

COMPANY RESULTS

Elite Commercial REIT (ELITE SP)

1H22: Counter-cyclical Yield Play That Hedges Against Inflation

NPI grew 17.7% yoy in 1H22, driven by the maiden acquisition of 58 commercial buildings completed on 9 Mar 21. DPU declined 2.7% yoy to 2.56 pence as cost of debt edged higher by 0.2ppt qoq to 2.3%. The overhang from lease break options is largely resolved. ELITE's properties have rent reviews every five years benchmarked against UK CPI and rental escalation of 15.4% is expected starting Apr 23. ELITE is a recession-resistant counter-cyclical yield play. Maintain BUY. Target price: £0.79.

1H22 RESULTS

Year to 31 Dec (£m)	1H22	yoy % chg	Remarks
Gross Revenue	18.7	+17.7	Growth from maiden acquisition of 58 commercial buildings
Net Property Income (NPI)	18.1	+17.7	for £212.5m completed 9 Mar 21.
Distributable Income	12.2	+9.7	Higher interest expense offset by savings in tax expenses.
DPU (pence)	2.56	-2.7	

Source: ELITE, UOB Kay Hian

RESULTS

- **Elite Commercial REIT (ELITE)** reported 1H22 DPU of 2.56 pence (-2.7% yoy), which is in line with our expectations.
- **Resiliency supported by sovereign tenants.** Gross revenue and NPI grew 17.7% yoy in 1H22, driven by the maiden acquisition of 58 commercial buildings for £212.5m completed on 9 Mar 21. Portfolio occupancy remains high at 98% as of Jun 22. ELITE has collected 99.9% of rent for 3Q22 in advance and within seven days of due date.
- **Incurred higher cost of debt.** Interest expense increased 35% yoy due to increased borrowings to fund the acquisitions. Aggregate leverage eased 0.9ppt qoq to 41.9% but cost of debt rose by 0.2ppt qoq to 2.3%. ELITE generated savings in tax expenses after qualification of its UK entity as a UK REIT group.
- **Income stability with long WALE.** ELITE has a long WALE of 5.2 years as of the Jun 22 post-renegotiation of lease terms.
- **Mid-year valuation.** ELITE plans to conduct a mid-year valuation exercise to update the valuations of its properties after the renegotiation of lease terms. The valuation for its portfolio of 155 commercial properties increased 3.5% due to the removal of lease break options for a majority of its leases. It has recognised gain of £10.2m in fair value of investment properties in 1H22. NAV per unit increased 2% to £0.62.

KEY FINANCIALS

Year to 31 Dec (£m)	2020*	2021	2022F	2023F	2024F
Net turnover	21	35	37	37	39
EBITDA	16	29	32	31	32
Operating profit	16	29	32	31	32
Net profit (rep./act.)	7	23	22	19	20
Net profit (adj.)	7	23	22	19	20
EPU (GBP pence)	2.2	5.2	4.7	4.1	4.3
DPU (GBP pence)	4.4	5.4	5.2	4.7	5.0
PE (x)	27.2	11.8	12.9	14.9	14.3
P/B (x)	0.9	1.0	1.0	1.0	1.0
DPU Yld (%)	7.3	8.9	8.4	7.7	8.2
Net margin (%)	35.6	66.1	59.4	51.9	51.7
Net debt/(cash) to equity (%)	37.6	70.7	69.4	71.1	73.3
Interest cover (x)	6.6	6.0	6.2	4.2	4.3
ROE (%)	n.a.	9.1	7.6	6.6	7.0
Consensus DPU ()	n.a.	n.a.	4.9	5.0	5.4
UOBKH/Consensus (x)	-	-	1.05	0.94	0.92

*Period from 6 Feb 20 to 31 Dec 20.

Source: Elite Commercial REIT, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	£0.61
Target Price	£0.79
Upside	+29.5%
(Previous TP)	£0.81)

COMPANY DESCRIPTION

Elite is the first UK-focused S-REIT listed on the SGX. It principally invests in commercial real estate in the UK.

STOCK DATA

GICS sector	Real Estate
Bloomberg ticker:	ELITE SP
Shares issued (m):	478.9
Market cap (GBPm):	292.1
Market cap (US\$m):	354.5
3-mth avg daily t'over (US\$m):	0.2
Price Performance (%)	

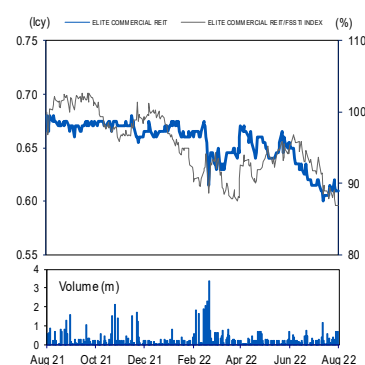
52-week high/low GBP0.68/GBP0.60

1mth	3mth	6mth	1yr	YTD
(1.6)	(7.6)	(7.6)	(10.3)	(8.3)

