

Singapore Company Update

Ascott Residence Trust

Bloomberg: ART SP | Reuters: ASCO.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

6 Jan 2021

BUY

Last Traded Price (5 Jan 2021): S\$1.07 (STI : 2,859.68)

Price Target 12-mth: S\$1.20 (12% upside)

Analyst

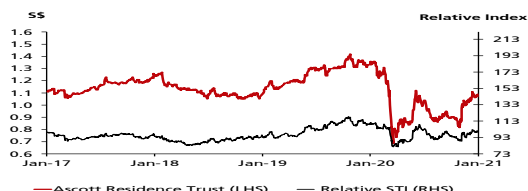
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What's New

- Gradual extension of France master leases in 2021 through a risk-sharing approach and variable formula
- New rental structure implies a drop of c.9.4% in revenues on a pro forma FY19 basis
- Impact manageable at c.2.5% revenue loss on a worst case scenario
- Opportunity to infuse stability to portfolio through acquisitions within the broader lodging asset class

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2018A	2019A	2020F	2021F
Gross Revenue	514	515	413	527
Net Property Inc	239	253	175	236
Total Return	128	197	50.0	101
Distribution Inc	155	166	81.8	129
EPU (S cts)	4.32	(1.9)	1.62	3.28
EPU Gth (%)	(16)	nm	nm	102
DPU (S cts)	7.16	7.61	2.65	4.18
DPU Gth (%)	1	6	(65)	58
NAV per shr (S cts)	122	125	125	124
PE (X)	24.8	nm	66.0	32.6
Distribution Yield (%)	6.7	7.1	2.5	3.9
P/NAV (x)	0.9	0.9	0.9	0.9
Aggregate Leverage (%)	39.6	34.3	37.3	36.3
ROAE (%)	3.5	(1.5)	1.3	2.6

Distn. Inc Chng (%)			0	0
Consensus DPU (S cts)			2.90	4.90
Other Broker Recs:	B: 6	S: 3	H: 1	

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



Brain Box

(Our NEW Pilot Research Platform) is available to Institutional Investors on Demand. Please contact your DBS Institutional Sales contact for a demonstration.

Risk-sharing for master leases in France

Investment Thesis

Compelling value. We see compelling value in Ascott Residence Trust (ART) at 0.8x P/NAV, more than -1.5 SD of its historical 10-year mean, with an attractive 6.9% FY22 dividend yield with upside if travel rebound occurs faster than expected. Our TP is raised to S\$1.20, offering total returns in excess of 21%. Our target price implies a target P/NAV multiple of 1.0x.

Distracted but not disrupted. Focus on big domestic travel markets and long-stay segment should pay off. Phased reopening a positive sign that portfolio has attained at least a breakeven level of operations. With a diversified portfolio deriving c.70% exposure from these "domestic markets", we believe ART can rebound ahead of peers. Our earnings estimates are cut by 12%-25% in reflection of our revised view of a 4-year normalization period for the sector.

Asset recycling to drive earnings and NAV upside. Healthy 36% gearing level and S\$2bn debt headroom could mean that acquisition of sponsor's > S\$1.0bn US multi-family portfolio may be considered in 2021.

Valuation:

We lower our operating margin assumptions for FY20 and FY22. Our DCF-backed target price is raised to S\$1.20 as we roll forward to FY21 earnings on lower WACC assumptions as the sector moves into an "early cyclical recovery" phase. Our S\$300m acquisition assumption is now expected to occur sometime at end-2021 (previously end-2020).

Where we differ:

We believe that the recovery in travel demand will be front-ended loaded post the distribution of a COVID-19 vaccine in 2021.

Key Risks to Our View:

Slower recovery in FY21 as the COVID-19 pandemic protracts.

At A Glance

Issued Capital (m shrs)	3,108
Mkt. Cap (S\$m/US\$m)	3,326 / 2,524
Major Shareholders (%)	
CapitaLand Ltd	25.2
The Ascott Limited	15.3
Free Float (%)	59.5
3m Avg. Daily Val (US\$m)	3.7
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	



Live more, Bank less

Ascott Residence Trust

WHAT'S NEW

What has happened

A refreshed rent structure pegged to underlying performance.

