MITA No. 013/06/2008

17 April 2009

# Ascott Residence Trust

Reinitiate Coverage

**BUY**

## Long term growth, albeit with near-term volatility

S$0.47

Fair Value: S$0.57

Stock Code:
Reuters: ASRT.SI
ISIN Code A68U
Bloomberg: ART SP

Event: Reinitiate Coverage

**General Data**

| | |
|---|---|
| Issued Capital (m) | 614 |
| Mkt Cap (S$m/US$m) | 288 / 193 |
| Major Shareholder | CapitaLand (47.23%) |
| Free Float (%) | 52.8% |
| NAV per share (S$) | 1.47 |
| Daily Vol 3-mth ('000) | 1,439 |
| 52Wk High (S$) | 1.360 |
| 52Wk Low (S$) | 0.350 |

**Part of a strong franchise.** We are re-initiating coverage on Ascott Residence Trust (ART). ART owns a portfolio of serviced residence and rental housing properties in the pan-Asian region. The REIT's properties are managed by The Ascott Group (Ascott), the serviced residence arm of 47.2% stakeholder CapitaLand. Ascott is the world's largest international serviced residence owner-operator and has a 25-year industry track record. Its serviced residence brands enjoy world-wide recognition and strong award-winning reputations. ART's highly diversified portfolio spans 11 cities in seven countries with no country contributing more than 25% of total FY08 revenue. ART trades at one of the highest forward yields within the S-REIT sector. It is also trading at a 68% discount to last reported NAV.

**Near-term yield volatility**. RevPAU is the key metric driving ART's earnings and distributions performance. 4Q08 RevPAU showed the first impact of global economic events. ART's China properties saw a 43% drop in 4Q RevPAU to S$127, as rates and occupancy fell post-Olympics. ART's Singapore properties saw a 12% decline in 4Q08 RevPAU to S$230. We expect RevPAU to remain volatile (and on a downtrend) with demand for corporate travel impacted by the current macroeconomic turmoil. We are estimating DPU of 6.6 S cents for FY09F (down 24% YoY) and 6.2 S cents for FY10F (down 7% YoY). These figures are roughly 6-7% below consensus.

**A viable investment option**. While we agree that yields will decline in FY09-10F, ART's current valuation seems to be pricing in a perpetual bear case. In our view, current share prices reflect a belief that business conditions deteriorate to a certain extent *and then stay that way*. The investment question then breaks down into two components: 1) A volatile (but still comfortable) yield over the next two years, and 2) A very low "floor" valuation that leaves ample room on the upside. We believe ART is a viable investment option for investors who can accept the near-term yield volatility and judge ART on the basis of its long-term prospects (which we think are sound).

**Re-initiating with BUY rating**. Our SOTP value of the trust is S$0.76. This incorporates our assumption of an equity issue of S$160m at the S$0.45 price level. Our fair value estimate for ART is S$0.57, at a 25% discount to our SOTP value. Key risks to our estimates include a worse-than-expected deterioration in the economic outlook in ART's operating markets, a larger-than-expected cash call or more-than-expected dilution, and higher debt costs.

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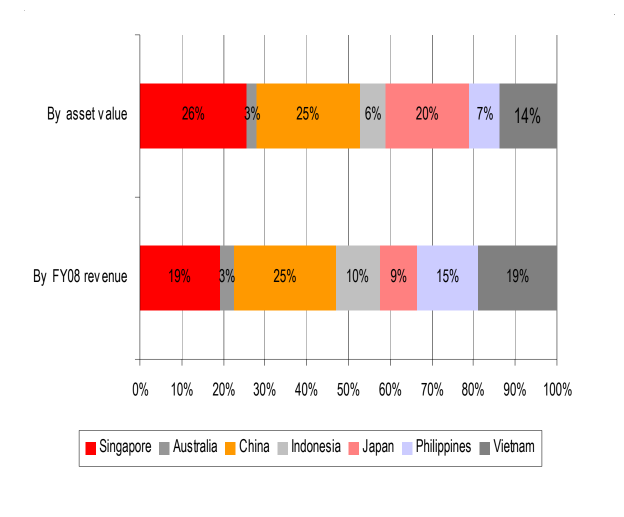
| Year to 31 Dec | Revenue (S$m) | PATMI (S$m) | Distr Income (S$m) | DPU (S cents) | DPU Growth (%) | DPU Yield (%) | P/NAV (x) |
|---|---|---|---|---|---|---|---|
| FY 07 | 154.8 | 160.5 | 45.1 | 7.7 | 33.1 | 16.4 | 0.3 |
| FY 08 | 192.4 | -42.2 | 53.7 | 8.8 | 14.0 | 18.7 | 0.3 |
| FY 09F | 164.9 | -42.5 | 41.0 | 6.6 | -24.4 | 14.1 | 0.4 |
| FY 10F | 157.9 | -44.8 | 38.4 | 6.2 | -7.3 | 13.1 | 0.4 |

# Table of Content

## Section A: ART snapshot

We are re-initiating coverage on Ascott Residence Trust (ART). ART is the only pure-play serviced residence trust listed on SGX. ART owns 38 serviced residence and rental housing properties across 11 cities in seven countries. CapitaLand Ltd has a 47.2% stake in ART. The REIT's properties are managed by The Ascott Group (Ascott), the serviced residence arm of CapitaLand.

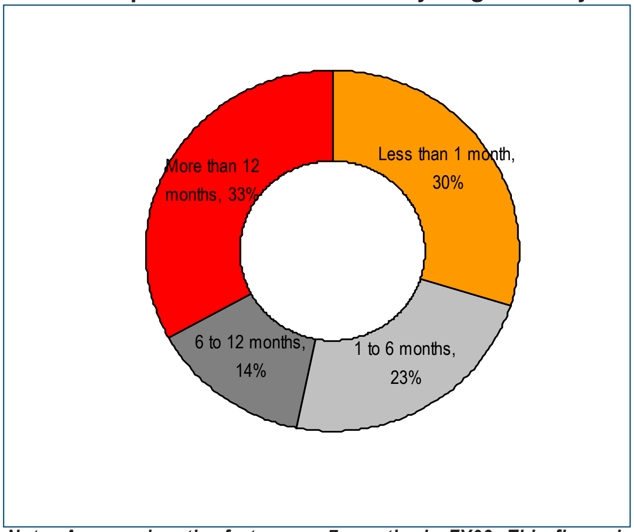
**Exhibit 1: Portfolio breakdown by country**




*Note: Excludes Somerset West Lake (Vietnam) acquisition in FY09*

*Source: Company*

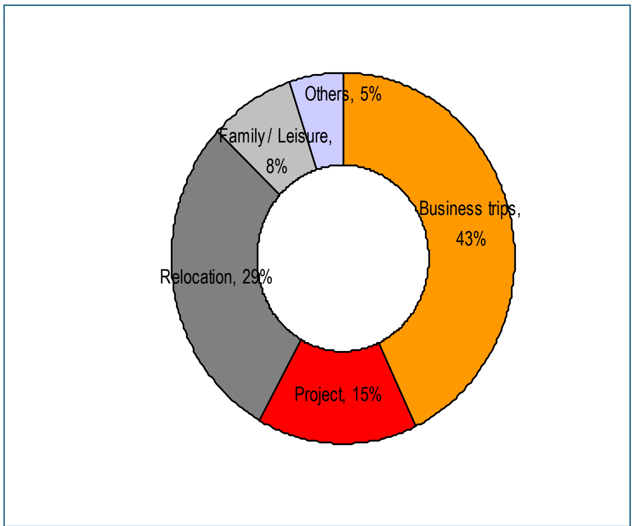
**Exhibit 2: Apartment rental income by length of stay**




