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 3,914 keys. As at 30 June 2019, 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

- FHREIT's 3QFY2019 results had been hammered in Australia. In 3QFY2019, revenue had fell 8.4% y/y while net property income fell 11.0% y/y. We estimate that a weaker Australia explained ~86% of the y/y decline in total revenue.
- FHREIT saw a challenging operating environment in Sydney, compounded by slower leisure demand in Melbourne. Occupancy rates were lower though still respectable at 86.7% though with lower average daily rate also lower, FHREIT's Australian portfolio saw a 6.5% y/y decline in revenue per available room ("RevPAR").
- Encouragingly though, refinancing risk at FHREIT had been significantly reduced, with FHREIT refinancing SGD386.2mn of debt in July 2019.
- We are maintaining FHREIT's issuer profile at Neutral (3), albeit precariously. We would lower this should weakness in FHREIT's operating performance show no sign of stabilising, leading to weaker income generation and stretching its credit profile beyond what is acceptable for a Neutral (3) name.
- We think the FHREIT 3.08% '24s is trading at fair value, relative to Ascott Residence Trust ("ART") curve. We see as ART as FHREIT's closest comparable. While we hold ART's issuer profile at Neutral (4), we are monitoring this issuer for an upgrade. Despite ART being an improving credit, we think the FHREIT 2.63% '22s and FHREIT 4.45%-PERP is still paying a decent premium against the ARTSP 4.205% '22s and ARTSP 4.68%-PERP respectively which more than compensates for FHREIT's weakened credit profile.

Relative Value:

Bond	Maturity date/ Call Date	Aggregate leverage	Ask Yield to Maturity/ Ask Yield to Call	Spread (bps)
FHREIT 2.63% '22s	06/07/2022	35.0%	2.75%	110
FHREIT 3.08% '24s	08/11/2024	35.0%	2.96%	128
FHREIT 4.45%-PERP	12/05/2021	35.0%	3.79%	212
ARTSP 4.205% '22s	23/11/2022	32.8%	2.46%	82
ARTSP 4.0% '24s	22/03/2024	32.8%	2.88%	122
ARTSP 4.68%-PERP	30/06/2020	32.8%	2.96%	126

Indicative prices as at 31 July 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter; not inclusive of perpetuals as debt

Key Considerations

- **Weaker y/y operating performance:** FHREIT reported its third quarter results for the financial year ended September 2019 ("3QFY2019"). In 3QFY2019, FHREIT saw revenue declined 8.4% y/y to SGD35.0mn with declines since in master leases, room revenue as well as food & beverage. Based on our estimates, FHREIT's Australia portfolio explained ~86% of the total revenue decline y/y. Net property income ("NPI") saw an 11.0% y/y decline to SGD25.4mn, dragged predominantly by Australia.

- **Australia hospitality still down:** 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. Aside from 1QFY2019 where GOR and GOP grew y/y, Australia's weakness had existed for most of 2QFY2018 to 3QFY2019. In our earnings review for 2QFY2019, we flagged our dimming outlook over Australia hospitality. In AUD-terms, FHREIT's GOR and GOP for Australia had declined 5.4% y/y and 14.8% y/y respectively, a significantly larger decline versus previous quarters. In our view, these are quality properties though per company, the Sydney market was affected by a challenging environment led by softer corporate demand while Melbourne saw lower numbers of sporting and entertainment events which affected leisure demand. Per STR, a hotel sector data intelligence firm, occupancy rates for Sydney Centre hotels was 84% for the quarter ending June 2019 (shy of the 86.2% same time last year). FHREIT's predominantly Sydney-based portfolio (three in Sydney, one in Melbourne) saw occupancy at 86.7% (down from 3QFY2018's 89.2%). 3QFY2019 Australia RevPAR was lower at AUD186 in 3QFY2019 versus AUD199 in 3QFY2018, on the back of both weaker average daily rates (down 3.1% y/y at AUD216) and the lower y/y occupancy.

- **Waiting patiently for Australia sale to happen:** YTD, there had been various media reports that FHREIT is putting 436-room luxury Sofitel Sydney Wentworth up for sale, while there is no certainty a transaction will take place, we think there is a good possibility that FHREIT will seek a buyer as the REIT is aware of its outsized concentration risk to Australia. In 3QFY2019, Australia comprised 29% of 3QFY2019 NPI (34% of 3QFY2018 NPI). Australia In our view, an eventual sale is a credit positive, especially if the price tag is at least at book value of AUD307.9mn as at 30 September 2018. Our base case though does not factor in a sale and is an upside case.

- **Interest coverage weaker though still manageable:** With FHREIT's operating performance also hammered this quarter, EBITDA (based on our calculation which does not include other income and other expenses) was down by 11.8% y/y at SGD22.3mn. Interest expense though was somewhat down by 1.4% y/y to SGD4.9mn mainly due to lower amortisation of debt upfront costs. EBITDA/Interest coverage was lower at 4.6x still healthy though lower 3QFY2018's 5.1x. Assuming FHREIT pays the full perpetual distribution of SGD4.45mn p.a (SGD1.1mn per quarter) and taking 50% of this as interest, we find EBITDA/(Interest plus 50% perpetual distribution) at 4.1x.

- **Refinancing risk significantly reduced post quarter end:** As at 30 June 2019, reported aggregate leverage was 35.0% (up somewhat from 34.1% as at 31 March 2019) while taking 50% of perpetual as debt, we estimate adjusted aggregate leverage at 37%, still manageable. Short term debt as at 30 June 2018 was SGD436.3mn (representing 51% of total debt) though encouragingly post quarter end in July 2019, FHREIT had refinanced SGD325mn of bank loan facility, MYR95mn (~SGD31.6mn) in asset based securities raised in the MYR bond market and JPY2.35bn (~SGD29.6mn) in Tokutei Mokuteki Kaisha bonds. In our view, this lowers FHREIT's refinancing risk substantially.

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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.

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