- Ascott Residence Trust announced the extension of master lease agreements for their assets in France.
- Most assets will be extended for a period of 3 years except for 4 assets which will be extended for a further 2 years (after a one-year extension in March 2020).
- Alongside the extension of leases, the lease structure for all leases will be revised as shown below to include a variable rent component. We estimate overall rents will drop by 9.4% (ranging +7% to -21% on an asset level) when compared to FY19 rent levels.
- We estimate rental declines of c.-4.1% and c.-5.6% as the revised lease structure takes effect in 1Q and 2Q/3Q 2021 respectively with the full impact of the rent reset to be felt in 4Q21, when all the properties move over to the new lease structure.

Towards a more sustainable structure ?

- The revised rental structure shifts from a fully fixed structure to one that has a mix of fixed (60%) and variable components (40%), pegged to 10.35% of underlying revenues.

- The revised overall rent (based on FY19 level) is estimated to be c.26.8% of revenues, which is slightly lower than c.29% of revenues under the previous lease structure.
- This is within the range of independent consultant HVS - fixed rent for operating leases in the market to be in the range of 15% to 31% of total revenues while variable rents within the range of 0% to 13% of total revenue.

Approximately 3.4 months' worth of rent holiday

- Approximately 5m Euros worth of rent abatement was given to master lessees during the lock-down period(s) in Paris and France.
- This translates to approximately 3.4 months of rent based on total rental revenue in 2019.
- At its peak, 12 of ART's properties in France were temporarily closed. All assets are expected to have restarted operations by the end of last year.
- Christie & Co estimates that the rent abatement in France is up to an equivalent of 8 months' worth of rent holiday, putting ART's abatement in the mid-range of the market.
- While risk of rental abatement is likely one off, the change in lease structure will have a -1.1% impact on pro forma DI and -0.8% impact on DPU.

New master lease structure for ART's assets in France

Property	Previous lease structure (in € '000)			New lease structure (in € '000)				Effective date for commencement of new lease structure (by asset, FY21)			
	2019 actual rent	2019 revenue	Weights by asset	New fixed rent	New variable rents (based on 2019 rev)	Total revised rents (based on 2019 rev)	% Decline in total rents	1Q	2Q	3Q	4Q
Citadines Croisettes Cannes	318	1,324	2%	180	137	317	0%				
Citadines Antigone Montpellier	534	3,159	3%	290	327	617	16%				
Citadines Les Halles Paris	3,356	10,522	19%	2,000	1,089	3,089	-8%				
La Clef Louvre Paris	1,588	5,449	9%	850	564	1,414	-11%				
Citadines Place d'Italie Paris	2,040	6,696	12%	1,130	693	1,823	-11%				
Citadines Presqu'île Lyon	1,056	3,643	6%	530	377	907	-14%				
Citadines Austerlitz Paris	327	1,652	2%	180	171	351	7%				
Citadines Maine Montparnasse Paris	965	2,512	5%	500	260	760	-21%				
Citadines Castellane Marseille	364	2,184	2%	190	226	416	14%				
Citadines Republique Paris	1,022	2,966	6%	580	307	887	-13%				
Citadines Montmartre Paris	1,428	4,551	8%	790	471	1,261	-12%				
Citadines Tour Eiffel Paris	1,929	5,556	11%	1,070	575	1,645	-15%				
Citadines Trocadero Paris	1,515	5,246	9%	840	543	1,383	-9%				
Citadines Prado Chanut Marseille	469	1,652	3%	260	171	431	-8%				
Citadines City Centre Lille	740	2,638	4%	410	273	683	-8%				
Total	17,651	59,749		9,800	6,184	15,984	-9.4%				
% total rent / revenue		29.5%				26.8%					

Assets on new lease structure	Assets on previous lease structure
1Q	-4.1%
2Q	-5.6%
3Q	-5.6%
4Q	-9.4%

Source: Company, DBS Bank

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Our thoughts

Near term pain for unitholders. The pandemic has taken a toll across all of ART's geographical markets with France standing out as one of the first few markets where master leases were temporarily re-structured to variable rent terms due to the widespread closures. The timing of the master lease renewal is unfortunate, as we are still in a fragile period where COVID-19 cases in France remain high and domestic travel demand is uncertain in the near term due to provincial travel bans within the country. That said, we believe that the roll-out of the vaccine inoculation this year should help alleviate uncertainty over time.

