

Singapore Company Update

ARA US Hospitality Trust

Bloomberg: ARAUS SP | Reuters: ARAU.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

28 Feb 2024

BUY

Last Traded Price (27 Feb 2024): US\$0.300 (STI : 3,157.32)

Price Target 12-mth: US\$0.40 (33% upside) (Prev US\$0.45)

Analysts

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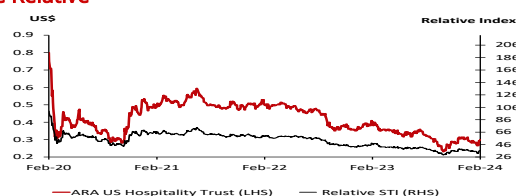
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What's New

- 2H23 DPU of 1.929 UScts missed our estimate, though operational performance and margins improved
- Portfolio valuations stayed flattish y-o-y at US\$751.4m, despite increase in capitalisation rates
- Lower FY24F DPU by c.14.5% to 3.48 UScts on higher cost of debt and shift in management fees to more cash, partially offset by higher margins
- Maintain BUY with revised TP of US\$0.40

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2022A	2023A	2024F	2025F
Gross Revenue	169	176	183	187
Net Property Inc	41.4	47.7	52.7	54.0
Total Return	9.51	(11.1)	(0.7)	0.17
Distribution Inc	17.5	19.8	20.2	20.9
EPU (US cts.)	1.66	0.25	0.0	0.0
EPU Gth (%)	nm	(85)	nm	nm
DPU (US cts.)	3.05	3.44	3.48	3.59
DPU Gth (%)	760	13	1	3
NAV per shr (US cts.)	80.3	74.7	74.7	74.7
Distribution Yield (%)	10.2	11.5	11.6	12.0
P/NAV (x)	0.4	0.4	0.4	0.4
Aggregate Leverage (%)	39.4	41.0	40.2	40.9
ROAE (%)	2.2	0.3	(0.2)	0.0

Distn. Inc Chng (%): (12) (15) -

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

Better days ahead

Investment Thesis:

Best poised amongst the S-REITs to ride on the US travel demand uptrend. ARA US Hospitality Trust (ARAHT) is the first pure-play US upscale select-service hospitality trust to be listed in Singapore and Asia, with its portfolio consisting of 35 Hyatt, Marriott, and Hilton-branded hotels geographically diversified across the US. With the travel demand momentum likely to sustain into FY24, ARAHT is well positioned to capture the recovery with its pricing power, leaner operating model, and positive operating leverage.

Portfolio optimisation strategy to underpin long-term growth. ARAHT actively manages its portfolio through the divestment of underperforming assets and redeployment of capital into acquisitions with strong underlying market fundamentals. Its maiden acquisition of three Marriott-branded hotels and a recent Hilton acquisition have exceeded expectations in terms of recovery and set the stage for future acquisition targets. We see this as a testament to the manager's asset management strategy and the key to building a more diversified and resilient portfolio that is primed for long-term growth.

Sustained uplift in RevPAR to drive re-rating in near term. We believe that the market is severely underestimating consumers' desire to travel and ARAHT's recovery potential. We also anticipate that the worst is truly over, despite recessionary fears, and that ARAHT will continue to deliver robust operating metrics to catalyse a share price rerating. ARAHT's RevPAR is projected to surpass pre-pandemic levels in FY24F.

Maintain BUY with revised TP of US\$0.40 (vs. US\$0.45 previously). We maintain our BUY call for ARAHT with a target price of US\$0.40, based on DCF valuation (WACC of 8.39% and terminal growth rate of 2.25%). The stock is attractive, at less than 0.5x P/NAV against 11.6%/12.0% yields for FY24F/25F.

Key Risks

The key risks for ARAHT are 1) a slower-than-expected recovery in corporate travel demand going forward, 2) higher cost pressures, and 3) higher cost of debt.

At A Glance

Issued Capital (m shrs)	577
Mkt. Cap (US\$m/US\$m)	173 / 173
Major Shareholders (%)	
ARA REAL ESTATE INV 23	20.5
Gordon Tang	9.3
Phillip Securities Pte Ltd	8.1
Free Float (%)	46.3
3m Avg. Daily Val (US\$m)	0.06
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	

WHAT'S NEW

Better days ahead

2H23 was a miss, albeit continued improvement in margins.

