Asia Credit Research

# Earnings Review: Frasers Hospitality Trust ("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 3,913 keys. As at 31 March 2019, total assets stood at SGD2.5bn with a market cap of SGD1.4bn It is sponsored by Frasers Property Limited ("FPL"), a major Singapore-based property developer.

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

## Recommendation

- FHREIT's 2QFY2019 results had been marked by a deterioration in Japan, Malaysia and Australia with overall y/y gross revenue and net property income down by 7.6% and 9.1% respectively.
- In our view, any negative impact from underlying performance in Australia which makes up 40% of net property income has been magnified in SGD-terms and would persist in light of our dimming growth outlook over Australia. We are now advocating FHREIT to diversify and would view a sale of Sofitel Sydney Wentworth as a credit positive, especially if price tag is at least at book value of AUD307.9mn as at 30 September 2018.
- We maintain FHREIT's issuer profile at Neutral (3) on the back of its still healthy credit metrics though see its credit gap with Ascott Residence Trust ("ARTSP") Issuer profile: Neutral (4)) as narrowing in part due to the weakened performance at FHREIT and simultaneously we see ART's credit profile as an improving one, especially if it merges with Ascendas Hospitality Trust (Issuer profile: Unrated).
- Comparing to ARTSP, which we see as FHREIT's closest peer, we still prefer the FHREIT 4.45%-PERP over the ARTSP 4.68%-PERP. The FHREIT 4.45%-PERP allows a spread pick up of 50bps which more than compensates for its one year longer call date. On the senior bonds, we prefer FHREIT 2.63% '22s over ARTSP 4.205% '22s, the bonds are trading at similar spreads, despite FHREIT 2.63% '22s maturing five months earlier.

## Relative Value:

| Bond | Maturity/Call date | Aggregate leverage | Ask Yield to Maturity/ Ask Yield to Call | Spread (bps) |
|---|---|---|---|---|
| FHREIT 2.63% '22s | 06/07/2022 | 34.1% | 2.96% | 101 |
| FHREIT 3.08% '24s | 08/11/2024 | 34.1% | 3.24% | 121 |
| FHREIT 4.45%-PERP | 12/05/2021 | 34.1% | 3.71% | 177 |
| ARTSP 4.205% '22s | 23/11/2022 | 35.7% | 2.95% | 100 |
| ARTSP 4.0% '24s | 22/03/2024 | 35.7% | 3.20% | 121 |
| ARTSP 4.68%-PERP | 30/06/2020 | 35.7% | 3.19% | 124 |

*Indicative prices as at 2 May 2019 Source: Bloomberg*
*Aggregate leverage based on latest available quarter; not inclusive of perpetuals as debt*

## Key Considerations

- **Hammered in Japan and Malaysia:** Gross revenue was down 7.6% y/y in the second quarter for the financial year ended September 2019 ("2QFY2019") to SGD34.6mn on the back of weaker performance mainly in Japan, Australia and Malaysia. Net property income ("NPI") was down 9.1% y/y to SGD25.2mn. While weakness at these three markets had been flagged, the magnitude of such fall had been larger than expected. While FHREIT does not disclose property-by-property performance on a quarterly basis, it discloses Gross Operating Revenue ("GOR") and Gross Operating Profit ("GOP") by geography. Both are used in the formula to calculate rents that FHREIT receive. For Malaysia, y/y GOR and GOP fell by 11.5% and 30.3% respectively in MYR-terms. Revenue per available room ("RevPAR") was down 7.5% y/y, mainly due to lower average daily rate that the Westin KL could charge amidst intense competition. Though we think occupancy was prioritised, as occupancy rate increased to 81.9% (78% in 2QFY2018). A weaker demand in banqueting, indicative of slowing corporate expenditures and domestic consumption further dragged results. For Japan, y/y GOR and GOP fell 1.9% and 4.6% respectively. While REVPAR was steady (up 0.4% y/y), structurally declining banqueting business and higher utilities costs had negatively affected the ANA Crowne Plaza Kobe performance. Based on our estimation, y/y Japan and Malaysia NPI fell by 32% and 35% respectively, making up ~55% of the total fall in NPI in SGD terms.

