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 on the SGX with a market cap of SGD2.4bn. As at 31 March 2018, ART's portfolios consist of 73 properties with 11,430 apartment units in 37 cities across 14 countries.

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

Recommendation

- ART is currently only maintaining one external rating (the other was dropped in 1Q2018). In our view, the Frasers Hospitality Trust's FHREIT 4.45%-PERP is of better value than both ARTSP perps. Adjusting for tenure, the FHREIT perpetuals offers a spread pick up of 20bps over ARTSP 5.00% PERP. Additionally, we see FHREIT as having a stronger credit profile and hold the issuer profile at Neutral (3) versus ART at an issuer profile of Neutral (4).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread
FHREIT 4.45%-PERP	12/05/2021	33.0%	4.28%	212
ARTSP 5.00%-PERP	27/10/2019	36.1%	3.52%	160
ARTSP 4.68%-PERP	30/06/2020	36.1%	3.96%	192

Indicative prices as at 23 April 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter

Key Considerations

- **Increase in revenue driven by acquisitions:** Reported gross revenue was up 1.4% y/y to SGD112.8mn. This was driven by additional revenue from acquisitions made in 2017, namely Ascott Orchard Singapore ("AOS"), two serviced residences in Germany and DoubleTree by Hilton Hotel in New York. These helped mitigate the revenue impact of (1) divestments (18 rental housing properties in Japan and two properties in China) and (2) decline in performance in certain existing properties. Reported gross profit was up 2.7% y/y to SGD48.7mn. On a same-store basis (excludes the impact of acquisitions and divestments), ART's portfolio saw a 2.5% y/y decline, we think driven by weaker performance in Vietnam, Singapore, and the Philippines.

- **39% of gross profit now from Master Leases:** This has increased from 32% y/y in 1Q2017 following the acquisition of AOS (which is under a Master Lease with ART's Sponsor). Other significant assets under the Master Leases include Ascott Raffles Place Singapore and all of ART's 17 assets in France. These made up 65% of total gross profit from Master Leases. On the back of deterioration in the French hospitality market, we note that the four leases from France, which were renewed from 1 January 2018 onwards, were renewed at lower rents. In 1Q2018, gross profit from the French Master Leases fell 6.0% y/y. ART's remaining French Master Leases would expire in less than one to three years, and we think these are likely to be renewed at lower rates. Corporate demand for ART's Singapore properties have been weak, compounded by additional room supply which have led to declines in average daily room rates, despite still strong occupancies. Of ART's four Singapore properties (totalling SGD0.97bn in valuation), two properties are on Master Leases which help insulate ART somewhat. ART's remaining 11% of gross profit are from management contracts with a minimum guaranteed income.

- **At best flat performance for properties on management contracts:** For the two Singapore properties that are not on Master Leases, Revenue per Available Room ("RevPAU") has declined 7.0% y/y in 1Q2018. 50% of ART's gross profits are derived from properties on management contracts with no minimum guaranteed income while operating performance is fully market based. With the exception of Australia, we are not optimistic about a rebound over the next six months on the back of room oversupply and increasing competition (eg: New York City, Kuala Lumpur, Jakarta, Manila). Meanwhile, private home rentals have been an increasing competitive threat to the formal hospitality sector of Japan.

- **Interest coverage improved:** EBITDA (based on our calculation which does not include other income and other expenses) was SGD50.5mn (up 2.4% y/y).

Finance cost was down 2.3% y/y to SGD11.6mn, with resultant interest coverage as measured by EBITDA/Interest higher at 4.4x versus 4.2x in 1Q2017. Outstanding perpetuals at ART was SGD400mn as at 31 March 2018 (representing 8.0% of total capital). We estimate ART would pay SGD19.2mn p.a on distributions to perpetuals holders. Adjusting 50% of these as interest, we find Adjusted EBITDA/Interest at 3.6x.

- **Manageable aggregate leverage:** As at 31 March 2018, aggregate leverage was manageable at 36.1% (relatively flat against end-2017). ART's aggregate leverage has come down from the 41.1% in end-March 2017, post ART's rights issue that raised SGD442.7mn in equity to help fund acquisitions. Adjusting 50% of perpetuals as debt, we find adjusted aggregate leverage at 40% as at 31 March 2018.

- **Short term refinancing risk manageable:** Short term debt at ART was SGD231.5mn (this includes a JPY5.0bn (~SGD61.2mn) bond due in September 2018 and SGD100mn in bonds due in November 2018, with the remaining in bank debt). Cash balance was SGD190.9mn as at 31 March 2018, which allows ART to pay down the bulk of its debt from cash (if it so chooses). Nonetheless, we note that traditionally ART maintains a cash buffer, with cash making up ~4% of total assets. With aggregate leverage manageable, there is a good chance that ART may opt to refinance debt instead and keep the cash as war chest (eg: to acquire assets from Sponsor, which remains keen to recycle assets via ART). In end-2017, encumbered properties at ART amounted to SGD2.3bn, and assuming this has stayed the same in end-March 2018, there would be SGD2.6bn of unencumbered serviced residence properties that can help the REIT raise secured funding if need be. As at 31 March 2018, secured debt was 18% of total assets.

OCBC Global Treasury	
Treasury Advisory **Corporate FX & Structured Products** Tel: 6349-1888 / 1881 **Interest Rate Derivatives** Tel: 6349-1899 **Investments & Structured Products** Tel: 6349-1886 **GT Institutional Sales** Tel: 6349-1810	**Credit Research** **Andrew Wong** +65 6530 4736 WongVKAM@ocbc.com **Nick Wong Liang Mian, CFA** +65 6530 7348 NickWong@ocbc.com **Ezien Hoo, CFA** +65 6722 2215 EzienHoo@ocbc.com **Wong Hong Wei** +65 6722 2533 wonghongwei@ocbc.com

Explanation of Issuer Profile Rating / Issuer Profile Score

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 into a 7 point Issuer Profile Score 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.

Disclaimer for research report

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific 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