

# First REIT

24 February 2022

## Hold (initiation)

<b>BBG</b>	FIRT SP
<b>Market cap</b>	S\$491.4m
<b>Price (23 Feb 2022)</b>	S\$0.305
<b>52-week range</b>	S\$0.200 – S\$0.330
<b>Target Price</b>	S\$0.320
<b>Shares Outstanding</b>	1.61b
<b>Free Float</b>	64.2%
<b>Major Shareholder</b>	OUE 22.8%

<b>P/BV (12/21)</b>	0.8x
<b>Net Debt to Equity (12/21)</b>	0.5x

Source: Company data, Bloomberg, SAC Capital

## Ready to move on

**Restructured MLA terms provide more sustainable income.** 14 of First REIT's Indonesian properties underwent a restructuring of their MLA. The new terms saw Siloam direct rental contribution increase from 1.5% to 46.6% and is estimated to rise to 81.3% in the long run. Having Siloam as a counterparty provides more assurance against future defaults. Siloam, as a healthcare operator, has more stable earnings and has remained profitable over the past two FY. As opposed, existing counterparty property developer Lippo Karawaci is more cyclical and has been in the red since FY18. With straight-line accounting applied to the base rental escalation of 4.5%, we expect topline to remain relatively constant. The performance-based rent (8% of GOR) term could be a potential growth driver in the future.

**Acquisition of 12 Japan nursing Homes from OUE LH.** The Japan portfolio is expected to provide higher income and cashflow stability to First REIT. Of the purchase price of S\$168m, S\$16.2m will be offset via intercompany loan, S\$20.3m will be paid in cash and S\$131.5m (@S\$0.305 per unit) will be in consideration units issued to OUE. The consideration units will form ~20% of the enlarged share base. Correspondingly, OUE's shareholding will increase to ~39%.

Aside from the purchase price, First REIT will inherit ~S\$128m debt, however cost of debt is expected to fall slightly possibly owing to lower interest rate JPY debt. The Japan portfolio is expected to contribute ~15% of future rental income and provide a slight uplift on DPU. We expect the acquisition to be completed by 1H22.

**Room for growth.** First REIT's gearing is at 33.6% (end FY21). Post Japan acquisition, gearing is estimated to rise to ~36.4% on a pro forma basis. This leaves ample debt room (~S\$350m at 50% leverage limit) for First REIT to pursue acquisition targets. Moreover, First REIT can potentially take advantage of lower interest JPY debt to finance future growth. In FY22, First REIT is also due to receive exceptional income of ~S\$30.6m in settlement amount over termination of development work in Surabaya.

**Initiate HOLD at TP of S\$0.32.** We expect the DPU to remain fairly constant over our forecasted period. Our DDM-derived TP is S\$0.32 (COE 12.5%). Exchange rate risk exists as 80% of revenue will be denominated in IDR. A 10bps drop in S\$/IDR is likely to cause a 10bps drop in DPU. First REIT currently does not hedge the exchange rate risk, but the Japan acquisition is expected to provide some natural hedge against IDR. While First REIT is trading at a dividend yield of 8.6%, real yield is actually closer to 2.1% amidst the rising risk-free rate.