2H23 revenue increased 2.0% y-o-y to US\$89.5m from US\$87.8m in 1H23. Gross operating profit (GOP)/net property income (NPI) grew 5.3%/26.4% y-o-y to US\$31.3m/US\$25.7m, respectively. GOP margin improved to 35.0% in 2H23 from 33.9% in 2H22. NPI margin expanded to 28.7% in 2H23 from 23.1% in 2H22, mainly due to lower property taxes. 2H23 distributable income improved 18.9% y-o-y to US\$11.2m from US\$8.7m in 2H22; 2H23 DPU lifted to 1.929 US\$cts compared to 1.627 US\$cts in 2H22, though it fell short of our estimate.

Portfolio valuation stayed flattish at US\$751.4m (+0.5% y-o-y), despite the increase in capitalisation rates, as the newly acquired Hilton hotel helped mitigate the decline in the valuations of the Hyatt portfolio. NAV declined significantly to US\$0.74 as at Dec 2023 from US\$0.80 as at Dec 2022, primarily attributable to the decline in the cash balance. Average cost of debt increased to 4.8% as at Dec 2023 from 3.8% as at Dec 2022, with a weighted average debt expiry of 2.5 years. 74.5% of debt is hedged to fixed interest rates, and all debt maturing in FY24 has been refinanced while the manager is proactively seeking to refinance the upcoming US\$77m loan due in Feb 2025.

Portfolio valuations

US\$m	As at 31 Dec 2022	As at 31 Dec 2023
Hyatt Portfolio	643.1	614.3
Marriott Portfolio	104.7	105.6
Hilton Hotel	-	31.5
Portfolio value	747.8	751.4

Source: Company, DBS Bank Ltd

Corporate travel has yet to fully return. While corporate travel has not completely returned to pre-pandemic levels, the manager noted a steady increase across different markets, though the pace of recovery varies. Notably, some companies have started to reinforce Work In Office (WIO) policies, which could aid in the recovery of this travel segment. However, with the advancement of technology and cutbacks in corporate travel budgets amid the macroeconomic uncertainties, occupancy rates are still unlikely to return to pre-pandemic levels (high 70%) by end-FY24. Nonetheless, ARAHT is well positioned in the select-service segment, which targets business travellers seeking cost-effective options of a specific standard. This segment includes employees in sales, technical support, etc., who frequently travel for work.

Portfolio optimisation strategy. ARAHT actively manages its portfolio through the divestment of underperforming assets and redeployment of capital into acquisitions with strong underlying market fundamentals. Two Hyatt Place hotels were further divested in 2H23 – Hyatt Place Oklahoma City for US\$8m in 3Q23 and Hyatt Place Pittsburgh Airport for US\$7.7m in 4Q23, given they are located in submarkets with a weak demand outlook and experienced a spike in wage costs due to labour union pressures. The manager has reiterated its commitment to building a stronger and more resilient portfolio.

Cost of debt to increase. The manager guided for the average cost of debt to increase to c.6% for FY24F from 4.8% for FY23, barring any unforeseen circumstances, as favourable hedges entered during the IPO roll off in Feb 2024. The REIT follows a policy of hedging around 50% of its outstanding debt. However, striking a delicate balance is crucial, as hedging too much may result in paying a fixed rate even as interest rates decline, while the timing of entering into these hedges is also important.

Refinancing sentiment within the US. The manager shared that lending activity in the US is currently marked by increased caution, stemming from the impending wave of maturities due in 2024. The underlying concern revolves around a substantial portion of the maturing debt favouring floating rates with durations spanning three to five years. However, the risk is comparatively low for ARAHT, with a leverage of only 40% (limited by the MAS limit of 50%) and room rates repricing daily. Further, the REIT's borrowings, primarily from the Singapore local banks, are built on longstanding business relationships, rendering the banks more accommodating and willing to collaborate.

Maintain BUY with revised TP of US\$0.40. We estimate FY24/25F DPU at 3.48/3.59 US\$cts, indicating a 14.5% cut for FY24F DPU. Our GOP margin projection is lifted to 37.0% for FY24F, as wage pressures (largest portion of expenses) are starting to moderate in the US, with job openings per hotel falling 38% y-o-y in 4Q23 while our NPI margin projection increases to 28.9% for FY24F on lower property taxes. However, this is more than offset by higher interest expenses, as average cost of debt for FY24F appears to be at c.6%, and there will be a shift in management fees to more cash to not dilute the existing unitholder base should they issue new shares at 0.4x P/B. Nonetheless, we believe that ARAHT has navigated through the most challenging times and is well positioned now to emerge stronger and see better days ahead.