*Note: Average length of stay was 7 months in FY08. This figure is skewed due to the long-stay profile of the Japan rental housing properties.*

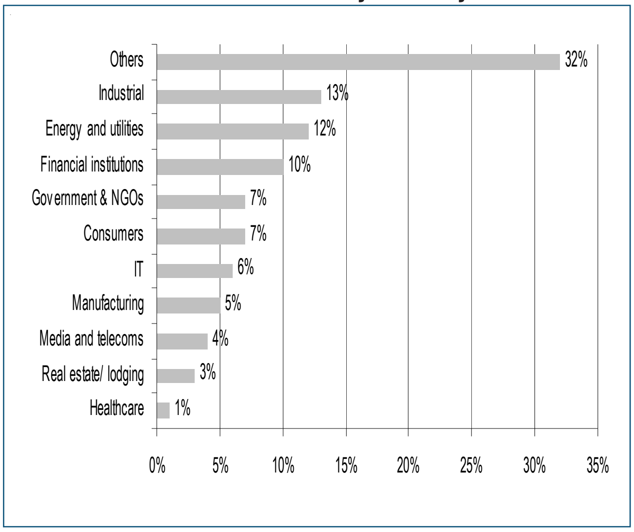
*Source: Company*

**Exhibit 3: FY08 rental income by market segment**




*Source: Company*

**Exhibit 4: FY08 rental income by industry**




*Source: Company*

## Section B: Strengths

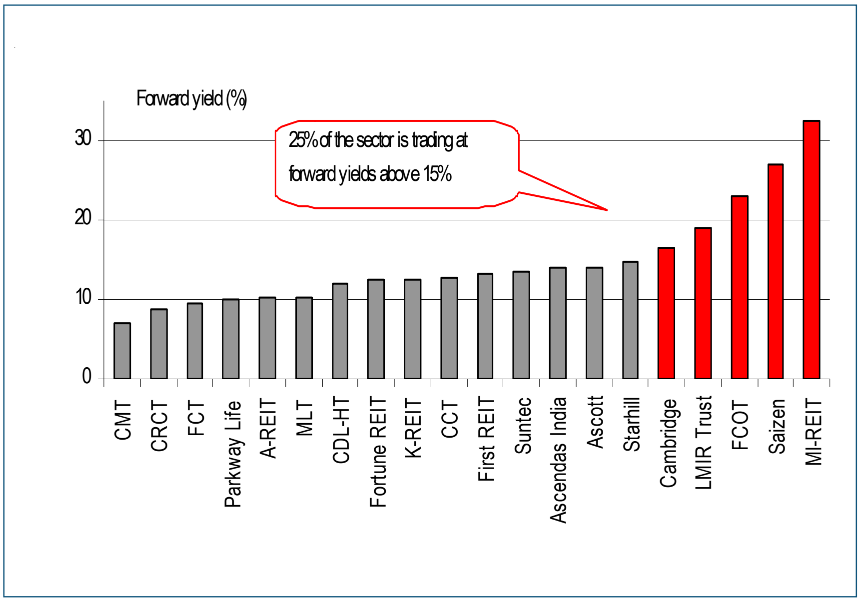
**A strong franchise**. ART's properties are managed by Ascott, the real estate arm of parent CapitaLand. Ascott is the world's largest international serviced residence owner-operator and has a 25-year industry track record. The "Ascott", "Citadines" and "Somerset" brands enjoy world-wide recognition and strong award-winning reputations. Corporate travel makes up the bulk of ART's business and has historically been the least price-sensitive travel segment. A strong brand and franchise can be a key differentiator in winning the hearts and wallets of corporate travelers. ART also enjoys a right of first refusal over future sales of Ascott's pan-Asian serviced residence and rental housing properties. While this is not a market conducive to acquisitions, the pipeline gives ART an edge when conditions do improve. Additionally, strong parentage continues to be favored in the present tight credit conditions and we believe the CapitaLand connection may go a long way in maintaining lending relationships.

**Geographical diversification**. ART's portfolio spans 11 cities in seven countries: Singapore, Australia, China, Indonesia, Japan, The Philippines and Vietnam. No country contributed more than 25% of total revenue in FY08. ART's exposure to the growth potential in emerging markets is neatly balanced with the income stability offered by stable markets (50-50 contributions). Due to a variety of demand patterns and economic profiles, global economic events have affected ART's operating markets to differing degrees. This diversification mitigates some of the impact of recent woes on ART's performance, while positioning the REIT to capture an upturn in the longer term. We note that ART has one of the most diversified portfolios within the S-REIT sector. This is also in sharp contrast to closest peer CDL Hospitality Trusts, which derives the majority of its revenue from Singapore.

**One of the cheapest S-REITs**. ART is currently trading at a 68% discount to last reported NAV. It is also trading at one of the highest forward yields within the S-REIT sector, about 110 basis points above the median S-REIT yield of 13%. Our thesis for the S-REIT sector (rating: **NEUTRAL**) is that perceived risk is driving a significant valuation gap between individual REITs. This has manifested in a strong preference for sponsored REITs. ART does not seem to be benefiting from its strong parentage and is in fact trading at an average 450bps premium to its sister CapitaLand-linked REITs[1] . There are some differences - such as the relative volatility of earnings in the shorter-stay hospitality sector versus traditional office and retail REITs and the higher risk premiums demanded for foreign exposure. However, these factors only partially explain the valuation gap and we believe ART's unique portfolio has been penalized because of expected earnings volatility in the near-term.

***[1] We note that this is based on our conservative FY09F estimate for ART's DPU yield. The valuation gap widens if the (higher) consensus yield estimate is used.***

**Exhibit 5: Forward yields across the S-REIT sector**



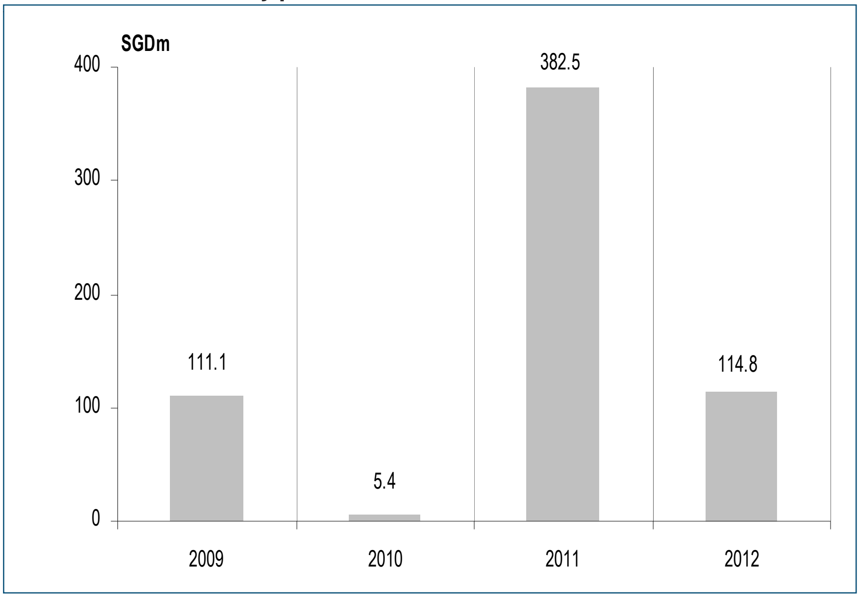

*Source: OIR estimates, Bloomberg consensus estimates*

## Section C: Risks

**Uncertain environment**. The shorter stay hospitality sector sees more (and more immediate) volatility relative to traditional office and retail REITs. The bulk of ART's rental income is derived from corporate travel in the guise of business trips, relocation or project work. Current macroeconomic events are expected to dampen corporate demand for extended-stay accommodation. In turn, this will impact ART's earnings performance and consequently, distributions to unitholders. The outlook for 2009 is highly uncertain - the manager has said that the hospitality industry is facing "unprecedented" challenges and "fast deteriorating market conditions". It has also guided that ART's "operating performance in 2009 is expected to remain profitable but lower than 2008". While we believe these concerns have already been priced in, visibility remains low. A key risk to our estimates is a worse-than-expected deterioration in the outlook in ART's operating markets.

