the Trust level. It will contribute 1.3% of gross revenue to the Trust and 14% to the US portfolio. We do recognise that it is a large space. They have two lease renewals coming up. We expect them to renew because they have been there since day one as the properties are built-to-suits. to move. The rest of the top ten US tenants have been in the properties between seven to ten years. Some of the top tenants have expanded two to three times within this portfolio. So it does show that they do like the space. Whenever there is a need for space, priority will be given to these tenants, because of economies of scale and easier management.

Mr Donald Chua, Bank of America-Merrill Lynch: I have a couple of questions. First, is on the acquisition of the US portfolio, besides diversification and the mandate of Ascendas Reit being able to go to the US, how should we think of the synergies of having a UK portfolio, Australia portfolio, US portfolio and Singapore portfolio? And going forward as well.

And second question is, in terms of acquisitions going forward from here, where would the offshore focus be on? Given that US is a new market for Ascendas Reit, will you be looking to concentrate more on the US or go back to the UK or Australia?

Third question is on the portfolio appraised value. Could you remind us how much the appraised value increased post the last evaluation from CapitaLand, post the merger?

And lastly is on CAPEX, what kind of maintenance CAPEX will we be expecting from this portfolio going forward? Thanks.

Mr William Tay: In terms of diversification, that's a very good question. We do ask ourselves if should we be looking at it from the customer's angle, in other words follow the customer where they go. But if you look at that, we actually like the idea of being part of a larger group. This customer can be with the REIT in the US, Australia, and UK, while we are able to offer them solutions across the larger platform, whether is it China, South East Asia or other countries that CapitaLand is in. I think that is one key advantage that we like to believe that we can offer to our customers. Within this portfolio per se, there are some synergies in a sense that we are meeting customers who also are our tenants in Australia. For example Northrop Grumman are with us in US as well as in Australia.

If you look at our diversification strategy, we have been investing into the assets that is supporting the drivers of each economy. In Singapore, we are knowledge-based focused, which is why we like the Business Park space. When we invested into logistics assets in Australia, it was due to e-commerce and strong domestic demand. When we went to UK, it was also due to e-commerce. Its e-commerce penetration is one of the highest in the world which is why we like the logistics space in the UK. We are now investing into the US and again technology is a big player and contributor to the US GDP, which is why we like the tech cities. So we are not going to diversify into different asset class just to spread the basket. There is a thesis behind our strategy, which is looking at the asset class that is supporting the drivers of the economy.

I was looking around the room and everybody is with a handphone. The future of work is really around technology, and the growth of technology contribution in the US is huge. We like each of these cities because whilst tech is a strong contributor to the GDP growth, the living costs are still very affordable. This is why these cities have become very conducive grounds for tech workers to live and work.

On the point of the offshore focus, we continue to like these few countries. The first time when I met all of you, I did mention about reorganising the team to focus on Europe and the US. So we have been looking at the US market for a while, and when this opportunity came, we did express our interest to have a chance to look at these assets.

On the portfolio appraised value disclosed by CapitaLand, i think that it is not appropriate for me to comment as it was part of a larger transaction which is ASB, the platform that they were buying over.

And on the CAPEX, we have set aside about US$10 million over the next three years.

Mr Lawden Tan: I want to add that more than 60% of our lease are actually triple net, which means that insurance, tax and property expenses are borne by the tenants.

Mr Terence Khi , JP Morgan: Just wanted to ask on financing and debt. I see that you are taking about $400 million of debt for this acquisition. What is the funding costs? And I also saw on the slides that you are looking to fully naturally hedge the acquisition, so would this funding cost also be extended for the rest of the USD debt and will it be onshore or offshore debt?

Ms Yeow Kit Peng, Head, Capital Markets & Investor Relations: We will have a combination of onshore as well as offshore debt in USD. Pricing for the onshore loans is very competitive. Based on current base rates, we expect the 5-year unsecured loan to be under 3%. Yes, we plan to achieve a high level of natural hedge by funding the USD assets with USD liabilities to minimize any adverse currency volatility. This is consistent with our investments in Australia and UK.
What is the effective tax for the US portfolio?

Ms Yeow Kit Peng: It will be in the single digit area. This is achieved through on-shore interest and tax allowances on depreciation.

Mr David Lum, Daiwa Institute of Research: I assume that this is a related party transaction and you and the Sponsor agreed on the price for the US portfolio. If the Sponsor were to put it down in the open market for competitive bidding, how much would it have fetched if they decide to do that? I am not going to hold you to it.

Mr William Tay: We are acquiring the US properties at around 0.8% to 2% discount to the independent valuations.

