



**Transcription for ENBD REIT**

*19<sup>th</sup> June 2019*



## Corporate Participants

**Harshjit Oza**

*SHUAA Capital*

**Anthony Taylor**

*ENBD REIT – Head of Real Estate*

**Muhammad Asif Siddique**

*ENBD REIT – CFO*

## Presentation

### Operator

Ladies and gentlemen, welcome to ENBD REIT's 31<sup>st</sup> March 2019 full year results conference call. I now hand over to your host, Harshjit Oza, SHUAA Capital. Sir, please go ahead.

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### Harshjit Oza

Good afternoon and good morning everyone. Thank you for joining with us for ENBD REIT's March 2019 full year results call.

*[Introductions]*

I will now hand over the call to Anthony to go ahead with his remarks. Thank you.

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### Anthony Taylor

Good afternoon everyone and welcome to our final quarterly NAV call for the 2018/2019 financial year.

*[Introductions]*

Before we go through the presentation and results for the year in detail, I would like to take a moment to reflect on ENBD REIT's performance for the year.

2018/19 was a year for building resilience, via an active approach to improving the quality of the portfolio, safeguarding income, maintaining strong occupancies, and seeking out new investment opportunities.



In the last 12 months, we saw the opening of South View School, the REIT's first education asset, which we had acquired under development in August 2017 as part of our strategy to diversify our alternative portfolio. In November, we also secured a \$90 million financing facility with Standard Chartered Bank, a deal that will support our focus on reducing future financing costs and facilitate our diversification efforts.

Following shareholder approval in February to March of this year, we engaged in a share buyback programme which was designed to:

- positively impact liquidity in our stock,
- limit small trades having a disproportionate impact on our share price, and;
- to demonstrate management's support for the stock at these levels.

In the last 12 months, in what has been a very challenging market environment, we have focused on maintaining WAULT and maximising rental income across the portfolio to deliver consistent returns to investors. I am also pleased to announce that for the first time, we are presenting a detailed financial information pack, which will be available to the market via our website on a quarterly basis. We think this is a big step forward in increasing the transparency of our reporting and will include a more comprehensive overview of key figures by assets, and provide as much information as possible to our investor community.

We will now go into the results for the year. As this is the final quarter of our financial year, we will also take a look at some additional items that may be of interest to those on the call. At the end, there will be room for a question and answer session for any areas that may require further explanation.

We're starting on slide four where we have a snapshot of ENBD REIT's key metrics as at the 31<sup>st</sup> March 2019. Portfolio numbers are holding but slightly off December 2018 quarter end. NAV is now at USD 270 million, down 4.8% which includes a dividend payment of USD 6.8 million made in the quarter, valuation losses of USD 7 million, and our share buyback programme seeing outflows of USD 2 million in the period.

The property portfolio is down from the last financial year from USD 463 million to USD 450 million, reflective of downward pressure in the local real estate market, but on balance, the value of our holdings has proved robust. This is, to a large extent, due to the diversification strategy that we have been successfully implementing.

The portfolio remains largely unchanged from the previous quarter with 11 properties covering office, residential and alternative asset classes. In terms of portfolio composition, our holdings are 64% office, 18% residential, and



18% alternative. Occupancy in the portfolio is at 86% and unexpired lease term or WAULT stands at 3.48 years.

The year ahead remains challenging, but we are confident on the steps that we are taking to address market headwinds through a number of initiatives including lowering debt and other costs and maintaining occupancy numbers.

I will now hand over to our CFO, Asif, to take you through more of the numbers.

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#### **Muhammad Asif Siddique**

Thanks, Anthony. On slide five, you can see the payments made to ENBD REIT's shareholders since listing. As at 31<sup>st</sup> March 2019 our share price was USD 0.57, with a NAV per share of \$1.08, which have been used to calculate the percentage return.

The Board of Directors has proposed a final dividend payment of USD 5,399,754 or 2.15c per share, which equates to approximately 100% of the net rental income generated in the period. The proposed dividend will be distributed to shareholders on the 15<sup>th</sup> July subject to their approval at the AGM, which will be held on the 24<sup>th</sup> June. This brings the total dividend payable to shareholders for the year to 8.65% of the share price and 4.54% of the NAV as at 31<sup>st</sup> March.