**Balance sheet recapitalization risk**. As of 31 Dec 08, ART is geared at 37% debt-to-assets (before the Somerset West Lake acquisition). The bulk of its loans are maturing 2011 onwards and it has minimal refinancing needs of S$111.1m in 2009. While ART's current gearing sits comfortably below the 60% regulatory requirement, lender and market risk appetite for leverage has decreased significantly in the present environment. We believe that expectations of falling asset values and tighter loan-to-value demands may trigger a sector-wide overhaul of capital structures, potentially via equity issues. Our valuation assumes that ART will have to raise S$160m in equity at the S$0.45 price level. A key risk to our assumptions is a larger-than-expected cash call or more-than-expected dilution

**Exhibit 6: Debt maturity profile as of 31st December**



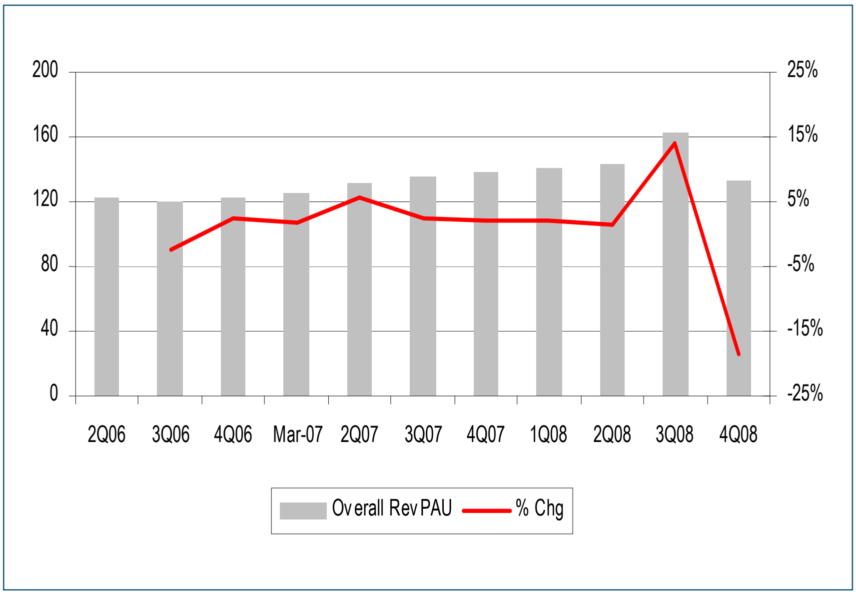

*Note: Excludes Somerset West Lake acquisition*

*Source: Company*

**Some leasehold properties and forex risk**. ART owns a mixture of freehold and leasehold properties. The remaining tenure for its properties in Singapore and China ranges from 54 to 74 years. However, the remaining land lease tenures at ART's Indonesia and Vietnam properties only span 16-17 years and 24-33 years respectively. Because of its regional presence, ART is exposed to exchange rate fluctuations in the Chinese RMB, US dollar, Philippine Peso, Australian dollar and the Japanese Yen against the Singapore dollar. The risk of owning overseas assets is somewhat mitigated by ART's policy to borrow in the same currency as the underlying assets.

## Section D: Investment thesis

**Exhibit 7: Overall RevPAU trend**




*Source: Company*

**Recent RevPAU performance.** RevPAU[2] is the key metric driving ART's earnings performance, and consequently distributions. The RevPAU trend for ART's overall portfolio has been relatively consistent with 4Q08 RevPAU data showing the first impact of global economic events. ART's China properties saw a 43% drop in 4Q RevPAU to S$127, as rates and occupancy fell post-Olympics (when the Ascott Beijing was able to charge 3x usual rates). ART's Singapore properties saw a 12% decline in 4Q08 RevPAU to S$230. The overall RevPAU of S$133 in the fourth quarter represents a decline of 8% against the full-year S$145 RevPAU.

We expect RevPAU to remain volatile (and on a downtrend) with demand for corporate travel impacted by the current macroeconomic turmoil. Note also that because of its shorter-stay profile, ART's performance will see a more immediate impact vis-à-vis traditional REITs - 1H09 RevPAU data will be a fair reflection of the health of the corporate travel business.

*[2] RevPAU, or Revenue per available room/unit, is a ratio commonly used to measure financial performance in the hospitality industry. It is a function of both room rates and occupancy. Note that it only focuses on room rental income.*

**Exhibit 8: Recent RevPAU performance by country**

| REVPAU by country (S$/day) | 1Q08 | 2Q08 | 3Q08 | 4Q08 | FY08 |
|---|---|---|---|---|---|
| Singapore | 251.0 | 252.0 | 262.0 | 230.0 | 249.0 |
| %Chg QoQ | 17% | 0% | 4% | -12% | 24% |
| Australia | 164.0 | 144.0 | 152.0 | 172.0 | 153.0 |
| %Chg QoQ | 12% | -12% | 6% | 13% | 32% |
| China | 139.0 | 144.0 | 223.0 | 127.0 | 161.0 |
| %Chg QoQ | -7% | 4% | 55% | -43% | 11% |
| Indonesia | 74.0 | 74.0 | 73.0 | 72.0 | 74.0 |
| %Chg QoQ | 1% | 0% | -1% | -1% | 3% |
| Japan - serviced resi | 135.0 | 150.0 | 148.0 | 155.0 | 150.0 |
| %Chg QoQ | -8% | 11% | -1% | 5% | -1% |
| Philippines | 147.0 | 140.0 | 132.0 | 136.0 | 134.0 |
| %Chg QoQ | 4% | -5% | -6% | 3% | 3% |
| Vietnam | 144.0 | 146.0 | 140.0 | 143.0 | 144.0 |
| %Chg QoQ | 3% | 1% | -4% | 2% | 7% |
| **Overall RevPAU** | **141.0** | **143.0** | **163.0** | **133.0** | **145.0** |
| **%Chg QoQ** | **2%** | **1%** | **14%** | **-18%** | **10%** |

*Source: Company*

**RevPAU drives yields and valuation**. We constructed a sensitivity analysis to assess the impact of changes in overall RevPAU. We focused on two key indicators: 1) FY09F-10F distribution yields, and 2) Our SOTP valuation of the trust. Our valuation assumes that ART will have to raise S$160m in equity at the S$0.45 price level and we ran a second set of numbers incorporating that assumption. We also assume that ART's gross profit margin falls as RevPAU declines. Note that this is truly a worst case analysis - it assumes that this level of RevPAU decline is portfolio-wide and importantly, that the decline continues into perpetuity.

