Issuer Profile:

Neutral (3)

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Neutral (3)

Ticker:

AREIT

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Ascendas Real Estate Investment Trust ("AREIT")

Recommendation

- **AREIT's revenue growth in 1H2020 has been driven by inorganic growth, though its reported aggregate leverage has been maintained at 36.1% while EBITDA/Interest coverage was manageable at 4.1x. Industrial REITs in general have been more resilient against REITs operating in other real estate segments. We are maintaining our issuer profile of AREIT at Neutral (3). Indicative of its considerable access to capital markets, AREIT has also managed to raise a replacement green perpetual at 3.0%, with the REIT issuing a notice to call the existing AREIT 4.75%-PERP on 14 October 2020.**
- **Bond Recommendation: In our view, the AREIT curve historically trades tight versus its closest large cap peer in the SGD-space namely CapitaLand Mall Trust ("CMT", Issuer profile: Positive (2)) by 20-30bps and we prefer the CMT curve instead for the yield pick-up. Among high grade long dated bonds, we see better value in Mercatus Co-operative Limited ("MRCOOP", Issuer profile: Unrated), MRCOOP 3.08% '30s which is paying 2.91% in yield to maturity. While MRCOOP is an unlisted entity, the company owns retail malls in Singapore including Jurong Point and NEX with full set of annual financials available publicly. AREIT's sole green perpetual, the AREIT 3.0%-PERP is trading at a yield to call of 3.0%, which suggest a senior-sub spread of 127bps against the AREIT 3.14% '25s and attractive relative to the rest of its own curve. We though are Neutral on the AREIT 3.0%-PERP given that its Sponsor CapitaLand Ltd ("CAPL", Issuer profile: Neutral (3)) has a perpetual with a shorter first call date in October 2024 which is also trading at a yield to call of 3.0%. The AREIT 3.0%-PERP is externally rated unlike the CAPLSP 3.65%-PERP which has no external issue ratings.**

Relative Value:

Bond	Maturity / Call date	Aggregate Leverage	Ask YTM/YTC	Spread	Recommen-dation
AREIT 2.655% '21s	07/04/2021	36.1%	0.72%	52bps	UW
AREIT 4.0% '22s	03/02/2022	36.1%	1.08%	85bps	UW
AREIT 3.2% '22s	03/06/2022	36.1%	1.18%	94bps	UW
AREIT 2.47% '23s	10/08/2023	36.1%	1.44%	115bps	UW
AREIT 3.14% '25s	02/03/2025	36.1%	1.68%	126bps	UW
AREIT 2.65% '30s^	26/08/2030	36.1%	2.35%	155bps	UW
AREIT 3.0%-PERP^	17/09/2025	36.1%	3.00%	253bps	N
CAPITA 2.8% '23s	13/03/2023	34.4%	1.59%	131bps	N*
CAPITA 3.2115% '23s	09/11/2023	34.4%	1.80%	148bps	N*
CAPITA 3.48% '24s	06/08/2024	34.4%	1.83%	145bps	UW*
CAPITA 3.2% '25s	21/08/2025	34.4%	2.00%	153bps	N*
CAPITA 3.15% '26s	11/02/2026	34.4%	2.20%	170bps	UW*
CAPLSP 3.65%-PERP	17/10/2024	64.4%[1]	3.02%	263bps	UW*
MAPLSP 3.58% '29s	13/03/2029	62.6%[1]	2.55%	184bps	n.a
MRCOOP 3.08% '30s	23/01/2030	82.6%[1]	2.91%	214bps	n.a

Indicative prices as at 25 September 2020 Source: Bloomberg
Aggregate leverage based on latest available financials
Note: (1) Unadjusted net gearing based on latest available financials
**Based on Monthly Credit View (03 September 2020)*
^ Denote green bonds and green perpetuals

Background

- Ascendas REIT ("AREIT") is the largest business space and industrial REIT in Singapore, with a market cap as at 25 September 2020 of SGD11.8bn. Total assets were SGD14.3bn as at 30 June 2020, including interest in joint ventures. As at 30 June 2020, AREIT have a diversified portfolio of 96 properties in Singapore, 35 properties in Australia, 38 properties in the UK and 28 properties in the US.