In the worst case scenario of zero variable rents, rental loss will approximate 8m Euros (\$13m), equivalent to 2.5% of our full year revenue forecast in FY21 (\$527m), which is manageable and likely priced in in our view.

A play on potential upside in operational performance from 2021 onwards. The change in lease structure can be seen as a form of "risk-sharing" with the Sponsor in the near term, and allows ART to participate in the property upcycle when operational conditions stabilise in the longer term. That said, we estimate underlying revenues will have to be 10% higher than FY19 levels for ART to exceed previous rents in France. ART may be able to negotiate for better lease terms in FY23 at expiry of the master leases should the pace of recovery beat expectations.

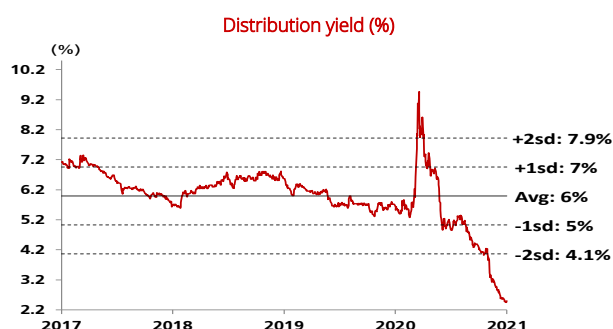
Deeper look at the broader lodging asset class to bring overall stability to the REIT. The pandemic has been a watershed event for the hospitality sector, putting both historically resilient master lease assets and geographically diversified portfolios to the test. We believe that the approach the manager should take is to bring added stability to the REIT by broadening asset class types within the portfolio (i.e multi-family or rental housing properties), especially those that may have withstood the impact of the pandemic better.

Maintain BUY. We believe that investors will likely look beyond this near-term hump in earnings and look forward to the overall rebound in operational metrics with potential upside from acquisitions in the medium term.

Company Background

Ascott Residence Trust's (ART) investment portfolio primarily comprises real estate used mainly for hospitality purposes or as rental housing properties (including investments in real estate-related assets and/or other related value-enhancing assets or instruments).

Historical Dividend yield and PB band



Source: Bloomberg Finance L.P., DBS Bank estimates



Source: Bloomberg Finance L.P., DBS Bank estimates

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Income Statement (\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Gross revenue	496	514	515	413	527
Property expenses	(269)	(275)	(262)	(238)	(291)
Net Property Income	227	239	253	175	236
Other Operating expenses	(30.6)	(30.3)	(30.2)	(30.8)	(32.9)
Other Non Opg (Exp)/Inc	38.2	(2.9)	1.96	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.20	0.20
Net Interest (Exp)/Inc	(45.1)	(45.9)	(49.7)	(61.5)	(59.9)
Exceptional Gain/(Loss)	0.0	0.0	(160)	0.0	0.0
Net Income	189	160	14.8	83.1	143
Tax	(51.9)	(43.5)	(44.7)	(14.5)	(25.1)
Minority Interest	(8.3)	(4.2)	(0.1)	(2.1)	(3.5)
Preference Dividend	(19.2)	(19.2)	(19.7)	(16.5)	(13.3)
Net Income After Tax	110	93.3	(49.7)	50.0	101
Total Return	195	128	197	50.0	101
Non-tax deductible Items	(49.4)	19.9	(48.5)	26.9	27.9
Net Inc available for Dist.	152	155	166	81.8	129
Growth & Ratio					
Revenue Gth (%)	4.4	3.6	0.1	(19.8)	27.6
N Property Inc Gth (%)	2.0	5.5	5.5	(30.6)	34.6
Net Inc Gth (%)	16.3	(15.2)	nm	nm	102.6
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	45.7	46.5	49.1	42.4	44.8
Net Income Margins (%)	22.2	18.1	(9.6)	12.1	19.2
Dist to revenue (%)	30.7	30.1	32.1	19.8	24.5
Managers & Trustee's fees	6.2	5.9	5.9	7.5	6.3
ROAE (%)	4.5	3.5	(1.5)	1.3	2.6
ROA (%)	2.1	1.7	(0.8)	0.7	1.3
ROCE (%)	2.9	2.9	(7.2)	1.6	2.2
Int. Cover (x)	4.4	4.6	4.5	2.3	3.4

