

COMPANY UPDATE

Digital Core REIT (DCREIT SP)

Rebalancing Towards Investment Grade Tenants

Cyxtera, DCREIT's second-largest tenant accounting for 22.6% of annualised rent, was downgraded by Moody's from B3 to Caa2 on 17 Feb 23. In the event that Cyxtera files for bankruptcy protection, our FY25 DPU forecast and target price would be reduced by 15% and 14% respectively to 3.5 US cents and US\$0.67 assuming DCREIT backfills half of the vacant data centre spaces. DCREIT provides FY25 distribution yield of 8.7% (KDCREIT: 5.3% and MINT: 5.7%). Maintain BUY. Target price: US\$0.78.

WHAT'S NEW

- **The second shoe to drop.** We expect Cyxtera Technologies, which was described as a global colocation and interconnection provider and rated B3 in Digital Core REIT's (DCREIT) IPO prospectus dated 29 Nov 21, to be under greater financial strain as financing for technology companies is tightened in the aftermath of the demise of Silicon Valley Bank. The tenant was already downgraded by Moody's Investors Service from B3 to Caa2 on 17 Feb 23. Its outlook was also changed from stable to negative. Moody's cited governance weakness and difficulty in refinancing revolving credit facilities of US\$120m as basis for their downgrade. Moody's believes Cyxtera is at high risk for default without an equity capital infusion and full refinancing over the next few months. Cyxtera's share price has collapsed 85% in 2022 and 28% on a ytd basis in 2023.
- **Big shoes to fill.** Cyxtera is DCREIT's second largest-tenant, accounting for 22.6% of annualised rent as of Dec 22. The exposure to Cyxtera is straddled across six data centres. Cyxtera remains current in rents and has not defaulted. Sponsor Digital Realty could provide support through a cash flow guarantee in the event that Cyxtera files for chapter 11 bankruptcy protection.
- **Sensitivity analysis on progress of backfilling vacant space.** Our sensitivity analysis indicates that FY25 DPU and our target price could drop by up to 29% and 27% respectively in the event that Cyxtera files for chapter 11 bankruptcy protection. Our base case scenario, which assumes DCREIT backfills half of the vacant data centre space, provides FY25 DPU forecast of 3.5 US cents and target price of US\$0.67. Our worst-case scenario, whereby none of the vacant space is backfilled, provides FY25 DPU forecast of 2.9 US cents and target price of US\$0.57.
- **Balance sheet flexibility** is preserved with an aggregate leverage at 34.0% after the acquisition of 25% interest in Frankfurt data centre (Sep 22: 26.2%). DCREIT has headroom for debt-funded acquisitions of US\$150m based on aggregate leverage of 40%. Weighted average cost of debt deteriorated from 3.1% to 3.9%. The proportion of borrowings hedged to fixed rates has increased from 50% to 75%.

KEY FINANCIALS

Year to 31 Dec (US\$m)	2021	2022	2023F	2024F	2025F
Net turnover	n.a.	115	112	112	112
EBITDA	n.a.	72	73	73	73
Operating profit	n.a.	72	73	73	73
Net profit (rep./act.)	n.a.	13	43	44	43
Net profit (adj.)	n.a.	42	44	44	43
EPU (US\$ cent)	n.a.	3.7	3.9	3.9	3.8
DPU (US\$ cent)	n.a.	4.0	3.8	4.1	4.1
PE (x)	n.a.	12.5	11.9	12.1	12.4
P/B (x)	n.a.	0.6	0.6	0.6	0.6
DPU Yld (%)	n.a.	8.6	8.3	8.7	8.8
Net margin (%)	n.a.	11.7	38.0	39.1	38.6
Net debt/(cash) to equity (%)	n.a.	50.3	52.9	55.5	58.4
Interest cover (x)	n.a.	6.7	3.1	3.1	3.0
ROE (%)	n.a.	n.a.	4.6	4.8	4.8
Consensus DPU (US\$ cent)	n.a.	n.a.	3.9	4.0	4.1
UOBKH/Consensus (x)	-	-	0.98	1.02	1.00

Source: Digital Core REIT, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	US\$0.465
Target Price	US\$0.78
Upside	+67.7%
(Previous TP)	US\$0.97

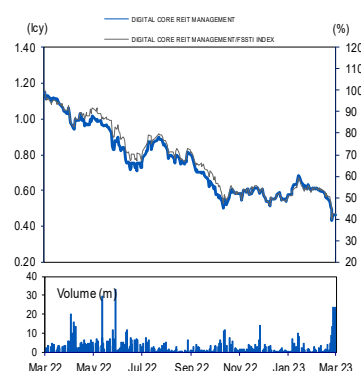
COMPANY DESCRIPTION

DCREIT is a pure-play data centre REIT. Its 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. Its sponsor Digital Realty is the world's largest data centre owner and operator.