- AREIT is 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. AREIT announced a change in financial year end from 31 March to 31 December (matching CAPL). The immediately preceding financial year was a nine-month period from 1 April 2019 to 31 December 2019 ("2019") while the current financial year is a 12-month period from 1 January 2020 to 31 December 2020 ("2020").
- AREIT is incorporated in Singapore while the SGD perpetual and bonds are issued by HSBC Institutional Trust Services (Singapore) Limited, in its capacity as trustee of AREIT.

Key Considerations

- **Raised a replacement perpetual at low cost of 3%:** On 10 September 2020, AREIT priced a perpetual at a low rate of 3.0%. Forward rates at that point were implying that the existing AREIT 4.75%-PERP could reset to 3.0% on the first call date of 14 October 2020. In theory, AREIT had priced the new perpetual at no cost savings versus letting the perpetual reset lower. While it was interesting that AREIT did not push harder for cost savings, a perpetual at 3.0% is significantly lower than just two months prior. Not coming to market would have open itself up to one month of uncertainty of 5Y swaps rising at reset date.

- **Green finance framework:** AREIT is the pioneer issuer of green fixed income securities in Singapore. The REIT issued its first time 10Y green bond amounting to SGD100mn in August 2020 and a first time NC5 green perpetual amounting to SGD300mn in September 2020. The issuances were issued pursuant to AREIT's Green Finance Framework. The framework is prepared in line with the International Capital Market Association ("ICMA")'s Green Bond Principles and with Loan Market Association ("LMA")'s Green Loan Principles. Net proceeds raised will be used to finance or refinance in whole or in part new or existing eligible projects including green buildings, renewable energy, energy efficiency, waste management, sustainable water management and clean transportation. Cash though is fungible as such the first two issuances very likely would be applied towards refinancing. However, amount equal to the net proceeds from the green finance transactions will be allocated exclusively to eligible projects.

- **Revenue growth driven by inorganic growth:** Gross revenue for 1H2020 was up 14.6% y/y to SGD521.2mn driven by the contribution of 28 new business park properties in the US and two business park in Singapore. SGD59.6mn of revenue 1H2020 was from the US versus zero in 1H2019 as the US portfolio's acquisition was only completed on 11 December 2019. This more than offset the rental rebates provided for eligible tenants, divestment of Wisma Gulab in January 2020 and two other smaller properties. AREIT also saw lower occupancies, particularly in Singapore where we observe a decline in occupancies in AREIT's science parks, business parks and light industrial (eg: non-renewal of lease at 31 Joo Koon Circle). AREIT did not disclose its same store sales growth although we expect this to be negative, on a h/h basis taking out the contribution from the US portfolio, we estimate that revenue was down by 0.25%.

- **Portfolio occupancy may be softer in 2021:** Overall portfolio occupancy was at 91.5% as at 30 June 2020 (31 March 2020: 91.7%), with improvements seen in Australia (98.4% from 97.3%) though occupancy dipped in Singapore and the US. UK occupancy was flat compared to 31 March 2020. As at 30 June 2020, overall lease expiry looks manageable with only 8.2% of leases coming due in 2H2020 by gross rental income and 15.8% in 2021. However, for the Singapore portfolio, 11.3% of leases by gross rental income would come due in 2H2021 and 20.8% would come due in 2021. Singapore portfolio occupancy was 87.9% as at 30 June 2020, with lease expiries heavy and some occupancy boosted by temporal demand (eg: stockpiling), we expect Singapore portfolio occupancy to be softer going forward. In 1H2020, Singapore makes up 71.5% of portfolio net property income.

- **Manageable interest coverage ratio:** EBITDA (based on our calculation which does not include other income and other expenses) was up by 10.0% y/y to SGD349.5mn while interest expense was up by 5.1% y/y from higher average debt balance. Resultant EBITDA/Interest was somewhat higher at 4.1x (1H2019: 3.9x). In 10 September 2020, AREIT issued a notice that it would be calling its existing AREIT 4.75%-PERP and on the same date also price a perpetual of the same size of SGD300mn at 3.0%. At 3.0% p.a, perpetual distribution would be SGD9.0mn p.a. (SGD4.5mn of half a year of perpetual distribution), we find Adjusted EBITDA/(Interest plus 50% perpetual distribution) at 3.9x, still manageable.

