Ascott Residence Trust

BUY

Last Traded Price (20 Oct 2016): S$1.135 (STI : 2,842.62)
Price Target 12-mth: S$1.32 (16% upside) (Prev S$1.31)

Potential Catalyst: Further acquisitions and asset recycling to accelerate growth, improvement in performance of ART's Chinese properties
Where we differ: Below consensus on lower assumed sales

Analyst
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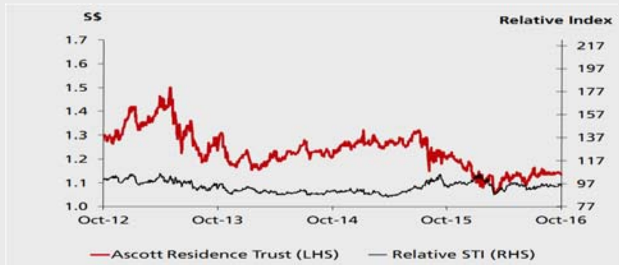
What's New

- **3Q16 DPU of 2.35 Scts ahead of expectations due to one-off realised forex gains**
- **Mixed performance with higher contributions from Australia and the US offset by weaker operations in China and Singapore**
- **Raise FY16-17F DPU by 1-5% to account for forex gains and lower assumed cost of debt**

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2014A	2015A	2016F	2017F
Gross Revenue	357	421	464	490
Net Property Inc	180	205	219	229
Total Return	121	152	111	102
Distribution Inc	126	123	134	134
EPU (S cts)	4.83	4.61	6.14	6.13
EPU Gth (%)	(5)	(4)	33	0
DPU (S cts)	8.20	7.99	8.20	8.11
DPU Gth (%)	(2)	(3)	3	(1)
NAV per shr (S cts)	137	141	137	134
PE (X)	23.5	24.6	18.5	18.5
Distribution Yield (%)	7.2	7.0	7.2	7.1
P/NAV (x)	0.8	0.8	0.8	0.8
Aggregate Leverage (%)	37.6	38.4	39.4	39.6
ROAE (%)	3.5	3.3	4.5	4.5

Distn. Inc Chng (%):			5	2
Consensus DPU (S cts):			8.10	8.40
Other Broker Recs:		B: 8	S: 0	H: 4

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Unrealised potential

Diversified portfolio underpins resilience. We maintain our BUY recommendation on Ascott Residence Trust (ART) with revised TP of S$1.32. Amid the volatility in the Singapore hospitality market, we believe ART's diversified portfolio with serviced residences and rental housing across 14 countries in the Asia Pacific, Europe and the US, offers investors a more resilient DPU outlook. ART's resiliency and cashflow visibility also comes from having 40-50% of its income sourced from master leases and management contracts with minimum guaranteed income.

Value from recent acquisitions/AEIs yet to be fully realised. ART has announced c.S$1.2bn worth of acquisitions over the last two years, increasing the value of its assets under management (AUM) by one-third to S$5bn. Combined with completed and ongoing asset enhancement initiatives (AEIs), ART should progressively realise benefits over the next few years.

Divestments to strengthen balance sheet. ART's headline gearing of c.41% is slightly elevated and we are mindful of ART's adjusted gearing (treating 50% of perpetual securities as debt) which stands at 42-44%. However, we understand this is temporary as ART is reviewing its portfolio mix, and looking to divest some of its lower yielding properties.

Valuation:
To incorporate the realised forex gains in 3Q16 and lower assumed interest rates given prospects of achieving interest savings as ART refinances its borrowings over the next couple of years, partially offset by moderation of average daily rate (ADR) growth in Japan due to potential impact of the recent strengthening of the JPY, we raised our FY16-17F DPU by 1-5%. We have also raised our DCF-based TP to S$1.32 from S$1.31.

Key Risks to Our View:
Oversupply and forex volatility. The key risk to our call is potential oversupply in ART's key markets as well as impact from forex volatility. These risks are mitigated by ART's diversified portfolio with no country contributing more than 20% of the group's net property income.