**Exhibit 9: RevPAU sensitivity analysis - DPU yield only**

| RevPAU chg vs FY08 | WITHOUT CASH CALL | | WITH CASH CALL |
|---|---|---|---|
| | FY09F yield | FY10F yield | FY10F yield |
| 0% | 20.7 | 20.6 | 14.6 |
| -10% | 17.8 | 17.8 | 12.7 |
| -15% | 15.9 | 15.9 | 11.5 |
| -20% | 13.9 | 14.0 | 10.2 |
| -25% | 12.1 | 12.1 | 9.0 |
| -30% | 10.3 | 10.4 | 7.9 |
| -35% | 8.5 | 8.6 | 6.8 |
| -40% | 6.9 | 7.0 | 5.7 |
| -45% | 5.3 | 5.4 | 4.7 |
| -5% | 19.3 | 19.2 | 13.6 |
| -50% | 3.7 | 3.9 | 3.7 |
| -55% | 2.2 | 2.4 | 2.8 |
| -60% | 0.8 | 1.0 | 1.9 |

Current share price levels

*Note: This model assumes the RevPAU decline continues into perpetuity.*

*Source: OIR estimates*

**DPU volatility acceptable at current price.** Our first take-away is that at current share price levels, unitholders will enjoy comfortable distribution yields even with extreme RevPAU volatility. This holds true even with our assumption of a S$160m equity issue to recapitalize ART's balance sheet. Note that based on the model, the current share price of S$0.47 reflects an expectation for a FY10F yield of 9-10% (post-dilution). This is based on a 20-25% portfolio-wide decline in RevPAU from FY08 levels that is sustained for the next two years.

**Exhibit 10: RevPAU sensitivity analysis - yield & SOTP value**

| RevPAU chg vs FY08 | WITHOUT CASH CALL | | | WITH S$160m CASH CALL | |
|---|---|---|---|---|---|
| | FY09F yield | FY10F yield | SOTP est | FY10F yield | SOTP est |
| 0% | 20.7 | 20.6 | 1.14 | 14.6 | 0.89 |
| -10% | 17.8 | 17.8 | 0.91 | 12.7 | 0.74 |
| -15% | 15.9 | 15.9 | 0.76 | 11.5 | 0.65 |
| -20% | 13.9 | 14.0 | 0.61 | 10.2 | 0.55 |
| -25% | 12.1 | 12.1 | 0.46 | 9.0 | 0.46 |
| -30% | 10.3 | 10.4 | 0.32 | 7.9 | 0.37 |
| -35% | 8.5 | 8.6 | 0.18 | 6.8 | 0.28 |
| -40% | 6.9 | 7.0 | 0.05 | 5.7 | 0.20 |
| -45% | 5.3 | 5.4 | -0.08 | 4.7 | 0.12 |
| -5% | 19.3 | 19.2 | 1.03 | 13.6 | 0.82 |
| -50% | 3.7 | 3.9 | -0.20 | 3.7 | 0.04 |
| -55% | 2.2 | 2.4 | -0.32 | 2.8 | -0.04 |
| -60% | 0.8 | 1.0 | -0.43 | 1.9 | -0.11 |

Current share price levels

*Note: This model assumes the RevPAU decline continues into perpetuity.*

*Source: OIR estimates*

**Current price indicating "a perpetual bear case"**. We then used the model to analyze the sensitivity of RevPAU changes on our SOTP valuation of the trust[3]. We note that the high volatility in the SOTP value is due to its residual, net asset nature. This is the downside of leverage - asset values fall but the level of debt stays the same - and is true for any S-REIT. Of course, the same phenomenon is reversed to the unitholders' benefit in an up-cycle. Note that the revalued gross asset values in this model are based on the assumption that this RevPAU decline continues in perpetuity. So the current share price is reflecting a 20-25% YoY decline in RevPAU, with *no scope of improvement in following years*. This represents a fundamental mispricing, in our opinion.

**A viable investment option**. In our view, current share prices are then reflecting a "floor scenario" - business conditions deteriorate to a certain extent *and then stay that way*. The investment question then breaks down into two components: 1) a volatile (but still comfortable) yield over the next two years, and 2) a very low "floor" valuation that prices in a *perpetually* grim scenario, leaving ample room on the upside. We are confident in both the long-term fundamentals of the extended-stay business in the pan-Asian region as well as in the long-term prospects of ART's properties. ART becomes a viable investment option if investors can accept short-term yield uncertainty and re-look ART as a long-term value play

*[3] Sum of the Parts (SOTP) valuation: Revalued gross asset values less estimated debt and minority interests.*

## Section E: Valuation

**Not your father's S-REIT**. ART trades at one of the highest forward yields within the S-REIT sector, and about 110 basis points above the median S-REIT yield of 13%. We have already highlighted the 450 bps premium to its sister CapitaLand-linked REITs[4] . In some ways, ART is a different animal compared to traditional S-REITs. A key differentiator is the earnings model - ART is quicker to feel the impact of economic events on its bottom-line than traditional office/retail S-REITs because of its shorter-stay profile. Consequently, we expect FY09 earnings to be more volatile relative to other S-REITs. However, this also means that ART will also be one of the first to see earnings improvement when economic fundamentals start to recover. We think the key reason why ART trades at such high yields relative to the sector is because the market is penalizing its higher yield volatility in the near-term. However, declining distributions are an issue across the sector and we think ART is a viable investment option if investors can accept, and look beyond, near-term yield volatility.

*[4] We note that this is based on our conservative FY09F estimate for ART's DPU yield. The valuation gap widens if the (higher) consensus yield estimate is used*

**Exhibit 11: Peer comparison**

| | Share price (S$) | Market Cap (S$m) | Price/NAV (x) | Curr yr DPU Yield (%) | Borrowings in S$m (as of 31-Dec) | | | Total assets in S$m | Gearing (%) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Repayable in 1 yr | *% of total borrowings* | Total borrowings | (at 31-Dec) | |
| **Office** | | | | | | | | | |
| Frasers Commercial Trust | 0.170 | 125.1 | 0.17 | 22.9 | 616.4 | *65.1* | 946.4 | 1,757.9 | 53.8 |
| CapitaCommercial Trust | 0.870 | 1,218.4 | 0.29 | 12.9 | 696.0 | *27.2* | 2,561.6 | 6,871.4 | 37.3 |
| K-REIT Asia | 0.675 | 443.8 | 0.30 | 12.6 | 0.0 | *0.0* | 577.1 | 2,092.3 | 27.6 |
| Suntec REIT^ | 0.695 | 1,097.2 | 0.35 | 13.6 | 823.7 | *44.3* | 1,860.8 | 5,431.6 | 34.3 |
| Office Total | | | 0.28 | 15.5 | 2,136.1 | *35.9* | 5,945.9 | 16,153.2 | 36.8 |
| **Retail** | | | | | | | | | |
| CapitaMall Trust^ | 1.290 | 4,091.4 | 0.82 | 7.1 | 652.9 | *20.7* | 3,156.9 | 7,509.0 | 42.0 |
| Frasers Centerpoint Trust^ | 0.715 | 445.4 | 0.59 | 9.5 | 62.0 | *19.3* | 322.0 | 1,129.4 | 28.5 |
| Starhill Global REIT | 0.465 | 446.8 | 0.32 | 14.8 | 17.0 | *2.6* | 666.0 | 2,163.4 | 30.8 |
| Retail Total | | | 0.58 | 10.5 | 731.9 | *17.7* | 4,144.9 | 10,801.7 | 38.4 |
| **Healthcare** | | | | | | | | | |
| Parkway Life REIT | 0.755 | 455.1 | 0.56 | 10.1 | 34.0 | *13.6* | 250.8 | 1,080.6 | 23.2 |
| Healthcare Total | | | 0.56 | 10.1 | 34.0 | *13.6* | 250.8 | 1,080.6 | 23.2 |
| **Hospitality** | | | | | | | | | |
| Ascott Residence Trust^ | 0.470 | 288.4 | 0.32 | 14.1 | 117.5 | *18.8* | 624.4 | 1,687.6 | 37.0 |
| CDL Hospitality Trusts | 0.595 | 494.1 | 0.42 | 11.9 | 273.0 | *100.0* | 273.0 | 1,501.6 | 18.2 |
| Hospitality Total | | | 0.37 | 13.0 | 390.5 | *43.5* | 897.4 | 3,189.2 | 28.1 |
| **Industrial** | | | | | | | | | |
| Ascendas REIT | 1.440 | 2,424.2 | 0.79 | 10.3 | 738.1 | *38.5* | 1,915.4 | 4,610.3 | 41.5 |
| Cambridge Industrial Trust | 0.280 | 223.0 | 0.38 | 16.4 | 369.1 | *100.0* | 369.1 | 977.9 | 37.7 |
| Macarthurcook Industrial REIT | 0.270 | 70.7 | 0.21 | 32.6 | 224.4 | *100.0* | 224.4 | 566.2 | 39.6 |
| Mapletree Logistics Trust^ | 0.450 | 872.7 | 0.51 | 10.4 | 217.7 | *18.8* | 1,159.4 | 3,046.3 | 38.1 |
| Industrial Total | | | 0.47 | 17.4 | 1,549.4 | *42.2* | 3,668.4 | 9,200.6 | 39.9 |
| **Overseas** | | | | | | | | | |
| Ascendas India Trust | 0.490 | 370.8 | 0.46 | 14.1 | 31.5 | *51.1* | 61.6 | 1,038.8 | 5.9 |
| CapitaRetail China Trust | 0.915 | 567.7 | 0.73 | 8.9 | 61.0 | *14.7* | 414.7 | 1,325.7 | 31.3 |
| First REIT | 0.540 | 148.0 | 0.58 | 13.1 | 50.8 | *100.0* | 50.8 | 339.5 | 15.0 |
| Fortune REIT*# | 2.960 | 2,436.4 | 0.39 | 12.4 | 0.0 | *0.0* | 432.2 | 1,638.8 | 26.4 |
| Lippo-Mapletree Indonesia^ | 0.250 | 267.6 | 0.35 | 19.0 | 0.0 | *0.0* | 118.9 | 1,006.1 | 11.8 |
| Saizen REIT# | 0.145 | 65.5 | 0.14 | 27.0 | 293.0 | *69.8* | 420.0 | 914.4 | 45.9 |
| Overseas Total | | | 0.44 | 15.7 | 436.3 | *29.1* | 1,498.1 | 6,263.4 | 23.9 |
| S-REITs Total | | | 0.43 | 14.7 | 5,278.2 | *32.2* | 16,405.6 | 46,688.7 | 35.1 |