## Analyst

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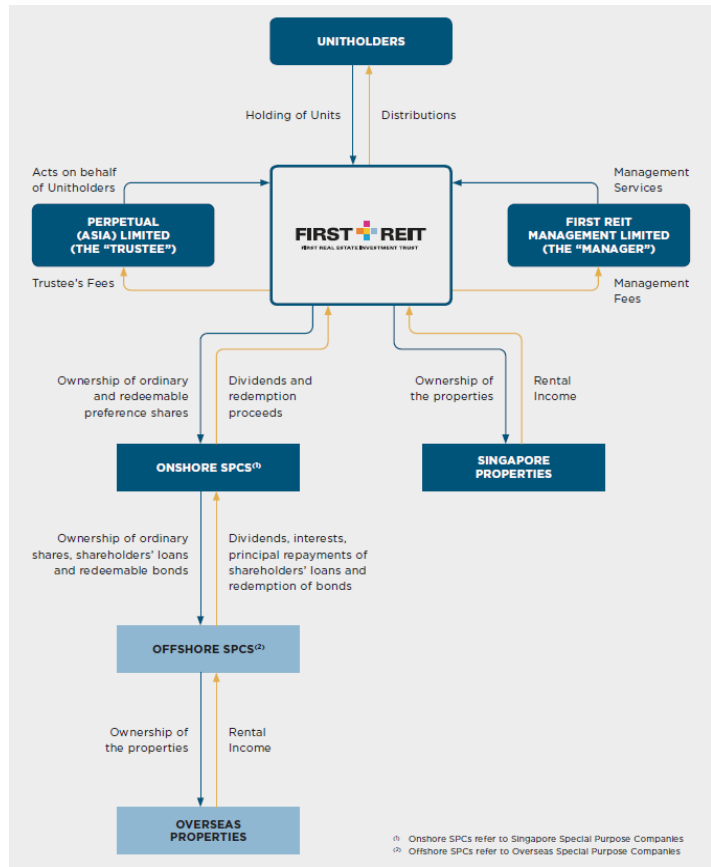
YE 31 Dec (S\$m)	FY19A	FY20A	FY21A	FY22E	FY23E
Rental income	115.3	79.6	102.3	110.6	119.5
Net property income	112.9	77.5	100.2	107.3	115.9
Net profit	45.5	(355.8)	59.9	83.7	66.7
Distributable income	68.4	33.4	42.1	39.0	54.2
EPS (S cents)	5.74	(44.33)	4.00	4.56	3.23
DPU (S cents)	8.60	4.15	2.61	2.61	2.62
Net cash / (debt)	(453.4)	(469.7)	(298.0)	(441.7)	(442.4)
<b>Valuation</b>					
NPI margin (%)	97.9	97.3	97.9	97.0	97.0
ROIC (%)	5.5	5.9	8.0	6.9	7.0
Dividend yield (%)	28.2	13.6	8.6	8.7	8.7

From FY22E onwards, shares outstanding (~2.1b) is estimated to include consideration units issued for Japan acquisition

## Background

First REIT is a Singapore healthcare REIT which focuses on investing in healthcare and healthcare-related real estate assets in Asia. First REIT currently owns a portfolio of 19 properties, including 16 properties in Indonesia (12 hospitals, 2 integrated hospitals & malls, 1 integrated hospital & hotel and 1 hotel & country club) as well as 3 nursing homes in Singapore. First REIT's Indonesia healthcare properties are operated by Indonesia largest hospital chain PT Siloam International Hospitals Tbk, a subsidiary of the REIT's sponsor PT Lippo Karawaci Tbk.

First REIT's sponsors include the aforementioned Indonesia-listed property developer PT Lippo Karawaci Tbk and Singapore-listed healthcare company OUE Lippo Healthcare Limited, the healthcare subsidiary of Singapore-listed real estate company OUE Limited. First REIT has right-of-first-refusal agreements with both sponsors which include ROFR to the pipeline of hospitals across Indonesia operated by Siloam as well as ROFR from the healthcare network of OUELH across Pan-Asia. In Dec 2021, First REIT entered into a sale and purchase agreement to acquire a portfolio 12 Nursing Homes in Japan from OUELH.



Source: Company data

## Master Lease Agreement Restructuring

In May 2021, First REIT successfully completed the restructuring of the master lease agreements of 14 Indonesian healthcare assets to avoid the possible consequences of default and termination by Lippo Karawaci, which was severely impacted by the COVID pandemic. While the new terms saw a 38% reduction in base rent, the REIT avoided the consequences of default and termination of leases.

### Summary of key changes to restructured MLA Terms

	Former MLA Terms	Revised MLA Terms
Currency	SGD	IDR
Base Rent	S\$92.2m	<b>S\$56.7m (IDR613.1b)</b>
Base Rent Escalation	2x SG CPI increase (capped at 2%)	<b>4.5% annually</b>
Variable / Performance Based Rent	0% to 2% of GOR of respective properties	<b>8.0% of preceding FY respective hospital GOR</b>
Total Rent Payable	Base + Variable	<b>Higher of Base or Performance-Based Rent</b>
Security Deposit	6 months	<b>8 months</b>

Source: Company data, SAC Capital

Siloam has also been added as a counterparty under the restructured MLA terms. Siloam's direct rental contribution is projected to increase from 1.5% (before restructured MLA) to 46.6% (after restructured MLA) to 81.3% in the long run. This arrangement is expected to provide additional safeguard to First REIT as Siloam (a healthcare operator) will be able to generate more stable earnings than Lippo Karawaci (a property developer). Over the past few years, Siloam was able to remain profitable in FY20 and FY21 while Lippo Karawaci has been in the red since FY18, which operations were further impacted by the COVID pandemic.