- **Compounded by weakness in Australia:** Australia, FHREIT's largest market contributing 40% to NPI, saw GOR and GOP fall by 4.0% and 6.1% respectively in AUD-terms. Of the four properties in Australia, three are located in Sydney and one in Melbourne. The drag is mainly attributable to Sofitel Sydney Wentworth and Fraser Suites Sydney. RevPAR had declined 5.4% y/y from both lower average daily rates and occupancy. Despite the oversupply in Sydney and Melbourne, FHREIT's occupancy was still high at 88.2% (albeit down from 89.5% in 2QFY2018), in our view this indicates still good demand. The biggest cause for the lower RevPAR in our view was lower average daily rates at AUD248 versus AUD258 in 2QFY2019. Historically we were relatively comfortable with FHREIT's portfolio, despite 40% of NPI coming from Australia given it is from four different properties. In January 2019, the media first broke news that FHREIT may be looking to sell the Sofitel Sydney Wentworth, although there has been no updates since then. Nevertheless, with the Australian growth outlook dimming, we think any negative impact from underlying performance is magnified in SGD-terms (AUD has depreciated ~8% against the SGD since early January 2018 to 31 March 2019). In any case, we are advocating FHREIT to diversify and would view a sale of Sofitel Sydney Wentworth as a credit positive, especially if price tag is at least at the book value of AUD307.9mn as at 30 September 2018.

- **Singapore slightly down while UK was solid:** Singapore continues to be the second most important market for FHREIT contributing 25% of 2QFY2019 NPI. It reported an increase in GOR of 0.9% although GOP fell 0.7% y/y while we estimate NPI fell by 1% y/y. FHREIT's Singapore portfolio underperformed that of its closest peer. Higher occupancies at Frasers Suites Singapore helped buffer an overall fall in average daily rates, dragged by lower rates at InterContinental Bugis which is facing competition in that micro market from new supply in a similar bracket. The Germany property is under a third party master lease. For the UK, GOR and GOP increased 14.2% and 11.4% respectively and we estimate that NPI in SGD terms grew by 7% y/y. Growth in RevPAR was strong at 13.2% y/y led by increase in occupancy (renovation of was completed in February 2019) while average daily rates was stable.

- **Interest coverage lower from weaker operating performance:** EBITDA (based on our calculation which does not include other expenses and other income) was down 9.7% y/y to SGD22.2mn. Given existence of largely fixed costs, FHREIT only managed to report property expenses that were 3.4% lower y/y despite the larger fall in top line. Lower other property expenses, operations and maintenance ("O&M") expense and staff costs were observed with O&M expenses falling 4% y/y while staff costs fell 10% y/y. Finance cost increased by 2.7% y/y to SGD5.1mn, in part due to higher average debt balance in 2QFY2019 versus 2QFY2018. As at 31 March 2019, FHREIT's effective cost of debt had increased 10bps to 2.6% (back to 2017 levels). Resultant EBITDA/Interest coverage was lower though still manageable at 4.4x (2QFY2018: 5.0x). FHREIT has SGD100mn in outstanding perpetuals. Assuming it pays out SGD4.5mn in distributions p.a, SGD1.1mn per quarter and taking 50% of this as interest, we find EBITDA/(Interest plus 50% perpetual distribution) at 4.0x.

- **Heavy near-term refinancing needs:** Reported aggregate leverage was healthy 34%, in line with that of end-2018, though assuming half of the perpetual as debt, we find adjusted aggregate leverage at 36%, which is still manageable. As at 31 March 2019, FHREIT faced SGD418.6mn in short term debt, representing 50% of total debt. Of these, SGD325mn consists of bank loans. Another MYR95mn (~SGD31mn) relates to a secured debt securitised against the Westin KL and has an expected maturity in July 2019. Per FHREIT, it is in the midst of refinancing these short-term debts. In our view, FHREIT is still able to access the MYR market for refinancing of this tranche of debt, despite the operating weakness at the property which is unlikely to abate in the next 12 months. Apart from the Westin KL, the rest of FHREIT's properties valued at

SGD2.3bn remains unencumbered, which should help it raise secured debt, if need be. FHREIT maintains considerable access to debt markets.

| OCBC Global Treasury | |
|---|---|
| **Treasury Advisory**<br>**Corporate FX & Structured Products**<br>Tel: 6349-1888 / 1881<br>**Interest Rate Derivatives**<br>Tel: 6349-1899<br>**Investments & Structured Products**<br>Tel: 6349-1886<br><br>**GT Institutional Sales**<br>Tel: 6349-1810 | **Credit Research**<br>**Andrew Wong**<br>+65 6530 4736<br>WongVKAM@ocbc.com<br>**Ezien Hoo, CFA**<br>+65 6722 2215<br>EzienHoo@ocbc.com<br>**Wong Hong Wei, CFA**<br>+65 6722 2533<br>wonghongwei@ocbc.com<br>**Seow Zhi Qi**<br>+65 6530 7348<br>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 held financial interests in the above-mentioned issuer or company as at the time of the publication of this report.



Co.Reg.no.:193200032W