Asia Credit Research

Earnings Review: Ascendas Real Estate Investment Trust ("AREIT")

Issuer Profile: Neutral (3)

Ticker: **AREIT**

Background

Ascendas REIT ("AREIT") is the largest business space and industrial REIT in Singapore, with total assets of SGD10.8bn as at 30 September 2018. AREIT owns a diversified portfolio of 145 properties as at 30 September 2018, 99 are in Singapore, 35 in Australia and 11 are in the UK. AREIT is sponsored by the Ascendas-Singbridge group, which has a deemed interest of ~18.9% in AREIT.

Ezien Hoo, CFA
+65 6722 2215
EzienHoo@ocbc.com

Recommendation

- Gross revenue growth in 3Q2018 was led by acquisitions in Australia and its first acquisition in the UK while the existing portfolio in Singapore saw lower occupancies. While aggregate leverage looks low at 33.2%, we think this would have risen back to ~36% from its October 2018 acquisition of another 26 properties in the UK.
- AREIT continued to flex its muscles in the capital markets, with an overnight equity private placement in September 2018. Reflecting its strong financial flexibility, this equity placement was raised as a "blank cheque", with details of the then proposed second UK acquisition lacking. Additionally, AREIT has SGD9.6bn of unencumbered investment properties.
- We prefer the AREIT 3.14% '25s over City Development Ltd's CITSP 3.48% '26. At around the same ask yield to maturity, the AREIT 3.14% '25s mature 15 months earlier. At the shorter end of the AREIT curve, we think bondholders are better off with the FCTSP 3.0% '20s which provides a spread pick up of 14bps over the AREIT 2.95% '20s. The FCTSP '20s also mature six months earlier.
- We hold CITSP's issuer profile at Positive (2) while we hold also hold FCTSP at the same issuer profile as AREIT of Neutral (3).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread
AREIT 4.75%-PERP	14/10/2020	33.2%	3.52%	143bps
AREIT 3.14% '25	02/03/2025	33.2%	3.37%	97bps
AREIT 2.95% '20	03/08/2020	33.2%	2.61%	55bps
CITSP 3.48% '26	15/06/2026	21.7%[1]	3.49%	100bps
FCTSP 3.0% '20	21/01/2020	28.6%	2.68%	69bps

Indicative prices as at 29 October 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter; CITSP based on net gearing as at 30 June 2018

Key Considerations

- **Acquisition led top-line growth:** In the second quarter for the financial year ended March 2019 ("2QFY2019"), AREIT's gross revenue increased by 1.1% y/y to SGD218.1mn driven by the acquisition of Cargo Business Park in Melbourne in September 2018, 167-177 Australis Drive in Melbourne in June 2018, its first portfolio in the UK (12 logistics properties) in August 2018, contribution from 100 and 108 Wickham Street acquired in Australia in September and December 2017 respectively and the redevelopment completion of 20 Tuas Avenue 1 in Singapore. These were partly offset by lower occupancy of properties in Singapore (overall Singapore occupancy was at 87.1%, down from 90.1% as at 30 September 2017). On 7 September 2018, the construction of 1-7 Wayne Goss Drive in Brisbane was completed. The property is still physically vacant though vendor had provided a rental support. On a q/q basis, gross revenue at AREIT increased 0.7%, mainly due to acquisitions. Removing impact of asset movements, we estimate that AREIT's gross revenue had declined ~1% q/q.

- **Lower interest coverage ratio though still manageable:** EBITDA (based on our calculation) was SGD143.2mn, down 1.8% y/y due to higher management fee and higher professional and transaction fees on acquisition. Management fees had risen 5.0% y/y to SGD13.4mn in line with the larger asset size (SGD10.8bn as at 30 September 2018 from SGD10.3bn as at 30 September 2017). Trust and other expenses have also increased due to expenses incurred from investment activities. Interest expense had increased 16.2% y/y to SGD31.6mn, driven by higher average debt balance in 2QFY2019 against 2QFY2018. Additionally, AREIT's interest cost is now higher (3.0% as at 30 September 2018, 10 bps more than 30 September 2017). Resultant EBITDA/Interest coverage was lower at 4.5x (2QFY2018: 5.4x), also lower than the immediately preceding quarter of 5.0x.

