Quarz Capital Management, Ltd. Sends Open Letter to the Board and Management of Sabana REIT and ESR Cayman to Engage on the Proposals to Unlock a Total Potential Return of >30% in Sabana REIT's Unit Price

GEORGE TOWN, Cayman Islands, November 14, 2019 /PRNewswire/ -- Quarz Capital Management, Ltd. (QCM), an investment manager, today issued a letter urging Sabana REIT to expeditiously execute on multiple levers such as the optimization of occupancy rates, enhancement of its 151 Lorong Chuan flagship asset and the utilization of its substantial debt headroom of more than ~S$150million to potentially increase its DPU by more than ~45% to S$0.0422 (Dividend yield of ~9.4%) by 2021E. Sabana also has a substantial untapped plot ratio which can potentially increase its GFA by more than ~1.3million when fully utilized.

QCM believes that the sizeable discount that Sabana trades to its book value can be attributed to ESR's majority controlling stake in the managers and substantial unitholdings in Sabana and ESR REITs. This has created substantial overlapping investment mandates of the both REITs which can potentially result in corporate governance concerns. We find ESR's argument that they can manage the 2 REITs independently unconvincing. Both REITs primarily invest in the Singapore industrial real estate sector which is limited in size and transactions, which can undoubtedly result in both REITs bidding for the same assets as well as evaluating potential transactions regarding each other's portfolio. With recently HK-listed ESR having a fiduciary duty to enhance shareholder value through maximizing the value of its investments, its substantially larger stake (by value) in ESR REIT can potentially create corporate governance concerns on which REIT should have priority. It is also inequitable to minority investors if the REITs are forced to invest out of Singapore such that ESR can mitigate this issue.

QCM proposes that ESR REIT merge with Sabana REIT in a cash and unit transaction where 0.92 units of ESR REIT and S$0.067 of cash will be exchanged for 1 unit of Sabana REIT (total value of ~S$0.545 per unit, ~2.7% discount to book value). The merger can solve the critical issue of overlapping investment mandates between the 2 trusts which has important corporate governance implications.

For Sabana REIT unitholders, this potential offer provides an attractive takeover premium of ~21% and addresses the persistent discount at which the unit price trades to its Net Asset Value partly due to continued lack of information on the resolution of the overlapping investment mandates of the 2 REITs.

ESR REIT unitholders can potentially benefit from a ~7% jump in DPU (Dividend yield of ~7.1%) post-merger attributed to the optimization of the many levers for Sabana's portfolio which includes the addition of a retail component at 151 Lorong Chuan post 2Q20 and optimization of management fee payments and occupancy rates. Sabana also has more than ~1.3million of untapped GFA which ESR REIT can capitalize on. Due to the low leverage ratio of Sabana (~30.9%), the combined entity will have ~S$180m of debt headroom to make DPU accretive acquisitions.

The combined entity will be the 4th largest SGX-listed industrial REIT investing in Singapore with assets in excess of ~S$3.9billion. The potential free float Market Cap of ~S$1.4billion is proximate to the estimated ~S$1.7billion required to be included in the FTSE EPRA NAREIT Developed Markets Index which can drive a further rerating of its unit price.

We are positive that the inclusion of the enlarged Trust in the index and potential increase in global institutional investors following and investing in the Trust can potentially drive further yield compression and unit price upside.

Due to the current overlapping investment mandates and low leverage ratio (~30.9%), we urge Sabana to postpone any significant acquisitions which would require capital raising until full rationalization of the overlap is achieved. Focusing on the optimization of its current asset base such as increasing occupancy rates and enhancing 151 Lorong Chuan are 'low hanging fruits' which can already potentially provide sizeable and attractive DPU upside to Sabana's unitholders.

QCM believes that its recommendations will deliver substantial unitholder value and has delivered the following letter to Sabana's REIT management team, board of directors, ESR Cayman and other stakeholders.