Company Background

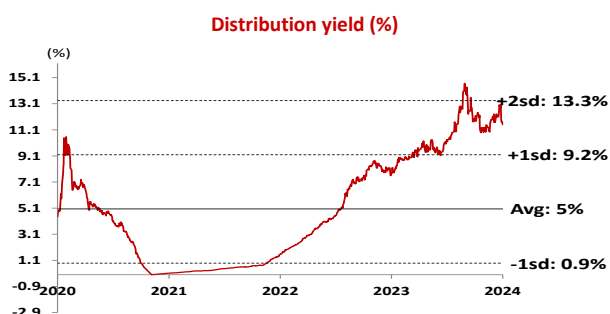
ARA US Hospitality Trust (AUHT) is a Singapore-listed stapled security which comprises ARA US Hospitality Property Trust (ARA H-REIT) and ARA US Hospitality Management Trust (ARA H-BT). The trust is the first pure-play US upscale select service hospitality trust to be listed in Singapore and Asia.

Quarterly operating statistics for 2019, 2022, 2023 (excluding pandemic)

	2Q19 (from 9 May)	3Q19	4Q19	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23
Occupancy	82.8%	81.3%	77.0%	54.6%	70.7%	71.0%	64.7%	61.7%	76.0%	74.0%	65.5%
ADR (US\$)	126	124	122	119	134	137	131	130	142	142	135
RevPAR (US\$)	105	101	94	65	95	97	85	80	108	105	88
Revenue (US\$m)	28.8	46.9	39.3	32.8	48.5	48.7	39	36.2	49.8	48.6	40.9
GOP (US\$m)	12.3	17.8	13.0	8.7	18.9	17.3	12.4	10.5	20.2	18	13.3
GOP margin	42.9%	37.9%	33.0%	26.5%	39.0%	35.5%	31.8%	29.0%	40.6%	37.0%	32.4%
NPI (US\$m)	9.9	13.5	9.2	5.3	15.8	11.9	8.4	6.4	15.6	13.2	12.5
NPI Margin	34.4%	28.8%	23.4%	16.2%	32.6%	24.4%	21.5%	17.7%	31.3%	27.2%	30.5%
No. of hotels open	41	41	41	41	41	36	36	36	37	36	36

Source: Company, DBS Bank Ltd

Historical Distribution Yield and PB band



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



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

ARA US Hospitality Trust

Income Statement (US\$m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Gross revenue	131	169	176	183	187
Property expenses	(106)	(128)	(128)	(130)	(133)
Net Property Income	24.9	41.4	47.7	52.7	54.0
Other Operating expenses	(25.1)	(33.4)	(33.7)	(33.9)	(34.1)
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	(12.2)	(12.6)	(15.8)	(19.5)	(19.7)
Exceptional Gain/(Loss)	(5.7)	16.6	0.0	0.0	0.0
Net Income	(18.2)	12.0	(1.8)	(0.8)	0.18
Tax	4.34	(2.5)	3.22	0.05	0.0
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	(13.8)	9.51	1.41	(0.7)	0.17
Total Return	(13.8)	9.51	(11.1)	(0.7)	0.17
Non-tax deductible Items	15.8	8.00	31.0	20.9	20.7
Net Inc available for Dist.	2.02	17.5	19.8	20.2	20.9
Growth & Ratio					
Revenue Gth (%)	67.2	29.3	3.8	4.0	2.4
N Property Inc Gth (%)	nm	66.4	15.1	10.5	2.5
Net Inc Gth (%)	85.4	nm	(85.1)	nm	nm
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	19.0	24.5	27.2	28.9	28.9
Net Income Margins (%)	(10.6)	5.6	0.8	(0.4)	0.1
Dist to revenue (%)	1.5	10.4	11.3	11.1	11.2
Managers & Trustee's fees	19.2	19.8	19.2	18.6	18.3
ROAE (%)	(3.7)	2.2	0.3	(0.2)	0.0
ROA (%)	(1.8)	1.2	0.2	(0.1)	0.0
ROCE (%)	0.0	0.9	1.9	2.6	2.6
Int. Cover (x)	0.0	0.6	0.9	1.0	1.0

