

COMPANY UPDATE

Digital Core REIT (DCREIT SP)

Impending Acquisition At Huge Valuation Discount Provides Lucrative Yield

DCREIT has exercised its option to acquire additional interest in a Frankfurt data centre at an attractive discount of 17.8% to the refreshed valuation and 1H24 NPI yield of 5.7%. Based on existing market conditions, acquiring 10% of the Frankfurt data centre provides DPU accretion of 1.7%. If market conditions improve, acquiring a 40% stake enhances DPU accretion to 7.0%. DCREIT provides 2025 distribution yield of 6.1% (KDCREIT: 4.3% and MINT: 5.3%). Maintain BUY. Target price: US\$0.88.

WHAT'S NEW

- Increasing stake in Frankfurt data centre at lucrative NPI yield.** Digital Core REIT (DCREIT) has exercised its option to acquire an additional stake of 0.2-40.0% in Wilhelm-Fay Straße 15 and 24, a fully fitted freehold data centre in Frankfurt, from sponsor Digital Realty. Based on existing market conditions, DCREIT is likely to acquire an additional interest of 10.0%, which brings its aggregate interest in the Frankfurt data centre to 59.9%. The purchase consideration estimated at €47.0m (US\$51.7m) represents an attractive discount of 17.8% to the refreshed valuation. The latest valuation has increased 13% to US\$628.7m compared to US\$556.4m as of Dec 23. It generated NPI of €13.4m (US\$14.7m) in 1H24. The additional stake provides an attractive NPI yield of 5.7%.
- Continuing to increase geographical diversification.** The acquisition is fully funded by a Euro-denominated term loan at an all-in cost of 3.6%. It is expected to be accretive to pro forma 2023 DPU by 1.7%. NAV per unit would increase 4.5% to US\$0.70. Aggregate leverage will increase by 1.3ppt to 35.8%. Geographically, the reliance on North America would be reduced from 66% to 63%. Data centres in Germany and Japan have expanded by 3ppt to 37% of annualised rent (Frankfurt: 29%, Osaka: 8%).
- Operational improvements led to higher valuation.** The state-of-the-art Frankfurt data centre was completed in 2017 (phase I) and is located within the supply-constrained Sossenheim sub-market. It is linked via dark fibre to the sponsor Digital Realty's crosstown Hanauer Landstraße campus, a leading connectivity hub. It is 100% powered by renewable energy. Two anchor tenants, hyperscale cloud service providers rated AAA and AA+ respectively, have renewed their leases for five years at positive cash rental reversion of 2.0% in 1Q24. Occupancy for the Frankfurt data centre improved 6.3ppt qoq to 98.5% in 2Q24 after signing several new leases. There is growth potential to lease-up the remaining vacant space of 1.5%.
- Contemplating potential blue-sky scenario.** Management has up to early-Dec 24 to decide on the size of stake to acquire. If market conditions improve, DCREIT could acquire up to 40% of the Frankfurt data centre. In this scenario, the acquisition would be accretive to pro forma 2023 DPU by 7.0%. NAV per unit would increase 6.0% to US\$0.71. Aggregate leverage increases by 6.5ppt to 41.0%.

KEY FINANCIALS

Year to 31 Dec (US\$m)	2022	2023	2024F	2025F	2026F
Net turnover	115	103	94	92	95
EBITDA	61	52	45	40	42
Operating profit	61	52	45	40	42
Net profit (rep./act.)	0	(109)	34	36	38
Net profit (adj.)	31	33	32	36	38
EPU (US\$ cent)	2.8	3.0	2.4	2.7	2.8
DPU (US\$ cent)	4.0	3.7	3.6	3.6	3.7
PE (x)	21.4	20.1	24.7	22.0	21.4
P/B (x)	0.7	0.8	0.9	0.9	0.9
DPU Yld (%)	6.7	6.2	6.0	6.1	6.2
Net margin (%)	0.1	(105.8)	36.1	39.7	39.8
Net debt/(cash) to equity (%)	50.3	68.7	56.5	58.9	61.3
Interest cover (x)	5.8	2.6	3.2	2.2	2.2
ROE (%)	n.a.	(12.6)	4.0	4.1	4.3
Consensus DPU (US\$ cent)	-	-	3.5	3.6	3.7
UOBKH/Consensus (x)	-	-	1.02	1.01	1.00

