Asia Credit Research

Earnings Review: Frasers Hospitality Trust ("FHREIT")

Recommendation

- 4QFY2018 was a challenging quarter for FHREIT, compounded by weaker AUD against SGD and we expect increasing new hotel supply to weigh on the outlook of its Australia and Malaysian portfolio. Credit metrics remain manageable, with aggregate leverage of 33.6% and EBITDA/Interest coverage of 4.6x.
- FHREIT receives fixed rent under its Master Leases (eg: leased to Sponsor-related entities) which provides a base line income certainty. We estimate that FHREIT receives at least SGD55mn per annum in fixed rent, providing a 2.0x coverage to interest and perpetual distribution
- We are overweight the FHREIT 4.45%-PERP which is paying a YTC of 4.48% with a first call date in May 2021. This perpetual offers a 55bps pick-up against the ARTSP 4.68%-PERP, which more than compensates for its 10 months longer call date. We see the FHREIT 3.08% '24s as trading at fair value. We hold Ascott Residence Trust ("ARTSP") and Frasers Centrepoint Trust ("FCTSP") at an issuer profile of Neutral (4) and Neutral (4) respectively.

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield-to-call	Spread
FHREIT 3.08% '24	08/11/2024	33.6%	3.47%	104bps
FHREIT 4.45%-PERP	12/05/2021	33.6%	4.48%	230bps
FCTSP 2.77% '24	08/11/2024	28.6%	3.51%	108bps
ARTSP 4.00% '24	22/03/2024	35.7%	3.58%	119bps
ARTSP 4.68%-PERP	30/06/2020	35.7%	3.92%	182bps

Indicative prices as at 31 October 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter

Issuer Profile: Neutral (3)

Ticker: **FHREIT**

Background

Frasers Hospitality Trust ("FHT") is a stapled group comprising a REIT and Business Trust. FHT invests in hospitality assets globally (except Thailand) and currently owns 15 properties across 9 cities with 3,914 keys. As at 30 September 2018, total assets stood at SGD2.5bn. It is sponsored by Frasers Property Limited ("FPL"), a major Singapore-based property developer.

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Key Considerations

- **Decline in y/y operating performance:** In the fourth quarter for the financial year ended September 2018 ("4QFY2018"), gross revenue was down 6.9% y/y to SGD38.7mn while net property income ("NPI") went down by 6.7% y/y to SGD29.4mn. Australia, Japan, Malaysia and the UK saw NPI decline while Singapore and Germany saw NPI growth. EBITDA (based on our calculation which does not include other income and other expenses) was down 7.4% y/y at SGD26.1mn given that management/trustee fees tend to be sticky unless asset size changes. Interest expense was also relatively flat at SGD5.7mn on the back of relatively unchanged average debt balance in 4QFY2018 versus 4QFY2017. On the back of weaker operating performance, resultant EBITDA/Interest coverage was lower, though still manageable at 4.6x versus 4.9x in 4QFY2017. We estimate that FHREIT has at least SGD100mn in perpetuals outstanding. Assuming that the REIT pays out 4.45% p.a as distribution rate on the perpetuals, EBITDA/(Interest plus 50% of perpetual distribution) was 4.5x in 4QFY2018. In 4QFY2018, FHREIT reported a SGD1.4mn net loss from fair value of investment properties. In local currency terms, 13 out of 15 FHREIT properties saw flat-to-improved valuation. InterContinental Singapore saw a 1% y/y decline in valuation while the Westin KL saw a 2% y/y decline.

- **Weaker Australia results with growth expectations moderating:** Australia traditionally makes up 40% of NPI though in 4QFY2018 this had declined to 36%. FHREIT discloses Gross Operating Revenue ("GOR") and Gross Operating Profit ("GOP") by geography, which are used in calculating rental incomes received by FHREIT. In 4QFY2018, Australia saw a y/y decline in GOR and GOP at 2.0% and 6.8% respectively. The decline in trading performance was driven by overall softer corporate demand while Sofitel Sydney Wentworth in Sydney's Central Business District faced competitive pressures from increased supply in its micro-market. This is especially more so given SSW being a heritage-listed hotel (built in 1966) and has not undergone a major refitting in recent years. Novotel Sydney Darling Square performed better, albeit from a lower based compared to last year as it had more rooms nights available in 4QFY2018. Sydney's high occupancy of more than 85% is expected to persist although new supply will start kicking in from 2020 onwards. Novotel Melbourne on Collins continued to perform well. Melbourne though is also expected to see supply growth in the medium term, in addition to purpose-built hotels, there has been apartment-to-hotel conversions happening in the city centre (driven by slowing residential sales).