At A Glance

Issued Capital (m shrs)	1,651
Mkt. Cap (Sm/USm)	1,874 / 1,352
Major Shareholders (%)	
CapitaLand Limited	43.8
AIA Group Ltd	5.0
Free Float (%)	51.2
3m Avg. Daily Val (US$m)	0.83
ICB Industry : Real Estate / Real Estate Investment Trust	

WHAT'S NEW

Positive surprise

Boost one-off realised exchange gains

- 3Q16 DPU increased 14% y-o-y to 2.35 Scts which was ahead of expectations given it represented 30% of our original FY16F DPU. The better than expected results were due to realised exchange gains of S$3.3m arising from repayment of foreign currency bank loans with the divestment proceeds from the sale of units at Fortune Garden Apartments in Beijing.
- On a normalised basis excluding the one-off costs in 3Q15, 3Q16 DPU would have been flat y-o-y at 2.15 Scts. The flattish performance is largely due to the increased number of shares post the equity placement earlier this year and weaker contribution from China, Singapore and the UK, offsetting higher income from Australia and boost from the acquisition of Sheraton Tribeca New York.

Mixed performance continues

- Contribution from the US grew 115% y-o-y largely on the back of the Sheraton Tribeca New York acquisition. Nevertheless, due to the increase in the supply of new hotel rooms (3-4%) and a lower number of events this year, revenue per available unit (RevPAU) fell 14% y-o-y to US$242. The drop in RevPAU predominately relates to the Element New York Times Square West property.
- Similar to the US operations, Australia reported higher earnings contribution (+22% y-o-y), primarily due to the acquisition of Citadines Melbourne which was only acquired in July 2015.
- Following on from the trend seen in prior quarters this year, the China operations continue to be plagued by overcapacity and soft demand in Tier 2 cities with gross profit down 9% in SGD terms.
- Japan which has been a key growth driver for ART over the past two years, showed some softness for the first time. While earnings still grew 9% y-o-y in SGD terms, (RevPAU) was flat y-o-y in JPY terms due to some weakness in corporate and leisure demand on the back of a strengthening JPY.
- Meanwhile, Singapore continues to face the challenge of weak corporate demand with a lower number of project groups as well as clients reducing their average length of stay. This resulted in gross profit dropping 9% with RevPAU falling 13% y-o-y.
- Post the Brexit referendum, the UK properties reported a credible performance with gross profit up 3% in GBP terms due to lower provision of incentive fees despite RevPAU dipping 2% y-o-y. We understand that thus far, the London market has been relatively stable compared to initial fears over a significant downturn post Brexit.

Steady gearing

- Gearing remains steady at 41% with ART's all-in blended borrowing cost dipping slightly to 2.4% from 2.5%.
- The proportion of fixed rate borrowings was maintained at 80%.
- NAV per unit fell marginally to S$1.30 from S$1.32, taking into account the issuance of management fees in units and payment of 1H16 DPU.

Incorporating realised forex gains and lower assumed interest rates

- To incorporate the realised forex gains in 3Q16 and lower assumed interest rates given prospects of achieving interest savings as ART refinances its borrowings over the next couple of years, partially offset by moderation of ADR growth in Japan due to potential impact of the recent strengthening of the JPY, we raised our FY16-17F DPU by 1-5%. We have also raised our DCF-based TP to S$1.32 from S$1.31.

Maintain BUY, TP S$1.32

- With ART trading at a c.12% discount to its book value and offering an attractive 7.1-7.2% yield, we reiterate our BUY call.

Quarterly / Interim Income Statement (S$m)

FY Dec	3Q2015	2Q2016	3Q2016	% chg yoy	% chg qoq
Gross revenue	113	119	124	9.5	3.8
Property expenses	(58.0)	(61.5)	(66.4)	14.6	8.1
Net Property Income	55.2	57.9	57.5	4.1	(0.7)
Other Operating expenses	(6.5)	(7.3)	(7.1)	9.3	(3.1)
Other Non Opg (Exp)/Inc	10.3	(1.1)	(1.3)	na	(17.3)
Net Interest (Exp)/Inc	(12.1)	(11.7)	(12.0)	0.9	(2.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	na	na
Net Income	46.9	37.7	37.1	(20.9)	(1.7)
Tax	(10.3)	(17.3)	(5.6)	(45.2)	(67.5)
Minority Interest	(1.2)	(1.1)	(1.4)	(21.7)	27.3
Net Income after Tax	35.5	19.3	30.0	(15.3)	55.9
Total Return	45.8	55.6	32.1	(29.8)	(42.2)
Non-tax deductible Items	(8.9)	(25.3)	11.5	nm	nm
Net Inc available for Dist.	32.0	35.0	38.7	21.1	10.6
Ratio (%)					
Net Prop Inc Margin	48.8	48.5	46.4		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

