F·P·A FINANCIAL

Investment Perspectives

5 April 2021

HOTEL RESEARCH

ARA US Hospitality Trust

SGX: XZL
Bloomberg: ARAUS:SP
ISIN Code: SGXC80011726

RECOMMENDATION: NEUTRAL

Current Price : US$0.525
Current Target Price: US$0.577

Issued Stapled Securities: 567.34 million
Market Capitalisation: US$297.85 million

52 Week Range: US$0.250 - US$0.560

PRICE PERFORMANCE

COMPANY DESCRIPTION

ARA US Hospitality Trust (ARA H-Trust or the Group) is a Singapore-listed stapled group comprising ARA US Hospitality Property Trust (ARA H-REIT) and ARA US Hospitality Management Trust (ARA H-BT). The Group's current portfolio comprises 41 Marriot and Hyatt-branded upscale select-service hotels that span 22 states in the United States (US).

SUMMARY

Owing to the impact of COVID-19, ARA H-Trust's financial performance was severely impacted during the financial year ended 31 December 2020 (FY2020). Owing to significant declines in hotel occupancies and temporary hotel closures, the Group's portfolio generated revenue of US$78.2 million in FY2020. With the Group's efforts to reduce operating costs, a gross operating profit of US$12.7 million was achieved. However, an after-tax net loss of US$94.5 million was recorded for the period, partially due to a revaluation deficit of US$67.0 million in relation to property, plant & equipment (PPE). This translated to a loss per stapled security of 16.65 cents. No distributable income was reported for the period after distribution adjustments.

RECOMMENDATION

Since our last company update on 29 August 2020, we note that ARA H-Trust's share price has rebounded strongly. While the share price has fluctuated, it recently reached US$0.555 which is above the target price of US$0.493 in our last company update. On valuation terms, our peer comparison analysis shows that ARA H-Trust's current P/B ratio of 0.85x is lower than the peer average P/B of 0.93x. This could suggest that ARA H-Trust is potentially undervalued at the current share price of US$0.525. Adopting a relative valuation approach, we estimate a target price of US$0.577 if ARA H-Trust were to trade at the peer average P/B multiple of 0.93x. This current target price would represent an upgrade from our previous target price of US$0.493 in our last company update. Meanwhile, we note that the US hotel market is expected to rebound in 2021 with the re-emergence of leisure travel demand. At the same time, business travel is travel is expected to begin a slow return in the second half of 2021. Nonetheless, a full recovery in travel could take a few years and this could weigh on the recovery of the Group's portfolio performance. Given the above, we will now issue a neutral recommendation on ARA H-Trust and our current target price is US$0.577.

KEY FINANCIALS

Full year, ended Dec 31	Revenue (US$ million)	EPS (cents)	P/E (x)	Distributable income (US$ million)	DPS (US cents)	Distribution yield (%)	NAV per stapled security (US$)	P/B (x)
2019 actual*	115.0	1.89	18.52	23.9	4.21	12.0	0.87	0.60
2020 actual	78.2	(16.65)	n/m	-	-	-	0.62	0.85
2021 forecast	106.2	(6.97)	n/m	-	-	-	-	-
2022 forecast	142.6	(4.92)	n/m	-	-	-	-	-

Figures have been rounded. P/E, P/B and dividend yield figures are based on current price of US$0.525. n/m: not meaningful.
** Period from 9 May 2019 (listing date) to 31 Dec 2019. P/E and dividend yield are based on annualised EPS and DPS figures.*
Source: ARA H-Trust, FPA Financial

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FINANCIAL REVIEW FOR FY2020

Financial performance

Owing to the severe impact of the COVID-19 pandemic, the Group's portfolio suffered from a significant drop in hotel occupancies and temporary hotel closures in FY2020. For the period, the Group recorded revenue of US$78.2 million as compared with US$115.0 million for FY2019 (from listing date of 9 May 2019 to 31 December 2019). Operating expenses of US$65.5 million were lower than US$71.9 million in FY2019, as measures including the temporary suspension & consolidation of hotel operations (i.e scaling down on F&B and housekeeping services) and comprehensive cost & labor reductions were implemented since March 2020 to substantially reduce operating costs. Consequently, gross operating profit amounted to US$12.7 million, as compared to US$43.1 million during FY2019.

Meanwhile, hotel management fee, derived based on 3% of total Group revenue, was US$2.3 million due to lower revenue. Property taxes of US$13.2 million were incurred compared to US$4.9 million during FY2019, mainly due to the addition of the 3 Marriot hotels (acquired in January 2020) and timing of receipt of notices from various counties. Other expenses of US2.2 million were closely in line with US$2.1 million in FY2019. Net of these expenses, the Group recorded a net property loss of US$5.0 million compared to a FY2019 profit of US$32.6 million.