# Converted to S$, based on respective exchange rates at the end of last reported financial period

*Share price and market cap in HK$

For CMT, ex-Rights gearing level will fall to 29.1%

Cambridge Industrial Trust has already refinanced all borrowings due this year

^OIR estimates used for DPU yield. Rest are consensus estimates

***Source: Bloomberg consensus estimates, OIR estimates, Companies***

**Not substitutable with CDL Hospitality Trusts**. ART is inevitably pitted against CDL Hospitality Trusts [CDLHT, NOT RATED] as they are the only two hospitality-focused SGX-listed REITs. There are some key fundamental differences, however, and we believe each has its distinct investment merits. For one, ART has one of the most diversified portfolios within the S-REIT sector, with no country contributing more than 25% of total revenue in FY08. CDLHT, on the other hand, derives the majority of its revenue from Singapore. Its revenue model is also different - because of lease structure, CDLHT's revenue is derived from both a fixed and a variable component. Additionally, hotel properties have a shorter stay profile (and a different customer base) vis-à-vis serviced residences and rental housing properties. Historical occupancy data for the two property types has varied significantly during crisis periods

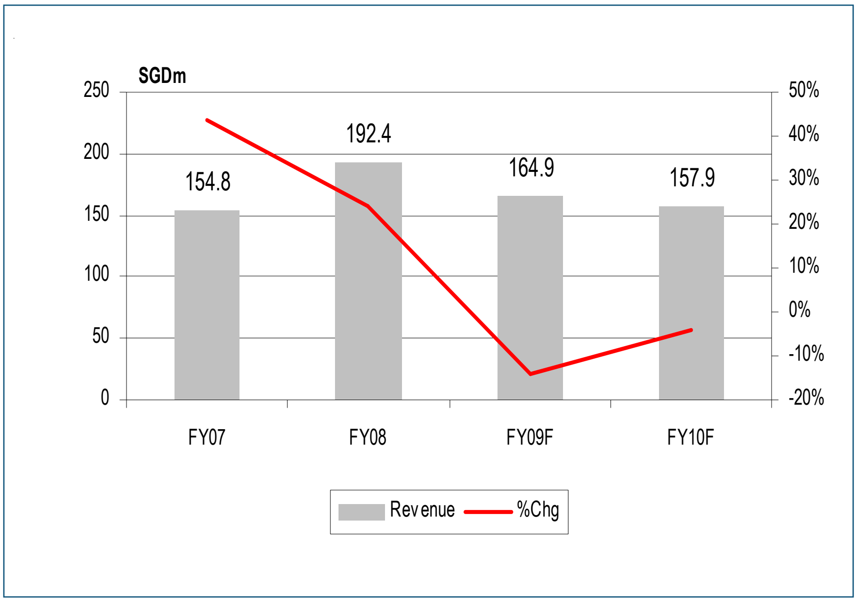
**Exhibit 12: OIR's RevPAU forecasts by country**

| YoY %Chg in RevPAU | FY09F | FY10F | FY11F | FY12F |
|---|---|---|---|---|
| Singapore | -35% | -5% | 8% | 8% |
| Australia | -15% | -5% | 4% | 4% |
| China | -35% | -5% | 8% | 8% |
| Indonesia | -13% | -5% | 4% | 4% |
| Japan | -15% | -5% | 4% | 4% |
| Philippines | -13% | -5% | 4% | 4% |
| Vietnam | -13% | -5% | 4% | 4% |

*Source: OIR estimates*

**Earnings forecasts**. We are taking a fairly conservative view on RevPAU figures over the next two years. We note that visibility is low and regional economic data has disappointed on the downside in the last few months. RevPAU, and consequently ART's performance, could be fairly volatile in the next few months. We will be keeping a close eye on RevPAU data in 1H09. We expect ART to earn revenue of S$164.9m in FY09F (down 14% YoY) and S$157.9m in FY10F (down 4% YoY). Our revenue estimates are 3-6% below consensus. This translates to DPU estimates of 6.6 S cents for FY09F (down 24% YoY) and 6.2 S cents for FY10F (down 7% YoY). Our DPU estimates are roughly 6-7% below consensus. We note that our earnings forecasts do not take an equity issue into account due to timing uncertainty (but our fair value estimate does). As a rough guide, FY09-10F yields would fall about 350-400 basis points if we incorporate an equity issue of S$160m at the S$0.45 price level (the impact of reduced interest expense is mitigated by dilution from an enlarged shareholder base).

