

Singapore Company Update

ARA US Hospitality Trust

Bloomberg: ARAUS SP | Reuters: ARAU.SI

Refer to important disclosures at the end of this report

17 Aug 2022

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BUY

Last Traded Price (16 Aug 2022): US\$0.475 (STI : 3,253.79)
Price Target 12-mth: US\$0.70 (47% upside)

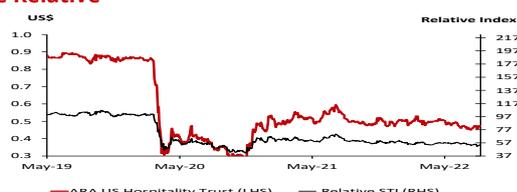
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What's New

- Robust 1H22 operating metrics expected to continue in 2H22, corporate travel demand the next swing factor
- Close correlation seen with VIX and ARAHT; stock could head higher as travel fever continues
- Estimates tweaked to account for recent divestments and capex
- Trading at 0.7x P/NAV with 7.1%/ 12.1% yield; maintain BUY call and TP of US\$0.70

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2021A	2022F	2023F	2024F
Gross Revenue	131	151	178	191
Net Property Inc	38.1	46.8	56.1	60.1
Total Return	(13.8)	3.40	10.9	14.4
Distribution Inc	2.02	19.3	32.9	35.7
EPU (US cts.)	(2.4)	0.59	1.88	0.0
EPU Gth (%)	85	nm	221	nm
DPU (US cts.)	0.36	3.38	5.74	6.18
DPU Gth (%)	nm	850	70	8
NAV per shr (US cts.)	68.9	68.9	68.9	68.9
PE (X)	nm	81.0	25.2	nm
Distribution Yield (%)	0.7	7.1	12.1	13.0
P/NAV (x)	0.7	0.7	0.7	0.7
Aggregate Leverage (%)	44.3	45.3	45.6	45.9
ROAE (%)	(3.7)	0.9	2.7	3.6

Distn. Inc Chng (%):	(28)	(6)	-
Consensus DPU (US	7.0	22.0	-
Other Broker Recs:	B: 1	S: 0	H: 0

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

Shooting for the stars!

Investment Thesis

Maintain BUY with unchanged TP of US\$0.70. Recent sector-wide data shows a front-end loaded recovery unfolding as the summer break works its magic this holiday season. ARAHT's US hotel portfolio is best poised amongst the S-REITs to ride on this travel demand uptrend, propelling an uplift in RevPAR, which we think will drive a share price re-rating.

Encouraged by the positive operating leverage observed for ARAHT; likely to sustain. As the pent-up travel demand momentum translates to higher revenues, we note a better flow-through on every incremental dollar. Hence, we expect the outsized bottom-line growth relative to top-line growth to continue as we enter 3Q22, which is typically the best performing quarter on the back of the peak summer season.

Lean select service model should ensure higher profitability. ARAHT's select service operating format continues to help alleviate cost pressures from heightened costs of labour and utilities, which is highly positive in an inflationary environment and tight job market.

Valuation:

Our DCF-based TP of US\$0.70 is based on a WACC of 7.46% and terminal growth rate of 2.25%.

Where we differ:

We are more optimistic about ARAHT's recovery trajectory.

Key Risks to Our View:

Lower-than-expected surge in travel demand going forward.

At A Glance

Issued Capital (m shrs)	568
Mkt. Cap (US\$m/US\$m)	270 / 270
Major Shareholders (%)	
Fairshore Asset Mgmt Co	9.5
Yu Duan	8.5
Yang Shi Ying	8.0
Free Float (%)	74.0
3m Avg. Daily Val (US\$m)	0.05

GIC Industry : Real Estate / Equity Real Estate Investment (REITs)



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WHAT'S NEW

Shooting for the stars

Encouraged by the positive operating leverage observed for ARAHT; likely to sustain. We note a better flow-through on the incremental dollar as ARAHT hotels ramp up to cater to the stronger travel demand as a result of pent-up demand momentum. In 1H22, a 54% y-o-y growth in gross revenue translated to a 95% y-o-y growth in gross operating profit and 131% y-o-y growth in net property income. We expect the outsized bottom-line growth relative to top-line growth to continue as we enter 3Q22, which is typically the best performing quarter on the back of the peak summer season.

