Issuer Profile:

Neutral (4)

Ticker:

FCOTSP

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Frasers Commercial Trust ("FCOT")

Summary

- Announced on 2 Dec 2019, Frasers Logistics & Industrial Trust ("FLT") will acquire all FCOT units held by FCOT unitholders in exchange for a combination of cash and new units in FLT, subject to, among other things, approvals by FCOT and FLT unitholders and the Singapore Court.
- We think the merger is likely to be approved by unitholders of both REITs as the transaction (1) is accretive to both their respective distribution per unit, (2) will create an enlarged REIT with an asset base of SGD4.2bn by market capitalisation, and (3) will enhance the geographical and asset diversification of the REITs.
- FCOT is expected to be delisted following the completion of the merger in end March/April 2020. As such, we believe that the delisting put of FCOT's outstanding bonds will be triggered. With respective to this, FCOT had on 16 Dec 2019 announced that it has sufficient financial resources (including lines of credit) to redeem all of FCOT's outstanding bonds in full at the option of the bondholders. If FCOT were to be delisted, we may cease coverage of FCOT and pickup coverage of FLT instead.

Recommendation

- We recommend bondholders not to exercise the delisting put as the coupon rate is attractive for the balance tenor.
- We are also **overweight on FCOTSP 2.835% '21s** as it is offering a higher yield than SUNSP 3% '21s, despite a much lower aggregate leverage.
- Broadly, the merger is credit positive for FCOT bondholders (though FCOT will be subsumed under FLT) as the geographical and asset diversification benefit for FCOT bondholders is stark.

Bond	Outstanding Amount	Maturity	Aggregate Leverage	Ask Yield	Spread
FCOTSP 2.625% '20	**SGD100mn**	**28/02/2020**	**29.0%**	**1.53%**	**9.7bps**
FCOTSP 2.835% '21	**SGD100mn**	**11/08/2021**	**29.0%**	**2.43%**	**101bps**
SUNSP 3% '21	SGD150mn	16/07/2021	38.2%	2.37%	96bps

Indicative prices as at 17 Jan 2020 Source: Bloomberg
Aggregate leverage based on latest available quarter

Background

- Listed on the Singapore Exchange on 30 Mar 2006, Frasers Commercial Trust ("FCOT") holds a portfolio of six office and business park assets in Singapore, Australia and the United Kingdom. As at 31 Dec 2019, the total asset value was ~SGD2.3bn (Singapore: 56%, Australia: 37%, United Kingdom: 7%).
- The REIT is sponsored by Frasers Property Ltd ("FPL") which has a 26% interest in FCOT.
- FCOT's key assets comprise China Square Central ("CSC") and Alexandra Technopark ("ATP") in Singapore, and Caroline Chisholm Centre ("CCC") in Canberra, Australia.

Key Considerations

- **Broad-based improvement**: FCOT recorded a strong first quarter results for financial year ending 30 Sep 2020 ("1QFY2020") with a 20% gain in revenue to SGD37.8mn and a 26% y/y gain in net property income ("NPI") to SGD26.7mn. This came on the back of substantial improvement at ATP (+58% y/y increase in NPI to SGD9.1mn) and CSC (+44% y/y increase in NPI to SGD5.5mn). FCOT's properties in Australia – 357 Collins Street and Central Park also saw better performance, though partially offset by a weaker AUD against SGD.

- **Upgrading of ATP paid off:** ATP recorded a 40% y/y increase in revenue to SGD12.3mn and a 58% y/y jump in NPI to SGD9.1mn over the quarter on the back of a recovery in committed occupancy rate to 97.2% from 68.6% a year ago. The completion of the SGD40mn asset enhancement initiative ("AEI") in Jan 2019 has delivered tangible positive outcomes for FCOT. In addition, signing rents have also risen 10-15% from the passing rent of the property as at end 2018. ATP now has a more diversified tenant profile with the addition of well-established local and international firms. ATP is FCOT's largest asset and accounts for 27% of the portfolio valuation. Back in 4QFY2017, occupancy rate first started sliding due to the departure of Hewlett-Packard Enterprise Singapore and Hewlett-Packard Singapore. Subsequently, Microsoft Operations exercised the option to pre-terminate its leases two years earlier (i.e. 26 Jan 2020). Cumulatively, these brought ATP's committed occupancy to a low of 59.2% as at 31 Mar 2019 (i.e. 2QFY19). In the same quarter though ATP completed its AEI works, and committed occupancy recovered to 93.7% as at 30 Jun 2019, with Google Asia Pacific committing to ~33% of the property's NLA for a term of 5 years commencing in 2QFY2020. We expect occupancy at ATP to stabilise and continue to bring about y/y improvement in gross revenue and NPI.

