

Singapore Company Update

Prime US REIT

Bloomberg: PRIME SP | Reuters: PRIE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

9 Feb 2023

BUY

Last Traded Price (8 Feb 2023): US\$0.525 (STI : 3,388.52)

Price Target 12-mth: US\$0.63 (20% upside) (Prev US\$0.65)

Analysts

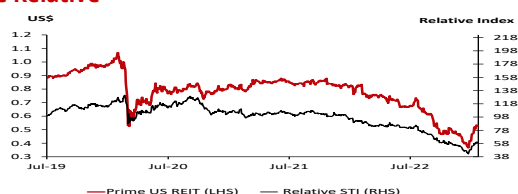
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What's New

- FY22 DPU -3% y-o-y to 6.55 UScts, slightly below, due to higher interest cost and one-off termination fee in FY21
- Key positives: i) Portfolio occupancy relatively stable; ii) strong reversions from 2 tenants who signed long lease; iii) interest rates are significantly hedged until mid-2024
- Datapoints to watch: i) Gearing rose to 42% due to 7% drop in portfolio valuation; ii) higher operating costs
- Maintain BUY; lower TP to US\$0.63

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2021A	2022A	2023F	2024F
Gross Revenue	157	163	167	174
Net Property Inc	101	97.9	109	114
Total Return	68.2	(26.9)	66.9	69.4
Distribution Inc	75.6	77.2	71.5	71.8
EPU (US cts.)	5.83	(2.3)	5.61	5.80
EPU Gth (%)	166	nm	nm	3
DPU (US cts.)	6.78	6.55	6.00	6.00
DPU Gth (%)	(2)	(3)	(8)	0
NAV per shr (US cts.)	84.7	75.3	75.1	74.7
PE (X)	9.0	nm	9.4	9.0
Distribution Yield (%)	12.9	12.5	11.4	11.4
P/NAV (x)	0.6	0.7	0.7	0.7
Aggregate Leverage (%)	37.6	41.9	43.4	44.2
ROAE (%)	7.2	(2.9)	7.5	7.8

Distn. Inc Chng (%): (4) (4)
 Consensus DPU (US): 6.60 6.20
 Other Broker Recs: B: 5 S: 0 H: 1

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Navigating through headwinds

Investment Thesis:

Positioned for return-to-office trends in the US, albeit with a rocky recovery. PRIME US REIT (PRIME)'s well-diversified portfolio of class A US office assets in submarkets with in-migration of residents and employment is positioned to benefit from return-to-office trends in the US, albeit with a rocky recovery.

Impacts from inflation and higher interest costs are largely known and expected to stabilise from FY23 onwards. Even though inflation and higher interest costs may impact earnings, we believe these headwinds are largely expected and that earnings will likely stabilise from FY23F onwards. In addition, gearing/capital management remained under control despite a decline in portfolio valuation.

Trading below pandemic trough in Mar 20; downside risks could be limited. PRIME's share price has derated to below the pandemic trough of Mar 20. We believe most of the known headwinds are priced in and the downside risks could be limited. Our target price has a total upside (including dividends) of 31%, mainly from FY23 yield of 11%, terminal growth of 1.9%, and an 18% valuation re-rating, as news of a potential recovery in the US office market would drive valuation higher.

Maintain BUY; lowered TP to US\$0.63. We maintain our BUY rating but trim our TP to US\$0.63 from US\$0.65. We trim our FY23F-24F DPU estimates by c.4%, mainly due to higher operating costs. Our DCF-based TP is based on a risk-free rate of 4% and beta of 0.95x. TP implies a c.10% yield and 0.8x P/NAV.

Key Risks

Slower-than-expected economic recovery and potential recession in the US. This situation would impact businesses, and that may cause a rising risk of vacancies.

Non-renewal of leases. PRIME's earnings may be adversely affected by bankruptcy, insolvency, or downturns in the businesses of its tenants, which may lead to the non-renewal of their leases.