Source: Digital Core REIT, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	US\$0.595
Target Price	US\$0.88
Upside	47.9%
(Previous TP)	US\$0.86

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), Canada (Toronto), Germany (Frankfurt) and Japan (Osaka) with an appraised valuation of US\$1.3b. 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):	1,298.8
Market cap (US\$m):	772.8
Market cap (US\$m):	772.8
3-mth avg daily t'over (US\$m):	1.9

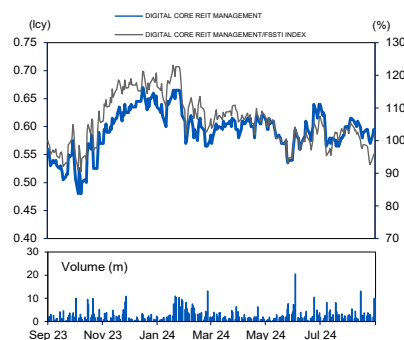
Price Performance (%)

52-week high/low	US\$0.675/US\$0.435			
1mth	3mth	6mth	1yr	YTD
(0.8)	10.2	5.3	6.2	(7.8)

Major Shareholders

Major Shareholders	%
Digital Realty Trust	30.9
Sumitomo Mitsui Fin	5.4
Cohen & Steer	7.0
FY24 NAV/Share (US\$)	0.67
FY24 Net Debt/Share (US\$)	0.38

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- **Merits of impending acquisition overlooked by the market.** DCREIT has been a laggard in the recent rally for data centre REITs, which benefits from increased demand from adoption of generative AI. We expect the sizeable discount of 17.8% to the refreshed valuation and lucrative NPI yield of 5.7% for the impending acquisition to be a catalyst for DCREIT to catch-up with peers in terms of share price performance.
- **Signing direct leases with end-user customers at Los Angeles.** Leases for the two Los Angeles data centres (200 North Nash Street and 3015 Winona Avenue) were assigned to Brookfield and amended to expire earlier in Sep 24 as part of the agreement to resolve the bankruptcy of Cyxtera. DCREIT is actively signing direct leases with end-user customers at both data centres, which were previously 57% occupied. Management is confident of retaining 80% of Cyxtera’s colocation customers. DCREIT takes over the operations of the two data centres in Oct 24.
- **Weighting alternatives at Linton Hall Road.** Lease for data centre at 8217 Linton Hall Road in Northern Virginia is due for expiry in Jun 25. The data centre is water-cooled and can support high power density AI workloads. It accounts for 11.4% of DCREIT’s annualised rents. The existing tenant has not commenced negotiation for extension or renewal. Management could release the data centre as Northern Virginia has the tightest vacancy rate at a record-low of 0.9%. According to datacenterHawk, rental rate for Northern Virginia is projected to increase 10.5% to US\$210/kW/month on a wholesale basis in 2024. Alternatively, management could consider redeveloping the 32-acre site (equivalent to 18 football fields) to expand capacity. The data centre has a 24MW NOVEC sub-station on site.
- **Maintaining conservative level of gearing.** Aggregate leverage edged slightly higher by 0.8ppt qoq to 34.4% as of Jun 24 due to its share buyback programme. DCREIT has debt headroom of US\$134m based on aggregate leverage of 40%. Management could deploy the headroom for acquisitions or share buybacks.
- **Cost of debt moderated due to repositioning.** DCREIT repaid US\$140m of floating rate loans at 6.4% in Mar 24 using proceeds from the divestment of two Silicon Valley data centres completed in Jan 24. It has secured a four-year yen-denominated term loan at an all-in cost of 1.5% from Mizuho. Yen-denominated borrowings have expanded by 9ppt to 17% of its total debt as of Jun 24. Thus, average cost of debt eased 0.6ppt yoy to 4.1% in 2Q24 (1Q24: 3.9%). Management expects cost of debt to be stable at 4.1% in 2024 as 93% of its borrowings are hedged to fixed interest rates.