- **CSC is ready:** In 1QFY2020, revenue at CSC rose substantially by 33% y/y to SGD8.1mn, with NPI markedly higher by 44% at SGD5.5mn. Looking back, FY2019 was the first full year CSC recorded y/y growth in top line figures after three consecutive years of decline. We think the improvement seen in FY2019 can be attributed to the 304-room Capri by Fraser hotel within the development which has brought about an increase in customer base and footfall to the retail component of CSC since opening in May 2019 after ~3 years of construction. Looking ahead, FCOT can look forward to a full quarter of contributions from CSC in 2QFY2020 as business operations have commenced in phases starting Nov 2019. The asset enhancement works at the retail podium also expanded NLA by ~25% to around 80,000 sq ft. Overall property committed occupancy rate was 90.8% as at 31 Dec 2019.

- **Proposed merger with Frasers Logistics & Industrial Trust ("FLT"):** Announced on 2 Dec 2019, FLT will be acquired all FCOT units held by FCOT unitholders in exchange for a combination of cash and new units in FLT. We think the merger is likely to be approved by unitholders of both REITs as the transaction (1) is accretive to both their respective distribution per unit, (2) will create an enlarged REIT with an asset base of SGD4.2bn by market capitalisation, and (3) will enhance the geographical and asset diversification of the REITs. FCOT is expected to be delisted following the completion of the merger in end March/April 2020. FCOT had also on 16 Dec 2019 announced that it has sufficient financial resources (including lines of credit) to redeem all of FCOT's outstanding bonds in full at the option of the bondholders.

- **FCOT's standalone credit metrics:** Reported aggregate leverage is healthy at 29.0% (FY2019: 29.6%, FY1208: 28.3%). EBITDA/Interest based on our calculation was stronger at 4.4x (FY2019: 3.5x, FY2018: 3.0x), due to 27%y/y rise in EBITDA on the back of the strong performance mentioned above. Given we expect the strong performance at ATP and CSC to persist and continue to lift the portfolio, we think the improvement in EBITDA is likely to be maintained as well. Average borrowing rate was slightly lower at 2.90% p.a. (FY2019: 2.97% p.a., FY2018: 3.02% p.a.). In FY2020, FCOT will see its FCOTSP 2.625% '20s with an outstanding amount of SGD100mn mature in Feb 2020, along with ~SGD94mn of bank borrowings. Although FCOT has a mere SGD16.2mn of cash on hand as at 31 Dec 2019, we are not overly concerned as all of its assets, which are valued at SGD2.3bn in aggregate, remain unencumbered. This offers FCOT flexibility to obtain secured borrowings if needed.

- **Credit metrics of the enlarged REIT:** Broadly, the merger is credit positive for FCOT bondholders (though FCOT will be subsumed under FLT) as the geographical and asset diversification benefit for FCOT bondholders is stark. As at 30 Sep 2019, FLT has 92 properties within the logistics and industrial markets in Australia, Germany and The Netherlands, with a portfolio value of SGD3.3bn (~1.4x of FCOT). FLT's properties are fully occupied. Although combined aggregate leverage is estimated to rise to 31.5% from 29.0%, it remains well below the existing cap of 45%. FCOT's standalone aggregate leverage is 29.0% as at 31 Dec 2019, while that for FLT is 31.5% as at 30 Sep 2019 (31 Dec 2019 has yet to be announced for FLT).

In addition, combined EBITDA/Interest will improve to 6.0x based on our estimation. FCOT's standalone EBITDA/Interest is 4.4x, while FLT's standalone EBITDA/Interest is 7.5x. We have assumed that the exchange is 1.076 AUD per SGD in our calculation.

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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