

COMPANY UPDATE

Digital Core REIT (DCREIT SP)

The Spirit Is Willing But The Market Is Weak

The timing of DCREIT announcing its maiden acquisition coincided with the Fed stating that it would be persisting with its hawkish stance. Steep rate hikes are expected to continue till end-22. We see the positive impact of DCREIT acquiring 25% of the Frankfurt facility (scenario A) being neutralised by steep rate hikes on 2 Nov (75bp) and 14 Dec 22 (50bp). DCREIT provides a distribution yield of 4.9% for 2023 (KDCREIT: 5.4% and MINT: 5.3%). Maintain BUY with target price at US\$0.98.

WHAT'S NEW

- **Embarking on maiden acquisition post-IPO.** DCREIT has announced that it will be acquiring a data centre in Frankfurt, Germany valued at €558m (about US\$558m) and a data centre in Dallas, Texas valued at US\$199m from sponsor Digital Realty. There are two potential scenarios:

- Acquisition of 25.0% of Frankfurt data centre fully funded by debt, which will increase its portfolio size by 10%. Aggregate leverage is expected to increase from 25.7% to 33.0%.
- Acquisition of 89.9% of Frankfurt data centre and 90.0% of Dallas data centre, supported by an equity fund raising (EFR) exercise, which will increase portfolio size by 48%. The mix of debt and equity funding is expected to be 60:40. Aggregate leverage is expected to increase from 25.7% to 37.5%.

OVERVIEW OF TRANSACTION

	A. DEBT-FUNDED SCENARIO	B. EQUITY FUND RAISING SCENARIO
Proposed Acquisition	25.0% interest in Frankfurt Facility	89.9% interest in Frankfurt Facility 90.0% interest in Dallas data centre
Agreed Value (100% Share)	€558m (US\$558m) for Frankfurt Facility	€558m (US\$558m) for Frankfurt Facility US\$199m for Dallas data centre
Purchase Consideration	Purchase Consideration: US\$140m Total Acquisition Cost: US\$146m	Purchase consideration: US\$681m Total acquisition cost: US\$700m
Net Rentable Square Feet (100% Share)	450,662	568,538
1H22 Pro Forma DPU Accretion	2.0%	3.1%
Pro Forma Aggregate Leverage (Jun 22)	33.0%	37.5%

Source: DCREIT

- **Expansion into two new core data centre markets.** Frankfurt is the second largest data centre market in Europe while Dallas is the fifth largest in North America. Both data centres are purpose-built and were completed within the past five years (average age: three years). They are fully integrated with sponsor Digital Realty's global platform and tethered via dark fibre to Digital Realty's interconnection hubs. Both data centres are powered by renewable energy (Frankfurt: hydroelectric power, Dallas: wind power).

KEY FINANCIALS

Year to 31 Dec (US\$m)	2020	2021	2022F	2023F	2024F
Net turnover	n.a.	n.a.	106	107	107
EBITDA	n.a.	n.a.	56	56	56
Operating profit	n.a.	n.a.	56	56	56
Net profit (rep./act.)	n.a.	n.a.	6	28	29
Net profit (adj.)	n.a.	n.a.	33	29	29
EPU (US\$ cent)	n.a.	n.a.	2.9	2.5	2.5
DPU (US\$ cent)	n.a.	n.a.	3.9	4.0	4.1
PE (x)	n.a.	n.a.	27.3	31.5	31.6
P/B (x)	n.a.	n.a.	1.0	1.0	1.0
DPU Yld (%)	n.a.	n.a.	4.8	4.9	5.1
Net margin (%)	n.a.	n.a.	6.0	26.1	27.4
Net debt/(cash) to equity (%)	n.a.	n.a.	35.9	54.2	57.3
Interest cover (x)	n.a.	n.a.	4.9	2.6	2.6
ROE (%)	n.a.	n.a.	n.a.	2.9	3.2
Consensus DPU (US\$ cent)	n.a.	n.a.	4.0	4.1	4.2
UOBKH/Consensus (x)	-	-	0.96	0.96	0.97

Source: Digital Core REIT, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	US\$0.80
Target Price	US\$0.98
Upside	+22.5%

COMPANY DESCRIPTION

DCREIT invests in a diversified and stabilised portfolio of mission-critical data centre facilities. Its initial portfolio comprises 10 freehold data centres concentrated within top-tier markets in the US (North Virginia, Silicon Valley and Los Angeles) and Canada (Toronto) with an appraised valuation of US\$1.4b.