During the period, the Group recorded other income of US$8.8 million primarily comprising government grant income recognized in profit or loss. With the enlarged portfolio, depreciation & amortization amounted to US$25.6 million compared with US$13.7 million during FY2019. At the same time, no management fees were payable to the REIT and Trustee Managers for FY2020, while trustee fees payable to the Trustee-Manager and REIT Trustee were higher than FY2019 given a full year impact. Net finance costs were US$11.7 million compared with US$6.0 million for FY2019, as the Group drew down on new loans during FY2020, primarily for the acquisition of the Marriot hotels. Other trust expenses of US$2.6 million were incurred primarily due to professional fees accrued as a result of the Group's larger portfolio. A revaluation deficit of US$67.0 million in relation to property, plant & equipment (PPE) was incurred during the period, largely due to lower occupancies and average daily rate (ADR) as a result of the COVID-19 pandemic. Neither a revaluation deficit nor surplus was recorded for FY2019.

As a result, the Group recorded a net loss before taxation of US$103.3 million compared with a profit of US$8.9 million during FY2019. Tax credits of US$8.8 million relating primarily to the recognition of deferred tax assets were recorded during the period. Factoring in these tax credits, a net loss after tax of US$94.5 million was recorded as compared with a net profit of US$10.7 million for FY2019.

Accordingly, the Group recorded a loss per stapled security of 16.65 cents for FY2020 versus earnings per stapled security (EPS) of 1.89 cents for FY2019. The Group's financial results for FY2019 and FY2020 are summarised in **Exhibit 1** on the next page.

Exhibit 1: Group's financial results for FY2019 and FY2020

[US$'000]	FY2019 (1)	FY2020	
	Actual	Actual	IPO forecast (2)
Revenue	114,952	78,161	192,176
Operating expenses	(71,860)	(65,464)	(114,367)
Gross operating profit	43,092	12,697	77,809
Hotel management fee	(3,448)	(2,270)	(5,765)
Property taxes	(4,926)	(13,231)	(9,044)
Other expenses	(2,120)	(2,242)	(2,376)
Net property (loss)/income	32,598	(5,046)	60,624
Other income	-	8,812	-
Depreciation & amortisation	(13,694)	(25,582)	(25,128)
REIT Manager's & Trustee-Manager's management fees	(2,512)	-	(4,296)
Trustee-Manager's trustee fee	(77)	(120)	(120)
REIT Trustee's fee	(71)	(116)	(107)
Net finance costs	(5,995)	(11,660)	(10,914)
Other trust expenses	(1,341)	(2,605)	(2,500)
Net (loss)/income before tax and revaluation of PPE	8,908	(36,317)	17,559
Revaluation of PPE	-	(66,979)	-
Net (loss) income before tax	8,908	(103,296)	17,559
Taxation	1,795	8,831	(1,730)
Net (loss)/income after tax	10,703	(94,465)	15,829
Weighted average no. of stapled securities	566,979	567,286	568,729
EPS (cents)	1.89	(16.65)	2.78

(1) Period from listing date of 9 May 2019 to 31 Dec 2019
(2) Based on forecasts disclosed in ARA H-Trust's IPO Prospectus
Source: ARA H-Trust, FPA Financial

Meanwhile, no distributable income was recorded for FY2020 after distributions adjustments. This compared with a US$23.9 million distributable income for FY2019, which was equivalent to a distribution per stapled security (DPS) of 4.21 cents. The Group's statement of distributable income for FY2019 and FY2020 is summarized in **Exhibit 2**.

Exhibit 2: Group's FY2019 and FY2020 statement of distributable income

[US$'000]	FY2019 (1)	FY2020
Net (loss)/income after tax - [A]	10,703	(94,465)
Add/(less): Distribution adjustments		
Depreciation & ammortisation	13,694	25,582
Revaluation of PPE	-	66,979
Amortisation of upfront debt-related costs	84	263
Interest expenses on lease liabilities	-	279
Manager's fees paid/payable in stapled securities	1,256	-
Deferred tax credits	(1,874)	(8,863)
Others (2)	-	10,225
Net distribution adjustments - [B]	13,160	94,465
Distributable income = [A] + [B]	23,863	-
DPU (cents)	4.21	-

(1) Period from listing date of 9 May 2019 to 31 December 2019
(2) Relates to upward adjustment to arrive at NIL distributable income for FY2020
Source: ARA H-Trust, FPA Financial

Capital management

Balance sheet summary

The Group reported total assets of US$736.4 million as at 31 December 2020, as compared with US$758.6 million as at 31 December 2019. The decline in total assets was mainly attributed to a US$22.3 million decrease in cash & cash equivalents to US$29.8 million. At the same time, a decrease in PPE of US$9.6 million, in part owing to PPE movements arising from a revaluation deficit of US$106.7 million on the Group's hotels (which are presented as PPE in the books of ARA H-Trust), also contributed to the drop in total assets. Meanwhile, total liabilities was US$387.2 million as at 31 December 2020, higher compared to US$265.4 million as at 31 December 2019. The increase was mainly due to a rise in loans & borrowings as the Group drew down new loans in FY2020, primarily for the acquisition of the 3 new Marriott hotels. In addition, higher derivative financial liabilities were recorded in relation to US$9.0 million in fair value losses on interest rate swaps entered into by ARA H-REIT for hedging purposes.

As a result, the Group's net assets amounted to US$349.2 million as at 31 December 2020. Based on 567.3 million stapled securities in issue, net asset value (NAV) per stapled security was US$0.62, as compared with US$0.87 as at 31 December 2019. A summary of the Group's balance sheet as at 31 December 2019 and 31 December 2020 is shown in **Exhibit 3**.