- **Singapore overall steady:** Singapore, which contributed 24% to NPI, saw overall stable results with GOR and GOP up 0.2% y/y and 1.5% y/y respectively. This was attributed to improvements at Frasers Suites Singapore. We understand that FSS has been repositioned to attract a higher proportion of extended stay guests. New entrants around the Bugis area (Andaz and JW Marriot) continue to weigh on average daily rates ("ADR") on InterContinental Singapore ("ISS"). Despite overall Singapore higher occupancies of 90.3% (4QFY2017: 88.1%), RevPAR declined 1.3% y/y, driven by the lower ADR on ISS. ADRs for FSS may have played a part too as we expect the property to charge a lower ADR for guests willing to stay for a minimum seven days as required. Occupancy for Singapore is very healthy at 90.3% above market averages. Notably though, we have seen other hospitality properties in Singapore prioritizing occupancy over ADR to gain market share.

- **Germany was stable though cost pressures affected UK:** Properties in the UK contributed 19% to 4QFY2018 NPI. GOR for the UK increased 1.5% y/y though GOP declined 2.6% y/y driven by higher maintenance costs and higher labour cost (increased in UK minimum wages). RevPAR was relatively flat at GBP118 though would have improved by 3.8% y/y excluding ibis Styles London Gloucester Road which is undergoing renovations. This was previously known as the Best Western Cromwell which had undergone a rebadging. Occupancy remained healthy at 91.1%. Maritim Hotel Dresden in Germany contributed 7% y/y to NPI. This property is master leased to the Maritim Hotel Group, a third party. GOR and GOP had increased 4.6% y/y and 3.4% y/y respectively.

- **Japan negatively affected by one-offs though Malaysia continued to be weak:** In 4QFY2018, Japan contributed 8% to NPI. Japan performed weaker, with GOR and GOP down 11% and 8.7% respectively. This though was driven by one-offs with the ANA Crowne Plaza in Kobe negatively affected by typhoons that hit the Kansai region and closure of banquet space for renovations. Barring unforeseen events by Mother Nature, we think the property should rebound in 1QFY2019. In 4QFY2018, Westin Kuala Lumpur contributed 6% of NPI. The property saw GOR and GOP fall 14.8% and 21.6% y/y respectively in local currency terms. The hotel saw lower room as well as food and beverage revenue due to still weak corporate demand amidst an uncertain business outlook. Revenue Per Available Room ("RevPAR") was down 14.3% y/y while occupancy was down to 78.4% against 81.8% in 4QFY2017. This though is still likely to be much higher than overall Kuala Lumpur hotel occupancy (end-2017: 66.1% per HVS Research). While the Westin KL is located in a highly strategic location, the city saw a deluge of hotel openings in 2018, including notable brands planting their first flags in the city (eg: Banyan Tree, Four Seasons, W Hotel) which may have weighted on Westin KL's performance.

- **Manageable aggregate leverage though refinancing looming:** As 30 September 2018, reported aggregate leverage for FHREIT was 33.6%, somewhat lower than the 34.0% as at 30 June 2018. Adjusting 50% of perpetual as debt, we find adjusted aggregate leverage manageable at 35%. Reported short term debt as at 30 September 2018 was SGD408.1mn. FHREIT has a MYR95mn (~SGD31.4mn) asset-based security with expected maturity in July 2019. Remaining short term debt due relates to outstanding amounts from a term loan taken up at time of IPO. All in, short term debt represents 49% of gross debt, with FHREIT looking to refinance these in due course. With only 3.9% of its total debt being secured (only Westin KL is encumbered), SGD2.5bn of FHREIT's high-quality portfolio remains unencumbered, FHREIT has the ability to raise secured financing, if need be.

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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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