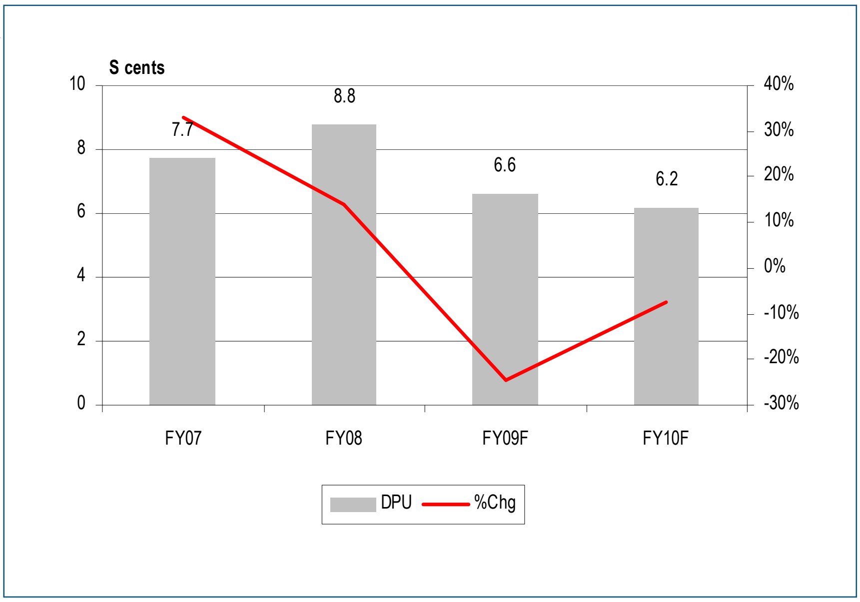
**Exhibit 13: Revenue forecasts for FY09-10F**




*Source: Company, OIR estimates*

**Long term growth, albeit with near-term volatility.** Our SOTP value of the trust is S$0.76. This incorporates our assumption of an equity issue of S$160m at the S$0.45 price level. On a sector-wide basis, we are generally ascribing a discount to the SOTP value to reach our fair value estimate in order to reflect depressed appetite for the S-REIT sector and a continuing onslaught of negative news flow. Our fair value estimate for ART is S$0.57, at a 25% discount to our SOTP value. Key risks to our estimates include a worse-than-expected deterioration in the economic outlook in ART's operating markets, a larger-than-expected cash call or more-than-expected dilution, and higher debt costs. We believe ART is a viable investment option for investors who can 1) accept short-term yield volatility, 2) and judge ART on the basis of its long-term prospects (which we think are sound). We re-initiate coverage on ART with a **BUY** rating.

**Exhibit 14: DPU forecasts for FY09-10F**




*Source: Company, OIR estimates*

## Appendix I: Company background

**Overview.** Ascott Residence Trust (ART) is the world's first pan-Asian serviced residence REIT. ART was listed on 31 Mar 06 and remains the only pure-play serviced residence trust investment option on SGX. ART owns 38 serviced residence and rental housing properties across 11 cities in seven countries.

**Strong parent.** CapitaLand Ltd holds a 47.2% stake in ART. ART is managed by Ascott Residence Trust Management Limited (ARTML), an indirect wholly-owned subsidiary of CapitaLand. ART's properties are managed by The Ascott Group (Ascott), the serviced residence arm of CapitaLand.

**Global franchise.** Ascott is the world's largest international serviced residence owner-operator. Its properties span 66 cities and 22 countries across Asia Pacific, Europe and the GCC region. The company has over 18,000 operating serviced residence units globally, as well as more than 6,000 units which are under development. Ascott also operates and/or manages serviced residences and rental housing properties owned by third parties. Ascott has a 25-year industry track record.

**Strong brand reputation**. Ascott operates three globally recognized brands - "Ascott", "Somerset" and "Citadines". Recent awards include DestinAsian Readers' Choice Awards 2009 'Best Serviced Residence in Asia Pacific', TTG Travel Awards 2008 'Best Serviced Residence Operator', Business Traveller UK Awards 2008 'Best Serviced Residence Company', Business Traveller Asia Pacific Awards 2008 'Best Serviced Residence Brand' and 'Best Serviced Residence', and TravelWeekly (Asia) Industry Awards 2008 'Best Serviced Residence (Group)'.

**Acquisition pipeline**. Ascott has granted ART a right of first refusal (ROFR) over future sales of properties by any of its entities that are used, or predominantly used, as serviced residences or rental housing properties in the pan-Asian region.

**Lead by senior Ascott management.** The REIT manager, ARTML, is headed by Mr. Chong Kee Hiong. Mr Chong is responsible for charting ART's business, investment and operational strategies. He is concurrently CEO of Ascott Real Estate, Ascott's real estate arm. Over at Ascott, his responsibilities include overseeing asset management; business development; and development and project management. Similarly, ARTML's deputy CEO Ms. Ng Lai Leng is also the Chief Corporate Officer of The Ascott Group.

**Exhibit 15: Understanding serviced residences**

| | Apartments for rent | Serviced residences | Hotels |
|---|---|---|---|
| Lease structure & terms | Long-term leases | Variable lease terms: one week to one year or longer | Short-term accomodation |
| Range of services | No service provided | Limited services provided | Full range of hospitality service |
| Cost structure | Minimal staff cost & low maintenance costs | Less intensive staffing & lower maintenance costs | High maintenance & more staff required |

*Source: Company*

## Appendix II: Portfolio summary

**Overview.** ART's 19 serviced residences and 19 rental housing properties are located within or close to central business districts in 11 cities across Australia, China, Indonesia, Japan, The Philippines, Singapore and Vietnam. Every property is served by public transportation and is within walking distance to amenities such as restaurants and supermarkets. Three serviced residences are managed under the "Ascott" brand, while 16 are managed under the "Somerset" brand. The 18 rental housing properties in Japan are managed under four local rental housing brands (Asyl Court, Gala, Joy City and Zesty) and the one rental housing property in Indonesia is unbranded.