At A Glance

Issued Capital (m shrs)	1,180
Mkt. Cap (US\$m/US\$m)	620 / 620
Major Shareholders (%)	
KBS REIT PROPERTIES	18.3
Keppel Corp Ltd	5.3
STEPPE INVESTMENTS P	5.3
Free Float (%)	71.1
3m Avg. Daily Val (US\$m)	0.92
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	

WHAT'S NEW

Navigating through headwinds

FY22 DPU -3% y-o-y due to higher interest cost, lower occupancies, and absence of one-off termination fee income; gearing increased to 42%, mainly due to decline in portfolio valuation (-7% y-o-y)

- FY22 DPU -3.4% y-o-y to 6.55 UScts, slightly below our estimates, largely due to higher interest costs (+27% y-o-y) and absence of one-off termination fee income received in 2H21, partially offset by full-year contributions from the acquisition of two assets in Jul 21.
- 4Q22 estimated DPU -19% y-o-y to 1.40 UScts, mainly due to higher interest costs, lower occupancy, and a one-off termination fee income largely recorded in 4Q21.
- 4Q22 revenue and NPI was flat q-o-q and -5% q-o-q, respectively. The lower NPI was due to higher operating costs as tenants returned to office.
- Gearing increased by 3.4ppt to 42.1% from 38.7% in 3Q22, largely due to the decline in portfolio valuation (-6.6% y-o-y).
- Effective interest rates inched up q-o-q to 3.4% from 3.1% in 3Q22. All-in average cost of debt inched up marginally q-o-q to 3.3% from 3.2% in 3Q22.
- Hedging ratio is at 82%, vs. 83% as at 3Q22, with fixed rates (hedged/fixed) expiring during mid-2024 to 2029 (65% is hedged/fixed from 2025 to 2026).
- Refinancing risks are largely mitigated, as debt facilities have one to two years of extensions. As such, the next refinancing requirement (67% of total debt) will be in 2024.

Key Highlights/Observations

Portfolio occupancy relatively stable q-o-q at 89.1% but saw larger decline at Promenade I&II (-13ppt); recorded strong 4Q22 reversions of c.20% mainly due to 2 tenants at Crosspoint that renewed/signed long leases at >25% reversions.

- **Portfolio occupancy held relatively stable at 89.1%.** The larger movements in occupancy were mainly from Promenade I&II (-13.4ppt q-o-q to 85.2%) and Tower 909 (+3.5ppt to 88.2%).
- **Leasing activities have slowed in 4Q22.** PRIME signed 143k sqft of leases in 4Q22 (-42% q-o-q), mainly led by the new lease at Tower 1 at Emeryville in 3Q22 (high base). 4Q22 leasing activities were mainly led by tenants from scientific R&D services, finance, biotechnology, manufacturing, and legal services. Despite the slowdown in 4Q22, 2Q22 was the slowest quarter for the year, with only 86k sqft of leases completed.
- **Strong positive rental reversions of 20%, mainly from Crosspoint.** In 4Q22, PRIME recorded very high positive reversions of 20.2%, substantially from two tenants from Crosspoint, which saw i) an existing tenant downsize from 84k sqft to 57.5k sqft but extend the lease to 2032, ii) a new

tenant backfilled space and signed a lease till 2034. Both leases saw reversion of >25%.