Interim Income Statement (US\$m)

FY Dec	2H2021	1H2022	2H2022	1H2023	2H2023
Gross revenue	77.8	81.3	87.8	86.0	89.5
Property expenses	(62.1)	(60.2)	(67.5)	(64.0)	(63.8)
Net Property Income	15.8	21.1	20.3	22.0	25.7
Other Operating	(11.9)	(16.1)	(17.3)	(16.5)	(17.2)
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	(6.1)	(6.2)	(6.4)	(7.3)	(8.6)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	(2.2)	(1.2)	(3.4)	(1.8)	0.0
Tax	3.66	(0.1)	(2.4)	3.03	0.19
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	1.43	(1.3)	(5.8)	1.25	0.16
Growth & Ratio					
Revenue Gth (%)	47	4	8	(2)	4
N Property Inc Gth (%)	73	34	(4)	8	17
Net Inc Gth (%)	(115)	(188)	366	(122)	(87)
Net Prop Inc Margin (%)	20.3	26.0	23.1	25.6	28.7
Dist. Payout Ratio (%)	N/A	N/A	N/A	N/A	N/A

Source: Company, DBS Bank Ltd

ARA US Hospitality Trust

Balance Sheet (US\$m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Investment Properties	0.0	0.0	0.0	0.0	0.0
Other LT Assets	739	770	759	761	770
Cash	19.2	50.6	20.1	24.3	24.3
ST Investment	0.0	0.0	1.36	1.36	1.36
Inventory	0.41	0.39	0.44	0.44	0.44
Debtors	4.75	5.24	3.45	3.59	3.67
Net Intangibles Assets	0.50	0.47	0.45	0.45	0.45
Other Current Assets	0.41	0.30	7.20	7.20	7.20
Total Assets	764	826	792	798	807
ST Debt	10.3	0.26	0.20	0.20	0.20
Creditor	17.7	19.0	18.5	28.4	28.4
Other Current Liab	0.17	0.32	0.52	0.52	0.52
LT Debt	328	326	325	321	330
Other LT Liabilities	8.36	21.5	20.2	20.2	20.2
Unit holders' funds	400	460	428	428	428
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	764	826	792	798	807
Non-Cash Wkg. Capital	(12.3)	(13.4)	(8.0)	(17.7)	(17.6)
Net Cash/(Debt)	(319)	(275)	(304)	(295)	(305)
Ratio					
Current Ratio (x)	0.9	2.9	1.7	1.3	1.3
Quick Ratio (x)	0.9	2.9	1.7	1.3	1.3
Aggregate Leverage (%)	44.3	39.4	41.0	40.2	40.9

Cash Flow Statement (US\$m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Pre-Tax Income	(18.2)	12.0	(14.4)	(0.8)	0.18
Dep. & Amort.	24.1	25.3	28.9	28.9	28.9
Tax Paid	0.80	0.0	0.0	0.05	0.0
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(1.3)	(2.2)	1.22	9.72	(0.1)
Other Operating CF	6.22	(10.0)	13.6	(7.9)	(8.1)
Net Operating CF	11.7	25.1	29.3	29.9	20.8
Net Invnt in Properties	0.0	38.8	(21.9)	(1.4)	(9.3)
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	(9.3)	(9.9)	(18.7)	0.0	0.0
Net Investing CF	(9.3)	28.9	(40.6)	(1.4)	(9.3)
Distribution Paid	0.0	(10.1)	(18.1)	(20.2)	(20.9)
Chg in Gross Debt	(10.0)	(12.0)	3.20	(4.0)	9.34
New units issued	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(12.2)	(12.9)	(20.3)	(19.5)	(19.7)
Net Financing CF	(22.2)	(35.1)	(35.1)	(43.7)	(31.3)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	(19.8)	18.9	(46.4)	(15.2)	(19.8)
Operating CFPS (US cts.)	2.27	4.76	4.91	3.53	3.65
Free CFPS (US cts.)	2.05	11.1	1.31	4.98	2.00

Source: Company, DBS Bank Ltd

Target Price & Ratings 12-mth History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	10 Aug 23	0.35	0.45	BUY

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

Source: DBS Bank Ltd

Analysts: 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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