Major Shareholders

	%
Exor Nederland	22.9
Ho Lee Group Trust	7.7
Sunway RE Capital	5.8
FY22 NAV/Share (GBP)	0.63
FY22 Net Debt/Share (GBP)	0.44

PRICE CHART



Source: Bloomberg

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- **Benefitting from higher inflation.** The leases with the UK government are full repairing and insuring triple net leases whereby operational expenses are borne by the tenant. Thus, ELITE is insulated from negative impact from higher inflation and higher cost of electricity. The leases provide high NPI margin of 97.1% in 2021. The leases have rent reviews every five years benchmarked against the UK Consumer Price Index (CPI). The built-in rental escalation is subject to an annual minimum increase of 1% and maximum of 5%. Based on consensus estimate of 8.6% for the UK's CPI in 2022, we estimate the step-up in rents at 15.4% for Apr 23.

STOCK IMPACT

- **Recession-resistant counter-cyclical yield play.** ELITE benefits from recession-resistant and counter-cyclical cash flows from its sovereign tenants. 99.3% of ELITE's gross rental income is derived from leases with the UK government. The UK government is rated AA by S&P and Aa3 by Moody's. Its primary occupier DWP uses ELITE's properties primarily as Jobcentre Plus, which provides front-of-house claimant-facing unemployment and other ancillary services.
- **Majority of 136 DWP leases have no break clauses.** 27 of the DWP leases are straight leases without break clauses. Break clauses were removed from 108 leases, of which rents for 97 leases were maintained while rents for 11 leases were reduced. The reduction in rents for the 11 commercial properties is estimated at 36% (before positive impact of rental escalation). DWP also signed a new five-year lease for one commercial property at East Street, Epsom. Properties with rental income secured till Mar 28 contributed 87.5% of gross rental income as of Jun 22.
- **Break options for 12 leases were exercised.** Tenants have exercised break options for 12 leases (DWP: 10, National Records of Scotland: 1 and HM Revenue & Customs: 1). ELITE will consider three options for the 12 commercial properties: a) re-let to other potential new tenants, b) divestment with vacant possession or following re-letting, or c) alternative uses, such as conversion or redevelopment.
- **Maximising value of John Street and Sidlaw House.** DWP and HM Revenue & Customs have vacated from John Street, Sunderland and Sidlaw House, Dundee on 1 Apr 22 and 29 Jun 22 respectively. Management intends to divest John Street to recycle capital. It is also exploring available options for Sidlaw House.

EARNINGS REVISION/RISK

- We have trimmed our 2023 DPU by 4% primarily due to higher interest rates. We have conservatively assumed that:
 - a) Bank of England (BOE)'s Monetary Policy Committee has just increased the Bank Rate by 50bp to 1.75%. UOB Global Economics & Markets Research sees possibility for another hike of 50bp to bring Bank Rate to 2.25% during the next meeting on 15 Sep 22. Thus, we expect term loan of £94m to be refinanced at interest rate of 4.0% in Jan 23. We estimated cost of debt at 3.25% in FY23 (FY22: 2.33%).
 - b) We have assumed the worst case scenario that commercial properties with break options exercised is vacant for nine months and rental income is halved after securing replacement tenants.

VALUATION/RECOMMENDATION

- **Maintain BUY.** Our target price for ELITE of £0.79 is based on DDM (COE: 7.75%, terminal growth: 1.8%).

SHARE PRICE CATALYST

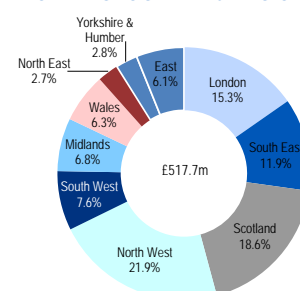
- Recession-resistant counter-cyclical yield play sheltered from uncertainties created by heightened geopolitical tension and the Russia-Ukraine war.
- Accretive acquisitions of government offices and commercial buildings in the UK.

KEY OPERATING METRICS – ELITE

		1021	2021	3Q21	4Q21	1Q22	2Q22	yoy	qoq
DPU	pence	1.22	1.41	1.48	1.32	1.28	1.28	-9.2%	0.0%
Occupancy	%	100.0%	100.0%	100.0%	100.0%	100.0%	98.0%	-2ppt	-2ppt
Aggregate Leverage	%	42.1%	42.1%	42.1%	42.4%	42.8%	41.9%	-0.2ppt	-0.9ppt
Average Cost of Debt	%	1.9%	1.9%	1.9%	2.0%	2.1%	2.3%	0.4ppt	0.2ppt
Weighted Average Lease Expiry (WALE)	year	7.4	6.6	6.4	6.0	5.5	5.2	-1.4yrs	-0.3yrs
Weighted Debt Maturity	year	2.8	2.5	2.3	2.1	1.8	1.6	-0.9yrs	-0.2yrs
% Borrowing In Fixed Rates	%	63%	63%	63%	63%	63%	63%	0.0%	0.0%

