Issuer Profile:

Neutral (3)

Ticker:

AREIT

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Ascendas Real Estate Trust ("AREIT")

Recommendation

- **First quarter results for the financial year ended December 2019 ("1Q2019") saw y/y revenue growth of 6.1%, driven by acquisitions in the UK, Australia and the completed redevelopment of a property in Singapore. Taking out UK contribution, y/y revenue would have increased by 1% y/y.**
- **EBITDA/Interest coverage was weaker though still healthy at 4.7x while reported aggregate leverage has risen to 37.2% (31 March 2019: 36.3%). In our view, planned but yet to complete greenfield development, redevelopment and small asset enhancement initiatives would lead aggregate leverage to increase, though contained below 39%.**
- **While Singapore had shown positive rental reversions and a marginally stronger occupancy of 88.9% as at 30 June 2019, operating performance of AREIT's properties in Brisbane had shown signs of sputtering.**
- **We think the AREIT 3.2% '22 is trading somewhat tight relative to its closest peers CCTSP 2.77% '22 and CAPITA 2.8% '23. We think the AREIT 2.95% '20 is trading fair against CAPITA 3.15% '20, given the stronger credit profile of CapitaLand Mall Trust ("CAPITA"). For the AREIT 4.75%-PERP, this is trading at tight senior-swap spreads of ~40bps, though perhaps understandably, given the high likelihood of a call in our view which makes it nearer to debt than equity. We think AREIT is able to replace this perpetual with a lower cost perpetual at first call in 2020. Among the short dated part of AREIT's curve, we prefer the perpetual.**
- **We are maintaining AREIT's Neutral (3) issuer profile on the back of its still manageable, albeit weaker credit metrics and lower occupancy in Australia. We hold CAPITA at an issuer profile of Positive (2) and Capital Commercial Trust ("CCTSP") at an issuer profile of Neutral (3).**

Relative Value:

Bond	Maturity / Call date	Aggregate leverage	Ask YTC / YTM	Spread
AREIT 4.75%-PERP	14/10/2020	37.2%	2.66%	93bps
AREIT 2.95% '20	03/08/2020	37.2%	2.23%	50bps
AREIT 3.2% '22	03/06/2022	37.2%	2.46%	76bps
CCTSP 2.77% '22	04/07/2022	34.8%	2.49%	79bps
CAPITA 3.15% '20	18/12/2020	34.2%	2.19%	46bps
CAPITA 2.8% '23	13/03/2023	34.2%	2.50%	80bps

Indicative prices as at 1 August 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter

Background

- Ascendas REIT ("AREIT") is the largest business space and industrial REIT in Singapore, with total assets of SGD12.0bn as at 30 June 2019. 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 CapitaLand Ltd ("CAPL", Issuer profile: Neutral (3)), which has a deemed interest of ~19% in AREIT. On 30 June 2019, CAPL completed the acquisition of Ascendas Pte Ltd and Singbridge Pte Ltd.
- Housekeeping matters: AREIT announced a change in financial year end from 31 March to 31 December (matching CapitaLand's financial year end since CapitaLand is now the Sponsor of AREIT), as such the current financial year is a nine-month period from 1 April 2019 to 31 December 2019 ("2019").

Key Considerations

- **Y/y growth driven by acquisitions:** Gross revenue was up 6.1% y/y for the quarter ended 30

June 2019 ("1Q2019") to SGD229.7mn driven by AREIT's foray into the UK (first portfolio of 12 properties was bought in August 2018 and another 26 properties bought in October 2018), four additional acquisitions in Australia (two properties bought in June 2018 and two in September 2018) and completed the redevelopment at 20 Tuas Avenue in Singapore. Removing the gross revenue contribution from the UK, AREIT's gross revenue would have only increased 1% y/y. Compared to the immediately preceding quarter ended 30 March 2019 ("4QFYE March 2019"), AREIT's gross revenue would have increased by 2.1% q/q. There were no outright asset movements between 4QFYE March 2019 and 1Q2019, though two Singapore properties were decommissioned for redevelopment in 1Q2019 and saw zero occupancy. The q/q revenue increase of 2.1% was driven by positive rental reversions (mostly in Singapore), higher overall occupancies in Singapore though partly offset by lower occupancy in Australia.

- **Weaker interest coverage but still healthy:** EBITDA (based on our calculation) was up by 11.7% y/y, mainly due to the impact on the adoption of FRS116 (no land rent expenses were included in 1Q2019). Despite the higher EBITDA, interest expense was up by 17.9% y/y (excluding lease liabilities). This was driven by higher average debt balance while average cost of borrowings was also higher (3% as at 30 June 2019 versus 2.9% as at 30 June 2018). Resultant EBITDA/Interest coverage was 4.7x, still manageable versus 4.5x in 4QFYE March 2019 and 5.0x in 1QFYE March 2019.

- **Overall portfolio occupancy looked relatively stable:** As at 31 March 2019, overall portfolio occupancy was 91.1% (91.9% as at 31 March 2019 and 90.5% as at 30 June 2018). However, the y/y marginal improvement was driven by UK in our view where portfolio occupancy was 100% and Singapore which saw occupancy improved slightly to 88.9% as at 30 June 2019 versus 88.3% as at 31 March 2019 and 88.1% as at 30 June 2018. AREIT's Australia portfolio occupancy dropped sharply to 92.3%, albeit from a high base of 98% as at 31 March 2019 and 98.6% as at 30 June 2018. Post quarter end, one of the Australian properties had been committed to be leased out though would still bring Australia committed occupancy only to 94.9%.

- **Parts of Australia sputtering?:** Puzzling to us too was a 9.9% negative rental reversion on its Logistics & Distribution Centres in Australia, given that the broad industrial space market had appeared strong across Australia in the quarter ended June 2019, including in Brisbane (where AREIT owns nine Logistics & Distribution Centres and two suburban offices). That being said, this -9.9% is likely on a small lease area. Based on our calculations, AREIT's Australia portfolio saw a 3% y/y increase in valuation in AUD-terms on a same-store basis (removing the four Australia properties bought post 31 March 2018). Of these, Brisbane properties which make up ~30% of Australian property value had declined 5% y/y on a same-store basis in AUD terms (excluding Cargo Business Park bought in September 2018).

- **Aggregate leverage gradually higher while refinancing risk is small:** As at 30 June 2019, AREIT's reported aggregate leverage was 37.2%, up from 36.3% as at 31 March 2019 and 35.7% as at 30 June 2018. AREIT has SGD300mn of perpetuals outstanding as at 30 June 2019 and taking 50% of this as debt, we estimate adjusted aggregate leverage at ~38%. We expect AREIT's reported aggregate leverage to still increase on the back of a greenfield development project it is undertaking (a business park for Grab), redevelopment of the two decommissioned properties in Singapore and small asset enhancement initiatives on three projects. We think any increase in aggregate leverage though will be contained at 5%. As at 30 June 2019, short term debt was ~SGD641mn, making up only 15% of gross debt and highly manageable. A large chunk of this amounting to SGD537mn relate to revolving credit facilities which we think will be extended as par for course. We are maintaining AREIT's Neutral (3) issuer profile on the back of its still manageable, albeit weaker credit metrics and lower occupancy in Australia.

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

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

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.

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