Value of past acquisitions yet to be realised. ART has had an active two years, marking its maiden entries into Malaysia and the US. In addition, ART has deepened its presence in Australia, China and Japan. All in, ART has acquired c.S$1.2bn worth of properties on an average yield of 5-8%. The benefits from these acquisitions should accrue over the next few years.

Asset enhancements to drive earnings. Beyond the announced acquisitions, another growth driver for ART are the asset enhancement initiatives it has undertaken or in the process of completing. Refurbishments, which are initiated every 7-10 years, are designed to enhance the market positioning of ART's various properties and should translate to higher occupancies and room rates. It has announced c.S$95m worth of renovations over the last 18 months in various cities including Barcelona, Dalian, Ho Chi Minh City, London, Manila, Singapore, Shanghai and Tianjin.

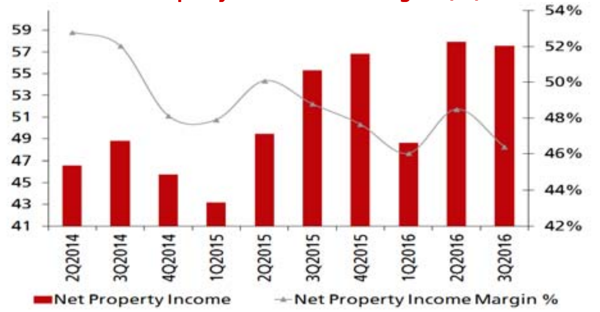
Australia, Japan and US - key growth markets. With a timely expansion into Australia and Japan, ART is well positioned to take advantage of the growing Australian and Japanese hospitality markets which should translate to healthy RevPAR growth. In addition, ART's entry into New York provides exposure to the recovering US economy. The abovementioned markets, representing c.34% of ART's 9M16 net property income (NPI), should help offset potential weakness from its Chinese properties (c.9% of group NPI) which are affected by the economic slowdown in China.

Steady income base from Europe and Japan rental properties. Around a third of ART's NPI comes from properties under master leases in France, Germany, Singapore and Japan (rental properties). With the prudent use of forex hedges, and having properties under management contracts with minimum guaranteed income (14% of group NPI) in Belgium, Spain and UK, ART provides investors with a solid income base.

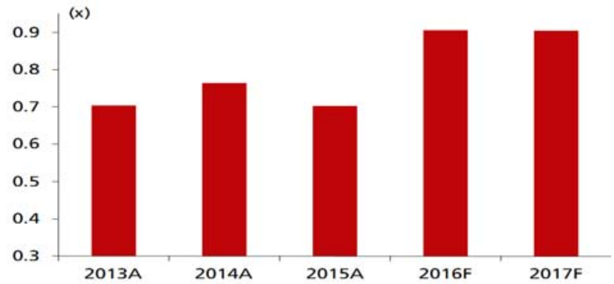
Ambitions to grow portfolio size to S$6bn. ART has ambitions to grow its portfolio from S$5bn currently to S$6bn by 2017. The properties will be sourced from its Sponsor and third parties.

Net Property Income and Margins (%)

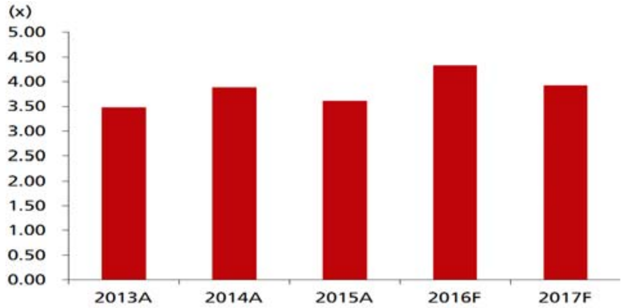
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Temporary increase in gearing. Post ART's recent acquisition of properties in Australia, Japan and the US, ART's headline gearing is expected to settle at around the 40-41% level. However, on an adjusted basis treating 50% of the perpetual securities as debt (in line with Moody's treatment), gearing is expected to hover around 42-44%. While cognizant of the higher gearing near term, we understand ART will look to pare down its debt by disposing some of its lower-yielding properties.