Mr Kok Wai Fai, UBS Securities: Just going back to the valuation question, it appears that the US REIT has been buying US office buildings which is Class A at above 7%. What are your thoughts on your entry yield as compared to these assets? And is that the case in the US that Business Parks are generally more expensive than office assets?

That's my first question and secondly on portfolio occupancy, it is only at 93% to 94%, so do you see any immediate low hanging fruit, say in Portland, and what should we be expecting moving into next year? Thank you.

Mr William Tay: US is a very big market. Even in the cities that we are invested in, we have seen yields ranging from 6% to 7.5%. I am not even surprised that some assets in the CBD locations also have a very wide range, depending on its specs, size, quality of its tenants, WALE etc. We are definitely within the range that the property consultants have assessed.

We have also observed that cap rates in other tech cities are within our range, which means that this is a scalable market for us.

And on the point about occupancy in Portland, you are right, there will be some low-hanging fruits which the asset management team is looking at. There is generally good demand Portland is also a place where there is a migration of technology companies because it is one of the cheaper location for technology companies. We have visited that place and we have seen tenants who told us that they moved there because it is easier to find workers. There is also a large research community and the companies are expanding. For the past one year, our asset managers have been able to fill some of the vacant space.

Mr Michael Lim, UBS Securities: I have two questions. The first one being, if you look at the expiries for 2020, you have got single-users as well as multi-tenanted, can you just give us a sense of which of the leases are coming up particularly for singleuser and whether there is any concentration for the multi-tenanted? And my second question is on the underlying rent for the portfolio, you mentioned that it is still below the market, can you just give us a sense of how much below, in terms of the number?

Mr William Tay: In 2020, that's the CareFusion lease that I mentioned. That is just one of their leases. They do have other space with us that is expiring beyond 2020.

And on the point about underlying rents compared to market rents, there is a huge range. We have leases that are under rented by between 10% to 50%. That is a huge range.

Mr Michael Lim: What is the blended number?

Mr William Tay: About 10% to 15%.

Mr Nicholas Teh, Credit Suisse: Hi, Nicholas from Credit Suisse. Just wanted to ask on the USD debt, how does that compare to the kind of rates you giving on your current SGD debt? And also in terms of the percentage overseas, the amount has been increasing over the years but just wanted to understand in the longer term, is there sort of a level that you wouldn't want your Singapore portfolio to drop down below, say, if it comes down to below 50%?

Mr William Tay: I will take your second question and let Kit Peng take your first. We have guided in the past that about 30% will be overseas. Now with this acquisition we have come up to 28%. So 30% to 40% seems like what we are able to look at in the near to mid-term. If there is no further Singapore acquisition, and if you are looking at just acquiring overseas, that is another $2.5 billion of acquisition, just to bring it up to 40%. Not forgetting that the sponsor still has more than $1 billion worth of Singapore assets on their balance sheet, wo the Singapore pie will continue to grow. This is a comfortable level that we think is good for us to manage.

Since I came on board, there were a lot of opportunities in the UK and US but we decided to enter the UK first last year. Why? Because it was a logistics platform, which requires less asset management attention. The portfolio has a very long WALE, a lot of triple net leases, so it is easier for us to manage. At the same time we could then scale up our people on the ground to manage those properties.

The timing to enter into the US is very right for us because the Sponsor has established about 12 to 14 people on the ground to manage these assets since their acquisition a year ago. We are very comfortable with the experience that they have gathered over the past one year and it will be good for us as we onboard these US assets into A-REIT.

Ms Yeow Kit Peng: Given our A3 credit rating and the good qualities of the properties in the US, we were able to get very good support from some Canadian, American and Japanese banks, and therefore the pricing for these loans is really very attractive.

Mr Brandon Lee, Citi: Just have a couple of questions. First one is with regards to the structure of the acquisition. May I understand what is the rationale behind blending the Singapore acquisition with the US acquisition? And if you were to strip off the Singapore one, would the transaction still be DPU accretive? That is my first question. The second question would be something outside of this acquisition, the Sponsor has been talking a bit about redevelopment of Science Park I, and I think about 70% of the assets belong to A-REIT. Is that something which you could comment on in terms progress, asset sales and what not? Thanks.

Mr William Tay: Sometimes it depends on timing, asset performance and whether some of the assets are able to be transacted e.g. if there is a moratorium.

On a standalone basis, they are both accretive.

About the Singapore Science Park rejuvenation, it's a long term plan and it involves many parties as well as government parties. The Sponsor has started the redevelopment of DNV DSO, Ascent and 5 Science Park Drive. They have already started the ball rolling and we are constantly talking to the Sponsor to see how we can collaborate. This conversation will be one that will take some time because there are many factors and parties involved.