QUARZ CAPITAL MANAGEMENT, LTD. ISSUES OPEN LETTER TO THE MANAGEMENT AND BOARD OF SABANA REIT (SGX: M1GU) AND ESR CAYMAN (HKG:1821)

ALL RECIPIENTS ARE ADVISED TO READ
"**IMPORTANT DISCLOSURE INFORMATION**"
AT THE END OF THE ATTACHED LETTER

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14 Nov 2019

PROPOSALS TO EXPEDITE THE INCREASE IN UNITHOLDER RETURNS AND THE MERGER OF ESR AND SABANA REITS

POTENTIAL CAPITAL GAINS AND DPU CAN GENERATE TOTAL RETURN IN EXCESS OF 30%

Dear Mr. Han, Mr de Portes and Members of the Board of Sabana REIT and ESR Cayman,

Quarz Capital with its affiliates have been long-term unitholders of Sabana REIT (the "Trust", "Firm", "Sabana", or "SSREIT SP") and are collectively one of the top 5 unitholders of the firm. We commend the board and management for their outstanding execution on the key initiatives outlined in the 2017 Strategic Review.

Non-core assets have been successfully disposed decreasing Sabana's leverage ratio to 30.9%, one of the lowest levels among S-REITs. In particular, Geo-Tele Centre was disposed at 3x its book value, netting the Trust a rich profit of ~S$66million. Exposure to master leases from Vibrant has also been reduced with the successful lease out of 18 Gul Way. The remaining 2 Vibrant leases expire in Nov 2020. Nr. 32&35 Penjuru Lane is a high specification chemical logistics Hub with an untapped GFA of 400,000 sqft while Nr. 51 Penjuru also has an untapped GFA of 150,000 sqft. We are positive in the tenantability of these assets given their competitive rent and high specifications. Our research reveals large income accretive opportunity through redevelopment and increase in rentable space.

We have identified multiple levers that Sabana has at its disposal to increase DPU by more than ~45% (Dividend yield of ~9.4%) by 2020E:

1) Completion of ~43,000 sqft retail space (F&B, supermarket, childcare, school etc.) at 151 Lorong Chuan ("New Tech Park") in 2H2020 can potentially yield incremental annual net property income ("NPI") of S$3.3million p.a.
2) Debt headroom of ~S$150million (factoring leverage ratio of ~41% vs ~31% currently) to purchase yield accretive assets which can potentially yield another S$10million in net property income.
3) Optimization of occupancy rate to national level of ~89% potentially generates an additional NPI of ~S$3.4million.
4) Partial payment of management fees in units can potentially increase distributable income by ~S$3m additionally.

Altogether, DPU can increase to S$0.0422 which can make Sabana one of the highest yielding SGX-listed REITs with Singapore assets. In the mid-term, 151 Lorong Chuan's underutilized plot ratio can be further optimized to yield an additional ~240,000 sqft of prime business park space while other key assets such as Nr. 32&35 Penjuru, Nr. 51 Penjuru, 3A Joo Koon Circle and 26 Loyang Drive can potentially increase their GFA by more than 50% yielding an additional ~1.3million sqft of total industrial space. We therefore call on the board and management to expedite on the execution of these levers to substantially boost unitholder returns in the near and mid-term.

We believe that it is for the same reasons that ESR Cayman ("ESR" or "1821 HK") purchased a substantial stake in Sabana at S$0.48/unit as well as the controlling stake in the REIT's manager at an estimated rich premium of P/E 2017 and 2018 of ~33.6x and ~26.1x respectively[1]. We welcome ESR as a major unitholder and owner of the REIT manager. With ESR's extensive expertise and success in Asia Pacific industrial real estate, we are confident in their capability to further drive value for Sabana REIT.

ESR's controlling stakes in the managers and major unitholdings in ESR and Sabana REITs have unfortunately created substantial overlapping investment mandates of the 2 REITs. Both REITs are mainly invested in Singapore industrial real estate properties. The cross ownership of its managers can potentially result in corporate governance concerns especially relating to divestments and acquisitions of properties. This key issue has been identified by the Monetary Authority of Singapore (MAS) when it did not approve the manager of the then Cambridge REIT (now ESR REIT) to be the manager of the then Macarthur Cook REIT (now AIMS APAC REIT) due to severe concerns of overlapping investment mandates. It also partly drove the merger between Ascott and Ascendas Hospitality Trust.