Exhibit 3: Summary of Group's balance sheet as 31 Dec 2019 and 31 Dec 2020

[US$'000]	31-Dec-20	31-Dec-19
Total assets	736,405	758,611
Total liabilities	387,229	265,395
Net assets	349,176	493,216
No. of issued stapled securities	567,342	567,342
NAV per share (US$)	0.62	0.87

Source: ARA H-Trust

Financial leverage review

As at 31 December 2020, the carrying amount of the Group's borrowings amounted to US$354.7 million compared with US$243.7 million a year ago. The increase in borrowings was mainly due to facilities drawn down to finance the acquisition of the Marriott portfolio and working capital, as well as the recognition of lease liabilities in relation to the adoption of SFRS(I)16 Leases with effect from 1 January 2020. With reference to **Exhibit 4**, the Group's debt of US$354.7 million comprised US$251.4 million and US$95.0 million in secured and unsecured bank loans respectively, as well as US$8.4 million in lease liabilities, all measured at carrying values which are net of unamortised upfront debt-related cost.

Exhibit 4: Summary of Group's debt as 31 Dec 2019 and 31 Dec 2020

	As at 31 December 2020				As at 31 December 2019			
	Secured US$'000	Unsecured US$'000	Lease liabilities US$'000	Total US$'000	Secured US$'000	Unsecured US$'000	Lease liabilities US$'000	Total US$'000
Amount repayable:								
Within 1 year	-	-	298	298	-	-	-	-
After 1 year	251,795	95,343	8,094	355,232	244,325	-	-	244,325
	251,795	95,343	8,392	355,530	244,325	-	-	244,325
Less: unamortised upfront debt-related costs	(445)	(360)	-	(805)	(586)	-	-	(586)
	251,350	**94,983**	**8,392**	**354,725**	**243,739**	**-**	**-**	**243,739**

Source: ARA H-Trust, FPA Financial

With reference to **Exhibit 5**, the nominal interest rate on the Group's secured loans ranges between 1.64% and 3.35%, while that for unsecured loans would be between 1.00% and 3.36%. The nominal interest rate on the Group's lease liabilities would be 3.28%. We note that the Group does not have any debt repayable during FY2021, except for US$298,000 in current lease liabilities.

Exhibit 5: Details on the Group's debt

				Carrying amount (US$'000)	
	Currency	Nominal interest rate (%)	Year of maturity	2020	2019
Secured bank loans	USD	1.64 - 3.35	2024	251,350	243,739
Unsecured bank loans	USD	1.00 - 3.36	2022 -2024	94,983	-
Lease liabilities	USD	3.28	2023 - 2072	8,392	-
-	-	-	-	354,725	243,739

Source: ARA H-Trust

Based on a total debt of US$354.7 million, the Group's gearing ratio, as measured by total debt over total assets, stood at 48.2% as at 31 December 2020 compared with 32.1% a year ago, as shown in **Exhibit 6**. Meanwhile, average cost of debt was 3.4% per annum in FY2020. As at 31 December 2020, approximately 77% of the Group's borrowings are hedged at fixed rates. Specifically, the Group has entered into interest rate swaps with a notional amount of US$266.3 million to swap floating rate interest on USD loan of US$266.3 million for fixed rate USD interest. As noted on the previous page, the Group had incurred US$9.0 million in fair value loss on interest rate swaps. We note that this has been recognized under the Group's other comprehensive income and taken to its hedging reserves. This recognition did not have a resulting impact on the Group's after-tax profit and per share earnings.

Exhibit 6: Summary of the Group's leverage indicators as 31 Dec 2019 and 31 Dec 2020

[US$'000]	31-Dec-20	31-Dec-19
Total assets	736,405	758,611
Total debt	354,725	243,739
Gearing ratio (%)	48.2%	32.1%
Average cost of debt, p.a (%)	3.4%	3.9%

Source: ARA H-Trust

Given the above, we note that the Group's leverage is relatively high at 48.2%, close to the gearing limit of 50% set by the Monetary Authority of Singapore (MAS) for S-REITs. Currently, the debt headroom stands at approximately US$27 million. The Group highlighted that that the increase in leverage was mainly a result of the decline in portfolio valuation, due in turn to current temporary disruptions in demand amidst the pandemic.

Meanwhile, we note that the Group's lender banks have granted further extension on financial covenant waivers up to June 2021. However, as noted on the previous page, the Group had taken on additional debt to finance its working capital. Further, the Group's cash balance stood at US$26.8 million compared with US$45.2 million a year ago. Thus, we foresee continued liquidity pressure going forward which could result in additional borrowings. Nonetheless, we are confident that the Group will be able to receive further extension on the financial covenant waivers, given that its financial position has largely suffered due to the COVID-19 pandemic. In fact, the Group's hotels are reported to have been generating positive cash flows from operations since July 2020, and we expect Group financial performance to improve with a recovery in the US hotel market (we will discuss the outlook for the US hotel market and travel on pages 8 and 9).