EARNINGS REVISION/RISK

- We raise our 2025 DPU forecast by 2% due to the acquisition of an additional 10% stake in the Frankfurt data centre, which is expected to start contributing in 1Q25.

VALUATION/RECOMMENDATION

- **Maintain BUY.** Our target price of US\$0.88 is based on DDM (cost of equity: 6.5%, terminal growth: 2.5%).
- **Pure play on data centre.** DCREIT provides a distribution yield of 6.1% for 2025 (KDCREIT: 4.3% and MINT: 5.3%).

SHARE PRICE CATALYST

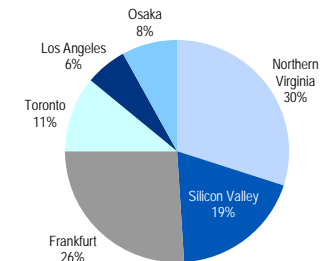
- Yield-accretive acquisitions tapping on sponsor’s extensive data centre pipeline.
- Organic growth from cash rental escalation of 1-3% (weighted average: 2%).

KEY OPERATING METRICS – DCREIT

	2Q23	3Q23	4Q23	1Q24	2Q24	yoy % Chg	qoq % Chg*
DPU (US cents)	1.92	n.a.	1.78	n.a.	1.80	-6.2%	1.1%
Occupancy	97.0%	97.0%	97.0%	95.0%	97.0%	0ppt	2ppt
Aggregate Leverage	34.2%	34.4%	33.5%	35.1%	34.4%	0.2ppt	-0.7ppt
Average Cost of Debt	4.7%	5.1%	4.7%	3.9%	4.1%	-0.6ppt	0.2ppt
WALE by Annualised Rents (years)	3.9	3.6	2.8	2.8	2.8	-1.1yrs	0yrs
Weighted Average Debt Maturity (years)	3.4	3.2	2.8	2.7	2.4	-1yrs	-0.3yrs
% of Borrowings in Fixed Rates	72%	72%	73%	93%	93%	21ppt	0ppt

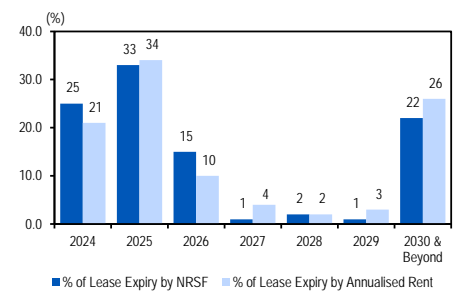
Source: DCREIT, UOB Kay Hian * hoh % chg for DPU