- **Buying unbuilt properties for expansion:** On 11 September 2020, AREIT completed the acquisition of 254 Wellington Road, a suburban office building in Melbourne Australia for ~SGD101.9mn, including transaction costs. This was a forward purchase where the agreement was signed on 3 October 2019 while the property was yet to be constructed. On 1 July 2020, AREIT announced that it will be buying a new logistics property to be developed on Kiora Crescent, Yennora, in Sydney, Australia for ~SGD22.4mn. Development of the property is expected to complete in 2Q2021. On 18 September 2020, AREIT announced the proposed acquisition of a suburban office building to be developed at 1 Giffnock Avenue, Macquarie Park, in Sydney, Australia AREIT will fund the construction cost and is entitled to receive monthly coupons from the developer at a rate of 5.75% p.a on the progressive payments made over the construction period. In a nutshell, AREIT will be earning an income from financing this development. The property development is expected to be completed around mid-2022. The total investment cost is expected at ~SGD159.8mn, after taking into account coupons that AREIT would be receiving and adding in transaction costs.

- **Aggregate leverage inching up:** As at 30 June 2020, AREIT's reported aggregate leverage was 36.1% (31 December 2019: 35.1%) from higher debt balance. For 1H2020, debt-to-EBITDA (inclusive of lease liabilities as debt) was 7.9x versus 7.6x in 1H2019. Taking 50% of perpetual as debt, we estimate that adjusted aggregate leverage was ~37%. As at 30 June 2020, cash balance at AREIT was SGD361.3mn. Asset movements post 30 June 2020, announced acquisitions, developments, redevelopments and asset enhancement initiatives are likely to be funded by internal cash or debt with the proportionate split affecting aggregate leverage. Assuming that these are debt-funded, we expect reported aggregate leverage to inch up to ~38%. In Singapore, aside from the built-to-suit development for Grab, AREIT is redeveloping UBIX (25 and 27 Ubi Road 4) and iQuest@IBP.

- **Manageable refinancing risk:** Debt is well staggered, at less than 20% of total debt maturing each year while AREIT maintains considerable access to both debt and equity capital markets. As at 30 June 2020, AREIT faced ~SGD787.9mn of short term debt (including short term lease liabilities). This representing 14% of total debt. On 3 August 2020, AREIT redeemed SGD100mn of bonds that came due. On 17 August 2020, a new 10Y green bond of SGD100mn was raised, likely for refinancing. This would have reduced short term debt due even if total debt remained the same. As at 30 June 2020, AREIT has SGD200mn of committed unutilized facilities while 92% of its investment properties (ie: SGD11.7bn) remain unencumbered and can be used to raise secured debt, if need be.