PORTFOLIO PERFORMANCE REVIEW FOR FY2020

During FY2020, the Group's portfolio performance was negatively impacted as its hotels suffered from a significant drop in occupancies and were temporarily closed from March-June 2020. In FY2020, overall portfolio occupancy stood at 41.0% and revenue per available room (RevPAR) was US$42, as shown in **Exhibit 7**. This compared with portfolio occupancy and RevPAR of 77.0% and US$94 respectively during FY2019 (only based on Hyatt portfolio). For FY2020, the Marriot portfolio – comprising 3 hotels – achieved 51.8% occupancy and RevPAR of US$61, outperforming the Hyatt portfolio – comprising 27 Hyatt Place and 11 Hyatt House hotels – with 40.2% occupancy and RevPAR of US$41, as shown in **Exhibit 7**. Management highlighted that the outperformance was partially attributed to the positioning of the Marriot hotels in areas where most full-service hotels were closed.

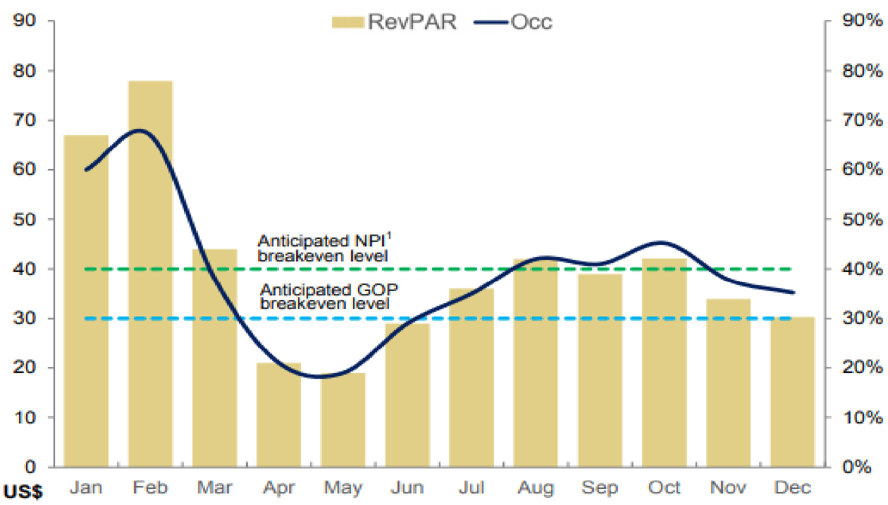
Exhibit 7: Portfolio performance for FY2020

Hotel Brand	1H 2020		2H 2020		FY 2020	
	Occ	RevPAR	Occ	RevPAR	Occ	RevPAR
Hyatt Portfolio	**42.6%**	**US$47**	**38.4%**	**US$36**	**40.2%**	**US$41**
Hyatt Place	42.3%	US$44	36.6%	US$32	39.0%	US$37
Hyatt House	43.2%	US$52	42.3%	US$45	42.7%	US$48
Marriott Portfolio	**52.5%**	**US$71**	**51.3%**	**US$55**	**51.8%**	**US$61**
AC Hotel	55.1%	US$96	39.9%	US$53	45.2%	US$68
Courtyard by Marriott	51.2%	US$64	44.1%	US$39	46.7%	US$48
Residence Inn	51.7%	US$60	69.9%	US$71	61.3%	US$66
ARA H-TRUST	**43.2%**	**US$48**	**39.3%**	**US$37**	**41.0%**	**US$42**

Source: ARA H-Trust

On a monthly performance review, portfolio occupancy and RevPAR were relatively strong in the first two months before bottoming at about 20% and US$20 respectively in end-April, as shown in **Exhibit 8**. From June onwards, portfolio performance rebounded as most hotels resumed operations and demand gradually recovered, achieving RevPAR of approximately US$40 and occupancy above 40% in October. In the last two months of 2020, however, performance moderated in part due to weaker demand during the colder season.

Exhibit 8: Monthly portfolio RevPAR & occupancy for FY2020



Source: ARA H-Trust

INDUSTRY OVERVIEW

Here, we will discuss the outlook of the Group's portfolio performance. To do so, we will consider the outlook of the US economy and hotel market.

US economic outlook

In the US, recent economic indicators suggest that the economic recovery is ongoing despite having slowed. Nonetheless, the US government recently approved a new US$1.9 trillion stimulus package to provide additional support to the economy. Together with progressive vaccine distribution, this would provide further impetus to the economic recovery. In January 2021, the International Monetary Fund (IMF) upgraded its GDP forecast for the US to 5.1% from 3.1% previously. Barring a virus resurgence, the US economy is expected to rebound strongly in 2021.

US hotel market outlook

Owing to the COVID-19 pandemic, key performance indicators for the US hotel market weakened significantly in 2020. Compared to a year ago, occupancy and average daily rate (ADR) for the US hotel market fell by 36.6% and 21.3% in 2020, according to STR & Tourism Economics (TE). As a result, US hotel RevPAR dropped sharply by 50.1%.