## Peer Comparison

First REIT is trading at a dividend yield of 8.6% and a P/NAV of 0.8x. We believe that with the restructured MLA terms and the addition of the Japan portfolio, First REIT will be able to sustain a similar DPU payout in the medium term. The potential growth drivers would include future acquisition and the performance of Indonesian hospitals. We initiate a HOLD with our DDM-based TP at S\$0.32 (COE:12.5%).

	BBG	Year End	Mkt Cap (\$m)	Div Yield	P/NAV	Gearing	Cost of Debt
Parkway Life REIT	PREIT SP	Dec-21	2,758.8	3.1%	1.9x	35.4%	0.5%
First REIT	FIRT SP	Dec-21	491.4	8.6%	0.8x	33.6%	4.0%

Source: Bloomberg, Company data, SAC Capital  
As at 17 Feb 2022

## Income Statement

FYE 31 Dec (\$m)	FY19A	FY20A	FY21A	FY22E	FY23E
<b>Rental and other income</b>	<b>115.3</b>	<b>79.6</b>	<b>102.3</b>	<b>110.6</b>	<b>119.5</b>
Operating expenses	(2.4)	(2.2)	(2.1)	(3.3)	(3.6)
<b>Net property and other income</b>	<b>112.9</b>	<b>77.5</b>	<b>199.2</b>	<b>107.3</b>	<b>115.9</b>
Interest income	2.4	1.4	0.1	0.1	0.1
Manager's fees	(11.4)	(9.4)	(9.1)	(10.4)	(10.8)
Trustee fees	(0.4)	(0.4)	(0.3)	(0.4)	(0.4)
Finance costs	(20.4)	(17.8)	(17.0)	(19.0)	(19.0)
Other expenses	(1.0)	(5.7)	(2.2)	(2.2)	(1.8)
FV loss on investment properties	(5.6)	(401.4)	(4.5)	-	-
Gain on disposal	-	-	2.7	-	-
FV gain/(loss) on derivatives financial instruments	(1.0)	(2.4)	3.2	-	-
Foreign exchange gains	-	2	2.8	-	-
Settlement Fees	-	-	-	29.0	-
<b>Total return before tax</b>	<b>75.4</b>	<b>(358.2)</b>	<b>75.8</b>	<b>104.4</b>	<b>84.0</b>
Income tax	(26.5)	5.8	(12.7)	(17.7)	(14.3)
<b>Total return after tax</b>	<b>48.9</b>	<b>(352.4)</b>	<b>63.1</b>	<b>86.6</b>	<b>69.7</b>
- Unitholders	45.5	(355.8)	59.9	83.7	66.7
- Perpetual securities holders	3.4	3.4	3.2	3.0	3.0
<b>Distributable Income</b>	<b>68.4</b>	<b>33.4</b>	<b>42.1</b>	<b>39.0</b>	<b>54.2</b>

