Securities Investors Association (Singapore)
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UEN No: S99SS0111B
GST Reg No: M90367530Y

Issuer: ESR Funds Management (S) Limited

Security: ESR-REIT

Meeting details:
Date: 24 April 2019
Time: 10.00 a.m.
Venue: Suntec Singapore International Convention and Exhibition Centre, Room 331 – 332, 1 Raffles Boulevard, Suntec City, Singapore 039593

Company Description

ESR-REIT, formerly Cambridge Industrial Trust, is a Singapore-based industrial real estate investment trust. The Trust principally invests directly or indirectly in income-producing real estate and real estate related assets, which are used for industrial, warehousing and logistic purposes. The Trust operates through the leasing of investment properties segment. Its properties range from logistics, warehousing, light industrial, general industrial to car showroom and workshop, and are located close to transportation hubs and industrial zones island-wide. It also includes multi-story suburban office building in specially designated Business Park zone of which serves as regional headquarters for multinational companies catering to knowledge-based activities. The Trust's portfolio includes single-tenanted and multi-tenanted properties. Its portfolio consists of approximately 50 properties located across Singapore. The Trust's Manager is Cambridge Industrial Trust Management Limited.
(Source: http://www.sgx.com/wps/portal/sgxweb/home/company_disclosure/stockfacts?code=J91U)

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1. As noted in the Corporate profile (page 9 of the annual report), the manager's objective is to provide unitholders with a stable income stream through the successful implementation of the following strategies:

• Acquisition of value-enhancing properties;
• Proactive asset management;
• Divestment of non-core properties; and
• Prudent capital and risk management.

The most significant milestone in FY2018 was the merger with Viva Industrial Trust ("VIT") via a Trust Scheme of Arrangement creating an enlarged portfolio of S$3.1 billion in total assets that was concluded on 15 October 2018.

In addition, the sponsor paid $62.0 million to acquire the VIT Manager, thereby facilitating the REIT level transaction.

In the "Letter to unitholders", it was said that the REIT completed a transformational merger …... for the interests of Unitholders" (page 11). And yet unitholders saw their most basic measure of value, being the net asset value per unit, decrease from 59.3 cents per unit to 46.7 cents per unit. This is a decrease of (21.2)%.

NET ASSETS ATTRIBUTABLE TO UNITHOLDERS

	FY2018 S$' million	FY2017 S$' million	Variance %
Total Assets	3,050.7	1,695.8	79.9
Total Liabilities	1,419.9	765.8	85.4
Net Assets Attributable to Unitholders	1,479.7	778.9	90.0
Net assets value ("NAV") per Unit (cents)	46.7	59.3	(21.2)

(Source: 2018 annual report)

The manager has said that NAV per unit decreased "*due to the dilutive effect of new units issued during the year to settle the consideration for the merger partially paid in units, payment of management fees and acquisition fees to the Manager in units, distribution payment in units pursuant to distribution reinvestment plan and the preferential offering units issued in March 2018*".

It had not mentioned that fair value adjustments relating to the merger amounted to S$283.2 million which represents the write-off of acquisition-related costs of S$21.7 million and the premium over the fair value of net assets of VIT of S$261.5 million at acquisition date.

As noted in the circular to unitholders dated 7 August 2018, the scheme consideration represents a 26.4% premium to the net asset value of VIT as at 31 March 2018 and the issue price of the Consideration Units represents a 7.5% discount to the NAV of ESR-REIT as at 31 March 2018.

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(i) **What deliberations did the board, especially the independent directors, have over the dilutive impact of the acquisition to the minority unitholders?**

(ii) **Please quantify the synergies expected from the acquisition and what is the "payback period" for the synergies to make up for the premium of $261.5 million paid over fair value that has been written off.**

Two of the reasons given were the track record of the target in Asset enhancement initiatives (AEIs) and the DPU accretion (on a historical pro forma basis).

(iii) **Did the REIT manager lack the AEI expertise prior to the acquisition? Did the REIT manager explore how it could build up its key management team with the right human talent and the appropriate AEI experience and track record?**

(iv) **Can the independent directors/REIT manager help unitholders understand if the DPU accretion on a historical pro forma basis of 5.6% can be projected forward and that DPU going forward would increase about 5.6% due to the acquisition?**

In addition, on the operational front, what is the impact on the REIT of the following:

(v) **Negative rental reversion: Would the continued negative rental reversion mean that DPU is capped?**

(vi) **Hyflux: What are the pro-active measures that can be taken by the REIT manager to protect the interests of the unitholders in the event of a default by Hyflux?** Hyflux accounted for 3.5% of the REIT's rental income.