On the outlook, latest forecasts by STR & TE suggest that the US hotel market is expected to rebound in 2021. On a year-on-year (y-o-y) basis, hotel occupancy and ADR are expected to increase by 16.6% and 4.3% respectively in 2021. Thus, hotel RevPAR is projected to recover by 21.6% y-o-y. For 2022, STR & TE expect a stronger recovery with hotel occupancy, ADR and RevPAR to increase by 24.1%, 8.2% and 34.2% respectively from a year ago. The latest STR & TE data of key performance indicators for the US hotel market are summarized in **Exhibit 9**.

Exhibit 9: Key performance indicators for the US hotel market (% change vs prior year)

Outlook			
Metric	2020 Actual	2021 Forecast	2022 Forecast
Supply	-3.6%	+5.4%	+2.4%
Supply (Total Room Inventory) *	+1.4%	+1.2%	+0.9%
Demand	-35.7%	+18.0%	+25.2%
Occupancy *	-36.6%	+16.6%	+24.1%
ADR	-21.3%	+4.3%	+8.2%
RevPAR *	-50.1%	+21.6%	+34.2%

**Reflects Total-Room-Inventory (TRI) methodology, which assumes no temporary hotel closures*
Source: STR

STR & TE highlighted that full recovery of hotel demand remains on track for 2023, though a full recovery in RevPAR could only come in 2024. STR & TE expect a strong rebound in travel activity to occur in the second half of 2020. Appetite for travel is anticipated to drive the recovery once virus-related conditions improve. Early indicators of a pick-up in hotel demand should be visible in Q2 2021, while leisure travel should rebound strongly in Q3 and corporate & group business show more progressive improvement.

Meanwhile, we note that a September 2020 survey by the World Travel & Tourism Council and Travel Leaders Group showed that 99% of US and Canadian travelers are eager to travel again, with 70% stating that they plan to take a holiday in 2021. Travel Leader's Group highlighted that the strong numbers indicate that leisure travelers will lead the recovery as concerns about COVID-19 are addressed.

Similarly, a January 2021 report by the American Hotel & Lodging Association (AHLA) reported that leisure travel is expected to return first, with consumers optimistic about national distribution of a vaccine and their ability to travel again this year. According to AHLA, 56% of Americans are likely to travel for leisure or vacation in 2021, roughly the same amount as in an average year. At the same time, business travel—which comprises the largest source of hotel revenue—remains nearly nonexistent, though it is expected to begin its slow return in the second half of 2021. However, with continued restrictions and consumer unease, AHLA highlighted that demand for business travel is not projected to return to 2019 levels until 2023.

SHARE PRICE PERFORMANCE REVIEW

Since our last company update on 29 August 2020, we note that ARA H-Trust's share price has rebounded strongly. While the share price has fluctuated, it recently reached US$0.555 which is above the target price of US$0.493 in our last company update. We believe the share price recovery has been driven by an improving outlook for the US economy, and in turn the hotel market. To a large extent, economic conditions have improved greatly due to vaccine distribution and stimulus support from the US government and Federal Reserve. As a result of vaccine rollouts, infection numbers in the US have come down and the overall virus situation is now in better control, which has in turn provided Americans with greater confidence of travelling again.

Meanwhile, in terms of shareholdings, we note that the current largest shareholder of ARA H-Trust is Mr Lim Hwee Chiang. He is the co-founder and deputy chairman of ARA Asset Management Limited, the parent company of ARA Real Estate Investors 23 Pte Ltd which is in turn the Sponsor of ARA H-Trust.

As at 10 March 2020, Mr Lim held a total deemed interest of 7.40% in ARA H-Trust. This had comprised a deemed interest in the 7.31% stake held by Citibank Nominees Singapore Pte Limited and a 0.088% stake held by JL Philanthropy Ltd. In June 2020, Mr Lim had acquired shares in ARA Asset Management Holdings (ARA Holdings) which since resulted in his deemed interest in all 54,121,914 stapled securities, representing a 9.54% stake, which ARA Holdings is deemed interested in. Accordingly, Mr Lim's total stake in ARA H-Trust increased to 16.94%, which remains accurate as at 16 March 2021.

Other notable shareholders include Dr Tan Kheng Lian and Mr Gordon Tang & his spouse, who respectively hold a 9.99% and 9.54% stake in ARA H-Trust. The former is the daughter of the late Dr Tan Chin Tuan and Chairman of the Tan Chin Tuan Foundation. The latter is a Singaporean billionaire who owns a controlling stake in Singapore-listed property developer SingHaiyi together with his wife who runs the company.

As of late, we note that there has not been any transaction of stapled securities executed by these major shareholders.

FINANCIAL PROJECTIONS

In this section, we will provide our projections for Group revenue, earnings and dividends for the financial year ending 31 December 2021 (FY2021) and 31 December 2022 (FY2022).

(I) Revenue projection

The Group's total revenue mainly comprises room revenue which includes payments for the rental of guestrooms, including charges for cancellation and guaranteed no show at its hotel properties. This component made up 93.5% of total revenue in FY2020 compared with 95.2% in FY2019, as shown in **Exhibit 10**. While the Group had scaled back on services like F&B, other operating revenue, which comprises F&B sales and revenue relating to ancillary operations such as meeting space rental, sundry sales and guest laundry, contributed 6.5% of total revenue in FY2020 compared with 4.8% in FY2019.