- **Entry into new market UK:** In 2QFY2019, AREIT spent SGD437.2mn in investing outflows, of which ~SGD364mn would have gone towards the purchase of its first portfolio in the UK (completed in August 2018). The proposed acquisition was originally fully funded by GBP debt. On 7 September 2018, AREIT raised gross proceeds of SGD452.1mn in an equity private placement where SGD250mn was intended to go towards funding a second UK portfolio. SGD109mn was intended for the funding of a build-to-suit facility in Singapore with the rest for debt repayment. Reflecting AREIT's ample financial flexibility from capital markets and uncommonly across REITs in Singapore, this equity placement was raised as a "blank cheque", with details of the proposed second UK acquisition lacking. With cash fungible and AREIT only reporting SGD27.1mn in cash balance as at 30 September 2018, we think it is far more likely that the equity proceeds had been used for other matters, pending deployment for their intended purpose. Post quarter end, AREIT completed the SGD459.2mn acquisition of 26 logistics properties in the UK on 4 October 2018.

- **Aggregate leverage would have increased from buying second UK portfolio:** As at 30 September 2018, reported aggregate leverage was healthy at 33.2% and lower against the 35.7% as at 30 June 2018. Adding 50% of perpetual as debt, we find adjusted aggregate leverage at 34.6%, still manageable. Nonetheless, with the completion of the second UK portfolio, we estimate that AREIT's aggregate leverage would have risen back to ~36%. We assume that AREIT would have needed to raise acquisition debt for the second UK portfolio. By asset value, the UK would be ~8% of AREIT's portfolio, with Australia at 14% and 78% from Singapore. AREIT has spent the past three years diversifying and this trend into new developed markets has been a constant theme despite management changes (new CEO was appointed in February 2018).

- **Manageable refinancing risk:** Short term debt coming due as at 30 September 2018 was SGD768.1mn, representing 22% of total debt. We continue to see AREIT's refinancing risk as manageable, with its strong access to capital markets and large unencumbered investment properties of SGD9.6bn (representing 90.4% of total investment properties at 30 September 2018).

<table>
<tr><th colspan="2"><u>OCBC Global Treasury</u></th></tr>
<tr><td><u>Treasury Advisory</u>
Corporate FX & Structured Products
Tel: 6349-1888 / 1881
Interest Rate Derivatives
Tel: 6349-1899
Investments & Structured Products
Tel: 6349-1886

<u>GT Institutional Sales</u>
Tel: 6349-1810</td><td><u>Credit Research</u>
Andrew Wong
+65 6530 4736
WongVKAM@ocbc.com
Ezien Hoo, CFA
+65 6722 2215
EzienHoo@ocbc.com
Wong Hong Wei, CFA
+65 6722 2533
wonghongwei@ocbc.com
Seow Zhi Qi
+65 6530 7348
ZhiQiSeow@ocbc.com</td></tr>
</table>

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.

investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

This report is intended for your sole use and information. By accepting this report, you agree that you shall not share, communicate, distribute, deliver a copy of or otherwise disclose in any way all or any part of this report or any information contained herein (such report, part thereof and information, "**Relevant Materials**") to any person or entity (including, without limitation, any overseas office, affiliate, parent entity, subsidiary entity or related entity) (any such person or entity, a "**Relevant Entity**") in breach of any law, rule, regulation, guidance or similar. In particular, you agree not to share, communicate, distribute, deliver or otherwise disclose any Relevant Materials to any Relevant Entity that is subject to the Markets in Financial Instruments Directive (2014/65/EU) ("**MiFID**") and the EU's Markets in Financial Instruments Regulation (600/2014) ("**MiFIR**") (together referred to as "**MiFID II**"), or any part thereof, as implemented in any jurisdiction. No member of the OCBC Group shall be liable or responsible for the compliance by you or any Relevant Entity with any law, rule, regulation, guidance or similar (including, without limitation, MiFID II, as implemented in any jurisdiction).

Co.Reg.no.:193200032W