- **Management continues to expect positive rental reversions in 2023.** One of the top 10 tenants (c.5% of CRI) with its lease expiring at the end of this year has been rumoured to be looking at other buildings. PRIME will be focused on engaging the tenant for the lease.
- **Passing rents are 6.3% (vs. 6.7% in 3Q22) below that of market rents.** Most assets are under-rented, except Reston Square and One Washingtonian Centre.
- **Portfolio valuation declined by 6.7% y-o-y with weighted average cap rate expanding by 47bps.** PRIME's portfolio valuation fell by 6.7% y-o-y and cap rates expanded between 25bps to 75bps. Larger properties that saw a larger decline were 222 Main (-9.5%; cap rates expanded 50bps), Village Centre Station II (-8.1%; 50bps – possibly due to lower occupancy), Park Tower (-6.9%; 25bps), and 171 17th Street (-4.8%; 50bps).
- **Majority of PRIME's assets have physical occupancy above 50%.** Overall physical occupancy in the US office market has improved, surpassing 50% for the first time since the start of the pandemic, albeit uneven across markets. Physical occupancy at PRIME's assets ranges between 25% to as high as mid-80%. Majority of the assets are above 50% physical occupancy.
- **Retirement of Barbara Cambon, CEO and CIO, from 8 Mar 2023, who will be succeeded by Harmeet Singh Bedi, current Deputy CEO and CFO.** Barbara has been the cornerstone of the REIT that has listed PRIME US REIT. We would like to wish Barbara all the best and a happy retirement. Congratulations to Harmeet on his promotion!

Maintain BUY; lowered TP to US\$0.63. We maintain our BUY rating but trim our TP to US\$0.63 from US\$0.65. We trim our FY23F-24F DPU estimates by c.4%, mainly due to higher operating costs.

Despite the challenging environment, PRIME's share price is currently trading at below Mar 20 pandemic low, offering FY23F yield of 11% and 0.7x P/NAV. At these levels, we believe the headwinds are largely priced in and it is at an interesting level to monitor for any potential short-term inflection in macroeconomic sentiment/outlook, especially when Fed rate hikes have started to taper.

Company Background

Prime US REIT (PRIME) is a pure play US office REIT listed in Asia. Its portfolio consists of 11 class A freehold prime office assets located largely in Denver, Salt Lake City, Atlanta, Washington DC (Suburban Maryland and Virginia), and the San Francisco Bay Area with an aggregate net lettable area of around 3.4m sqft.

Prime US REIT

Summary of results

Summary of results (US\$m)	4Q2022	3Q2022	%q-o-q	4Q2021	% y-o-y	FY2022	FY2021	% y-o-y
Revenue	40.6	40.6	0.0%	44.2	-8.2%	163.0	156.7	4.0%
NPI	22.9	24.2	-5.2%	27.6	-16.8%	97.9	100.7	-2.7%
DI	16.6	19.2	-13.7%	20.2	-17.7%	77.2	75.6	2.0%
DPU (est)	1.40	1.63	-14.1%	1.73	-19.1%	6.55	6.78	-3.4%
Portfolio occupancies (%)	89.1%	89.6%	-0.5 ppt	90.3%	-1.2 ppt			
Rental reversions	20.2%	10.1%	10.1 ppt	7.8%	12.4 ppt	13.0%	14.1%	-1.1 ppt
WALE (years)	4.1	4.0	0.1	4.2	(0.1)			
Gearing (%)	42.1%	38.7%	3.4 ppt	37.9%	4.2 ppt			
Av cost of debt (%)	3.3%	3.2%	0.1 ppt	3.0%	0.3 ppt			
ICR (x)	4.1	4.5	(0.4)	5.4	(1.3)			
Hedging Ratio	82%	83%	-1 ppt	87%	-5 ppt			
Leases expiring in FY2023	15.4%	15.9%	-0.5 ppt	17.5%	-2.1 ppt			
Leases expiring in FY2024	13.2%	15.7%	-2.5 ppt	11.7%	1.5 ppt			

* quarterly DPU are estimated; FY22 reversions are estimated

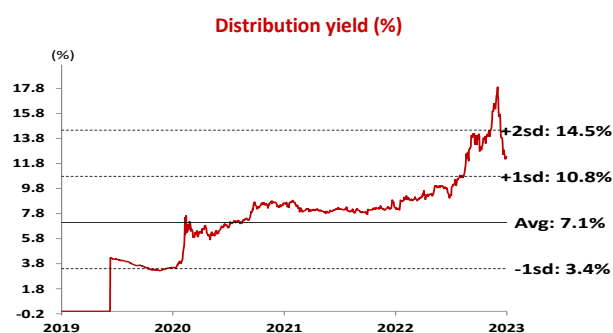
Source: Company, DBS Bank

Interim Income Statement (US\$m)