RENTAL INCOME BY CORE MARKET



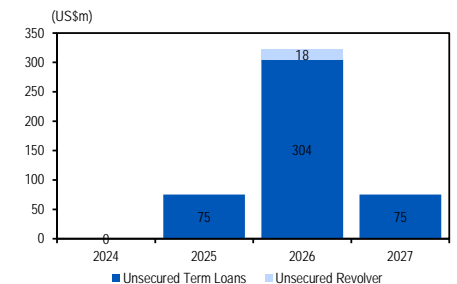
Source: DCREIT

LEASE EXPIRY PROFILE



Source: DCREIT

DEBT MATUITY PROFILE



Source: DCREIT

8217 LINTON HALL ROAD



Source: DCREIT

PROFIT & LOSS

Year to 31 Dec (US\$m)	2023	2024F	2025F	2026F
Net turnover	102.6	94.0	91.5	94.8
EBITDA	51.5	45.3	40.2	42.0
Deprec. & amort.	0.0	0.0	0.0	0.0
EBIT	51.5	45.3	40.2	42.0
Total other non-operating income	(141.9)	2.0	0.0	0.0
Associate contributions	(15.9)	12.5	20.8	21.2
Net interest income/(expense)	(20.1)	(14.0)	(18.3)	(18.8)
Pre-tax profit	(126.4)	45.8	42.8	44.4
Tax	9.6	(6.5)	(1.2)	(1.2)
Minorities	8.1	(5.3)	(5.3)	(5.5)
Net profit	(108.6)	34.0	36.3	37.8
Net profit (adj.)	33.3	32.0	36.3	37.8

BALANCE SHEET

Year to 31 Dec (US\$m)	2023	2024F	2025F	2026F
Fixed assets	1,114.9	1,118.6	1,126.6	1,134.6
Other LT assets	194.2	413.0	413.0	413.0
Cash/ST investment	12.1	23.0	23.6	22.3
Other current assets	187.9	11.0	11.0	11.3
Total assets	1,509.0	1,565.6	1,574.2	1,581.2
ST debt	0.0	0.0	0.0	0.0
Other current liabilities	23.0	20.4	20.6	21.3
LT debt	555.5	528.0	545.0	560.0
Other LT liabilities	10.9	11.7	11.7	11.7
Shareholders' equity	790.5	894.0	885.4	876.7
Minority interest	129.2	111.6	111.6	111.6
Total liabilities & equity	1,509.0	1,565.6	1,574.2	1,581.2

CASH FLOW

Year to 31 Dec (US\$m)	2023	2024F	2025F	2026F
Operating	59.4	61.8	63.4	65.7
Profit for the year	(126.4)	45.8	42.8	44.4
Tax	9.6	(6.5)	(1.2)	(1.2)
Deprec. & amort.	0.0	0.0	0.0	0.0
Associates	15.9	(12.5)	(20.8)	(21.2)
Working capital changes	12.3	(2.9)	0.1	0.3
Non-cash items	148.7	8.2	9.5	9.6
Other operating cashflows	(0.8)	29.6	33.0	33.8
Investing	(48.0)	(74.9)	(8.0)	(8.0)
Capex (growth)	0.0	0.0	0.0	0.0
Investments	143.1	407.7	407.7	407.7
Others	(191.1)	(642.8)	(415.7)	(415.7)
Financing	(25.0)	24.1	(54.8)	(58.9)
Distribution to unitholders	(43.0)	(45.9)	(48.5)	(50.1)
Proceeds from borrowings	51.5	0.0	17.0	15.0
Loan repayment	0.0	27.5	0.0	0.0
Others/interest paid	(33.5)	97.4	(23.3)	(23.9)
Beginning cash & cash equivalent	25.2	12.1	23.0	23.6
Changes due to forex impact	0.0	0.0	0.0	0.0
Ending cash & cash equivalent	11.7	23.0	23.6	22.3

KEY METRICS

Year to 31 Dec (%)	2023	2024F	2025F	2026F
Profitability				
EBITDA margin	50.2	48.2	44.0	44.3
Pre-tax margin	(123.2)	48.8	46.7	46.8
Net margin	(105.8)	36.1	39.7	39.8
ROA	(7.0)	2.2	2.3	2.4
ROE	(12.6)	4.0	4.1	4.3
Growth				
Turnover	(10.8)	(8.4)	(2.6)	3.6
EBITDA	(15.1)	(12.0)	(11.2)	4.4
Pre-tax profit	n.a.	n.a.	(6.7)	3.9
Net profit	n.a.	n.a.	7.0	3.9
Net profit (adj.)	6.8	(4.1)	13.7	3.9
EPS	6.5	(18.9)	12.5	2.9
Leverage				
Debt to total capital	37.7	34.4	35.3	36.2
Debt to equity	70.3	59.1	61.6	63.9
Net debt/(cash) to equity	68.7	56.5	58.9	61.3
Interest cover (x)	2.6	3.2	2.2	2.2

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