You will note the final proposed dividend has come off slightly from the interim dividend for the first six months of the year. This has been due to pressures on rental income in line with the market trends.

On slide six, we would like to summarise the progress made in our share buyback programme, which commenced on the 21<sup>st</sup> February following all the necessary approvals. The programme has been placed on hold during our closed period from 1<sup>st</sup> April to the announcement of our year-end financial results. A total of 3.25 million shares have been purchased at an average price of 59.5c per share, leaving a further 1.15 million shares available for purchase in the future. The purchased shares were subsequently cancelled, thereby, adding USD 1.5 million additional value to shareholders based on 31<sup>st</sup> March NAV.

We will take a look at ENBD REIT's capital structure on slide seven. As we announced in previous quarters, we had secured a competitive USD 90 million financing facility with Standard Chartered, reducing our cost of borrowing, which is currently the largest expense for the REIT. We expect to fully complete the refinancing of our existing debt shortly. As you can see



with Standard Chartered, we secured favourable terms of three months LIBOR plus 2.15 profit margin.

At a current LTV of 40%, we have room to increase our LTV to 47% when fully drawn on our available debt facilities. We are also looking at potential hedging options available, given the reprieve on international interest rates recently.

I will now pass back to Anthony to take you through the property portfolio.

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### **Anthony Taylor**

Thanks, Asif. Moving onto slide nine, you can see that the portfolio remains well diversified and composition remains steady. In the coming year, we will continue to look for acquisition opportunities to grow and diversify our portfolio through the utilisation of our debt facilities. In terms of allocation, you will see from these pie charts that diversification of our holdings is at the heart of our investment strategy and remains a key focus for management. The alternative portion of the portfolio is becoming particularly important, given challenges prevailing in the residential sector and pressure starting to build in the office segment. Our alternative assets currently include a balance of student accommodation, education, and retail. At 18% of the portfolio, we are looking to increase the allocation in the sector by targeting acquisitions of industrial and healthcare assets with the remaining facilities. The office sector remains our largest holding at 64%.

Slide 10 shows the occupancy across our holding remains strong, although it has experienced some downward pressure moving from 88% to 86% driven by both the residential and office portfolios. We have seen significant pressure predominantly in our Al Thuraya 1 and Bingham Terrace assets. In the case of some properties, rental rate adjustments have been necessary to safeguard occupancy and we expect to see the occupancy improving in the near-term, albeit at lower rental levels, especially in the case of our residential properties. This is, of course, heavily influenced by prevailing market conditions, which remain challenging.

As we acquire further assets, one of the key criteria is that these properties will be 100% occupied as we have successfully achieved in our acquisitions to date with all four assets acquired post-listing remaining 100% occupied.

On slides 11 and 12, generally speaking, we're pleased to report that valuations across the portfolio are holding up in difficult market circumstances, with overall valuations coming down 1.2% in the final quarter and down 2.65% year-on-year. This number is slightly skewed by the completion and revaluation of the South View School development asset



and would have been down 4.7% for the year across the portfolio excluding this one-off event. As you would expect, the greatest downward pressure on valuations has been experienced in the residential segment with some pressure now coming through in the office portfolio.

In light of these valuations, we reiterate our commitment to diversifying the portfolio; we will be looking to acquire assets that show the best potential for high occupancy levels and long-term lease agreements.

We will take a look at the portfolio segment in more detail on slides 13-15, starting with the office buildings. As mentioned, we are starting to see pressures coming through in the office market. Al Thuraya 1 in Dubai Media City still occupies the most significant share of our total portfolio value at 20% followed by The Edge at 17%. WAULTs in the office portfolio are mostly strong with The Edge and Burj Daman at 2.46 and 2.76 years respectively, while overall office portfolio occupancy is also strong at an average of 84%. Gross rental yield from the office segment is steady at 8.3%.

Post the 31<sup>st</sup> March, Al Thuraya 1 has become our biggest challenge in this quarter as a significant tenant, Huawei, representing 20% of occupancy has vacated in May, so leasing there is currently a focus for the real estate team. We are, however, pleased to announce that we have had some success leasing vacant space in Burj Daman this quarter, which should move the occupancy in this asset closer to 80%.