This issue is particularly critical for Sabana which has substantial debt headroom to make DPU accretive acquisitions. We are not convinced by ESR's argument that they are able to clearly manage Sabana and ESR REITs independently. As a recently listed company in Hong Kong, ESR has a fiduciary duty to enhance the value of their shareholders which translates to ensuring that the value of its stakes in both ESR and Sabana REITs are maximized. The 2 REITs primarily invest in the Singapore industrial sector which is limited in size and transactions. Undoubtedly, both might tender for the same assets. As ESR's stake in ESR REIT has a substantially larger value vs the stake in Sabana, this can potentially create corporate governance concerns on which REIT should have priority. It would be clearly inequitable to Sabana's minority unitholders if the REIT is forced to invest out of Singapore such that ESR can mitigate this issue. The duplicity in cost to manage the 2 REITs independently is also suboptimal for ESR shareholders.

We believe that the uncertainty over its future and the continued lack of information on the resolution of the overlapping investment mandate are some of the key reasons resulting in Sabana to trade at a sharp discount of ~20% to its book value of S$0.56 per unit.

<u>Quarz believes that a Win-Win value accretive solution for all stakeholders including ESR is the merger by way of a Trust Scheme between ESR and Sabana REITs. We propose a cash + unit offer totaling ~S$0.545 per Sabana unit (proximate to book value) comprising of 0.92 ESR units and S$0.067 of cash for 1 Sabana unit.</u>

<u>For Sabana unitholders, this represents an attractive merger premium of ~20%.</u> This price is higher than that paid by ESR for Vibrant's stake in Sabana (S$0.48/unit). However, the critical difference is that Vibrant could bundle the sale of the controlling stake in the REIT manager at a rich valuation of P/E 2018 of 26.1x together with Sabana units in the all-cash transaction.

With the completion of the 151 Lorong Chuan retail extension, optimization in the payment of management fees, as well as vacancy rates, ***<u>we believe that DPU to ESR unitholders in the enlarged REIT can jump by ~7% to S$0.037[2] (Dvd Yield of ~7.1%).</u>*** Sabana's low leverage ratio of 30.9% results in overall leverage level to decline to ~40.4% which can potentially increase DPU by another ~4% to ~S$0.0385 (Dvd Yield of ~7.4%) to unitholders of the enlarged REIT when fully utilized.

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[1] 51% stake at ~S$21million (valuation of ~S$41million for entire manager). Sabana's REIT manager had net profit of S$1.19million and S$1.53million respectively in 2017 and 2018

[2] Excluding capital return in ESR REIT's 1H19 distributable income

The increase in debt headroom of the enlarged REIT to more than ~S$180million can enable ESR to capitalize on its extensive network and industry expertise to make value accretive acquisitions regionally. We are confident in their capability to build the enlarged trust into a successful Pan Asian industrial real estate REIT.

The combined entity will be the 4th largest Industrial REIT owning Singapore assets and rank among the 14th largest REITs[3] in Singapore with assets in excess of ~S$3.9billion. The potential free float Market Cap of ~S$1.4billion is proximate to the ~S$1.73billion required to be included in the FTSE EPRA NAREIT DM index tracked by global REIT funds with >S$250billion of assets under management. We are bullish that the inclusion of the enlarged Trust in the index and the increase in global institutional investors following and investing in the Trust can potentially drive further yield compression and unit price upside.

It would be critically detrimental to the interest of Sabana's unitholders if the Trust was limited to investing in certain jurisdictions or asset classes such that ESR could resolve the overlapping investment issue brought about by its purchase of Sabana's manager. This is especially in view of the immense value accretive opportunity in the combination of the 2 REITs.

Due to the overlapping investment mandates and the low leverage level, we urge Sabana to postpone any significant acquisitions which would require capital raising until the clear rationalization of the investment mandate overlap. Focusing on the optimization of the occupancy rates of the existing asset base and the enhancement and refurbishment of 151 Lorong Chuan are 'low hanging fruits' which can potentially provide sizeable and attractive DPU upside to Sabana's unitholders.

Quarz firmly believes that its recommendations can provide a clear pathway to deliver a significant potential total return of more than ~30% for all Sabana's unitholders in the mid-term. As long-term unitholders, we look forward to working with Sabana REIT's board and management to move forward expeditiously on delivering value to all unitholders.

Sincerely yours,

Mr. Jan F. Moermann
Chief Investment Officer, Quarz Capital Management, Ltd.

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Head of Research, Quarz Capital Asia (Singapore)

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About Quarz Capital Management

Quarz Capital Management, Ltd. is a value oriented and research driven investment advisory firm that seeks to earn above average, long-term returns by identifying value investments across the globe.
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[3] By Asset Base

IMPORTANT DISCLOSURE INFORMATION

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