Asia Credit Research

Earnings Review: Frasers Commercial Trust ("FCOT")

Issuer Profile: Neutral (4)

Ticker: **FCOTSP**

Background

Frasers Commercial Trust ("FCOT") holds office and business park assets and is sponsored by Frasers Property Ltd ("FPL", which holds a 26.8% interest in FCOT). FCOT reported a portfolio value of SGD2.13bn as at 31 March 2019 which comprises China Square Central ("CSC") and Alexandra Technopark ("ATP") in Singapore, and 357 Collins Street, Melbourne Caroline Chisholm Centre, Canberra and 50% of Central Park, Perth in Australia and 50% of Farnborough Business Park ("FBP") in the UK.

Seow Zhi Qi
+65 6530 7348
zhiqiseow@ocbc.com

Recommendation

- While we see continued weakness at FCOT, we expect portfolio statistics to improve given the asset enhancement initiative ("AEI") at ATP has been completed. Separately, FCOT has room to pursue asset injections by the sponsor given its significantly low aggregate leverage and financial flexibility. Even though we retain our Neutral (4) Issuer Profile, we note that acquisitions at this point can possibly add pressure to its issuer profile unless its core existing assets strengthen.
- We think **FCOTSP '20s and FCOTSP '21s are trading tight**. If we had to pick between the two, we think FCOTSP '21s is preferable as it offers a 35bps pick up for a longer tenor of 18 months.
- We have both FCOT and Suntec REIT at Neutral (4) Issuer Profile. We think **SUNSP '20s and '21s look more attractive relative to FCOT's bonds** despite having a higher aggregate leverage. Both SUNSP bonds are offering a 10bps pick up over the respective FCOTSP bonds.

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread
FCOTSP 2.625% '20	**28/02/2020**	**29.1%**	**2.49%**	**55bps**
FCOTSP 2.835% '21	**11/08/2021**	**29.1%**	**2.83%**	**90bps**
MCTSP 3.6% '20	24/08/2020	34.8%	2.39%	44bps
SUNSP 3.35% '20	10/02/2020	38.6%	2.60%	65bps
SUNSP 3% '21	16/07/2021	38.6%	2.95%	100bps

Indicative prices as at 24 April 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter

Key Considerations

- **Softness stems largely from ATP:** Gross revenue for second quarter of financial year ending 30 September 2019 ("2QFY2019") was 9.7% lower y/y at SGD30.4mn. This was mainly due to lower occupancy rate at ATP (at 59.2% down from 70.4% a year ago), divestment of 55 Market Street (in Aug 2018) and effects of the weaker Australian dollar (~4.49% dip y/y). NPI declined in tandem by 10.5% y/y as a result of lower gross revenue, higher property tax for ATP and higher amortisation of lease incentives for Central Park and 357 Collins Street. Including the 50.0% interest in FBP in the UK which was acquired on 29 January 2018 (and accounted for as a share of results of joint venture), NPI would have fallen by a small extent of 4.5% y/y instead. ATP, whose NPI fell by 26.6% y/y (~SGD1.7mn), is the key culprit for the fall in FCOT's NPI y/y.

- **Portfolio statistics weaker:** Committed occupancy rate for FCOT as at 31 March 2019 was 81.5% (1QFY2019: 83.8%), dragged by Singapore portfolio whose occupancy rate was 67.5% (1QFY2019: 75.0%) largely due to the exits of Hewlett-Packard Enterprise Singapore Pte Ltd and Hewlett-Packard Singapore Pte Ltd from ATP. Occupancy rate appears below market as according to URA, vacancy rate outside the core business areas in Downtown Core and Orchard Planning Area is 12.6% as at 4Q2018. Portfolio occupancy rate would have been worse without its Australia portfolio whose occupancy rate improved to 94.0% from 90.7% at the end of the previous quarter due to a take-up of 86,000sqft by WeWork at Central Park. Actual occupancy of FCOT is 78.8% (1QFY2019: 80.7%).

- **In Singapore, improvement seen at CSC, partially offset decline at ATP:** CSC accounts for 28% of FCOT's asset value but just 18% of FCOT's NPI despite recording a 29% y/y growth over the quarter. Occupancy rate at CSC was better at 95.3% excluding the retail podium which is still close for asset enhancement works compared to 92.8% (also excluding the retail podium) a year ago. The SGD38mn asset enhancement initiative ("AEI") is expected to complete in 2H2019. JustCo, a co-working company, will be occupying the entire second storey of the retail podium. The commencement of operations of the China Square Hotel in 2Q2019 is also expected to bring increased activity and vibrancy to CSC. ATP accounts for 26% of FCOT's asset value and 21% of FCOT's NPI in 2QFY2019, with NPI down 26% y/y. Occupancy rate at ATP is low at 59.2%. Given the SGD45mn AEI at ATP has been completed, we expect occupancy rate at ATP to normalise albeit at a slow place as accessibility to the building may constrain its attractiveness. While management is in advanced discussions with prospective tenants to lease spaces at ATP, no concrete information has been made public yet. Expiring leases at both properties look manageable (CSC: 1.4%, ATP: 0.2% of portfolio gross rental income).

- **Central Park in Perth, Australia will undergo AEI:** Central Park saw NPI fall by 10% y/y, due to a 4.49% y/y dip in AUD against SGD and higher amortisation of leases and incentives. Occupancy though has recovered from 68.3% a year ago to 83.5% as at 31 March 2019 with a long WALE of 7.7 years. The latest addition is WeWork, who took up a significant amount of space. The AEI planned for Central Park will take place beginning 2Q2019 and complete in 3Q2020. It will cost FCOT SGD11.5mn. The properties in Australia, in aggregate, make up 39% of FCOT's total asset and 49.3% of FCOT's NPI for the quarter.

- **Financial flexibility given debt headroom:** Aggregate leverage is healthy at 29.1%, though up from 28.4% as at 31 December 2018. The increase was due to additional borrowings to finance the ongoing asset enhancement initiatives at ATP and CSC. Reported interest coverage is 4.67x (1QFY2019: 4.90x), with the average borrowing rate at 2.98% (1QFY2019: 2.97%). Near-term refinancing needs look minimal with just SGD2mn debt maturing in FY2019 while FCOT has a cash balance of SGD24.0mn. In addition, all of FCOT's assets are unencumbered, which offers flexibility and the low leverage level provides substantial headroom for FCOT to acquire assets from sponsor, Frasers Property Ltd (which it has the right of first refusal for). That said, we think acquisitions can possibly add pressure to FCOT's issuer profile unless its core existing assets perform better.

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 **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.

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.

Co.Reg.no.:193200032W