Moving onto the residential portfolio, the segment remains under pressure and while reduced rental rates have been successful in maintaining higher occupancies, the approach has put current valuations under pressure as well. As is the nature of residential assets, WAULT in this part of the portfolio is lower than the average at 0.83 years, and gross rental yield stands at 8.2%.

On slide 15, we look at the alternative portfolio. With longer-term leases, the sector continues to perform well at 100% occupancy, and the growth of this sector in ENBD REIT's portfolio is a high priority for us in 2019 through new acquisitions.

I will now hand back to Asif to take you through the financials in a bit more detail.

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**Muhammad Asif Siddique**

Thanks, Anthony. On slide 17, we look at key themes in the financial performance that have emerged during the reporting year, these include:

- stable net rental income or funds from operations;



- a 16% increase in gross income due to holding acquired assets for a full financial year;
- Not only is our net rental income stable, but we also have strong cash flows and a healthy cash balance to meet ongoing obligations despite the challenging market conditions;
- On the negative side, unrealised valuation losses having an adverse impact on the REIT's audited net income.

On slide 18, we have provided a summary of financial performance for the full year ended 31<sup>st</sup> March 2019, compared to the previous year. Gross income has improved by 16% due to post-listing acquisitions, where USD 3.3 million and USD 1.8 million additional revenue was reported in The Edge and Souq Extra respectively, due to these properties being held for the full year.

Expenses have increased, which is reflective of the increased size of the portfolio, as well as additional drawdown of debt to achieve completion of South View School and interest rate increases throughout this period. We will take you through the expenses in more detail on the next slide.

We are pleased to confirm we have maintained our net rental income or FFO at USD 12.4 million in spite of the current market conditions. However, the resulting fall in valuation losses of USD 21.7 million have taken our net audited income to negative USD 9.3 million. As valuation losses are a non-cash element, and our cash flows remain positive, we are committed to distributing dividends from the net rental income generated going forward. Further the reduction of share capital in this quarter and the subsequent creation of a significant distributable reserve allows us to continue making dividend payments from net rental income, despite negative movements in valuations.

Moving onto slide 19, you get a clearer picture of our annual expenses, which have increased by USD 5.3 million, predominantly due to an increase of USD 4.5 million in finance costs and proportional increases in operating expenses due to new assets acquired in the previous year and now held for the full financial year.

The pie chart on the left of this slide breaks down total expenses. While finance and operating expenses have increased as mentioned before, fund expenses remain stable year-on-year. We are committed to reducing financing costs in the future by refinancing the remaining of our existing USD 134 million facility outstanding with Emirates NBD. In the appendix, you will find a more detailed summary of our financials covering our statement of financial position and statement of comprehensive income.

I will now hand back to Anthony for some closing remarks.





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### **Anthony Taylor**

Thanks, Asif. This concludes the presentation. As a final note, I would like to recap on the various steps we have taken over the course of the financial year to improve shareholder's returns:

- The refinancing of existing debt at more attractive terms to reduce costs going forward
- Implementing a share buyback programme to capitalise on a significantly discounted share price
- Implementing a share capital reduction plan to ensure dividends generated from net rental income can be maintained regardless of movement in capital values
- Renegotiating all contracts with service providers in order to try and bring down costs throughout the portfolio
- The rolling out of green initiatives on our buildings to reduce utility consumption and operational costs
- Finally, actively sourcing new investment opportunities in the alternative sector, mainly industrial and healthcare assets, which we are likely to execute once refinancing has all been completed

The outlook for 2019/20 remains challenging, but with the initiatives we have taken in this financial year, we are confident that the portfolio is well placed to ride out the market conditions and to benefit from positive changes in market sentiment in the future.

We're appreciative of the time you have taken to join us and look forward to welcoming our shareholders at our AGM on the 24<sup>th</sup> June. We encourage you to please take a look at the financial information pack now available on our website and invite you to provide any feedback.

We will now hand back to the host who will open the call for questions.

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### **Question and Answer Session**

#### **Operator**

*[Operator instructions]*

Our first question is from Mohamad Haidar from Arqaam Capital. Please go ahead.

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**Mohamad Haidar**

I have a question on FFO. We have seen gross rentals growing to \$10 million in the last quarter, but FFO fell to \$2.5 million. Is this purely because of higher finance charges? I think we have seen also margins compressing from 80% to 73%. What is the reason behind this or the higher costs in this last quarter?