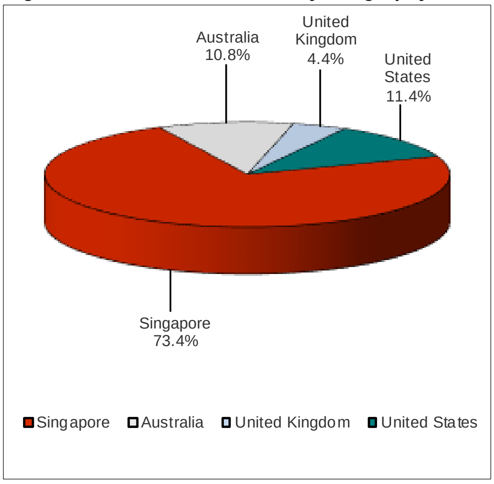
Ascendas Real Estate Investment Trust

Table 1: Summary Financials

Year Ended 31st Dec	FYE Mar18	FYE Mar19	1H FY20
Income Statement (SGD'mn)			
Revenue	862.1	886.2	521.2
EBITDA	571.0	587.5	349.5
EBIT	571.0	587.5	349.5
Gross interest expense	109.8	126.5	84.8
Profit Before Tax	496.9	517.5	293.7
Net profit	494.1	503.1	279.0
Balance Sheet (SGD'mn)			
Cash and bank deposits	25.0	52.3	361.3
Total assets	10,353.8	11,413.8	14,295.2
Short term debt	909.9	611.9	787.9
Gross debt	3,519.2	4,097.8	5,513.7
Net debt	3,494.2	4,045.5	5,152.4
Shareholders' equity	6,498.7	6,946.0	8,256.3
Cash Flow (SGD'mn)			
CFO	538.9	612.4	325.7
Capex	132.7	176.1	76.0
Acquisitions	226.6	914.2	107.1
Disposals	60.8	37.6	123.7
Dividends	308.8	477.3	134.0
Interest paid	118.4	128.7	71.9
Free Cash Flow (FCF)	406.2	436.4	249.7
Key Ratios			
EBITDA margin (%)	66.23	66.30	67.05
Net margin (%)	57.31	56.77	53.54
Gross debt to EBITDA (x)	6.16	6.97	7.89
Net debt to EBITDA (x)	6.12	6.89	7.37
Gross Debt to Equity (x)	0.54	0.59	0.67
Net Debt to Equity (x)	0.54	0.58	0.62
Gross debt/total asset (x)	0.34	0.36	0.39
Net debt/total asset (x)	0.34	0.35	0.36
Cash/current borrowings (x)	0.03	0.09	0.46
EBITDA/Total Interest (x)	5.20	4.64	4.12

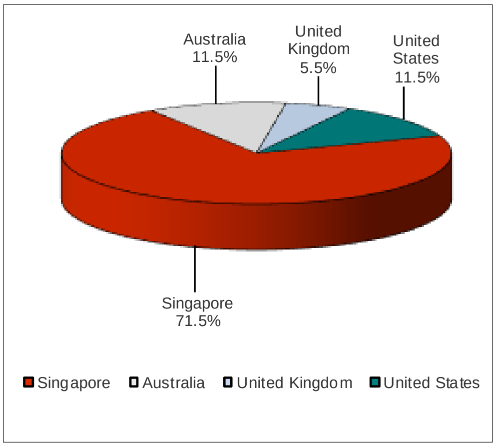
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Geography - 1H FY20



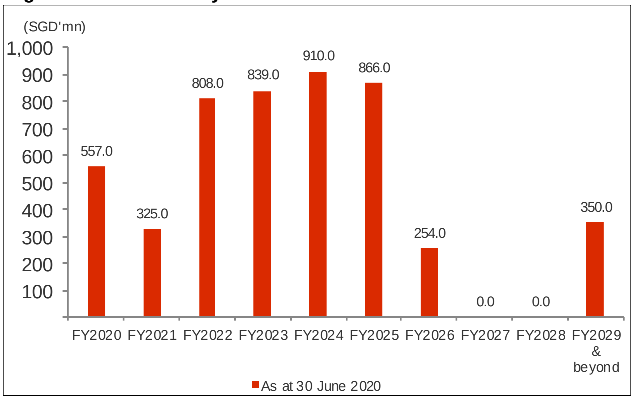
Source: Company

Figure 2: NPI breakdown by Geography - 1H FY20



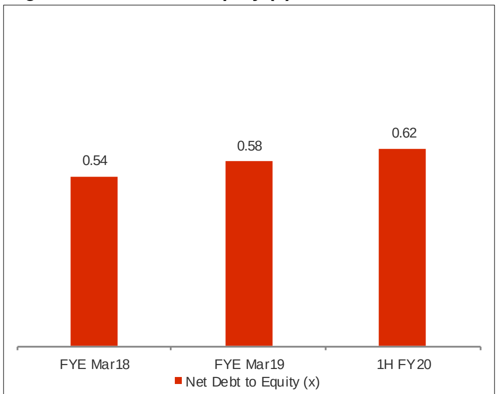
Source: Company

Figure 3: Debt Maturity Profile



Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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 bond represents **better relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Neutral ("N") – The represents **fair relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Underweight ("UW") – The represents **weaker relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

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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