Share Price Drivers:

Overcoming past disappointments. ART's share price has been range bound over the last year due to inconsistent DPU growth over the last two years on account of the dilution impact from the rights issue in late 2013 and weakness from its Chinese properties. However, we believe ART will re-rate as the full benefits from c.S$1.2bn worth of acquisitions and refurbishment activities over the past two years are realised.

Key Risks:

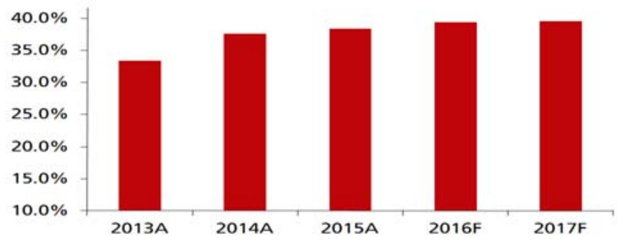
Interest rate risks. Any increase in interest rates will result in higher interest payments and reduce the income available for distribution, which will result in lower distribution per unit (DPU) for unitholders. As at 30 September 2016, 80% of ART's debts are on fixed rates.

Currency risk. As ART earns rental income in various currencies, a depreciation of any foreign currency against the SGD could negatively impact DPU. Nevertheless, through the use of currency hedges for EUR and JPY sourced income, as well as the benefits from having a diversified portfolio, FX volatility has had a minimal impact on ART's earnings historically. In FY13-FY15, changes in ART's basket of currencies had only a net 0.8-1.5% negative impact on earnings.

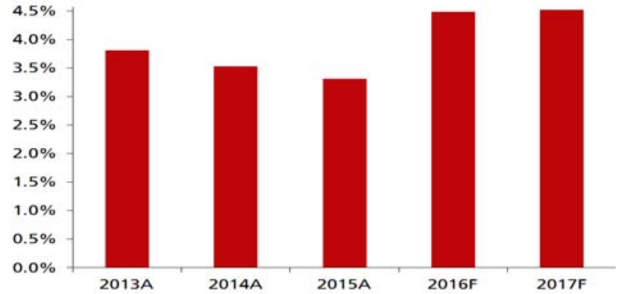
Company Background

Ascott REIT's Investment portfolio primarily comprises real estate used mainly as serviced residences or rental housing properties (including investments in real estate-related assets and/or other related value-enhancing assets or instruments).

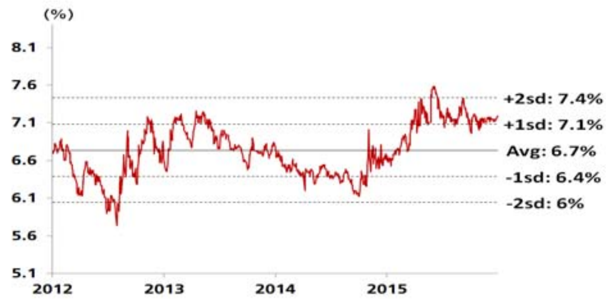
Aggregate Leverage (%)



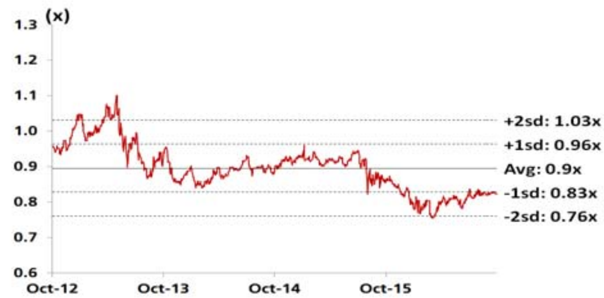
ROE (%)



Distribution Yield (%)



PB Band (x)



Source: Company, DBS Bank

Income Statement (S$m)