Exhibit 10: Breakdown of the Group's revenue for FY2019 and FY2020

	FY2019*		FY2020	
Component	**US$'000**	**% of total**	**US$'000**	**% of total**
Room revenue	109,450	95.2%	73,045	93.5%
Other operating revenue	5,502	4.8%	5,116	6.5%
Total revenue	114,952	100.0%	78,161	100.0%

**Listing date of 9 May 2019 to 31 Dec 2019*

Source: ARA H-Trust

Given the above, we will now estimate room revenue and other operating revenue for FY2021 and FY2022.

Projected room revenue for FY2021 and FY2022

In FY2020, the Group's overall portfolio, comprising 5,340 rooms across 41 hotels, achieved RevPAR of US$42 compared with US$94 in FY2019, as shown in **Exhibit 11**.

Exhibit 11: Breakdown of Group's actual portfolio performance for FY2019 and FY2020

	Total rooms		Room weighting		RevPAR (US$)		Weighted portfolio RevPAR (US$)	
Hotel brand	**FY2019**	**FY2020**	**FY2019**	**FY2020**	**FY2019 (1)**	**FY2020**	**FY2019**	**FY2020**
Hyatt House	1,526	1,526	30.8%	28.6%	113	48	35	14
Hyatt Place	3,424	3,424	69.2%	64.1%	85	37	59	24
AC by Marriot	-	135	-	2.5%	140	68	-	2
Courtyard by Marriot	-	124	-	2.3%	104	48	-	1
Residence Inn by Marriot	-	131	-	2.5%	100	66	-	2
Overall portfolio	**4,950**	**5,340**	**100.0%**	**100.0%**	**-**	**-**	**94**	**42**

(1) Based on period from listing date to 31 Dec 19 for Hyatt-brand hotels and year-end results for Marriot-brand hotels
Source: ARA H-Trust, FPA Financial

For FY2021, we see the potential for the Group's portfolio to achieve stronger RevPAR performance in tandem with a recovery in the broader hotel market. In 2021, the US hotel market is expected to rebound as improved economic and virus-related conditions provide people with greater confidence to travel. To a large extent, leisure travel demand in the US is expected to drive the recovery in 2021, given Americans' strong desire to travel. The Group sees leisure demand returning before summer 2021 followed by the re-emergence of corporate transient travel. Meetings, incentives, conferencing & exhibitions (MICE) and group travel is anticipated to resume in late 2021.

Given the overall outlook of the US hotel market, there are several reasons to believe that the Group's portfolio is well-positioned to recover. First, the Group's portfolio derives demand from leisure travel, corporate travel and group travel in the proportion of 40%, 40-45% and 15% respectively. This suggests that its hotels are in a good position to capture the return of leisure travel demand which is expected to lead the demand recovery. Second, the Group's portfolio is predominantly catered to the US domestic market, which provides insulation from weak international travel owing to continued border control measures. Last, the select-service nature of the Group's hotels provide it with cost-efficiency as compared to full-service hotels. Further, we note from the Group that limited and select-service hotels continue to lead in recovery as compared to full-service hotels.

Against the above backdrop, we would assume a y-o-y RevPAR growth of 21.6% and 34.2% for the Group's portfolio in FY2021 and FY2022 respectively, as proxied by RevPAR forecasts from STR & TE which have been discussed on page 8. At the same time, we would also assume that the Group does not acquire any new hotel properties during FY2021 and FY2022. Consequently, the projected RevPAR for the overall portfolio in FY2021 and FY2022 would be US$51 and US$68 respectively, as shown in **Exhibit 12**.

Exhibit 12: Projected portfolio RevPAR for FY2021 and FY2022

	Total rooms		Room weighting		RevPAR (US$)		Weighted portfolio RevPAR (US$)	
Hotel brand	**FY2021**	**FY2022**	**FY2021**	**FY2022**	**FY2021**	**FY2022**	**FY2021**	**FY2022**
Hyatt House	1,526	1,526	28.6%	28.6%	58	78	17	22
Hyatt Place	3,424	3,424	64.1%	64.1%	45	60	29	39
AC by Marriot	135	135	2.5%	2.5%	83	111	2	3
Courtyard by Marriot	124	124	2.3%	2.3%	58	78	1	2
Residence Inn by Marriot	131	131	2.5%	2.5%	80	108	2	3
Overall portfolio	**5,340**	**5,340**	**100.0%**	**100.0%**	**-**	**-**	**51**	**68**

Source: FPA Financial

Based on the above projected RevPAR figures, the estimated room revenue generated by the Group's portfolio in FY2021 and FY2022 would be US$99.3 million and US$133.3 million, as shown in **Exhibit 13**. These projections are derived based on the assumption that all hotel rooms remain operational throughout FY2021 and FY2022.

Exhibit 13: Projected room revenue for FY2021 and FY2022

Period	Total rooms	Portfolio RevPAR (US$)	No. of days	Room revenue (US$'000)
FY2021	5,340	51	365	99,293
FY2022	5,340	68	365	133,252

Source: FPA Financial

Projected other operating revenue for FY2021 and FY2022

As noted in **Exhibit 10** on page 11, other operating revenue contributed 6.5% of total revenue in FY2020. For FY2021 and FY2022, we would assume other operating revenue to make up the same proportion of total revenue in FY2020 at 6.5%. Accordingly, room revenue would make up the remaining 93.5% during these periods.