STOCK DATA

GICS sector	Real Estate			
Bloomberg ticker:	DCREIT SP			
Shares issued (m):	1,123.3			
Market cap (US\$m):	522.4			
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3-mth avg daily t'over (US\$m):	1.5			
Price Performance (%)				
52-week high/low	US\$1.16/US\$0.43			
1mth	3mth	6mth	1yr	YTD
(22.5)	(21.8)	(42.9)	(57.3)	(15.5)
Major Shareholders				%
Digital Realty Trust				35.0
Sumitomo Mitsui Fin				7.0
-				-
FY23 NAV/Share (US\$)				0.82
FY23 Net Debt/Share (US\$)				0.43

PRICE CHART



Source: Bloomberg

ANALYST(S)

Jonathan Koh, CFA, MSc Econ
+65 6590 6620
jonathankoh@uobkayhian.com

TOP 10 TENANTS (DEC 22)

	Tenant	Trade Sector	No. of Locations	Annualised Rent (US\$M)	% of Total
1	Fortune 50 Software Company	Hyperscale CSP	3	27.7	39.1
2	Global Colocation and Interconnection Provider	Colocation / IT SP	6	16.0	22.6
3	Social Media Platform	Social Media	1	11.9	16.8
4	Global Technology Solutions Provider	Hyperscale CSP	1	7.0	9.9
5	Fortune 25 Technology Company	Hyperscale CSP	1	4.7	6.7
6	Global Cloud Provider	Hyperscale CSP	1	1.6	2.3
7	IT Service Provider	Colocation / IT SP	1	1.4	2.0
8	Multi-national Service Provider	Others	1	0.2	0.3
9	Utility Provider	Others	1	0.05	0.1
10	Communications Infrastructure Company	Others	2	0.04	0.1
Others	n.a.	n.a.	n.a.	0.2	0.3
	Total			70.7	100.0

Source: DCREIT

SENSITIVITY ANALYSIS FOR IMPACT ON FY25 DPU AND TARGET PRICE

% Backfilled	Occupancy for Data Centre Portfolio	FY25 DPU (US cents)	FY25 Distribution Yield (%)	Target Price (US\$)	% Upside
0%	73.8%	2.9	6.2	0.57	22.6
10%	76.2%	3.0	6.4	0.59	26.9
20%	78.6%	3.1	6.7	0.61	31.2
30%	81.1%	3.2	6.9	0.63	35.5
40%	83.5%	3.4	7.2	0.65	39.8
50%	85.9%	3.5	7.5	0.67	44.1
60%	88.3%	3.6	7.7	0.69	48.4
70%	90.7%	3.7	8.0	0.71	52.7
80%	93.2%	3.8	8.2	0.74	59.1
90%	95.6%	3.9	8.5	0.76	63.4
100%	98.0%	4.1	8.7	0.78	67.7

Source: UOB Kay Hian

STOCK IMPACT

- **A silver lining.** Non-investment grade tenants accounted for 32% of annualised rents (Cytera Technologies: 24.1% and Sungard Availability Services: 7.3%) as of Jun 22. DCREIT would have the opportunity to rebalance its tenant base toward investment grade tenants in the event that Cytera files for chapter 11 bankruptcy protection.
- **Supply constraints conducive for backfilling of vacant spaces.** Northern Virginia and Silicon Valley, which are the largest data centre markets in the US, accounted for 35% and 32% of DCREIT's annualised rents respectively as of Dec 22. Northern Virginia remains supply constrained and vacancy is very tight at 1%. The supply constraint in Northern Virginia and Silicon Valley augurs well for DCREIT's effort to backfill its vacant data centre spaces.
- **No exposure to US regional banks.** Management has clarified that DCREIT does not have any customer or banking relationship with Silicon Valley Bank, First Republic Bank or other US regional banks. None of its tenants are financial services firms, technology start-up companies or backed by venture capital.
- **Attracting interest from institutional investors.** Interesting, Sumitomo Mitsui Financial Group, through various entities and funds under Sumitomo Mitsui and Daiwa Securities, has become a major unitholder with a combined 7.0% stake in DCREIT. Daiwa Securities has recently purchased 1.7m units on 21 Feb 23 and increased its deemed interest by 0.15ppt to 9.0%.

EARNINGS REVISION/RISK

- Our FY25 DPU forecast and target price would be reduced by 15% and 14% respectively to 3.5 US cents and US\$0.67 assuming DCREIT backfills half of the data centre spaces vacated by Cytera. FY24 distribution yield would be lowered from 8.7% to 7.5%.

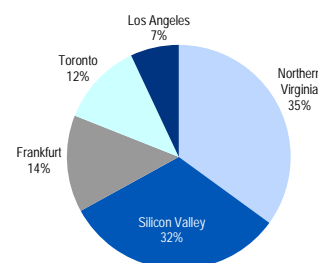
VALUATION/RECOMMENDATION

- **Maintain BUY.** Our target price of US\$0.78 is based on DDM (cost of equity: 7.25% (previous: 6.75%), terminal growth: 2.2% (previous: 2.8%)).