FY Dec	2013A	2014A	2015A	2016F	2017F
Gross revenue	317	357	421	464	490
Property expenses	(155)	(177)	(217)	(245)	(261)
Net Property Income	161	180	205	219	229
Other Operating expenses	(13.0)	(19.9)	(30.4)	(23.2)	(23.7)
Other Non Opg (Exp)/Inc	0.0	1.29	9.25	0.0	0.0
Net Interest (Exp)/Inc	(42.6)	(41.2)	(48.3)	(45.2)	(52.3)
Exceptional Gain/(Loss)	6.63	0.0	0.0	0.0	0.0
Net Income	112	120	135	151	153
Tax	(36.2)	(36.9)	(36.8)	(25.7)	(26.1)
Minority Interest	(6.7)	(7.9)	(13.8)	(6.3)	(6.4)
Preference Dividend	0.0	(1.4)	(13.4)	(19.2)	(19.2)
Net Income After Tax	69.3	74.1	71.2	99.9	102
Total Return	209	121	152	111	102
Non-tax deductible Items	(93.8)	4.51	(28.4)	22.5	32.8
Net Inc available for Dist.	115	126	123	134	134
Growth & Ratio					
Revenue Gth (%)	4.2	12.8	17.9	10.2	5.6
N Property Inc Gth (%)	1.3	11.8	13.5	7.2	4.4
Net Inc Gth (%)	11.2	6.9	(4.0)	40.4	1.7
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	50.9	50.4	48.6	47.2	46.7
Net Income Margins (%)	21.9	20.7	16.9	21.5	20.7
Dist to revenue (%)	36.3	35.2	29.3	28.8	27.4
Managers & Trustee's fees	4.1	5.6	7.2	5.0	4.8
ROAE (%)	3.8	3.5	3.3	4.5	4.5
ROA (%)	2.1	1.9	1.6	2.1	2.1
ROCE (%)	3.2	3.0	3.0	3.5	3.6
Int. Cover (x)	3.5	3.9	3.6	4.3	3.9

Source: Company, DBS Bank

Growth driven by acquisitions in China, Malaysia, Australia, US and Japan over the past 18 months

Quarterly / Interim Income Statement (S$m)

FY Dec	3Q2015	4Q2015	1Q2016	2Q2016	3Q2016
Gross revenue	113	119	106	119	124
Property expenses	(58.0)	(62.4)	(57.0)	(61.5)	(66.4)
Net Property Income	55.2	56.8	48.6	57.9	57.5
Other Operating expenses	(6.5)	(12.5)	(2.6)	(7.3)	(7.1)
Other Non Opg (Exp)/Inc	10.3	6.23	(0.1)	(1.1)	(1.3)
Net Interest (Exp)/Inc	(12.1)	(13.2)	(12.2)	(11.7)	(12.0)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	46.9	37.4	33.7	37.7	37.1
Tax	(10.3)	(16.6)	(6.3)	(17.3)	(5.6)
Minority Interest	(1.2)	(1.8)	(1.4)	(1.1)	(1.4)
Net Income after Tax	35.5	19.0	26.0	19.3	30.0
Total Return	45.8	68.1	25.9	55.6	32.1
Non-tax deductible Items	(8.9)	(31.2)	6.25	(25.3)	11.5
Net Inc available for Dist.	32.0	32.1	27.3	35.0	38.7
Growth & Ratio					
Revenue Gth (%)	15	5	(11)	13	4
N Property Inc Gth (%)	12	3	(14)	19	(1)
Net Inc Gth (%)	174	(46)	37	(26)	56
Net Prop Inc Margin (%)	48.8	47.7	46.0	48.5	46.4
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

Balance Sheet (S$m)