**Exhibit 16: Portfolio summary**

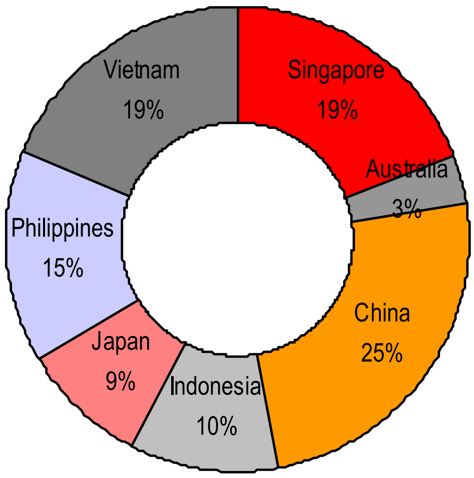
| Property | Stake (%) | Total # of rooms (units) | NLA (sqm) | Type | Date acquired | Tenure of land | Term of lease (yrs) | Tenure remaining (yrs) | Appraised Value 31-Dec-07 (S$m) | 31-Dec-08 (S$m) | Chg (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Singapore | | | | | | | | | | | |
| Somerset Grand Cairnhill | 100% | 146 | 18,629 | Somerset | 01-Mar-06 | Leasehold | 99 | 74 | 218.6 | 218.5 | 0.0% |
| Somerset Liang Court | 100% | 195 | 16,908 | Somerset | 01-Mar-06 | Leasehold | 97 | 69 | 181.4 | 181.5 | 0.0% |
| Australia | | | | | | | | | | | |
| Somerset Gordon Heights, Melbourne | 100% | 43 | 2,137 | Somerset | 28-May-07 | Freehold | - | - | 13.9 | 10.9 | -21.0% |
| Somerset St George Terrace, Perth | 100% | 84 | 4,000 | Somerset | 11-Jun-08 | Freehold | - | - | - | 29.1 | - |
| China | | | | | | | | | | | |
| Ascott Beijing | 100% | 310 | 59,422 | Ascott | 01-Mar-06 | Leasehold | 70 | 58 | 201.9 | 200.6 | -0.6% |
| Somerset Grand Fortune Garden, BJ | 81 units | 221 | 15,899 | Somerset | 01-Mar-06 | Leasehold | 70 | 60 | 52.6 | 49.6 | -5.7% |
| Somerset Xu Hui, Shanghai | 100% | 167 | 17,805 | Somerset | 01-Mar-06 | Leasehold | 70 | 58 | 61.7 | 53.6 | -13.1% |
| Somerset Olympic Tower, Tianjin | 100% | 185 | 25,043 | Somerset | 03-Oct-06 | Leasehold | 70 | 54 | 79.9 | 80.0 | 0.2% |
| Indonesia | | | | | | | | | | | |
| Ascott Jakarta | 100% | 198 | 21,371 | Ascott | 01-Mar-06 | Leasehold | 27 | 16 | 34.5 | 33.4 | -3.2% |
| Somerset Grand Citra, Jakarta | 57.4% | 203 | 29,666 | Somerset | 01-Mar-06 | Leasehold | 30 | 16 | 46.0 | 44.5 | -3.3% |
| Country Woods, Jakarta | 100% | 251 | 48,490 | Corporate Leasing | 01-Mar-06 | Leasehold | 20 | 17 | 23.6 | 20.1 | -14.7% |
| Japan | | | | | | | | | | | |
| Somerset Azabu East, Tokyo | 100% | 79 | 4,019 | Somerset | 05-Apr-07 | Freehold | - | - | 73.2 | 76.2 | 4.0% |
| Somerset Roppongi, Tokyo | 100% | 64 | 3,542 | Somerset | 05-Apr-07 | Freehold | - | - | 57.2 | 59.5 | 4.0% |
| 18 rental housing properties | 100% | 509 | 13,318 | Corporate Leasing | 18-Dec-07 | Freehold | - | - | 166.5 | 178.2 | 7.0% |
| The Philippines | | | | | | | | | | | |
| Ascott Makati | 100% | 306 | 34,282 | Ascott | 22-Mar-07 | Leasehold | 48 | 37 | 98.2 | 87.9 | -10.4% |
| Somerset Millenium, Makati | 100% | 138 | 4,448 | Somerset | 01-Mar-06 | Freehold | - | - | 14.5 | 12.6 | -12.7% |
| Somerset Salcedo, Makati | 71 units | 150 | 5,901 | Somerset | 01-Mar-06 | Freehold | - | - | 14.6 | 13.0 | -11.0% |
| Vietnam | | | | | | | | | | | |
| Somerset Grand Hanoi | 76% | 185 | 28,328 | Somerset | 01-Mar-06 | Leasehold | 45 | 30 | 99.4 | 98.7 | -0.7% |
| Somerset West Lake, Hanoi | 70% | 90 | 5,349 | Somerset | 01-Apr-09 | Leasehold | 49 | 33 | - | - | - |
| Somerset Chancellor Court, HCMC | 67% | 172 | 19,026 | Somerset | 30-Mar-07 | Leasehold | 48 | 33 | 60.3 | 60.3 | -0.1% |
| Somerset HCMC | 69% | 165 | 19,154 | Somerset | 01-Mar-06 | Leasehold | 45 | 24 | 61.4 | 57.1 | -7.0% |
| **Total** | | **3,642** | **396,737** | | | | | | **1,559.2** | **1,565.3** | **0.4%** |

*Source: Company, OIR Estimates*

## Appendix III: Overview of operating markets

**Overview.** The bulk of ART's rental income is derived from corporate travel in the guise of business trips, relocation or project work. Business travelers tend to have a preference for comfortable home-styled extended-stay accommodation. They are also the least price-sensitive of all travelers. It is possible to use macroeconomic indicators such as economic growth as a proxy to understand the health of the extended stay business. The size of inward foreign direct investment (FDI); business travel; and the expatriate population will drive demand for serviced residences and rental housing properties.

**Exhibit 17: Total revenue by country (FY08)**




*Source: Company*

**Singapore.** In FY08, Singapore contributed 19% of ART's total revenue. The Economist Intelligence Unit (EIU) forecasts a sharp contraction in Singapore's economy in 2009. The Ministry of Trade and Industry's official growth forecast is between -9.0% to -6.0%. Business travel and MICE are the key drivers of foreign arrivals in Singapore. The manager expects corporate travel and meeting business to be affected in the immediate term as companies trim discretionary expenditure. The longer term picture is more positive, both as the global economy improves, and with the completion of the two integrated resorts.

**Australia**. In FY08, Australia contributed 3% of ART's total revenue. The EIU expects real GDP to fall by 1.2% in 2009. It also expects economic growth to recover slowly to average 2% a year in 2010-13, down from an average of 3.1% in 2004-08. Guests staying at both of ART's properties are on short business trips - Melbourne is a popular MICE destination, while the Perth property attracts travelers from energy and mining companies active in Western Australia. However, capex plans have seen a sharp drop in the minerals resource sector in recent months.

**China.** In FY08, China contributed 25% of ART's total revenue. The Economist Intelligence Unit expects real GDP growth to slow sharply to 6% because of the global economic downturn. However, it expects the rapid expansion in government infrastructure spending and expansionary policies to support the economy. China's contribution to ART's total revenue increased by 17% YoY in 2008 but this was mainly due to higher rates achieved for the Olympics period for Ascott Beijing (3x usual). This feat is unlikely to be repeated this year with no major events slated for Beijing and a large supply of serviced residences in the city. The lack of a minimum length of stay requirement opens up the field between serviced residences and hotel operators. The Shanghai property has the highest proportion of short stay business, but it may benefit from the World Expo event in 2010. The other two properties house mainly long-stay guests - the average length of stay at the Tianjin property is more than six months.

**Exhibit 18: %YoY change in Real GDP**

| Real GDP growth (%) | 2008 | 2009F | 2010F | 2011F | 2012F | 2013F |
|---|---|---|---|---|---|---|
| Singapore | 1.1 | -7.5 | 1.9 | 2.8 | 3.6 | 3.1 |
| Australia | 2.1 | -1.2 | 0.5 | 1.2 | 2.4 | 2.7 |
| China | 9.0 | 6.0 | 7.0 | 8.4 | 8.7 | 8.9 |
| Indonesia | 6.1 | -1.3 | 0.6 | 3.3 | 4.3 | 4.5 |
| Japan | -0.7 | -6.4 | 0.3 | 1.0 | 1.2 | 1.4 |
| Philippines | 4.6 | -0.6 | 1.6 | 4.6 | 4.6 | 4.4 |
| Vietnam | 6.2 | 0.3 | 1.0 | 4.1 | 5.3 | 6.6 |

*Source: Economist Intelligence Unit*

**Indonesia**. In FY08, Indonesia contributed 10% of ART's total revenue. The EIU expects Indonesia's annual average real GDP growth rate to fall to 2.3% in 2009-13, from 5.7% in 2004-08. It expects external demand for the country's exports, domestic consumption and investment all to be weaker. According to Knight Frank, Jakarta will see a new influx of rental apartment stock with condominiums being offered as serviced residences.

**Japan.** In FY08, Japan contributed 9% of ART's total revenue. The EIU expects a severe recession in 2009 and negligible growth in 2010. ART's two serviced residences in the country are located in a prime business and embassy district in Tokyo that is popular with expatriates. The 18 rental housing properties attract a different market - the studio and one-bedroom accommodations house Japanese singles and couples. The rental housing portfolio enjoys average lease tenures of two years and an average occupancy of 90%. This boosts the income stability of ART's overall portfolio.

**The Philippines**. In FY08, the Philippines contributed 15% of ART's total revenue. The Philippines is a major destination for Offshore & Outsourcing (O&O) services. The EIU expects the country's economy to contract for the first time in ten years in 2009. It forecasts a 0.6% decline in real GDP, as exports of goods and services decline by 8% owing to weaker global demand. In recent months, three leading US computer-chip manufacturers announced plans to cut thousands of jobs at their production facilities in the Philippines. However, a Jones Lang LaSalle report believes that more companies are looking into migrating part of their outsourcing services work to the Philippines from India. The manager expects the country's advantages in securing business from the O&O industry to continue to contribute to rental accommodations demand.