## Balance Sheet

FYE 31 Dec (\$m)	FY19A	FY20A	FY21A	FY22E	FY23E
Investment properties	1,340.8	939.7	962.4	1,258.0	1,258.0
Other non-current assets	1.5	-	-	-	-
<b>Total non-current assets</b>	<b>1,342.3</b>	<b>939.7</b>	<b>962.4</b>	<b>1,258.0</b>	<b>1,258.0</b>
Trade and other receivables	48.8	45.0	32.5	41.9	45.2
Other non-financial assets	3.0	0.9	3.4	3.4	3.4
Cash and cash equivalents	33.0	19.3	51.2	52.9	53.8
<b>Total current assets</b>	<b>84.8</b>	<b>65.2</b>	<b>87.1</b>	<b>96.6</b>	<b>99.2</b>
<b>Total assets</b>	<b>1,427.1</b>	<b>1,004.9</b>	<b>1,049.5</b>	<b>1,354.6</b>	<b>1,357.2</b>
Deferred tax liabilities	39.7	20.0	20.6	20.6	20.6
Other financial liabilities	487.7	297.5	250.0	393.8	393.8
<b>Total non-current liabilities</b>	<b>527.4</b>	<b>317.5</b>	<b>270.6</b>	<b>414.4</b>	<b>414.4</b>
Income tax payable	2.0	0.7	1.2	1.2	1.2
Trade and other payables	18.8	17.3	18.9	28.2	30.5
Other financial liabilities	-	195.3	99.3	99.3	99.3
Other non-financial liabilities	23.0	10.1	7.1	7.1	7.1
Derivatives financial instruments	0.2	-	0.7	0.7	0.7
<b>Total current liabilities</b>	<b>44.1</b>	<b>223.4</b>	<b>127.2</b>	<b>136.5</b>	<b>138.7</b>
<b>Total liabilities</b>	<b>571.4</b>	<b>540.9</b>	<b>397.7</b>	<b>550.8</b>	<b>553.1</b>
Net assets attributable to unitholders	794.8	403.1	591.1	743.1	743.5
Perpetual securities holders	60.9	60.9	60.7	60.7	60.7
NAV per unit (\$)	1.00	0.50	0.37	0.39	0.39

## Ratios

FYE 31 Dec (\$m)	FY19A	FY20A	FY21A	FY22E	FY23E
<b>Profitability (%)</b>					
Net property income margin	97.9	97.3	97.9	97.0	97.0
Dividend payout ratio (%)	99.8	130.9	90.7	123.0	100.0
<b>Liquidity (x)</b>					
Current ratio	1.9	0.3	0.7	0.7	0.7
Interest coverage ratio	4.9	3.5	5.2	5.0	5.4
Net debt to equity	0.6	1.2	0.5	0.6	0.6
<b>Valuation (x)</b>					
P/NAV	0.3	0.6	0.8	0.8	0.8
<b>Returns (%)</b>					
Return on equity	5.7	(59.4)	12.1	12.5	9.0
Return on assets	3.2	(29.3)	5.8	7.0	4.9
Return on invested capital	5.5	5.9	8.0	6.9	7.0
Dividend yield	28.2	13.6	8.6	8.7	8.7

## Cash Flow

FYE 31 Dec (\$m)	FY19A	FY20A	FY21A	FY22E	FY23E
Total (loss)/return before tax	75.4	(358.2)	75.8	104.4	84.0
Interest income	(2.4)	(1.4)	(0.1)	(0.1)	(0.1)
Interest expense	17.5	14.7	11.8	19.0	19.0
FV change of investment properties	5.6	401.4	4.5	-	-
Manager's fees	4.9	2.8	4.5	4.5	4.5
Adjustment on rental straight-lining	-	-	(22.7)	(19.7)	(16.7)
Gain on disposal	-	-	(2.7)	-	-
Others	3.7	5.2	5.9	-	-
Changes in working capital	14.1	(0.3)	(3.1)	(0.9)	(1.1)
Income tax	(18.8)	(13.7)	(4.4)	(17.7)	(14.3)
<b>Cash flows from operating activities</b>	<b>100.1</b>	<b>50.4</b>	<b>66.2</b>	<b>90.2</b>	<b>75.3</b>
Increase in investment properties	(1.2)	(0.4)	(0.7)	(168)	-
Proceeds from disposal	-	-	6.2	-	-
Others	2.4	1.4	0.1	0.1	0.1
<b>Cash flows from investing activities</b>	<b>1.2</b>	<b>1.0</b>	<b>5.6</b>	<b>(167.9)</b>	<b>0.1</b>
Distribution to unitholders	(68.3)	(43.8)	(38.2)	(47.9)	(54.2)
Increase in borrowings	100.0	-	252.4	16.2	-
Repayment of borrowings	(110.0)	-	(393.2)	-	-
Interest paid	(14.3)	(17.9)	(10.6)	(19.0)	(19.0)
Distribution to perpetual securities holders	(3.4)	(3.4)	(3.4)	(3.0)	(3.0)
Others	-	-	152.9	131.5	-
<b>Cash flows from financing activities</b>	<b>(96.0)</b>	<b>(65.1)</b>	<b>(40.1)</b>	<b>77.7</b>	<b>(76.2)</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>5.2</b>	<b>(13.7)</b>	<b>31.7</b>	<b>0.1</b>	<b>(0.7)</b>

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