FY Dec	2013A	2014A	2015A	2016F	2017F
Investment Properties	3,177	3,724	4,290	4,567	4,577
Other LT Assets	81.1	80.9	80.2	75.7	71.7
Cash & ST Invts	205	193	220	174	147
Inventory	0.37	0.29	0.30	0.30	0.30
Debtors	11.7	36.4	49.7	50.2	53.0
Other Current Assets	107	87.8	84.2	84.2	84.2
Total Assets	3,582	4,122	4,725	4,951	4,933
ST Debt	50.3	249	258	258	258
Creditor	4.37	119	136	143	151
Other Current Liab	114	7.85	5.24	5.24	5.24
LT Debt	1,147	1,302	1,557	1,695	1,695
Other LT Liabilities	79.1	91.4	99.2	99.2	99.2
Unit holders' funds	2,093	2,255	2,587	2,663	2,630
Minority Interests	94.1	97.8	81.8	88.0	94.4
Total Funds & Liabilities	3,582	4,122	4,725	4,951	4,933
Non-Cash Wkg. Capital	0.68	(2.0)	(7.5)	(13.4)	(18.5)
Net Cash/(Debt)	(993)	(1,358)	(1,595)	(1,779)	(1,806)
Ratio					
Current Ratio (x)	1.9	0.8	0.9	0.8	0.7
Quick Ratio (x)	1.3	0.6	0.7	0.6	0.5
Aggregate Leverage (%)	33.4	37.6	38.4	39.4	39.6
Z-Score (X)	1.0	0.9	0.8	0.7	0.7

Source: Company, DBS Bank

Increase in gearing on the back of announced acquisitions

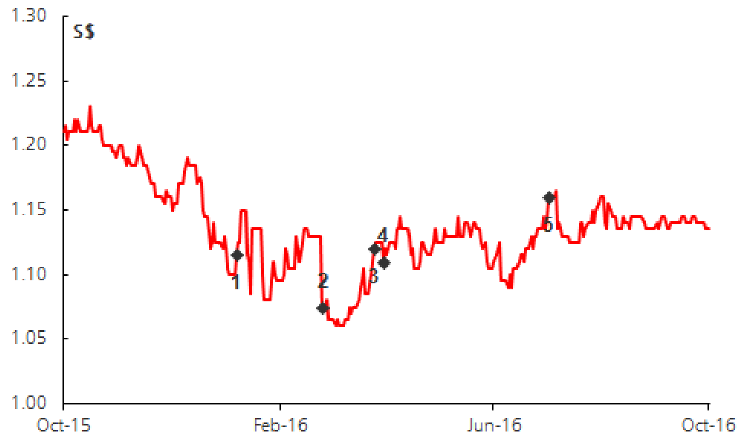
Cash Flow Statement (S$m)

FY Dec	2013A	2014A	2015A	2016F	2017F
Pre-Tax Income	112	120	135	151	153
Dep. & Amort.	13.5	16.3	16.6	16.4	16.4
Tax Paid	(13.3)	(22.4)	(24.1)	(25.7)	(26.1)
Associates &JV Inc/(Loss)	0.00	0.0	0.0	(0.2)	(0.2)
Chg in Wkg.Cap.	2.30	(25.8)	(14.8)	5.91	5.15
Other Operating CF	37.2	64.1	64.5	0.0	0.0
Net Operating CF	152	153	177	147	149
Net Invt in Properties	(42.2)	(40.0)	(46.8)	(267)	(12.3)
Other Invts (net)	(180)	(428)	(352)	(10.0)	(10.0)
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	2.23	7.76	1.76	0.0	0.0
Net Investing CF	(220)	(461)	(397)	(277)	(22.3)
Distribution Paid	(107)	(116)	(125)	(134)	(134)
Chg in Gross Debt	(89.8)	315	581	138	0.0
New units issued	398	0.0	0.0	98.5	0.0
Other Financing CF	(52.3)	99.7	(213)	(19.2)	(19.2)
Net Financing CF	149	298	243	83.7	(154)
Currency Adjustments	(0.8)	(2.0)	3.66	0.0	0.0
Chg in Cash	79.3	(12.0)	27.9	(46.1)	(27.4)
Operating CFPS (S cts)	10.9	11.6	12.5	8.69	8.65
Free CFPS (S cts)	8.03	7.33	8.48	(7.4)	8.22

Source: Company, DBS Bank

Acquisition of properties in Australia, Japan and US partially offset by asset disposals in Japan and Philippines

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	26 Jan 16	1.12	1.33	BUY
2:	15 Mar 16	1.08	1.33	BUY
3:	13 Apr 16	1.12	1.33	BUY
4:	18 Apr 16	1.11	1.28	BUY
5:	21 Jul 16	1.16	1.31	BUY

***Note**: Share price and Target price are adjusted for corporate actions.*

Source: DBS Bank

Analyst: Mervin SONG CFA

DBS Bank recommendations are based an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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