Asia Credit Research

Earnings Review: Ascott Residence Trust ("ART")

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 SGD2.6bn as at 2 May 2019. As at 31 March 2019, ART's portfolio consists of 73 properties with 11,430 units across 37 cities in 14 countries. By asset value, 59% of ART's assets are located in the Asia-Pacific region (Singapore contributing 20.8% to ART), 25.1% in Europe while 16% of assets are located in New York City.

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Recommendation

- ART reported a good set of results in 1Q2019, with gross revenue up 3% mainly due to stronger performance in Singapore, the UK and the Philippines.
- While ART historically focused on the extended stay segment, it has increased its exposure to the hotel segment (notably New York City) while more customers are staying for less than a week (excluding properties on master leases, 61% of rental income is from guests staying for one week or less in 1Q2019). Net-net we do not think it is a big leap for ART to expand into the hotel segment (shorter duration of stay) which dominates ASCHT's portfolio.
- We maintain ART's issuer profile at Neutral (4) for now, though monitoring ART for an upgrade, especially if our expectations of a merger with Ascendas Hospitality Trust ("ASCHT") (Issuer profile: Unrated) comes to fruition. While ASCHT is smaller in scale with total asset of SGD1.9bn, its standalone credit metrics are stronger and an equity-funded merger is likely to lead to an enlarged REIT with a relatively stronger credit profile. As at 31 March 2019, ART's total asset was SGD5.7bn.
- At these levels, we do not find the ARTSP 4.68%-PERP and the ARTSP 4.205% '22s particularly compelling versus bonds of its immediate peer. Within the ARTSP curve, we prefer the ARTSP 4.0% '24s which is paying 121bps in spread. For only a 4.4 months longer tenor, it is paying 10bps higher versus the ARTSP 3.523% '23s.

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield to Maturity/ Ask Yield to Call	Spread (bps)
ARTSP 4.205% '22s	23/11/2022	35.7%	2.95%	100
ARTSP 3.523% '23s	09/11/2023	35.7%	3.09%	111
ARTSP 4.0% '24s	22/03/2024	35.7%	3.20%	121
ARTSP 4.68%-PERP	30/06/2020	35.7%	3.19%	124
FHREIT 2.63% '22s	06/07/2022	34.1%	2.96%	101
FHREIT 3.08% '24s	08/11/2024	34.1%	3.24%	121
FHREIT 4.45%-PERP	12/05/2021	34.1%	3.71%	177

Indicative prices as at 9 May 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter; not inclusive of perpetuals as debt

Key Considerations

- **Overall good performance in 1Q2019:** Gross revenue was up 3% y/y in 1Q2019 to SGD115.9mn on the back of stronger performance mainly from Singapore, the UK and the Philippines. In Singapore, stronger demand was seen at the Master Leased properties (namely Ascott Raffles Place Singapore and Ascott Orchard Singapore which lifted variable rents) and the other two properties on management contracts also saw stronger market demand (up 23% y/y). For the UK, similarly stronger market demand lifted underlying revenue in GBP-terms (up 13% y/y) with Revenue Per Available Unit ("REVPAU") up 17% y/y (in SGD terms, revenue was up 10% y/y). The Philippines saw a revenue increase of 26% y/y in SGD-terms, driven by completion of asset enhancement initiatives which allowed Ascott Makati to charge higher average daily rates on top of higher occupancy. Overall portfolio REVPAU was 3% y/y stronger at SGD133. These helped offset revenue declines elsewhere in SGD-terms, chiefly France (down 7% y/y, from lower renewal rates of Master Leases and weaker EUR) USA (down 3% y/y, dragged by renovations, partly offset by the stronger USD). Revenue from overall Australia was down 6% y/y, dragged by the weaker AUD while China revenue was down 3% y/y dragged by the weaker RMB. The underlying revenue performance though for Australia and China was up by 2% and 1% respectively.

- **Manageable interest coverage:** EBITDA (based on our calculation which does not include other expenses and other income) was up 13% y/y to SGD51.0mn. While some of the declines in costs were attributable to lower professional and audit fees, the biggest difference was the reduction in direct expenses although this was a result of adoption of accounting standard FRS 116. Prior to the change, operating lease expense was taken in direct expenses and this is no longer the case. Finance expense was 15% y/y higher at SGD13.4mn as interest expenses are recognised on lease liability. On a like-for-like basis, finance expense would have been SGD1.0mn lower per company (down by 9% y/y) as a result of lower effective borrowing cost of 2.1% p.a. As at 31 March 2018, this was 20bps higher at 2.3% p.a. We find EBITDA/Interest manageable at 3.8x though assuming that ART pays out SGD19.2mn p.a in perpetual distribution (SGD4.8mn per quarter). Adjusting 50% of that as interest, we find EBITDA/(Interest plus 50% perpetual distribution) at 3.2x.

- **Low refinancing risk at ART and we expect perpetual to be replaced in October 2019:** As at 31 March 2019, reported aggregate leverage was 35.7% and manageable although perpetuals were relatively significant at SGD401.2mn. Taking 50% of this as debt, we find adjusted aggregate leverage at 42%, higher than its immediate peer. Short term debt at ART was only SGD157.4mn, representing only 8% of total debt while secured debt as a percentage of total assets was 16%. ART is in the midst of selling Ascott Raffles Place where asset held for sale recorded was SGD350.1mn (including of fair value gains). The price tag was 64% above pre-announcement book value and targeted to complete on 9 May 2019. Concurrently, ART is buying Felix Hotel in Sydney which would be rebranded as Citadines Connect Sydney Airport for ~SGD59mn. Additionally, ART is developing lyf at one-North with a total development cost of SGD117mn. Even assuming that the net proceeds fully funds the lyf development and Citadines Connect Sydney, we expect excess liquidity to be available to fund the short-term debt coming due and see low refinancing risk at ART. The ARTSP 5.0%-PERP faces first call in October 2019 (amount outstanding of SGD150mn) and we see high likelihood for this perpetual to be called as ART is able to raise a replacement perpetual at a lower cost of funding by at least 50bps versus the current 5.0% distribution rate in our view.

- **Monitoring ART for an upgrade in the next 6 to 12 months:** CapitaLand Ltd (“CAPL”) (Issuer profile: Neutral (3)) is in the midst of acquiring Ascendas Pte Ltd and Singbridge Pte Ltd. While a decision has not been announced, we expect ART to eventually merge with Ascendas Hospitality Trust (“ASCHT”) (Issuer profile: Unrated), Sponsored by Ascendas Land International Pte Ltd (part of CAPL’s target companies). While ASCHT is smaller in scale with total asset of SGD1.9bn, its standalone credit metrics are stronger and an equity-funded merger is likely to lead to an enlarged REIT with a relatively stronger credit profile. While ART historically focused on the extended stay segment, it has increased its exposure to the hotel segment (notably New York City) while more customers are staying for less than a week (excluding properties on master leases, 61% of rental income is from guests staying for one week or less in 1Q2019). Net-net we do not think it is a big leap for ART to expand into the hotel segment (shorter duration of stay) which dominates ASCHT’s portfolio.

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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 financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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