Labour costs kept in check. As ARAHT operates in the select service space, only lean staffing is needed, as additional amenities such as F&B options are limited. The ARAHT hotels are also generally smaller, with 120-150 rooms, which ensures that housekeepers can keep pace with the higher demand. Without a unionised labour force, ARAHT is able to adjust its labour force to cater to the incoming demand instead of bringing back all of its employees full time. This is positive for ARAHT, given that labour costs have increased significantly in the US due to a tight job market.

Room rates repricing an upside in inflationary environment. We continue to like hotels in this inflationary environment, as the daily repricing of room rates according to demand and supply acts as a natural inflation hedge, compared to monthly or annual lease structures that are less dynamic. This also allows for revenue growth to outpace expense growth; in 1H22, we see that ARAHT's revenue increased 54% y-o-y while operating expenses rose only 39% y-o-y.

US Consumer Price Index vs. US Hotel ADR (1995=100)



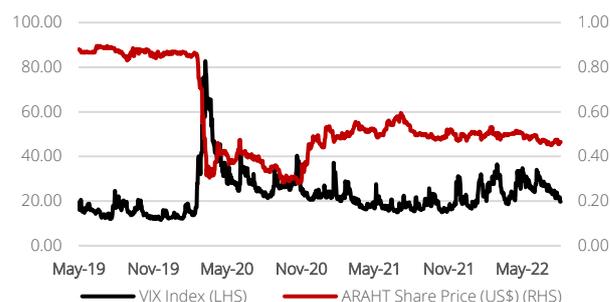
Source: U.S. Bureau of Labour Statistics, STR

Divestments. The sale of Hyatt Place Chicago Itasca was completed on 8 July 2022, and the sale of the four Hyatt Place hotels is estimated to be completed in 3Q22. We understand that the manager is looking to redeploy the proceeds into better performing assets or acquire new properties in time. We believe ARAHT will continue to optimise its portfolio and divest more of its non-core assets that have been underperforming.

Cost of debt. We note that the 81% of debt hedged to fixed rates mostly run till 2024. Hence, there will likely be no significant increase in interest rates in the next year or two. While there may be impact from rising rates on the unhedged portion of the company's debt, the impact is substantially mitigated. There are no refinancing requirements for the remainder of FY22 and FY23.

Biggest deterrent to travel. We believe that the biggest headwind to travel demand is the feeling of fear, which could stem from physical, economic, etc. risks. Travel demand plunged during the Global Financial Crisis (GFC) in 2007-2009 on fears of a recession and job losses, and during the COVID-19 pandemic on fears of contracting the virus. Hence, we use the VIX Index, which is an estimate of the expected volatility of the S&P 500 Index, or more commonly known as Wall Street's "fear gauge", as a proxy. Observing a strong negative correlation of 0.60 between the VIX Index and ARAHT's share price, we see that one of the worst dislocations for the hospitality industry is the fear factor. With the VIX Index currently hovering at much lower levels compared to 2008 levels, we believe that travel demand going forward will not be curtailed on recessionary fears, given a healthier macroeconomy with lower unemployment rates and higher savings levels.

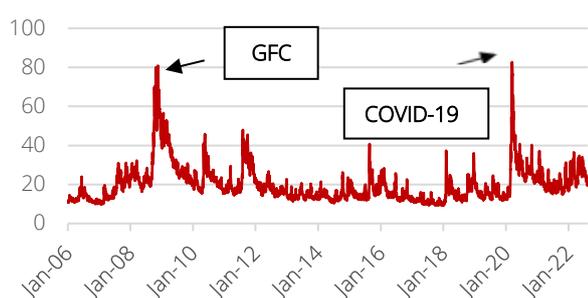
VIX Index vs. ARAHT's share price (Correlation: -0.60)



Source: Bloomberg Finance L.P., DBS Bank

ARA US Hospitality Trust

VIX Index



Source: Bloomberg Finance L.P., DBS Bank

Estimates revision and recommendation

Lower FY22F/23F NPI slightly to US\$46.9m/US\$56.1m to factor in the divestment of the five Hyatt Place hotels that had been underperforming.