FY Dec	2H2021	1H2022	2H2022	% chg yoy	% chg hoh
Gross revenue	84.7	81.8	81.2	(4.1)	(0.7)
Property expenses	(30.3)	(31.0)	(34.1)	12.5	10.0
Net Property Income	54.4	50.8	47.1	(13.3)	(7.3)
Other Operating expenses	(5.2)	(5.5)	(5.2)	(1.2)	(6.4)
Other Non Opg (Exp)/Inc	7.64	26.4	10.8	42.0	(59.0)
Associates & JV Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	(9.5)	(10.1)	(11.5)	(21.6)	(13.8)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	47.3	61.6	41.3	(12.7)	(33.0)
Tax	(0.8)	(4.5)	18.3	(2,439.2)	(512.2)
Minority Interest	0.0	0.0	0.0	-	-
Net Income after Tax	46.5	57.2	59.6	28.2	4.3
Total Return	29.3	57.2	(84.1)	nm	(247.1)
Non-tax deductible Items	10.8	(15.9)	120	1,006.3	(856.3)
Net Inc available for Dist.	40.2	41.3	35.8	(10.8)	(13.3)
Ratio (%)					
Net Prop Inc Margin	64.2	62.1	58.0		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

Historical PE and PB band



Source: Bloomberg Finance L.P., DBS Bank estimates



Source: Bloomberg Finance L.P., DBS Bank estimates

Income Statement (US\$m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Gross revenue	144	157	163	167	174
Property expenses	(48.6)	(56.0)	(65.1)	(57.4)	(60.1)
Net Property Income	95.0	101	97.9	109	114
Other Operating expenses	(9.6)	(9.8)	(10.7)	(10.1)	(10.2)
Other Non Opg (Exp)/Inc	(16.4)	16.2	37.3	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(14.9)	(17.0)	(21.6)	(25.0)	(26.8)
Exceptional Gain/(Loss)	(28.9)	(17.2)	(144)	0.0	0.0
Net Income	25.2	72.9	(40.8)	74.3	77.1
Tax	(2.0)	(4.7)	13.9	(7.4)	(7.7)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	23.2	68.2	(26.9)	66.9	69.4
Total Return	23.2	68.2	(26.9)	66.9	69.4
Non-tax deductible Items	48.9	7.41	104	4.62	2.38
Net Inc available for Dist.	72.1	75.6	77.2	71.5	71.8
Growth & Ratio					
Revenue Gth (%)	136.7	9.2	4.0	2.2	4.5
N Property Inc Gth (%)	136.5	6.0	(2.7)	11.6	4.4
Net Inc Gth (%)	(31.1)	193.8	nm	nm	3.8
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	66.2	64.2	60.1	65.6	65.5
Net Income Margins (%)	16.2	43.5	(16.5)	40.1	39.8
Dist to revenue (%)	50.2	48.2	47.3	42.9	41.2
Managers & Trustee's fees	6.7	6.2	6.6	6.1	5.9
ROAE (%)	2.7	7.2	(2.9)	7.5	7.8
ROA (%)	1.7	4.4	(1.7)	4.2	4.3
ROCE (%)	6.1	5.8	5.5	5.7	5.9
Int. Cover (x)	5.7	5.4	4.0	4.0	3.9

Source: Company, DBS Bank

Prime US REIT

Interim Income Statement (US\$m)