STOCK DATA

GICS sector	Real Estate
Bloomberg ticker:	DCREIT SP
Shares issued (m):	1,129.7
Market cap (US\$m):	903.8
Market cap (US\$m):	903.8
3-mth avg daily t'over (US\$m):	2.2

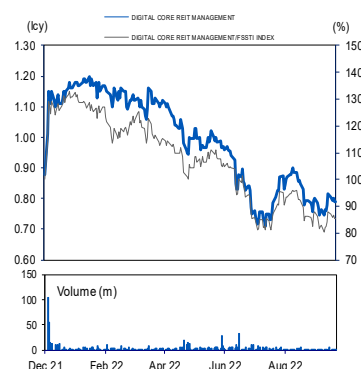
Price Performance (%)

52-week high/low			US\$1.20/US\$0.71	
1mth	3mth	6mth	1yr	YTD
(5.9)	(10.6)	(30.4)	n.a.	(31.0)

Major Shareholders

	%
Digital CR Singapore Holding, LLC	33.4
-	-
-	-
FY22 NAV/Share (US\$)	0.84
FY22 Net Debt/Share (US\$)	0.30

PRICE CHART



Source: Bloomberg

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- **Creating value by backfilling vacant spaces.** Capitalisation rates are 4.5% for the Frankfurt facility and 5.0% for the Dallas data centre. The Frankfurt facility's occupancy was 91.3% as of Jun 22 (vacancy: 8.7%). Yield is expected to improve from 4.5% to 5.0% when the vacant spaces are leased-up and backfilled. The average in-place contractual rental escalation for the two data centres is 1.6% per year
- **Improving customer diversification.** The acquisition will add nine new customers, bringing DCREIT's total number of customers to 25 post-acquisition. The proportion of its top five customers of total annualised rent will be reduced from 97% to 86%.
- **Potential EFR exercise.** If conditions in the equity market are conducive, DCREIT intends to embark on an US\$277m EFR, comprising a private placement of US\$180m (217m new units) and sponsor placement of US\$97m (117m new units). Digital Realty would maintain its stake in DCREIT at about 33.4%.

OVERVIEW OF DATA CENTRES

	FRANKFURT FACILITY	DALLAS DATA CENTRE
Land Lease Title	Freehold	Freehold
Completion	2017 (Phase 1) / 2022 (Phase 4)	2017
Property Type	Fully Fitted	Fully Fitted
Occupancy	91%	100%
Net Rentable Square Feet	450,662	117,876
Customer IT Load (kW)	34,098	6,975
1H22 Cash Net Property Income	€12m	US\$5m
Agreed Value	€558m (US\$558m)	US\$199m
Aggregate Consideration Payable (Scenario A)	€140m (US\$140m) (25.0% interest)	n.a.
Aggregate Consideration Payable (Scenario B)	€502m (US\$502m) (89.9% interest)	US\$179m (90.0% interest)
Number of customers	12	5
WALE by Annualised Rent (years)	4.7	15.4
WALE by NRSF Rent (years)	4.8	15.4

Source: DCREIT

STOCK IMPACT

- **DCREIT expects positive impact.** The deal is expected to be accretive to DPU by 2.0% for scenario A and 3.1% for scenario B. The acquisition of the Frankfurt data centre is funded by euro-denominated bank borrowings with weighted average interest cost of 3.5%. The acquisition of the Dallas data centre is funded by the EFR with issue price of placement units assumed to be US\$0.83.
- **Market conditions not conducive for EFR.** DCREIT will pursue scenario B if market conditions are conducive for the launch of an EFR exercise. The stock is currently trading at US\$0.80, which is at a 6% discount to NAV per unit of US\$0.85 as of Jun 22. Unfortunately, we believe scenario A is the most probable outcome given the current volatile market conditions for S-REITs and rising government bond yields.
- The acquisition is subject to approval by unitholders during an upcoming EGM.

EARNINGS REVISION/RISK

- **DCREIT has hedged 50% of its borrowings to fixed interest rate.** Unfortunately, the Fed has just hiked the Fed Funds Rate by 75bp to 3.00% on 21 Sep 22. We expect the Fed Funds Rate to hit 4.25% by end-22. DCREIT's cost of debt is expected to increase from 2.3% in 2Q22 to 3.9% in 2023. We have trimmed our 2023 DPU forecast by 1.5% after factoring in the proposed acquisition under scenario A and higher cost of debt at 3.9%.

VALUATION/RECOMMENDATION

- **Maintain BUY.** Our target price for DCREIT of US\$0.98 is based on DDM (cost of equity: 6.75%, terminal growth: 2.8%).
- **Pure play on data centre.** DCREIT provides a distribution yield of 4.9% for 2023 (KDCREIT: 5.4% and MINT: 5.3%). It deserves to trade at a premium due to its status as a pure play on data centres with acquisition-led growth supported by Digital Realty.
- **P/NAV at huge discount relative to peers.** DCREIT trades at P/NAV of 0.94x, which is a discount compared with other data centre REITs that are trading at an average P/NAV of 1.40x (KDCREIT: 1.43x and MINT: 1.36x).

