Asia Credit Research

# Earnings Review: Ascott Residence Trust (“ART”)

## Recommendation

- ART has reported a steady set of results in 3Q2018. Encouragingly we saw same-store sales growth on its existing properties. ART’s aggregate leverage though had risen to 36.4% (30 June 2018: 35.7%) and we expect aggregate leverage to rise further to 38% following its recently announced development of a co-living property in one-north which is intended to be debt-funded.
- For the senior bonds, we prefer ARTSP’s 4.00% ‘24s over the new ARTSP 3.523% ’23s. For only a four month additional tenure, the bond is paying 15 bps pick-up. Among the two ARTSP perpetuals, the ARTSP 4.68%-PERP is trading 77bps wider even though its first call date is only eights month longer, indicating that investors are pricing in higher call risk for the ARTSP 4.68%-PERP against the ARTSP 5%-PERP.
- Relative to both the ARTSP perpetuals, we prefer the FHREIT 4.45%-PERP which is paying a YTC of 4.50% with a first call date in May 2021. We hold Ascott Residence Trust (“ARTSP”) and Frasers Hospitality Trust (“FHREIT”) at an issuer profile of Neutral (4) and Neutral (3) respectively.

**Issuer Profile: Neutral (4)**

Ticker: **ARTSP**

**Background**

Ascott Residence Trust (“ART”) invests primarily in serviced residences and rental housing properties. It is the largest hospitality trust listed in the SGX with a market cap of SGD2.3bn. As at 30 September 2018, ART’s portfolio consists of 73 properties with 11,430 units across 37 cities in 14 countries.

By asset value, 60% of ART’s assets are located in the Asia-Pacific region (Singapore contributing 18.8% to ART), 27.7% in Europe (of which France and UK contributes 10.6% and 9.5% respectively). 12.4% of assets are in New York City.

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## Relative Value:

| Bond | Maturity/Call date | Aggregate leverage | Ask Yield-to-call/YTM | Spread |
|---|---|---|---|---|
| ARTSP 4.205% ‘22 | 23/11/2022 | 36.4% | 3.25% | 101bps |
| ARTSP 3.523% ‘23 | 09/11/2023 | 36.4% | 3.46% | 118bps |
| ARTSP 4.00% ‘24 | 22/03/2024 | 36.4% | 3.64% | 133bps |
| ARTSP 5.0%-PERP | 27/10/2019 | 36.4% | 3.06% | 108bps |
| ARTSP 4.68%-PERP | 30/06/2020 | 36.4% | 3.90% | 185bps |
| FHREIT 3.08% ‘24 | 08/11/2024 | 33.6% | 3.47% | 113bps |
| FHREIT 4.45%-PERP | 12/05/2021 | 33.6% | 4.50% | 238bps |

*Indicative prices as at 15 November 2018 Source: Bloomberg*
*Aggregate leverage based on latest available quarter*

## Key Considerations

- **Growth from existing properties:** Gross revenue increased 6.0% y/y to SGD134.5mn on the back of additional revenue from new acquisitions; the acquisition of Ascott Orchard Singapore, licensed as a hotel in October 2017 while the DoubleTree by Hilton Hotel New York Times Square South was acquired in August 2017. This was partly offset by decrease in revenues from divested properties (Citadines Biyun Shanghai and Citadines Gaoxin Xi’an were both sold in January 2018). Encouragingly, ART saw higher revenue from existing properties of SGD3.6mn, representing 48% of the total y/y growth. Among existing properties that performed better, Singapore and the UK in particular saw stronger demand from guests. Revenue Per Available Unit (“RevPAU”) for the two Singapore properties not on Master Leases (Somerset Liang Court and Citadines Mount Sophia) grew significantly by 19% y/y to SGD217, albeit from a low base in 3Q2017. All four UK properties are under Management Contracts (with Minimum Guaranteed Income) and saw RevPAU grow 6% y/y to GBP140.