Mr Chua Su Tye, Maybank Kim Eng: I have two questions. The first one, in terms of the US portfolio rent escalations, can you share which asset or which cities will be 2.5% relative to which asset will be 4% escalation. And for the FM Global asset which has a long WALE, how is the lease structure like in terms of escalation? Thanks.

Mr William Tay: For your first question, if I stretch that further to 1.5% to 4% escalations, we are talking about more than 95% of our leases with such escalations. In terms of whether it is this asset or that city, there is still a range in each of the cities. It actually depends on when each of the leases are signed in each of the city, so I can't give you a definite answer on which asset or which city.

Unfortunately for FM Global, we do have an NDA with them so we can't disclose much. But suffice to say, there is an annual rental escalation.

Ms Tan Xuan, CSLA Singapore: I have a few questions. Firstly on Nucleos. If I am not wrong, the asset was valued at $220 million when CapitaLand bought it from ASB. Can you explain what drove the $80 million gain in the past nine months?

Secondly, the original US portfolio had 33 assets and this round you are buying 28, can you explain the remaining five and would there will be opportunities in the future to buy those over?

And third question is on equity fund raising. It seems that you are raising a bit more equity this round, to leave opportunities to buy more time sensitive acquisition. Can we take that as an indication that future acquisitions in the near term may be from third parties?

Lastly, on the DPU accretion calculation, it seems quite low, less than 1%. Could you share some colour on that as well? Thank you.

Mr William Tay: When assessing opportunities, we take guidance from the valuers and we are actually able to buy below the two independent valuation. We think that is a very reasonable and attractive price.

On the US properties, we are actually buying the entire portfolio. For the REIT, we count each property by the land title. The Sponsor's figure of 33 was based on address. On EFR, yes we are raising a little bit more to bring down leverage. The leverage post transaction gives us a debt headroom of about S$1 bilion. That gives us flexibility to execute quickly when pursing potential acquisitions.
DPU accretion is 0.6% and DPU yield accretion is 3% despite a Rights issue. As explained earlier, the S$1.3 billion EFR is a huge one, hence the rights issue to balance the many various requirements.

Mr Wilson Ng, Morgan Stanley: Do you mind talking a bit about your Singapore operations? I noticed your 2QFY2019 rent reversions is tracking a little bit ahead of what you were expecting and also on occupancies in Singapore, do you expect them to improve from here?

Mr William Tay: We have been talking about flattish rent reversions since we came into this financial year. Given that there is a lot of uncertainty in the market, we felt that we have delivered a good outcome at 4% positive reversion this quarter, higher than the first quarter's 3%. But within this number, there is a range. There will be customers that renewed at flat rents, some that we were able to increase rents, and some simply need to move on, and then there is a non-renewal. Today our retention is still about 60 to 70% which is still healthy compared to previous years. After two quarters or rental reversions at 3% to 4%, we can quite comfortably say that we are probably looking at a low single digit to close the year.

As for occupancy, given this climate, I think we will still be hovering around 87% to 88% for the Singapore portfolio.

Mr Mervin Song, JP Morgan: Back to the US portfolio, there are not many leases in the next 12 months due for renewal, but can you touch on the rent free ranges and maybe the TIs or the commission that you have to pay? What's the AFFO (adjusted funds from operations) for the portfolio?

Mr William Tay: Our rent free, including TIs, range between 10% to 15% of total rent right now. It also varies between cities. US commission for new leases are around 5% to 6%. If it is renewal it can be negotiated down to maybe 4% to 5%.

Ms Yeow Kit Peng: The AFFO yield is in the same ballpark as the US peers such as Alexandria Real Estate, Kilroy Realty, Hudson Pacific, Highwoods Properties, etc.

Mr Vijay Natarajan, RHB Research Institute Singapore: Just two questions from me. On your Singapore portfolio, about 20% of your leases are up for renewals in FY2020. Considering there is a little bit of supply in the industrial market, what can we expect in terms of occupancy and rent reversions? And for UK market, let's say if Brexit happens, do you think you have any risk of your tenants moving out of your properties?

Mr William Tay: For any one year in Singapore, it is business as usual for 20% to 25% of total revenue to be due for renewal. We have not come to a stage where very drastic measures are needed to retain the customers. I have mentioned that it is currently a mixed bag of demand. We see demand coming from BioMed and precision engineering. However, we have also lost customers from these industries. For rent reversion, when we come to the next quarter, we will provide more guidance.

Yes there is a lot of supply coming up. Nevertheless we feel that the assets that we have are in very good locations. We should still be able to hold up occupancy at about same level as this year.