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**Muhammad Asif Siddique**

If you look at the financing cost, it increased over the year. As the interest rates increased, so too did the financing cost, but there is one other element which is a one-off cost. When we concluded the Standard Chartered facility, the first tranche was used to refinance existing debt facilities and any arrangement fee which was associated with the existing debt and had not been fully expensed, to that proportion which was refinanced, was charged in this quarter, so roughly half a million dollar one-off expense is part of that financing cost number. That is one of the items which created the gap in this FFO than any other quarter.

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**Mohamad Haidar**

So is it fair to assume that the FFO run rate in future quarters should be at 3 million and not 2.5 million?

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**Muhammad Asif Siddique**

That is correct, as long as the occupancies and finance costs remain the same.

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**Anthony Taylor**

Just to add to that, as we have indicated, there are some challenges on our largest asset, Al Thuraya 1, with one of our larger tenants vacating in this quarter. So we're likely to see a bit of pressure on that and as that will fill up, that run rate should be maintained or improving slightly, but in the next quarter we might see similar numbers coming through.

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**Mohamad Haidar**

And, sorry, Anthony, which specific asset is this tenant vacating?

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**Anthony Taylor**



Al Thuraya 1, our office building.

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**Mohamad Haidar**

And if understood correctly, you mentioned that occupancy in Burj Daman will improve to 80%.

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**Anthony Taylor**

Yes, we've achieved leasing in this asset during this quarter, Q2 2019, so that should be trending up to just below 80%.

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**Mohamad Haidar**

Okay, can you share at what rent per square foot are leased out in Burj Daman, please?

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**Anthony Taylor**

Well, we can actually. We're pleased to refer you to our financial information pack where we've tried to illustrate the average rent achieved on each asset per square foot. What we can't do is give the details of every lease. Obviously, that will impact our negotiations with tenants, but what we've tried to provide analysts is with as much information as possible to show you the types of rates that are being achieved on those assets, so please have a look on that. I believe it's up on the website now, so that will give you a good idea of the rates that we're achieving on all assets.

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**Mohamad Haidar**

Absolutely and given that all assets are nearly consolidated now, we should expect growth to arrive purely from higher occupancy/higher rents going forward, assuming no other new acquisitions.

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**Anthony Taylor**

True. I think where you'll see growth is coming through in the acquisitions as well as we still have some facilities available to deploy and if we look at the yields, the net yields, that we are able to achieve on acquisitions versus the cost of those facilities to draw down, there is a healthy spread that will improve the returns to the shareholder.

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**Mohamad Haidar**



And we've seen dividends at 100% of FFO in 2018. Is this the REIT's strategy going forward, because the mandate said that they should pay at least 80%, but you're paying 100% now? Is this where we should see dividends out going forward?

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**Anthony Taylor**

I think for the short to medium-term, yes, it's safe to assume we'll be looking to pay out 100% of our net rental income achieved through any period. We're slightly off the targets that we want to be in terms of dividend yield and until we reach those targets, we'll be paying out to shareholders as much as we can.

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**Mohamad Haidar**

Is it an option also for the REIT to exceed the 100% maybe if FFO falls a bit due to market conditions?

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**Anthony Taylor**

No. No, we will not take that strategy to distribute more than what we're generating in any particular period.

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**Operator**

Our next question comes from Anastasios Dalgiannakis, Green Coast. Please go ahead.

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**Anastasios Dalgiannakis**

I just wanted to ask, I really do not understand why you are not able to completely delete the other expense line that is 2.1 million versus 2.4 million for the previous year, so if we look at previous year, all the expenses they should have been reduced very significantly starting from legal, board fees – I assume you will not be paying your board anything, given you're making losses – and then miscellaneous expense should also be eliminated. Why are you failing constantly to eliminate that line and provide a boost to FFO through aggressive cost cutting? Thank you.

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**Muhammad Asif Siddique**

We looked at all the options how we can reduce the cost and we have some priorities. We looked at the financing cost initially. That was the first step. We are working towards achieving that target. Shortly we will achieve the



refinancing on the remaining facilities. That will help us to improve the FFO. At the same time...

