

MARK TO MARKET

Is it time for Sabana Reit to be euthanised?

Quarz and Black Crane's latest missive shows a not unwarranted lack of trust that will hamper the Reit's future growth

THE dissident minority unitholders of Sabana Shari'ah Compliant Industrial Reit (Sabana Reit) that voted down its proposed merger with ESR-Reit more than three months ago are now threatening to withhold their endorsement of two new independent directors at the coming annual general meeting.

Quarz Capital Management and Black Crane Capital said last week in an open letter to the board and management of Sabana Reit's manager that they are not convinced the proposed directors are committed to defend the interests of minority investors.

"We believe that directors who can explore the full range of options for Sabana Reit to close the substantial valuation gap are required and not just directors who are suited to the continuation of 'business as usual,'" they added, in the letter.

In January, the manager of Sabana Reit said it had appointed former CBRE Asia chairman Willy Shee Ping Yah and lawyer-turned-investor Yeo Wee Kiong as independent directors.

What exactly do Quarz and Black Crane want the manager of Sabana Reit to do? And, should minority unitholders be cheering the continued pressure they are applying on the manager of Sabana Reit?



By Ben Paul
benpaul@sph.com.sg
@BenPaulBT

For the most part, Quarz and Black Crane seem to want what every other unitholder wants; and what the manager of Sabana Reit ought to be trying to deliver.

In their letter, Quarz and Black Crane referred approvingly to Sabana Reit's announcement earlier this month that the lifestyle mall at its flagship property New Tech Park had received its Temporary Occupation Permit and will open in Q2 2021.

The mall, dubbed NTP+, spans some 43,000 sq ft, and comprises 25 units on the ground floor with a food court on the second level. As at March 10, NTP+ had a total occupancy rate of more than 83 per cent.

Quarz and Black Crane figure that a full year of rental contribution from NTP+ could potentially lift

Sabana Reit's annualised distribution per unit (DPU) to about S\$0.032. Based on Sabana Reit's closing price on Friday of S\$0.39, this reflects a DPU yield of about 8.2 per cent.

"This potentially makes Sabana one of the highest yielding (Singapore Exchange-listed) industrial Reits despite having one of the lowest leverage levels," Quarz and Black Crane noted in their letter.

For FY2020, Sabana Reit's total DPU fell by 5.5 per cent to S\$0.0276. Its aggregate leverage stood at 33.5 per cent as at Dec 31.

Quarz and Black Crane went on to say that Sabana Reit could further increase its DPU by lowering its interest cost to below 3 per cent (from as much as 3.2 per cent in H2 2020), increasing its overall occupancy rate to 85 per cent (from 76.5 per cent as at Dec 31), and pursuing redevelopment projects and asset enhancement initiatives.

In particular, they estimate that the development of an additional 200,000 sq ft of space at New Tech Park could lift Sabana Reit's DPU by more than 15 per cent.

Distrust limits growth

There is no conceivable reason that Sabana Reit would not be prepared to pursue these initiatives, or any other initiative that drives up its DPU in a sustainable manner and enhances the market value of its units.

For minority unitholders of Sabana Reit who rallied against the proposed merger with ESR-Reit only a few months ago, however, the big question is: What happens then?

If Sabana Reit is to be useful to its parent ESR Cayman, it will eventually have to begin raising funds and acquiring additional properties. But this will be hard to do if its minority investors fundamentally do not trust the manager.

Judging from their letter, Quarz and Black Crane certainly appear to be taking a hardline approach with the manager of Sabana Reit.

In the first place, they are demanding that the manager of Sabana Reit foot the entire cost of the failed merger with ESR-Reit - which they estimate to be S\$2.7 million.

On top of that, they are insisting that ESR Cayman should have no say in the nomination of any independent directors to the board of Sabana Reit's manager. "Otherwise, this can be interpreted as 'control' over the business affairs and strategic directions of Sabana Reit," they added, in the letter.

Yet, for many investors, the strategic backing of a corporate group like ESR Cayman is not a bad thing, especially when it comes to sourcing for promising assets outside of Singapore.

Indeed, beyond improving the revenue generating potential of its

existing assets, Sabana Reit's perceived ability to acquire additional properties with growth potential could be an important driver of the market valuation of its units.

Euthanise Sabana Reit?

Before going any further, let me emphasise that Quarz and Black Crane should be applauded for their effort in blocking the merger of Sabana Reit and ESR-Reit, which are both controlled by ESR Cayman.

The deal would have seen investors exchanging units in Sabana Reit for units in ESR-Reit on terms that valued Sabana Reit at a steep discount to its book value, just before upside from NTP+ kicked in.

Moreover, the distrust that Quarz and Black Crane are displaying towards Sabana Reit's manager is not unwarranted. After all, if the manager could not see how the proposed merger with ESR-Reit would have destroyed value for unitholders of Sabana Reit, it stands to reason that any deals it recommends in the future may well be similarly flawed.

Yet, without the prospect of a steady stream of acquisitions, Sabana Reit's growth would be limited and its currently elevated DPU yields may not compress to the levels of leading industrial property Reits.

For minority investors of Sabana

Reit, the best outcome now might well be if ESR Cayman came to the realisation that Sabana Reit's likely usefulness as an asset securitisation platform has been badly impaired, and that it is time to put an end to all the misery it is causing.

ESR Cayman could perhaps explore the possibility of making an offer for Sabana Reit's S\$840 million portfolio, optimising the value of each property, and eventually looking for profitable exit opportunities. Meanwhile, Sabana Reit could be wound up and any funds returned to unitholders.

Euthanising Sabana Reit and paying off its irate unitholders would also leave ESR Cayman with just one Singapore-listed Reit, putting an end to questions about their overlapping interests.

Best of all, unitholders of Sabana Reit would have the opportunity to immediately monetise their units, potentially at a price that is closer to its book value of S\$0.51 per unit. They could then use the proceeds to invest in the leading industrial property Reits in the local market, which have growth prospects that are probably far superior to Sabana Reit.

■ For more analysis and insight on market trends and corporate issues, listen to the Mark To Market podcast at bt.sg/mark2mkt