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 SGD11.3bn as at 31 December 2018. AREIT owns 171 properties. By value, 79% of its investment properties are located in Singapore, 14% are in Australia and 7% are in the UK. AREIT is currently 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

- AREIT's gross revenue has increased 4.2% y/y to SGD226.4mn with the increase coming from acquisitions made in the UK in 2018 and from Australia.
- With aggregate leverage rising to 36.7% and adjusted aggregate leverage (assuming 50% of perpetual as debt) at 38%, AREIT's credit profile has deteriorated y/y though steadily within our Neutral (3) issuer profile.
- With the announced proposed acquisition by CapitaLand of Ascendas Pte Ltd and Singbridge Pte Ltd, AREIT would become a CapitaLand-related REIT assuming deal completion. We see low risk of AREIT's strategic direction changing in the near-to-short term though expect AREIT's curve to settle closer to CapitaLand's blue chip REITs.
- We are Overweight the AREIT 4.75%-PERP which is trading at 3.54% yield to call, assuming the REIT calls at first call in October 2020 (spread of 156bps). The perpetual is now trading at a senior-sub spread of ~90bps.

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield to Call/ YTM	Spread
AREIT 4.75%-PERP	14/10/2020	36.7%	3.54%	156bps
AREIT 2.95% '20	03/08/2020	36.7%	2.60%	62bps
AREIT 4.0% '22	03/02/2022	36.7%	2.81%	81bps
CCTSP 2.77% '22	04/07/2022	34.9%	2.89%	89bps
CAPITA 2.8% '23	13/03/2023	34.2%	2.83%	80bps

Indicative prices as at 04 February 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter; reset date equals first call date for the perpetuals

Key Considerations

- **Acquisition led revenue growth:** Gross revenue for the third quarter of the financial year ended March 2019 ("3QFY2019") was up 4.2% y/y to SGD226.4mn, with the increase coming from acquisitions made in the UK in 2018 and increase in revenue from Australia (up 7.8% y/y) though was partly offset by a 1.6% y/y decline in Singapore which is still AREIT's main market. In 3QFY2019, AREIT recognised SGD10.0mn in gross revenue from its new UK assets, taking out this contribution, AREIT's gross revenue would have been flat y/y. Portfolio occupancy was 91.3% as at 31 December 2018, higher than 30 September 2018's 90.6%. While AREIT's strength is in large part driven by its significant scale and diversity, in our view, its Singapore properties have been showing pockets of weakness. AREIT's Singapore occupancy trails that of the overall Singapore market (per JTC data 4Q2018: 89.3%). AREIT's Singapore portfolio occupancy had dropped somewhat to 87.3% as at 31 December from 88.8% in end-2017 (though slightly higher versus 87.1% as at 30 September 2018). We think this was one main reason why AREIT has been intensifying its geographical diversification. AREIT entered Australia since-2015 and the UK since-2018 despite management team changes during this period. In end-2018, Australia occupancy was 98.1% versus 98.5% as at 30 September 2018 and end-2017 while UK properties were fully occupied.

- **Interest coverage ratio has fallen y/y though stable q/q:** EBITDA (based on our calculation which does not include other income and other expenses) was up 6.3% y/y to SGD151.7mn although interest expense expanded 18.7% y/y to SGD32.7mn from higher average debt balance and higher cost of debt. For 3QFY2019, average debt balance was SGD3.8bn against SGD3.5bn in 3QFY2018. EBITDA/Interest coverage was lower at 4.6x (3QFY2018: 5.2x), although slightly higher versus the immediately preceding quarter of 4.5x. While compressed, we think AREIT's interest coverage remains manageable.

- **Relatively high aggregate leverage:** AREIT's aggregate leverage as at 31 December 2018 was 36.7%, marginally higher than our expectations in our 2019 Credit Outlook (30 September 2018 aggregate leverage was 33.2%). AREIT's aggregate leverage had increased from its second portfolio acquisition in the UK which in our view was ultimately debt-funded. The second portfolio was bought in October 2018 for ~SGD452mn while the first portfolio was bought in August 2018 for SGD360mn. AREIT has SGD300.9mn in perpetuals in end-2018, taking 50% of this as debt, we find adjusted aggregate leverage at 38.0%, on the high side versus other REITs under our coverage.

- **Manageable short term debt coming due:** As at 31 December 2018, short term debt at AREIT was SGD964.0mn, representing 23% of gross debt and manageable (short term debt have been around 20%-40% of gross debt in the past year). This includes SGD95.0mn in SGD bonds coming due in May 2019. 91% of its investment properties (~SGD9.7bn) though remain unencumbered while the REIT maintains significant market access which helps in financial flexibility.

- **Becoming a CAPL-related REIT:** In January 2019, CapitaLand Ltd ("CAPL", Issuer profile: Neutral (3)) announced the proposed acquisition of Ascendas Pte Ltd ("ASC") and Singbridge Pte Ltd ("SBG"). We see high likelihood for the transaction to go through and post-transaction CAPL would own all the assets under ASC and SBG (which includes the parts related to AREIT). We have viewed AREIT's underlying credit strength, rather than its assets that are currently owned by ASC and SBG, including a ~19%-stake in AREIT and the AREIT REIT Manager. In the near-to-short term, we see low risk for the strategic direction of AREIT to change as AREIT would be the only industrials platform for CAPL. Compared to its linkages to JTC, AREIT's underlying credit strength has been more crucial for us in analysing AREIT's credit profile. As such, despite AREIT losing its indirect ownership linkage to JTC, we are maintaining our issuer profile on AREIT at Neutral (3). CAPL-related blue chip REITs have tended to trade tighter versus CAPL and we think the same would apply for AREIT. We think the AREIT curve would settle slightly inside of CapitaLand Commercial Trust ("CCTSP", Issuer profile: Neutral (3)), though would continue to trade wider versus CapitaLand Mall Trust ("CAPITA", Issuer profile: Positive (2)).

OCBC Global Treasury

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Tel: 6349-1886

GT Institutional Sales
Tel: 6349-1810

Credit Research
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

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.

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