Projected total revenue for FY2021 and FY2022

Given the above projections for room revenue and other operating revenue, we would estimate total revenue for FY2021 and FY2022 to be US$106.2 million and US$142.6 million, as shown in **Exhibit 14**.

Exhibit 14: Projected total revenue for FY2021 and FY2022

	FY2021 forecast		FY2022 forecast	
Component	**US$'000**	**% of total**	**US$'000**	**% of total**
Room revenue	99,293	93.5%	133,252	93.5%
Other operating revenue	6,954	6.5%	9,333	6.5%
Total revenue	106,248	100.0%	142,584	100.0%

Source: FPA Financial

(II) Earnings projection

Given our projected total revenue for FY2021 and FY2022, we will now estimate the Group's earnings for these periods.

Gross operating profit

To estimate gross operating profit, we will consider the Group's gross operating profit (GOP) margin which measures the operational profitability of the Group's portfolio. With reference to **Exhibit 15**, we note that FY2020 GOP margin stood at 16.2% compared with 37.5% for FY2019, reflecting the severe impact of the COVID-19 pandemic on hotel profitability.

Exhibit 15: Group's GOP margin for FY2019 and FY2020

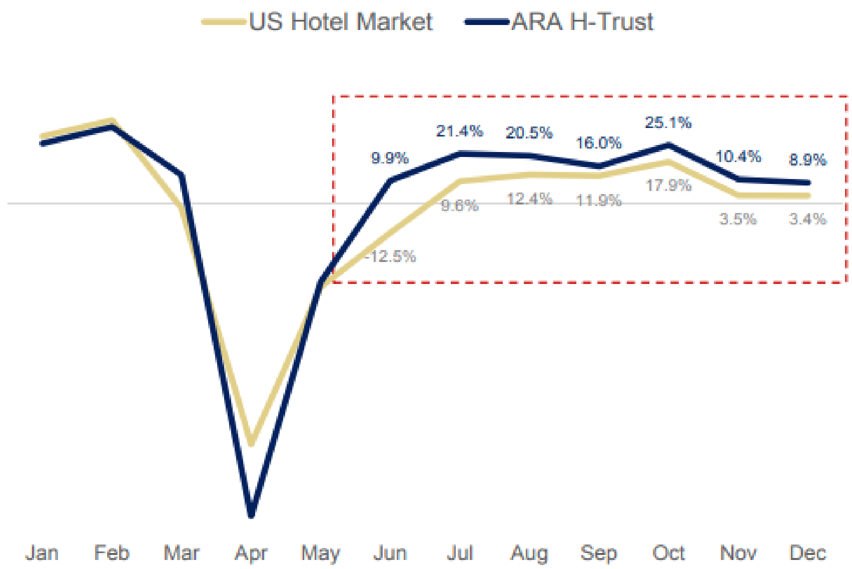
[US$'000]	FY2019 (1)	1H FY2020	2H FY2020	FY2020
Gross revenue	114,952	39,345	38,816	78,161
Gross operating profit	43,092	5,841	6,856	12,697
GOP margin (%)	37.5%	14.8%	17.7%	16.2%

(1) From listing date of 9 May 2019 to 31 Dec 2019

Source: ARA H-Trust

Nonetheless, the Group had implemented cost containment measures during the early onslaught of the pandemic to manage operational efficiency. For instance, F&B offerings and housekeeping services were scaled down as part of the Group's efforts to refine the operating model of its hotels. In addition, the Group streamlined labour management by adopting a leaner staffing model of 14 full-time employees per hotel compared to 21 previously. Thus, the Group achieved a higher GOP margin of 17.7% during 2H FY2020 compared with 14.8% in 1H FY2020, despite lower gross revenue during the former period. Comparatively, the Group's GOP margin outperformed the US hotel market since June 2020, as shown in **Exhibit 16**.

Exhibit 16: 2020 US hotel market & ARA H-Trust GOP margins



Source: ARA H-Trust

Looking ahead, STR highlighted that profit efficiencies like 'grab and go' F&B and less frequent room cleaning are expected to carry over when recovery in the US hotel market kicks into a higher gear, adding to substantial improvement in profit margins.

Considering the above, we would assume GOP margin for 1H FY2021 to be closely in line with 2H FY2020 at 17.7%, and further improve to 20% in 2H FY2021. For overall FY2021, we would then assume GOP margin to be the average of 1H FY2021 and 2H FY2021 at about 18.9%. Factoring a stronger hotel market recovery during FY2022, we would assume a GOP margin of 23% for the period.

Accordingly, we would we would estimate a gross operating profit of US$20.1 million and US$32.8 million for FY2021 and FY2022 respectively, as shown in **Exhibit 17**.

Exhibit 17: Projected gross operating profit for FY2021 and FY2022

[US$'000]	FY2021 forecast	FY2022 forecast
Gross revenue	106,248	142,584
Less: operating expenses	(86,167)	(109,790)
Gross operating profit	20,081	32,794
GOP margin (%)	18.9%	23.0%

Source: FPA Financial

Hotel management fee

Hotel management fee is computed based on 3% of the Group's total revenue. Based on a projected total revenue of US$106.2 million and US$142.6 million for FY2021 and FY2022, the estimated hotel management fee for the respective periods would be US$3.2 million and US$4.3 million.