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**Anastasios Dalgiannakis**

No, no, I'm not... excuse me, sorry to interrupt you. I'm not interested at all in the finance cost line. I am highlighting the other expenses. These are 2.1 million of expense there that should be explained to me why it's still 2.1 million and it's not going to zero. Why is that still the case? I'm not interested at all in the refinancing. You have board and committee fees there, that should be zero given you are making losses. You have legal and professional fees that were 10 times up in 2018 that should go much lower, and you have miscellaneous expenses that were inflated by \$250,000 in '18 that should also be reversed.

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**Anthony Taylor**

I think your point is well received. What we have been doing this year and we continue to do into the next financial year is to tackle the largest expenses in an orderly manner. One of our biggest costs has been, as Asif has addressed, the financing. We've dealt with that. We're now looking at some of the costs associated with the assets, which are the next biggest cost, and we are also working down through the fund level expenses to try and achieve savings. I don't think it's reasonable to not pay non-exec board members fees. That is not a strategy that we will be employing, but we are tackling...

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**Anastasios Dalgiannakis**

Other companies listed in the DFM – sorry to interrupt you, but other companies listed in the DFM when they make losses they eliminate board fees. We have seen that precedent in the DFM. I'm not sure why a non-exec or exec should be paid anything when you are making losses. It's a very market standard practice that aligns with board members, with the shareholders.

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**Anthony Taylor**

I think when we look at the health of this REIT and the losses that you're referring to are movements in valuations that have been impacted by market conditions. If you look at the income that's being generated off these buildings, these losses are not there, so again, we are managing a portfolio in difficult real estate market conditions. We are still maintaining healthy occupancies and generating positive income from these portfolios. I appreciate that the market has been soft and we are seeing some



movements in the valuations, but I don't think that would be sufficient to warrant that type of approach.

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**Operator**

Our next question comes from Ahmed Bajunaid, Bupa Arabia. Please go ahead.

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**Ahmed Bajunaid**

I have a couple of questions, just related probably to the previous topic around the expenses. Could you just elaborate on the breakdown of the fund expenses, what did they actually cover, if you can provide a breakdown? Also, on the financing costs, so you've mentioned you have plans to basically reduce the financing costs with some refinancing plans going forward, what's your expectations of the savings and what's the timeframe that you're... I mean, the timeframe where you will be achieving these savings, given that potentially all the future acquisitions will be done with debt? In this regard as well, so what's your targeted LTV that you're looking into in 2019? My understanding is that now the regulatory threshold is around 70%, if I'm not mistaken. Would you please confirm that? What would be your target related to that? I think more importantly just understanding, so the valuation impact here, I don't know, so what's your expectation now seeing what's in the market and the updated compositions of the portfolio? If we see more valuation or revaluation pressures going forward, how are you actually looking into the LTV? Do you see... I mean, what's your perspective in the LTV ratio with potentially further revaluations going forward?

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**Anthony Taylor**

There's quite a few points there to cover, so let me ask Asif to tackle the fund expenses and financing costs, and then I'll tackle the LTV and the strategy on the portfolio.

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**Muhammad Asif Siddique**

So if you look at the fund expenses, we have a management fee, which is part of the fund expenses, that's generally 1.5% of the NAV or the equity, so we are not charging anything on the debt, so it's very clear that the management fee is calculated on a quarterly basis on the NAV. In addition to that, there is obviously the board and committees cost, and regulatory requirements are there, so NASDAQ or the DFSA, those regulatory bodies we have to pay some fees, and in addition to that, administrative and custodian is there, so these are the main costs which are a part of it, and legal



expenses and IR and PR costs are part of the fund expenses. That's the composition of the fund expenses, but in terms of the financing cost, as I mentioned earlier that we have prioritised this on top, because this is one of the major expenses at a REIT level. This takes a major chunk of the net rental income, so we have addressed through [SCB] and we are going to address through refinancing, but in the year one it's always challenging to find the same results when the financing is done, refinancing or additional financing is happening, so we will see the results in the following year in terms of the finance cost reduction, but going forward, as we have seen in the international market, there is the possibility that there will be rate cuts. That will also impact positively on the net yield, which in comparison to last year, but it will have its impact on the cost side.

In terms of the LTV, Anthony will touch on that.