SHARE PRICE CATALYST

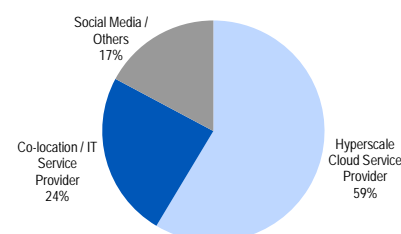
- Organic growth from cash rental escalation of 1-3% (weighted average: 2%).
- Yield-accretive acquisitions tapping on sponsor's large and growing data centre pipeline.

RENTAL INCOME BY CORE MARKET (DEC 22)



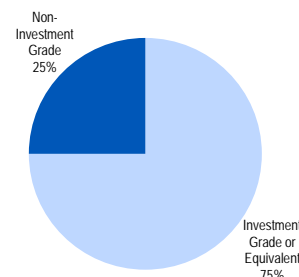
Source: DCREIT

CUSTOMER PROFILE BY TRADE SECTOR (DEC 22)



Source: DCREIT

CUSTOMER PROFILE BY CREDIT QUALITY (DEC 22)



Source: DCREIT

FRANKFURT FACILITY



Source: DCREIT

PROFIT & LOSS

Year to 31 Dec (US\$m)	2022	2023F	2024F	2025F
Net turnover	115.0	112.3	112.3	112.3
EBITDA	71.8	72.7	72.7	72.7
Deprec. & amort.	0.0	0.0	0.0	0.0
EBIT	71.8	72.7	72.7	72.7
Associate contributions	(0.5)	6.3	6.4	6.5
Net interest income/(expense)	(10.6)	(23.2)	(23.6)	(24.3)
Pre-tax profit	31.9	54.8	55.9	55.3
Tax	(13.1)	(6.6)	(6.6)	(6.5)
Minorities	(5.3)	(5.4)	(5.4)	(5.4)
Net profit	13.4	42.7	43.9	43.4
Net profit (adj.)	42.2	43.8	43.5	43.0

BALANCE SHEET

Year to 31 Dec (US\$m)	2022	2023F	2024F	2025F
Fixed assets	1,423.8	1,426.3	1,428.8	1,431.3
Other LT assets	154.2	154.2	154.2	154.2
ST debt	n.a.	n.a.	n.a.	n.a.
Cash/ST investment	25.2	26.8	27.8	28.1
Other current assets	9.3	8.3	8.3	8.3
Total assets	1,612.6	1,615.7	1,619.1	1,622.0
Other current liabilities	25.9	20.7	20.7	20.7
LT debt	495.0	515.0	532.0	550.0
Other LT liabilities	14.6	14.6	14.6	14.6
Shareholders' equity	934.9	922.7	908.9	893.5
Minority interest	142.1	142.6	142.9	143.1
Total liabilities & equity	1,612.6	1,615.7	1,619.1	1,622.0

CASH FLOW

Year to 31 Dec (US\$m)	2022	2023F	2024F	2025F
Operating	77.6	50.4	55.9	55.1
Pre-tax profit	1.5	30.9	32.1	31.5
Tax	(2.5)	(2.5)	(2.5)	(1.5)
Working capital changes	14.5	(4.2)	0.0	0.0
Non-cash items	(17.8)	10.1	10.1	10.1
Other operating cashflows	81.9	16.1	16.2	15.0
Investing	(1,452.3)	(2.5)	(2.5)	(2.5)
Capex (growth)	(1,294.7)	0.0	0.0	0.0
Capex (maintenance)	(2.6)	(2.5)	(2.5)	(2.5)
Investments	(68.9)	0.0	0.0	0.0
Others	(86.1)	0.0	0.0	0.0
Financing	1,400.0	(46.3)	(52.5)	(52.3)
Distribution to unitholders	(26.7)	(43.1)	(45.9)	(46.9)
Issue of shares	977.4	0.0	0.0	1.0
Proceeds from borrowings	497.5	20.0	17.0	18.0
Others/interest paid	(48.2)	(23.2)	(23.6)	(24.3)
Net cash inflow (outflow)	25.2	1.6	1.0	0.4
Beginning cash & cash equivalent	0.0	25.2	26.8	27.8
Ending cash & cash equivalent	25.2	26.8	27.8	28.1

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	62.5	64.7	64.7	64.7
Pre-tax margin	27.8	48.8	49.8	49.2
Net margin	11.7	38.0	39.1	38.6
ROA	n.a.	2.6	2.7	2.7
ROE	n.a.	4.6	4.8	4.8
Growth				
Turnover	n.a.	(2.3)	0.0	0.0
EBITDA	n.a.	1.3	(0.0)	(0.0)
Pre-tax profit	n.a.	71.7	2.1	(1.2)
Net profit	n.a.	218.4	2.8	(1.3)
Net profit (adj.)	n.a.	3.7	(0.5)	(1.3)
EPU	n.a.	4.4	(1.2)	(2.4)
Leverage				
Debt to total capital	31.5	32.6	33.6	34.7
Debt to equity	53.0	55.8	58.5	61.6
Net debt/(cash) to equity	50.3	52.9	55.5	58.4
Interest cover (x)	6.7	3.1	3.1	3.0

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