Cut FY22F distributable income estimate to US\$19.3m (prev: US\$26.7m) to factor in higher capital expenditure. We note that capex for the hospitality industry is perpetual due to the nature of the business, and we understand from the manager that the higher capex amount in FY22 was due to a deferment from the COVID-19 period. Nonetheless, we still expect a yield of 7.1% for FY22F and jumping to 12.1% in FY23F at current share price.

Maintain BUY and unchanged TP of US\$0.70. We remain optimistic about the recovery trajectory on the back of travel demand momentum and positive operating leverage, and we expect 2H22 performance to be better than in 1H22.

Scenario analysis (% recovery vs. pre-COVID-19 levels)

Scenarios	Metrics	Yr 2022	Yr 2023	Yr 2024
Bull	RevPAR growth	+45%	+20%	+10%
	% pre-COVID	100%	112%	124%
Base	RevPAR growth	+20%	+25%	+7%
	% pre-COVID	85%	105%	112%
Bear	RevPAR growth	+0%	+20%	+20%
	% pre-COVID	70%	80%	100%

EBITDA Projection Chart (Bull, Base, and Bear Case) (US\$m)

Scenarios	2019A	2020A	2021A	2022F	2023F	2024F
Bull	14.9	(91.6)	(6.0)	21.3	28.7	34.6
Base	14.9	(91.6)	(6.0)	15.7	24.9	28.9
Bear	14.9	(91.6)	(6.0)	7.3	12.8	21.5

DPU (Bull, Base, and Bear Case) (UScts)

Scenarios	2019A	2020A	2021A	2022F	2023F	2024F
Bull	4.2	0.0	0.4	4.3	6.4	7.2
Base	4.2	0.0	0.4	3.4	5.8	6.2
Bear	4.2	0.0	0.4	2.1	3.9	5.1

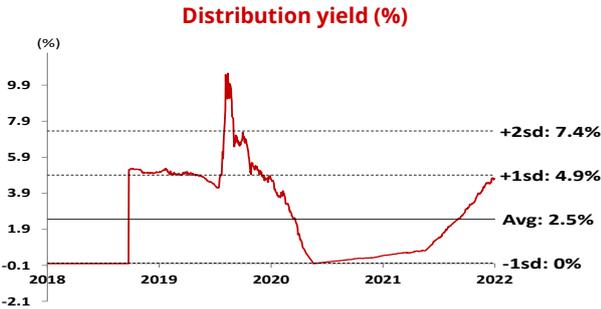
Source: Company, DBS Bank Estimates

Company Background

ARA US Hospitality Trust (AUHT) is a Singapore-listed stapled security which comprises ARA US Hospitality Property Trust (ARA H-REIT) and ARA US Hospitality Management Trust (ARA H-BT). The trust is the first pure-play US upscale select service hospitality trust to be listed in Singapore and Asia.