The UK market is stable. In fact in the last seven months, one of the units which had a rental guarantee was actually leased out. So we benefited from rental on top of the rental guarantee. There is still demand in UK, and we are fairly confident that the customers that we have today are mainly serving the domestic market, and hence less affected by the China-US trade war or Brexit. This is what we gathered from our tenants when we talked to them.

Mr Ervin Seow, CIMB: Just going back to Vijay's questions on the Singapore occupancy and rental reversions. Would it then be possible to get your outlook in terms of the various sub-segments? Which segment looks more promising and where do you see challenges?

Mr William Tay: Given the trend of the new industry, demand has been mainly from BioMed and technology. Business Park space are still in good demand and the supply is tight because the government doesn't just tender out a piece of land for Business Park unless they see that there is a good tenant. You are probably aware that there is one tender on-going right now in Biopolis at one-north. That area caters to the biomed sector.

For logistics space, there is still a lot of musical chairs. Kit Peng mentioned about the outlier for our reversions this quarter. The key reason for the high positive reversion is that the tenant is serving the pharmaceutical sector and they are in good shape.

For the Light industrial space, I think there are some challenges as well. The segment will face a lot more supply in the next two years which is why we felt the need to convert or redevelop our light industrial buildings to a high specifications space. As you have seen, whether is it from us or our competitors, the new demand requires high specifications space.

Mr Derek Tan: Now that you are in three overseas markets, which markets do you think you can scale a bit faster? Between your talks with your Sponsor, how should we think about the exposure in the US? Any other cities apart from the current three that you are looking at?

Mr William Tay: We constantly look at opportunities in all three countries. We don't see that there is a need to strictly allocate capital to each of the cities. Today the team is actively looking at deals in UK, in Europe and Australia, so we have not forgotten these markets. The US market is deeper than UK, Australia and Singapore. In terms of opportunities, US seems to be a large market for us to deepen not just in the three cities that we are in right now but also in other tech cities that is on the sunshine belt. Each city has its own ecosystem, for example, LA is more life science, San Diego is for technology, and Portland for sports industry. We will be happy to look at other tech cities.

In Australia we have been steadily growing for the past few years. When we entered it was about S$1 billion, now we are close to S$1.6 billion. We have announced our fourth suburban office in Melbourne, so we are still active in each of the submarkets.

Mr Derek Tan: Just to follow up on the US. To play the technology story, your peer is looking at US data centres and in the UK you have gone into logistics. So why not logistics and data centres in the US since the yields are quite similar?

Mr William Tay: In terms of logistics, we still like the UK because of the strength of e-commerce. We will monitor this segment in the US. But today, we are focusing on the strong drivers behind the economy and it is coming from the technology and innovation sector. You are right, if there are opportunities in data centres we will look at it as well.

Mr Vijay Natarajan: In Singapore is there any chance that some tenants in office locations are paying higher rents and may choose to move to Business Parks?

Mr William Tay: The usage of Business Park space in Singapore is regulated by the government. Tenants have to be in the industrial, technology or R&D sectors, to name a few. We have seen some tenants move into the Business Park space but we have also lost tenants to office space. So it may depend on the companies' requirements and the rental at the point in time. Based on today's Business Parks rents, if companies qualify, of course it will help lower their cost of operations.

But some industries are looking at how they can leverage on the rent difference. They may locate their front office in town but locate their back office, which may qualify under JTC's guidelines, in a business park space.

Mr William Tay: Any more questions? If not, just one final word. CapitaLand and Ascendas-SingBridge have just celebrated our integration recently and if you have seen on CapitaLand's website, we have put out an article on the CapitaLand Championship - Playing to win. I'd like to explain maybe the similarity of the DNA of this company, as well as the strategy of A-REIT. One thing that was mentioned in our celebration was that if you want to go far, go together. I like this in a sense that in terms of A-REIT. We also like how this can be played out as though it is a team effort. Ascendas Reit now has a portfolio across different geographies and across different asset classes. We are constantly trying to improve the tenant mix. The top companies in the world have changed - from oil and gas in the past to tech players now. We want to be able to reposition our portfolio, to be future-proofed. With diversification, whilst one sector could face some challenges, another sector may be doing well and can take up the slack. If the global economy is doing well, we will see the entire portfolio performing well all together. We believe that this strategy and our discipline approach to acquiring assets will carry us well into the future.

Thank you all for coming. I hope you have enough information. Before I close, I want to thank the Ascendas Reit team who has put this together. A lot of time has been spent on this, so I'd like to thank the team. Thank you!

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