**Vietnam**. In FY08, Vietnam contributed 19% of ART's total revenue. The EIU forecasts that real GDP will grow by just 0.3% in 2009, due to a poor outlook for growth in exports, private consumption and investment. In the first two months of 2009, new FDI commitments totaled just US$1.5bn, representing a fall of 64.1% YoY. The EIU believes that FDI inflows will slow dramatically in 2009-10, but the country's long-term prospects remain sound. Recent reports say the EU has shown interest in negotiating a free-trade agreement with Vietnam. Meanwhile, Vietnam's membership in the World Trade Organization will positively affect the business environment. ART's recent acquisition of a 70% stake in Somerset West Lake, its fourth property in the country and the second in Hanoi, will boost Vietnam's contributions to ART's total revenue.

## ART's Key Financial Data

| EARNINGS FORECAST<br>Year Ended 31 Dec (S$ m) | FY07 | FY08 | FY09F | FY10F |
|---|---|---|---|---|
| Revenue | 154.8 | 192.4 | 164.9 | 157.9 |
| Direct expenses | -85.1 | -96.9 | -87.9 | -84.2 |
| Gross profit | 69.7 | 95.5 | 77.0 | 73.7 |
| Finance income | 0.8 | 1.1 | 1.6 | 1.6 |
| Finance costs | -15.3 | -20.8 | -23.1 | -23.3 |
| Other operating income | 0.9 | 0.1 | 0.1 | 0.1 |
| Manager's management fees | -5.9 | -8.1 | -7.2 | -6.6 |
| Other fees | -1.7 | -2.2 | -1.7 | -1.6 |
| Forex gain - realised | 0.3 | -0.4 | 0.0 | 0.0 |
| Others | -0.1 | -0.8 | -0.7 | -0.6 |
| Net profit before unrealized gains | 48.7 | 64.3 | 46.1 | 43.2 |
| Other charges | -7.4 | -5.8 | 0.0 | 0.0 |
| Change in property values | 147.4 | -94.0 | -80.0 | -80.0 |
| Tax | -22.0 | -2.5 | -4.5 | -4.1 |
| Minority interests | -6.1 | -4.3 | -4.1 | -3.9 |
| PATMI | 160.5 | -42.2 | -42.5 | -44.8 |
| Net effect of non-tax items/ other adj | -115.5 | 95.8 | 83.5 | 83.2 |
| Total distributable amount | 45.1 | 53.7 | 41.0 | 38.4 |

| BALANCE SHEET<br>As at 31 Dec (S$ m) | FY07 | FY08 | FY09F | FY10F |
|---|---|---|---|---|
| Investment properties | 1,559.2 | 1,565.3 | 1,516.2 | 1,434.5 |
| Cash | 64.5 | 56.1 | 64.3 | 71.6 |
| Other current assets | 38.1 | 32.1 | 34.7 | 34.3 |
| Total assets | 1,689.1 | 1,687.6 | 1,649.2 | 1,574.5 |
| Current liabilities ex debt | 80.9 | 79.0 | 79.6 | 79.4 |
| Debt | 541.7 | 624.4 | 647.3 | 647.3 |
| Total liabilities | 650.5 | 722.6 | 746.1 | 745.9 |
| Minority interests | 65.7 | 65.9 | 77.8 | 79.7 |
| Unitholders' funds | 972.9 | 899.0 | 825.3 | 748.8 |
| Total equity and liabilities | 1,689.1 | 1,687.6 | 1,649.2 | 1,574.5 |

| CASH FLOW<br>Year Ended 31 Dec (S$ m) | FY07 | FY08 | FY09F | FY10F |
|---|---|---|---|---|
| PBT | 188.6 | -35.5 | -33.9 | -36.8 |
| Adjustments for: | | | | |
| Borrowing costs | 14.5 | 19.8 | 21.5 | 21.7 |
| Manager's mngt fees paid in units | 0.0 | 4.1 | 3.5 | 3.3 |
| Change in value of properties | -147.4 | 94.0 | 80.0 | 80.0 |
| Other adjustments | 13.6 | -11.9 | 1.2 | 0.8 |
| Cash flow from operating activities | 69.4 | 70.4 | 72.3 | 69.0 |
| | | | | |
| Acquisition of properties & subsidiaries | -380.8 | -30.7 | -22.9 | 0.0 |
| Others | -19.9 | -11.9 | -1.4 | -1.4 |
| Cash flow from investing activities | -400.7 | -42.5 | -24.3 | -1.4 |
| | | | | |
| Distributions to unitholders | -35.1 | -52.4 | -41.0 | -38.4 |
| Dividends to minority shareholders | -3.2 | -3.6 | -2.1 | -1.9 |
| Interest paid | -14.5 | -19.6 | -23.1 | -23.3 |
| Proceeds from bank borrowings | 222.7 | 329.7 | 22.9 | 0.0 |
| Proceeds from issue of new units | 202.8 | 3.8 | 3.5 | 3.3 |
| Repayment of bank borrowings | -8.3 | -297.6 | 0.0 | 0.0 |
| Other costs | -4.2 | 0.0 | 0.0 | 0.0 |
| Cash flow from financing activities | 360.2 | -39.6 | -39.8 | -60.4 |
| | | | | |
| Net change in cash | 28.9 | -11.7 | 8.2 | 7.3 |
| Cash at beg of period | 36.3 | 64.5 | 56.1 | 64.3 |
| Translation effects | -0.7 | 3.3 | 0.0 | 0.0 |
| Cash at end of period | 64.5 | 56.1 | 64.3 | 71.6 |

| Per share data<br>Year ended 31 Dec | FY07 | FY08 | FY09F | FY10F |
|---|---|---|---|---|
| Units outstanding, period end | 606.2 | 610.8 | 617.7 | 624.4 |
| EPU (S cents) | 26.5 | -6.9 | -6.9 | -7.2 |
| DPU (S cents) | 7.7 | 8.8 | 6.6 | 6.2 |
| CFPS (S cents) | 11.4 | 11.5 | 11.7 | 11.1 |
| NAV (S$) | 1.6 | 1.5 | 1.3 | 1.2 |

| Key rates & ratios<br>Year ended 31 Dec | FY07 | FY08 | FY09F | FY10F |
|---|---|---|---|---|
| DPU yield (%) | 16.4 | 18.7 | 14.1 | 13.1 |
| P/CF (x) | 4.1 | 4.1 | 4.0 | 4.3 |
| P/NAV (x) | 0.3 | 0.3 | 0.4 | 0.4 |
| Gross profit margin (%) | 45.0 | 49.6 | 46.7 | 46.7 |
| Distr to revenue (%) | 29.1 | 27.9 | 24.8 | 24.3 |
| Total debt/Total assets (x) | 0.3 | 0.4 | 0.4 | 0.4 |
| Total debt/Total equity (x) | 0.5 | 0.6 | 0.7 | 0.8 |

Source: Company data, OIR estimates

SHAREHOLDING DECLARATION:
The analyst's immediate family owns 419,000 shares in Ascott Residence Trust.

RATINGS AND RECOMMENDATIONS:
OCBC Investment Research's (OIR) technical comments and recommendations are short-term and trading oriented.
- However, OIR's fundamental views and ratings (Buy, Hold, Sell) are medium-term calls within a 12-month investment horizon. OIR's Buy = More than 10% upside from the current price; Hold = Trade within +/-10% from the current price; Sell = More than 10% downside from the current price.
- For companies with less than S$150m market capitalization, OIR's Buy = More than 30% upside from the current price; Hold = Trade within +/- 30% from the current price; Sell = More than 30% downside from the current price.



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