ARA US Hospitality Trust

Historical dividend yield and PB band



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



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

ARA US Hospitality Trust

Income Statement (US\$m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Gross revenue	78.2	131	151	178	191
Property expenses	(67.7)	(92.6)	(104)	(122)	(131)
Net Property Income	10.5	38.1	46.8	56.1	60.1
Other Operating expenses	(19.6)	(25.1)	(31.1)	(31.2)	(31.3)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(11.7)	(12.2)	(12.1)	(13.2)	(13.4)
Exceptional Gain/(Loss)	(67.0)	(5.7)	0.0	0.0	0.0
Net Income	(103)	(18.2)	3.64	11.7	15.3
Tax	8.83	4.34	(0.2)	(0.8)	(1.0)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	(94.5)	(13.8)	3.40	10.9	14.4
Total Return	(94.5)	(13.8)	3.40	10.9	14.4
Non-tax deductible Items	94.5	15.8	15.9	22.0	21.4
Net Inc available for Dist.	0.0	2.02	19.3	32.9	35.7
Growth & Ratio					
Revenue Gth (%)	(32.0)	67.2	15.8	17.9	7.1
N Property Inc Gth (%)	(74.5)	264.3	23.0	19.7	7.1
Net Inc Gth (%)	nm	85.4	nm	221.0	31.5
Dist. Payout Ratio (%)	0.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	13.4	29.1	31.0	31.4	31.4
Net Income Margins (%)	(120.9)	(10.6)	2.2	6.1	7.5
Dist to revenue (%)	0.0	1.5	12.7	18.5	18.7
Managers & Trustee's fees	25.1	19.2	20.6	17.5	16.4
ROAE (%)	(22.4)	(3.7)	0.9	2.7	3.6
ROA (%)	(12.6)	(1.8)	0.4	1.4	1.9
ROCE (%)	(3.6)	0.0	2.0	3.2	3.6
Int. Cover (x)	(2.1)	0.0	1.3	1.9	2.1

Balance Sheet (US\$m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Investment Properties	0.0	0.0	0.0	0.0	0.0
Other LT Assets	707	739	747	752	758
Cash & ST Invt	26.8	19.2	12.7	14.4	15.1
Inventory	0.33	0.41	0.41	0.41	0.41
Debtors	2.75	4.75	3.02	3.02	3.02
Other Current Assets	0.0	0.41	0.41	0.41	0.41
Total Assets	736	764	763	770	777
ST Debt	0.30	10.3	10.3	10.3	10.3
Creditor	16.0	17.7	9.45	11.1	11.9
Other Current Liab	0.09	0.17	0.17	0.17	0.17
LT Debt	354	328	335	341	347
Other LT Liabilities	16.4	8.36	8.36	8.36	8.36
Unit holders' funds	349	400	400	400	400
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	736	764	763	770	777
Non-Cash Wkg. Capital	(13.0)	(12.3)	(5.8)	(7.5)	(8.3)
Net Cash/(Debt)	(328)	(319)	(333)	(337)	(342)
Ratio					
Current Ratio (x)	1.8	0.9	0.8	0.8	0.8
Quick Ratio (x)	1.8	0.9	0.8	0.8	0.8
Aggregate Leverage (%)	48.2	44.3	45.3	45.6	45.9

Source: Company, DBS Bank

ARA US Hospitality Trust

Cash Flow Statement (US\$m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Pre-Tax Income	(103)	(18.2)	3.64	11.7	15.3
Dep. & Amort.	25.6	24.1	24.1	24.1	24.1
Tax Paid	0.0	0.80	(0.2)	(0.8)	(1.0)
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	8.55	(1.3)	(6.5)	1.69	0.79
Other Operating CF	67.2	6.22	(8.3)	(2.1)	(2.8)
Net Operating CF	(2.0)	11.7	12.8	34.6	36.5
Net Invnt in Properties	(85.3)	0.0	(7.6)	(5.4)	(5.7)
Other Invnts (net)	0.0	0.0	0.0	0.0	0.0
Invnts 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	(9.1)	(9.3)	0.0	0.0	0.0
Net Investing CF	(94.4)	(9.3)	(7.6)	(5.4)	(5.7)
Distribution Paid	(23.9)	0.0	(19.3)	(32.9)	(35.7)
Chg in Gross Debt	103	(10.0)	7.57	5.35	5.73
New units issued	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(12.2)	(12.2)	(12.1)	(13.2)	(13.4)
Net Financing CF	66.8	(22.2)	(23.8)	(40.8)	(43.4)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	(29.6)	(19.8)	(18.6)	(11.5)	(12.6)
Operating CFPS (US cts.)	(1.8)	2.24	3.32	5.67	6.16
Free CFPS (US cts.)	(15.0)	2.02	0.90	5.04	5.30

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:	20 Aug 21	0.50	0.75	BUY
2:	28 Feb 22	0.50	0.70	BUY
3:	14 Jun 22	0.48	0.70	BUY

Source: DBS Bank

Analyst: Tabitha FOO

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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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