(vii) **UE BizHub EAST rental arrangement:** The rental arrangement with the original vendor expired 5 years after the listing of VIT (in November 2013). Based on the last annual report by VIT, the amount of rental support was $9.5 million. **What is the underlying performance of UE BizHub EAST? What improvements have the manager made since the acquisition?**

2. On 27 February 2018, the REIT manager announced the pro rata and non-renounceable preferential offering of up to approximately 262.8 million new units on the basis of 199 New Units for every 1,000 existing units at the issue price of S$0.54 per New Unit (the "Issue Price") to raise gross proceeds of up to approximately S$141.9 million.

(i) **Can the board, especially the independent directors, help unitholders understand the rationale for a "non-renounceable" preferential offering?** Unitholders who are unwilling or unable to apply for the non-renounceable preferential offering will experience dilution. **Did the independent directors consider the impact on such minority shareholders?**

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At the close of the preferential offering, valid acceptances by unitholders only amount to 75.3%. The results of the fund raising was announced by the REIT on 26 March 2018.

	Number of New Units	% of Preferential Offering
Valid acceptances	197,888,352	75.3%
Excess applications	250,581,520	95.3%
Total	**448,469,872**	**170.6%**

(Source: Company announcement dated 26 March 2018)

(ii) Did the board and the REIT manager evaluate the low level of valid acceptance by unitholders?

In addition, the sponsor was allocated 13,055,943 New Units, being the remaining New Units which remain unsubscribed after satisfaction of all applications for Excess New Units by unitholders (other than the sponsor). It can be concluded that:

	Application/allocation	
Valid acceptances	197,888,352	75.29% of new units
Excess applications (non-sponsor):	51,905,319	19.75% of new units
Excess applications (sponsor)	198,676,201 of which the sponsor was allocated 13,055,943	4.97% of new units

In other words, the sponsor accounted for nearly 80% of the excess application. Also, it means that valid acceptances and excess applications other than the sponsor was only 95% of the preferential offering. The sponsor increased its stake in the REIT from 12.4% to 13.3% as a result of the non-renounceable preferential offering which issued new units at a discount of 7.1% to the volume weighted average price on the day of the announcement.

(iii) With the benefit of hindsight, and based on feedback received, has the board, especially the independent directors, carried out a review of the preferential offering and made improvements and changes to the REIT's capital raising framework?

3. The manager has showed the comparative trading performance of the REIT in FY2018 on page 104 (reproduced below):

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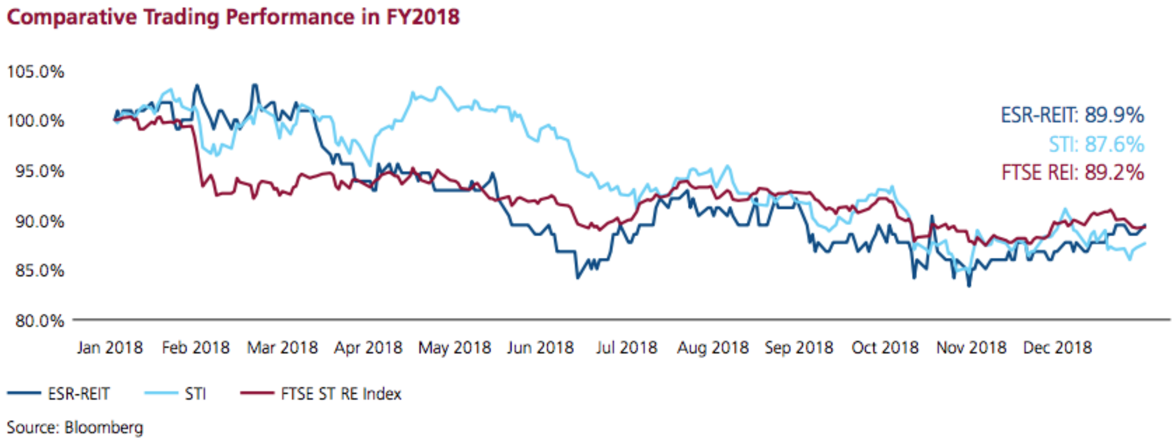

(Source: 2018 annual report)

(i) **Would the REIT manager/board help shareholders understand why "FTSE ST RE Index" was used in the comparison instead of the "FTSE ST REIT Index"? Would it be more appropriate to benchmark the REIT against the REIT index instead of against the broader real estate index which includes developers?**

(ii) **For the benefit of old and long standing unitholders, would the manager calculate and show the total unitholder returns?** As there was a change in control of the manager, the REIT could show the total unitholder returns on a 2-year (as ESR), 5-year and since inception basis.

A copy of the questions for the Annual Report for the financial year ended 31 December 2017 could be found here:

https://sias.org.sg/qa-on-annual-reports/?company=ESR-REIT&cid=6376,4535

The company's response could be found here: -----