- **Contribution from Master Leases tilted down to historical norms:** On a q/q basis, Master Leases now contribute less to reported gross profit. This follows the reclassification of Infiniti Garden in Japan away from Master Leases into a property under Management Contracts. In 3Q2018, Master Leases contributed 29% to reported gross profit (2Q2018: 32% and 1Q2018: 39%). Australia reported gross profit grew 5.9% y/y in AUD terms though this was offset by the weaker AUD against SGD. In France, ART had received lower rents upon the lease renewal of Master Leases of four properties with reported gross profit down 1.2% y/y. We expect ART’s remaining French Master Leases to be renewed at lower rates in the next one to three years. By rental income and excluding properties on Master Leases, average length of stay had gradually shortened, with 58% of guests now staying at ART properties for less than a week (9M2017: 56%).

- **Interest coverage improved slightly:** Despite the stronger reported gross profit of SGD64.2mn (up 9.2% y/y), EBITDA (based on our calculation which does not include other income and other expenses) was up 8.0% y/y to SGD59.6mn, driven by an 11.6% y/y increase in management fees from enlarged asset base. Finance costs were up 5.9% y/y to SGD12.0mn as ART had taken more debt to fund acquisitions. Average debt balance was SGD1.9bn in 3Q2018 against only SGD1.6bn in 3Q2017. Resultant EBITDA/Interest though was manageable at 5.0x (3Q2017: 4.9x). Outstanding perpetuals was SGD401.9mn as at 30 September 2018, representing 8% of total capital. Assuming ART pays out SGD19.2mn p.a in distribution for perpetuals per annum, we find EBITDA/Interest plus 50% perpetual distribution at 4.1x in 3Q2018.

- **Aggregate leverage rising:** As at 30 September 2018, aggregate leverage had risen to 36.4% (30 June 2018: 35.7%). Including 50% of perpetual as debt, we find adjusted aggregate leverage at 40%, on the high-side versus other REITs we cover. Shorter term debt was SGD240.0mn, making up only 13% of total debt and manageable in our view. This includes ART's SGD100mn bond due in end-November 2018. On 1 November 2018, ART had raised a new SGD100mn five year bond which will be used to refinance debt coming due.

- **First greenfield development - Co-living space**: In September 2018, ART announced the proposed acquisition of a land site in one-north, Singapore for the development of a co-living building under its Sponsor's "lyf" brand. Including the site tender price, the total development cost is ~SGD117mn, to be fully debt funded. This is a small project relative to ART's total asset size of SGD5.3bn and within the development threshold for REITs set by the regulators. Construction period will be from 4Q2018 to 4Q2020 (targeted opening in 2021). We expect ART's aggregate leverage to rise to 38% and adjusted aggregate leverage to rise to 40%. Co-living space is a new property type by CapitaLand, where the lyf brand was launched in 4Q2016. ART's extended stay segment traditionally targets corporate demand (eg: newly relocated expatriates or staff on long-term assignments in Singapore). In our view, the pool of expats are now younger, involved in new growth sectors, with divergent priorities and typically with less generous budgets for accommodation and view ART's move into this segment positively. We think minimum stay requirement at lyf will be three months, given that it is zoned as residential. We estimate that lyf will target guests paying SGD1,500-SGD3,000/per month against ~SGD5,000-7,000/per month for the current properties.


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|---|---|
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Explanation of Issuer Profile Rating (“IPR”) / Issuer Profile Score (“IPS”)

**Positive (“Pos”) –** The issuer’s credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

**Neutral (“N”) –** The issuer’s credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

**Negative (“Neg”) –** The issuer’s credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings (“IPR”) into a 7 point Issuer Profile Score (“IPS”) scale.

| IPR | Positive | | Neutral | | | Negative | |
|---|---|---|---|---|---|---|---|
| IPS | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

Explanation of Bond Recommendation

**Overweight (“OW”) –** The performance of the issuer’s specific bond is expected to outperform the issuer’s other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

**Neutral (“N”) –** The performance of the issuer’s specific bond is expected to perform in line with the issuer’s other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

**Underweight (“UW”) –** The performance of the issuer’s specific bond is expected to underperform the issuer’s other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

**Suspension –** We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

**Withdrawal (“WD”) –** We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

**Analyst Declaration**

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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