SHARE PRICE CATALYST

- Organic growth from cash rental escalation of 1-3% (weighted average: 2%).
- Yield-accretive acquisitions tapping on sponsor's large and growing data centre pipeline.

FRANKFURT FACILITY



Source: DCREIT

DALLAS DATA CENTRE



Source: DCREIT

CUSTOMERS FOR NEW CORE DATA CENTRES

Top 5 Customers	% of Total Annualised Rent
1 Fortune 25 Tech Company	38%
2 Fortune 50 Software Company	35%
3 IT Service Provider	20%
4 Global Colocation/IX Provider	4%
5 Global IT Solutions Provider	2%
Total – Top 5 Customers	99%



Source: DCREIT

PROFIT & LOSS

Year to 31 Dec (US\$m)	2021	2022F	2023F	2024F
Net turnover	n.a.	106.1	106.7	107.4
EBITDA	n.a.	56.0	55.6	56.0
Deprec. & amort.	n.a.	0.0	0.0	0.0
EBIT	n.a.	56.0	55.6	56.0
Associate contributions	n.a.	0.0	6.3	6.4
Net interest income/(expense)	n.a.	(11.3)	(21.3)	(21.7)
Pre-tax profit	n.a.	18.0	39.5	41.1
Tax	n.a.	(6.7)	(6.1)	(6.1)
Minorities	n.a.	(4.9)	(5.6)	(5.6)
Net profit	n.a.	6.4	27.8	29.4
Net profit (adj.)	n.a.	33.1	28.9	29.0

BALANCE SHEET

Year to 31 Dec (US\$m)	2021	2022F	2023F	2024F
Fixed assets	n.a.	1,443.0	1,445.5	1,448.0
Other LT assets	n.a.	1.1	147.1	147.1
ST debt	n.a.	n.a.	n.a.	n.a.
Cash/ST investment	n.a.	37.8	38.5	39.1
Other current assets	n.a.	3.5	3.6	3.6
Total assets	n.a.	1,485.5	1,634.6	1,637.8
Other current liabilities	n.a.	4.4	4.4	4.4
LT debt	n.a.	380.0	546.0	566.0
Other LT liabilities	n.a.	3.6	3.6	3.7
Shareholders' equity	n.a.	953.2	936.1	918.9
Minority interest	n.a.	144.3	144.6	144.8
Total liabilities & equity	n.a.	1,485.5	1,634.6	1,637.8

CASH FLOW

Year to 31 Dec (US\$m)	2021	2022F	2023F	2024F
Operating	n.a.	21.3	49.4	51.4
Pre-tax profit	n.a.	6.4	27.8	29.4
Tax	n.a.	(2.5)	(2.5)	(2.5)
Working capital changes	n.a.	4.9	0.0	0.0
Non-cash items	n.a.	(11.4)	10.4	10.4
Other operating cashflows	n.a.	23.9	13.7	14.1
Investing	n.a.	(1,299.0)	(148.5)	(2.5)
Capex (growth)	n.a.	(1,296.5)	(146.0)	0.0
Capex (maintenance)	n.a.	(2.5)	(2.5)	(2.5)
Financing	n.a.	1,315.5	99.7	(48.3)
Distribution to unitholders	n.a.	(43.5)	(45.0)	(46.6)
Issue of shares	n.a.	990.3	0.0	0.0
Proceeds from borrowings	n.a.	380.0	166.0	20.0
Others/interest paid	n.a.	(11.3)	(21.3)	(21.7)
Net cash inflow (outflow)	n.a.	37.8	0.6	0.6
Beginning cash & cash equivalent	n.a.	0.0	37.8	38.5
Ending cash & cash equivalent	n.a.	37.8	38.5	39.1

KEY METRICS

Year to 31 Dec (%)	2021	2022F	2023F	2024F
Profitability				
EBITDA margin	n.a.	52.7	52.1	52.2
Pre-tax margin	n.a.	17.0	37.0	38.3
Net margin	n.a.	6.0	26.1	27.4
ROA	n.a.	n.a.	1.8	1.8
ROE	n.a.	n.a.	2.9	3.2
Growth				
Turnover	n.a.	n.a.	0.5	0.6
EBITDA	n.a.	n.a.	(0.7)	0.8
Pre-tax profit	n.a.	n.a.	119.5	4.1
Net profit	n.a.	n.a.	335.0	5.8
Net profit (adj.)	n.a.	n.a.	(12.7)	0.5
EPU	n.a.	n.a.	(13.3)	(0.2)
Leverage				
Debt to total capital	n.a.	25.7	33.6	34.7
Debt to equity	n.a.	39.9	58.3	61.6
Net debt/(cash) to equity	n.a.	35.9	54.2	57.3
Interest cover (x)	n.a.	4.9	2.6	2.6

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