Source: Company, DBS Bank

Balance Sheet (\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Investment Properties	4,908	4,745	6,171	6,477	6,347
Other LT Assets	65.7	64.2	657	656	659
Cash & ST Invts	257	228	276	228	248
Inventory	0.21	0.33	0.67	0.67	0.67
Debtors	66.6	56.9	62.5	45.4	57.2
Other Current Assets	195	215	256	256	256
Total Assets	5,493	5,309	7,423	7,664	7,569
ST Debt	264	70.1	355	355	355
Creditor	237	141	173	112	141
Other Current Liab	3.76	6.80	37.1	37.1	37.1
LT Debt	1,681	1,835	2,286	2,604	2,490
Other LT Liabilities	135	125	229	229	229
Unit holders' funds	3,082	3,041	4,257	4,239	4,225
Minority Interests	89.4	89.7	85.5	87.5	91.1
Total Funds & Liabilities	5,493	5,309	7,423	7,664	7,569
Non-Cash Wkg. Capital	20.8	124	109	153	136
Net Cash/(Debt)	(1,688)	(1,678)	(2,366)	(2,731)	(2,597)
Ratio					
Current Ratio (x)	1.0	2.3	1.1	1.1	1.1
Quick Ratio (x)	0.6	1.3	0.6	0.5	0.6
Aggregate Leverage (%)	39.1	39.6	34.3	37.3	36.3
Z-Score (X)	0.8	0.9	0.6	0.6	0.7

Source: Company, DBS Bank

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Cash Flow Statement (\$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Income	189	160	14.8	83.1	143
Dep. & Amort.	13.3	13.3	13.3	13.3	13.3
Tax Paid	(20.2)	(19.8)	(23.2)	(14.5)	(25.1)
Associates & JV Inc/(Loss)	0.04	0.02	0.01	(0.2)	(0.2)
Chg in Wkg.Cap.	(42.2)	0.92	(6.0)	(44.3)	17.0
Other Operating CF	41.0	72.0	230	13.6	14.7
Net Operating CF	181	227	229	50.9	163
Net Invnt in Properties	(26.2)	(27.6)	(31.7)	(12.4)	(15.8)
Other Invnts (net)	(366)	25.1	304	(306)	130
Invnts in Assoc. & JV	0.0	0.0	(15.5)	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	1.64	1.78	1.95	0.0	0.0
Net Investing CF	(390)	(0.7)	259	(318)	114
Distribution Paid	(145)	(149)	(160)	(81.8)	(129)
Chg in Gross Debt	106	(35.0)	(198)	318	(114)
New units issued	438	0.0	(1.2)	0.0	0.0
Other Financing CF	(74.3)	(69.7)	(80.5)	(16.5)	(13.3)
Net Financing CF	325	(254)	(440)	220	(257)
Currency Adjustments	(2.2)	(1.9)	(0.7)	0.0	0.0
Chg in Cash	114	(29.7)	47.2	(47.4)	20.4
Operating CFPS (S cts)	10.4	10.5	8.96	3.09	4.72
Free CFPS (S cts)	7.21	9.23	7.52	1.25	4.76

Source: Company, DBS Bank

Target Price & Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	31 Jan 20	1.26	1.50	BUY
2:	21 Apr 20	0.85	1.10	BUY
3:	13 Jul 20	1.00	1.10	BUY
4:	29 Jul 20	0.90	1.10	BUY
5:	01 Dec 20	1.03	1.20	BUY

Source: DBS Bank

Analyst: Geraldine WONG

Derek TAN

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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 share price catalysts within this time frame)

*Share price appreciation + dividends

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