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Research Update:

AIMS AMP Capital Industrial REIT Rating Affirmed At 'BBB-'; Outlook Stable

Primary Credit Analyst:
Annabelle C Teo, Singapore (65) 6239-6376; annabelle.teo@standardandpoors.com

Secondary Contact:
Kah Ling Chan, Singapore (65) 6239-6336; kahling.chan@standardandpoors.com

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Research Update:

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Overview

- We expect AAREIT to maintain its position in Singapore's industrial property market and stable leverage and financial strength over the next 12-24 months.
- We are affirming our 'BBB-' long-term corporate credit rating and our 'axA-' long-term ASEAN regional scale rating on the Singapore-based industrial REIT.
- The stable outlook reflects our expectation that AAREIT will operate within its financial policy and generate steady cash flows over the next 12-24 months.

Rating Action

On April 4, 2016, Standard & Poor's Ratings Services affirmed its 'BBB-' long-term corporate credit rating on Singapore-based AIMS AMP Capital Industrial REIT (AAREIT). The outlook is stable. We also affirmed our 'axA-' long-term ASEAN regional scale rating on the REIT.

Rationale

We affirmed the rating because we expect AAREIT to maintain its stable position in Singapore's industrial property market and stable leverage and financial strength over the next 12-24 months.

AAREIT's asset quality is good but suffers from some asset concentration. With no major acquisitions since 2011, except for a partial stake in the Optus Centre in 2014, the REIT's top four assets contribute more than 50% of its revenue. However, we believe that this risk is mitigated through AAREIT's continuous improvement of its portfolio through various asset enhancement initiatives, redevelopment projects, and divestments of smaller lower-yielding assets over the past few years. In our view, the REIT's ongoing redevelopment project for 30 & 32 Tuas West Road in fiscal 2016 (year ended March 31, 2016) will strengthen its portfolio. We expect AAREIT to continue to focus on this strategy in the next 12-24 months. This strategy has helped the REIT maintain higher-than-average occupancy rates (of about 93% as of Dec. 31, 2015) and positive rental reversions, despite recent sluggishness in the Singaporean industrial market.

We expect AAREIT's revenue to increase about 6.5% in fiscal 2016, due to full-year contributions from the recently completed 20 Gul Way and 103 Defu

Lane 10. However, revenue growth could slow to 1%-2% in fiscal 2017, on the back of a weak market. We anticipate that the increased supply of industrial space in 2016 and 2017 will likely put pressure on rental reversions. We also forecast AAREIT's EBITDA margins to decline to about 65% in the next three years, from 71% in fiscal 2015, as the REIT continues to convert its master leases to multi-tenanted leases. The conversion will result in marginally declining EBITDA of about Singapore dollar (S$) 85 million in fiscal 2016, and S$82 million-S$84 million in fiscals 2017 and 2018.

We believe that AAREIT has enough rating headroom to absorb a decline in margins and slowdown in revenue growth. We anticipate that AAREIT's ratio of funds from operations (FFO) to debt will remain 12%-13% and its leverage (as measured by the ratio of total debt to total assets) will stay below 35% (31.5% as of Dec. 31, 2015). The REIT's low cost of debt should keep its EBITDA interest coverage at 3.9x-4.5x over the next three years.

Our base-case assumptions for AAREIT include:
- Rental growth of 6.5% in fiscal 2016, and 1%-2% in fiscal 2017.
- Occupancy rates of more than 94%, based on resilient demand and a strong record of tenant retention.
- EBITDA margin of around 71% in fiscal 2016, and 65%-67% in fiscals 2017 and 2018, given the declining exposure to master leases in the next three years.
- No new acquisitions or disposals of assets, with the focus mainly on organic growth.
- Development capital expenditure of about S$30 million in fiscal 2016 and S$40 million in fiscal 2017 for further asset enhancement initiatives and redevelopment projects.

Based on these assumptions, we arrive at the following credit metrics for fiscals 2016-2018:
- Ratio of FFO to debt of 12%-13%.
- EBITDA interest coverage of 3.9x-4.5x.
- A ratio of debt to assets of less than 35%.

Liquidity

We assess AAREIT's liquidity as adequate. This is because we expect the REIT's consolidated sources of liquidity, including cash and internal cash flows, to exceed its needs by more than 1.2x over the next 12 months. We expect liquidity sources to exceed uses even if EBITDA were to decline by 15%. Our liquidity assessment does not contemplate a sudden and sharp drop in property sales over the next 12 months.

AAREIT has S$100 million of debt due in the next 12 months, which we believe the REIT will be able to manage, given its S$144 million of undrawn bank lines available. We estimate that the REIT has significant headroom in the maintenance covenants on its bank facilities. The covenants include maintaining an interest coverage ratio of more than 2.0x and leverage of less than 45%.

Principal liquidity sources include:

- Cash and cash equivalents of about S$7.4 million as of Dec. 31, 2015.
- Cash FFO that we forecast at about S$65 million.
- Undrawn, multi-year, committed bank lines that mature beyond 12 months of about S$144 million.

Principal liquidity uses include:

- S$100 million of debt due in the next 12 months.
- Maintenance capital expenditure that we project at about S$4 million.
- Dividend payment that we estimate to be about S$67 million.

Outlook

The stable outlook reflects our expectation that AAREIT will continue to generate steady cash flows over the next 24 months. It also reflects our view that any future asset acquisitions or development will not raise the REIT's debt-to-asset ratio above 45%, which is in line with its financial policy. We expect AAREIT's EBITDA interest coverage to remain above 3x over the next 24 months.

Downside scenario

We could lower the rating if AAREIT embarks on aggressive debt-funded acquisitions that weaken its capital structure. We could also lower the rating if the quality of the REIT's asset portfolio declines or rental income falls, such that its credit metrics come under pressure. In particular, EBITDA interest coverage weakening to below 2.4x or the FFO-to-debt ratio falling below 9% on a sustained basis could trigger a downgrade.

Upside scenario

We could raise the rating if AAREIT significantly expands its portfolio and asset quality, thereby strengthening its market position and geographic diversity, and optimizes its lease expiry profile to minimize income volatility. We could also upgrade the REIT if it adopts a more conservative leverage policy resulting in the FFO-to-debt ratio being above 15%.

Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/--

Business risk: Satisfactory

- Country risk: Very low
- Industry risk: Low
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Related Criteria And Research

Related Criteria
- Standard & Poor's National And Regional Scale Mapping Tables, Jan. 19, 2016
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013

Ratings List

Ratings Affirmed

AIMS AMP Capital Industrial REIT	
Corporate Credit Rating	BBB-/Stable/--
ASEAN Regional Scale	axA-/--/--