FY Dec	2H2020	1H2021	2H2021	1H2022	2H2022
Gross revenue	72.4	72.1	84.7	81.8	81.2
Property expenses	(24.8)	(25.7)	(30.3)	(31.0)	(34.1)
Net Property Income	47.5	46.3	54.4	50.8	47.1
Other Operating	(4.9)	(4.5)	(5.2)	(5.5)	(5.2)
Other Non Opg (Exp)/Inc	2.68	8.51	7.64	26.4	10.8
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(7.2)	(7.5)	(9.5)	(10.1)	(11.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	38.1	42.8	47.3	61.6	41.3
Tax	1.98	(3.9)	(0.8)	(4.5)	18.3
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	40.1	38.9	46.5	57.2	59.6
Total Return	11.2	38.9	29.3	57.2	(84.1)
Non-tax deductible Items	25.0	(3.4)	10.8	(15.9)	120
Net Inc available for Dist.	36.2	35.4	40.2	41.3	35.8
Growth & Ratio					
Revenue Gth (%)	2	0	17	(3)	(1)
N Property Inc Gth (%)	0	(3)	17	(7)	(7)
Net Inc Gth (%)	233	(3)	20	23	4
Net Prop Inc Margin (%)	65.7	64.3	64.2	62.1	58.0
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

Balance Sheet (US\$m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Investment Properties	1,405	1,653	1,542	1,560	1,582
Other LT Assets	0.0	1.58	30.0	30.0	30.0
Cash & ST Invt	37.4	13.9	11.6	10.5	10.2
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	1.62	1.83	3.86	17.3	18.1
Other Current Assets	2.58	2.65	1.46	1.46	1.46
Total Assets	1,447	1,673	1,589	1,619	1,642
ST Debt	0.0	0.0	0.0	0.0	0.0
Creditor	14.5	15.9	18.1	10.5	11.0
Other Current Liab	7.35	10.6	7.62	7.62	7.62
LT Debt	480	629	666	703	726
Other LT Liabilities	36.8	26.4	3.95	3.95	3.95
Unit holders' funds	908	991	894	894	894
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	1,447	1,673	1,589	1,619	1,642
Non-Cash Wkg. Capital	(17.7)	(22.0)	(20.4)	0.64	0.95
Net Cash/(Debt)	(443)	(615)	(654)	(693)	(715)
Ratio					
Current Ratio (x)	1.9	0.7	0.7	1.6	1.6
Quick Ratio (x)	1.9	0.7	0.7	1.6	1.6
Aggregate Leverage (%)	33.2	37.6	41.9	43.4	44.2

Source: Company, DBS Bank

Prime US REIT

Cash Flow Statement (US\$m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Pre-Tax Income	25.2	72.9	(40.8)	74.3	77.1
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	0.0	0.0	0.0	(7.4)	(7.7)
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	3.75	1.72	(2.8)	(21.1)	(0.3)
Other Operating CF	60.9	21.1	133	4.62	2.38
Net Operating CF	89.9	95.7	89.2	50.4	71.5
Net Invnt in Properties	(176)	(260)	(29.5)	(17.6)	(22.4)
Other Invts (net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.0	0.0	(0.6)	0.0	0.0
Net Investing CF	(176)	(260)	(30.1)	(17.6)	(22.4)
Distribution Paid	(65.0)	(69.4)	(76.9)	(71.5)	(71.8)
Chg in Gross Debt	32.8	147	34.8	37.6	22.4
New units issued	118	80.0	0.0	0.0	0.0
Other Financing CF	0.0	(15.0)	(19.3)	0.0	0.0
Net Financing CF	85.6	143	(61.3)	(33.9)	(49.4)
Currency Adjustments	0.07	0.0	0.0	0.0	0.0
Chg in Cash	(0.4)	(22.1)	(2.3)	(1.1)	(0.3)
Operating CFPS (US cts.)	8.14	8.03	7.75	6.00	6.00
Free CFPS (US cts.)	(8.1)	(14.1)	5.03	2.76	4.10

Source: Company, DBS Bank

Target Price & Ratings 12-mth History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	26 May 22	0.73	0.88	BUY
2:	10 Nov 22	0.47	0.65	BUY

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Rachel TAN

Derek TAN

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS Bank unless otherwise specified.

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