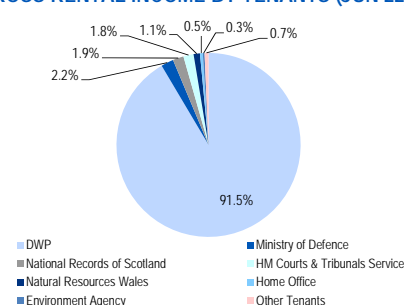
Source: ELITE, UOB Kay Hian

VALUATION BY GEOGRAPHIC REGIONS (JUN 22)



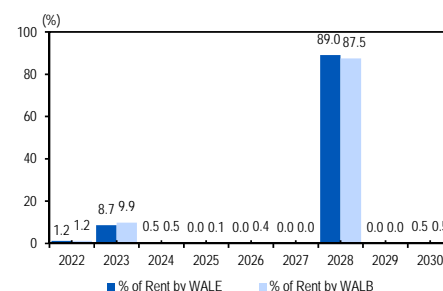
Source: Elite

GROSS RENTAL INCOME BY TENANTS (JUN 22)



Source: Elite

LEASE EXPIRY PROFILE (JUN 22)



Source: Elite

CONSUMER PRICE INDEX – UK



Source: CEIC

PROFIT & LOSS

Year to 31 Dec (GBPm)	2021	2022F	2023F	2024F
Net turnover	34.7	37.3	37.4	39.4
EBITDA	29.2	31.6	30.8	32.3
Deprec. & amort.	0.0	0.0	0.0	0.0
EBIT	29.2	31.6	30.8	32.3
Net interest income/(expense)	(4.9)	(5.1)	(7.3)	(7.5)
Pre-tax profit	24.3	26.5	23.5	24.8
Tax	(1.4)	(4.3)	(4.1)	(4.4)
Net profit	23.0	22.2	19.4	20.4
Net profit (adj.)	23.0	22.2	19.4	20.4

BALANCE SHEET

Year to 31 Dec (GBPm)	2021	2022F	2023F	2024F
Fixed assets	501.3	511.6	511.6	511.6
Other LT assets	0.5	0.5	0.5	0.5
Cash/ST investment	19.5	20.4	22.4	23.6
Other current assets	12.0	12.3	12.3	13.0
Total assets	533.4	544.7	546.8	548.7
ST debt	6.6	6.6	6.6	6.6
Other current liabilities	15.4	16.0	16.0	16.3
LT debt	217.3	220.0	225.0	230.0
Other LT liabilities	5.0	5.0	5.0	5.0
Shareholders' equity	289.0	297.1	294.2	290.7
Total liabilities & equity	533.4	544.7	546.8	548.7

CASH FLOW

Year to 31 Dec (GBPm)	2021	2022F	2023F	2024F
Operating	22.7	27.6	26.7	26.5
Pre-tax profit	(3.4)	36.7	23.5	24.8
Tax	(2.9)	(4.3)	(4.1)	(4.4)
Working capital changes	(6.3)	0.3	(0.0)	(0.3)
Non-cash items	30.7	1.4	2.2	2.8
Other operating cashflows	4.6	(6.5)	5.1	3.7
Investing	(9.4)	0.0	0.0	0.0
Capex (growth)	(9.4)	0.0	0.0	0.0
Capex (maintenance)	0.0	0.0	0.0	0.0
Financing	(14.1)	(26.7)	(24.6)	(25.4)
Distribution to unitholders	(17.6)	(24.3)	(22.3)	(23.9)
Issue of shares	0.0	0.0	0.0	0.0
Proceeds from borrowings	8.6	2.7	5.0	5.0
Others/interest paid	(5.1)	(5.1)	(7.3)	(6.5)
Net cash inflow (outflow)	(0.8)	0.9	2.1	1.2
Beginning cash & cash equivalent	20.2	19.5	20.4	22.4
Changes due to forex impact	0.1	0.0	0.0	0.0
Ending cash & cash equivalent	19.5	20.4	22.4	23.6

KEY METRICS

Year to 31 Dec (%)	2021	2022F	2023F	2024F
Profitability				
EBITDA margin	84.1	84.7	82.5	81.8
Pre-tax margin	70.1	71.0	62.9	62.9
Net margin	66.1	59.4	51.9	51.7
ROA	5.3	4.1	3.6	3.7
ROE	9.1	7.6	6.6	7.0
Growth				
Turnover	65.7	7.5	0.0	5.6
EBITDA	87.5	8.3	(2.6)	4.8
Pre-tax profit	84.2	8.9	(11.4)	5.6
Net profit	207.5	(3.3)	(12.7)	5.2
Net profit (adj.)	207.5	(3.3)	(12.7)	5.2
EPU	131.5	(9.1)	(13.2)	4.4
Leverage				
Debt to total capital	43.6	43.3	44.0	44.9
Debt to equity	77.5	76.3	78.7	81.4
Net debt/(cash) to equity	70.7	69.4	71.1	73.3

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