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#### **Ahmed Bajunaid**

Just before the LTV [audio], so now on the... you're saying... so the management fee is also part of the expenses. I just wanted to double-check, because there are two separate lines of 4 million and 6 million between the management fee and fund expenses, which have been under control between the two fiscal years, actually going down a little bit, so I'm just trying to understand, so going forward, how do we expect these two fees... I mean, management fees is probably more of a factor of the NAV, which is going down a little bit with valuations, but with fund expenses and all these administrative costs, either the actual operation or the... trying to be a bit more economical to save some of these fees, or now just probably also kind of reiterating the previous comment from the previous caller, with the results that we're seeing today, will there be any considerations from management to actually reconsider how these fund expenses are calculated or passed onto the investors.

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#### **Anthony Taylor**

Yes, just to address that last point, again yes, we are looking at all the expenses in the portfolio and, yes, we are looking to mitigate and minimise expenses as much as possible to generate returns for shareholders. As Asif has touched on, there are a number of on-going expenses that are required for a listed entity of this nature, and we will maintain those boards/committees in the appropriate manner, but we are looking to bring down our costs across all levels of the portfolio. The right strategy in this exercise is to tackle the largest expenses first and that's what we have been doing up until now. We will continue to do that over the next financial year.

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**Ahmed Bajunaid**

And so just would you update us on the potential valuation and impact on LTV?

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**Anthony Taylor**

Yes, so just to correct you on the regulations and the LTV, those currently still sit at 50%. There have been exemptions given to other entities for that LTV to increase. It's not something that we're exploring at the moment. I think I agree with you in current market conditions is a less levered position is prudent. However, sitting at the 40% LTV we had always had a target of being at around 45%, and again given the nature of real estate, we allow ourselves some flexibility; you can't choose the size of the assets always in terms of the ones you want to acquire, so we have a bit of flexibility to going up to 50%, but our target remains 50. We're obviously very mindful if we are getting closer to that 50% LTV in the current market conditions that we may be breaching that covenant, and it's not something that we would actively set out to do, so we're maintaining a very measured approach in the opportunities that we're looking to acquire, and watching how the impact on our current portfolio is reacting over the next quarters when making acquisition decisions. But to give you the guidance, we will be in that 45-50% range, hopefully, by the end of the year.

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**Ahmed Bajunaid**

If you don't mind, just one more follow-up question. So just on the assets, on the portfolio, so looking at the Al Thuraya assets now, and some of the other residential assets that have less than a year of WAULT, so is your plan to renew these leases and improve the occupancy going forward, or any plans to basically to let that expire, sell... would you be looking into selling any of the assets within the portfolio today?

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**Anthony Taylor**

I think the two are very different questions. One, our strategy is always to renew leases on the longest terms possible. Even if we had identified an asset for sale, it makes sense to be selling it with a strong income stream being generated from that asset, so yes, where we've seen our unexpired lease terms coming in, we are actively sitting with those tenants looking to renew and renew for as long as possible, and to give an indication of that, we'd offer preferential rates if they were to sign for a longer-term than if they were to renew year-on-year (in which case, we typically charge the tenant a slight premium to remain in this space.) But given the current market conditions, we also see that a lot of tenants are hesitant to take on commitments past year-on-year lease agreements, so again we have to work





with it. We're not looking to lose these tenants, but where we can, we will try and get them to commit for a longer period, and we'll incentivise them to do that as well. That's on the leasing.

On the acquisitions side... or, sorry, on the disposals side, we are constantly looking at this portfolio and identifying assets where long-term strategies either fit or fall outside of our targeted holdings. There are... again, if you go through our detailed financial information pack, there are assets today that you could see from the net yields are probably not performing where they should be, and then the decision for us is whether we look to hold them and manage them back up to a position that they do perform, or if we feel that they are opportune to dispose and reinvest that money elsewhere, we would also take that decision. So we are not averse to selling. Obviously, the market conditions now are not conducive to achieving the highest price, but we will weigh up that with the benefit of reinvesting that money in higher yielding assets, if any of those decisions are made.

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*[No further questions]*

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**Anthony Taylor**

Thank you everyone for joining this call and we look forward to seeing our shareholders at the AGM on the 24<sup>th</sup>. Have a good day.

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