Asia Credit Research

Earnings Review: Frasers Hospitality (“FHREIT”)

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 31 March 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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Recommendation

- Despite the relatively weaker performance in 2QFY2018 versus 2QFY2017, FHREIT’s portfolio is mostly unencumbered and anchored by prime properties in key gateway cities. We maintain FHREIT’s issuer profile at Neutral (3).
- We prefer the FHREIT 4.45%-PERP over both Mapletree Logistics Trust’s MLTSP 4.18%-PERP and Ascott Residence Trust’s ARTSP 4.68%-PERP. For a 6 months shorter call date, the FHREIT 4.45%-PERP pays 70bps more versus the MLTSP 4.18%-PERP.
- For a 10 month longer maturity, the FHREIT 4.45%-PERP is paying 20bps more versus the ARTSP 4.68%-PERP, which compensates for the longer tenure. A switch trade allows investors to move into a stronger credit.
- Despite FHREIT’s smaller scale, we hold FHREIT’s issuer profile at Neutral (3) versus both ARTSP and MLTSP at Neutral (4).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread
FHREIT 4.45%-PERP	12/05/2021	33.1%	4.31%	213
MLTSP 4.18%-PERP	25/11/2021	37.7%	3.70%	145
ARTSP 4.68%-PERP	30/06/2020	36.1%	3.95%	189

Indicative prices as at 27 April 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter

Key Considerations

- **Weaker operating results with interest rate coverage lower:** Gross revenue for the second quarter ended September 2018 (“2QFY2018”) decreased 3.1% y/y to SGD37.5mn, driven by weaker performance in Australia (48% contributor to gross revenue), Singapore (20%), UK (11%) and Malaysia (5%). Japan (11%) and Germany (5%) saw increases in gross revenue in 2QFY2018. Operations, maintenance and staff costs were higher during the quarter, resulting in a larger y/y decline in net property income of 4.0% to SGD27.7mn. Management and trustee fees was relatively stable at SGD3.2mn, while EBITDA (based on our calculation that does not include other income and other expenses) was SGD24.6mn (down 4.6% y/y). Interest expense was 11.1% higher at SGD4.9mn mainly due to higher debt levels and higher interest rate from refinancing into longer tenured bonds. Resultant EBITDA/Interest coverage was lower at 5.0x in 2QFY2018 versus 5.8x in 2QFY2017. FHREIT has SGD100mn in perpetual outstanding (representing 4% of total capital) and we assume that SGD4.5mn p.a in distribution is paid to perpetual holders. Including 50% of these as interest, we find adjusted EBITDA/Interest coverage at 4.9x, healthy in our view.

- **Japan and Germany operating performance up:** FHREIT tracks both Gross Operating Revenue (“GOR”) and Gross Operating Profit (“GOP”) at the asset level. These two metrics along with fixed rent are key components that go into rent formulas for each property. The rent formula ultimately decides the rent paid to FHREIT under each master lease and tenancy agreements. While Japan (the ANA Crowne Plaza Kobe) saw a 3.2% y/y decline in GOR (from softer room and banquet demand), GOP increased 3.5% y/y due to tighter cost controls and we think this helped drive rentals from Japan higher for 2QFY2018. The sole property (Maritim Hotel Dresden) is under a Master Lease agreement with the Maritim Hotel Group (a third party and the operator of the hotel) where the Master Lesee pays an annual fixed rent with a variable rent that provides upside. We think that the hotel had performed better beyond the annual fixed rent.

- **Australia operating performance down:** While 48% of gross revenue and 41% of net property income is from Australia, we view the properties to be sufficiently diversified across micro-markets and we are not overly concerned over FHREIT’s concentration to Australia. In 2QFY2018, Australia performance was dragged by softer corporate demand (including softer banquet revenue) in the Sydney market and Novotel Sydney Darling Square ("NSDS") which is still undergoing renovation. Novotel Melbourne on Collins (located in the key commercial district of Melbourne city) performed well. Additionally, 2QFY2018 results were absent a one-off write-back of consultancy fees that was included in 2QFY2017. Excluding the one-off item, GOP for Australia would be lower at 7.1% y/y. Average RevPAR for Australia held steady while average occupancy had declined to only 89.5% (from 93.2%) in 2QFY2017 given the ongoing renovation at NSDS.

- **Singapore serviced residences a drag though InterContinental did well:** Gross revenue for Singapore was down 7.7% y/y despite a 2.9% y/y drop in GOR and flat GOP. While the exact revenue split between the InterContinental Singapore Bugis ("Intercon") and Fraser Suites Singapore ("FSS") was not provided, it was disclosed that Intercon achieved higher RevPAR on the back of increased in average daily rates. With Singapore portfolio RevPAR declining 3.9% y/y, it can be inferred that average daily rates at FSS was weak. This is within expectations given that a minimum stay requirement of seven days applies to FSS (per the type of license it holds) while much of the recent growth in visitors to Singapore have been driven by leisure travellers who tend to have lower average length of stay of less than seven days. We maintain our view that we expect to see negative performance for the service residences sector in Singapore in 2018.

- **Aggregate leverage healthy though refinancing significant:** As at 31 March 2018, aggregate leverage was 33.1% (relatively flat versus end-2017) and healthy in our view. With perpetuals as a small proportion of the capital structure and taking 50% of these as debt, we find adjusted aggregate leverage at 35%. SGD118.7mn of debt will come due for the remaining 2018. This is only 14% of total debt and manageable in our view, we note that FHREIT is looking to refinance this and have commenced discussions with lending banks. Beyond 2018, SGD386.4mn of debt will come due next year. This is significant in our view though FHREIT would only look at refinancing at a later stage. Secured debt remains a very small portion of FHREIT's total debt, with only the Westin KL encumbered. We estimate that SGD2.3bn in property assets remains unencumbered, providing ample financial flexibility to raise secured debt, if need be.

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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.

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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.

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