Property taxes

As noted on page 3, the Group incurred property taxes of US$13.2 million during FY2020 mainly due to the addition of the 3 Marriot hotels and timing of receipt of notices from various US counties. For FY2021 and FY2022, we would assume the same amount of property taxes of US$13.2 million as incurred in FY2020.

Other expenses

Other expenses primarily comprise insurance expenses such as property insurance and lease rental expenses which include ground lease expenses and common area maintenance fees. As noted on page 3, the Group incurred other expenses of US$2.2 million in FY2020, closely in line with US$2.1 million for FY2019. For FY2021 and FY2022, we would assume the same other expenses of US$2.2 million as incurred in FY2020.

Other income

As noted on page 3, the Group recorded other income of US$8.8 million primarily comprising government grant income recognized in profit or loss during FY2020. Given the US government's recent approval of an additional US$1.9 trillion stimulus package, there would be continued support for the hardest hit sectors like hospitality and tourism in the US. Nonetheless, we would assume no other income for FY2021 and FY2022.

Depreciation & amortization

With reference to **Exhibit 18**, the Group recorded depreciation & amortization of US$25.6 million compared with US$13.7 million during FY2019 due to an enlarged portfolio

Exhibit 18: Breakdown of depreciation & amortization for FY2019 and FY2020

	At valuation		At cost				
[US$'000]	Freehold land	Buildings	Leasehold land	Motor vehicles	Furniture, fixtures & equipment	Capital work in progress	Total
For FY2019:							
Depreciation	-	10,664	-	-	3030	-	13,694
For FY2020:							
Depreciation	-	18,249	267	127	6915	-	25,558

Source: ARA H-Trust

We would assume the same amount of depreciation & amortization of US$25.6 million in FY2020 for FY2021 and FY2022.

Trustee-Manager's trustee fee and REIT Trustee's fee

Trustee-Manager's trustee fee is based on 0.02% per annum of the ARA H-BT Trust Property excluding intergroup balance, subject to a minimum fee of US$10,000 per month. As noted in **Exhibit 1** on page 4, the Group incurred US$120,000 in Trustee-Manager's trustee fee for FY2020. This would suggest that the minimum fee of US$10,000 per month was paid. Accordingly, we would assume US$120,000 in Trustee-Manager's trustee fee to be incurred during FY2021 and FY2022. Similarly, we would assume the same REIT Trustee's fee of US$116,000 incurred during FY2020 for FY2021 and FY2022.

Net finance costs

During FY2020, the Group incurred net finance costs of US$11.7 million as finance costs of US$11.8 million more than offset finance income of US$0.1 million, as shown in **Exhibit 19**.

Exhibit 19: Group net finance (costs)/income for FY2019 and FY2020

[US$'000]	FY2019 (1)	FY2020
Finance income		
Interest income from deposit accounts	382	114
Finance costs (at amortised cost)		
Amortisation of debt transaction costs	(84)	(263)
Interest expenses on lease liabilities	-	(279)
Interest paid/payable to banks	(6,293)	(11,232)
	(6,377)	(11,774)
Net finance costs	**(5,995)**	**(11,660)**

(1) From listing date of 9 May 2019 to 31 Dec 2019
Source: ARA H-Trust

Based on interest expense on bank loans of US$11.2 million, the effective interest rate would be about 3.24% = [US$11.2 million in interest expense on bank loans / US$346.3 million in bank borrowings] for FY2020. Currently, interest rates have been rising due to inflationary expectations induced by an improved growth outlook. Thus, we would assume a higher effective interest rate of 3.50% for FY2021. With reference to **Exhibit 4 and 5** on pages 5 and 6 respectively, we note that the Group does not have bank loans which are repayable in FY2021. Accordingly, the projected total interest expense on banks loans for the period would be US$12.1 million = [3.50% x US$346.3 million in bank borrowings], assuming no debt repayment. We would further adopt this figure for FY2022, assuming the Group also does not make any repayment on bank loans during the period.

Meanwhile, we noted on page 6 that the interest rate on the Group's lease liabilities of US$8.4 million would be 3.28%. Further, we also note in **Exhibit 4** on page 5 that the Group has US$298,000 in current lease liabilities which are repayable during FY2021. We will assume that repayment for these lease liabilities would be made during the period. Accordingly, interest expense on lease liabilities for FY2021 would be US$265,483 = [3.28% x US$8.1 million in lease liabilities after repayment of US$0.3 million due within FY2021]. We would further adopt this figure for FY2022, assuming the Group does not make repayment of any lease liabilities during the period. Lastly, we would assume the same amount of finance income and amortisation of debt transaction costs in FY2020 for FY2021 and FY2022.

Given the above, projected net finance costs for FY2021 and FY2022 would be US$12.5 million, as shown in **Exhibit 20**.

Exhibit 20: Projected net finance (costs)/income for FY2021 and FY2022

[US$'000]	FY2021 forecast	FY2022 forecast
Finance income		
Interest income from deposit accounts	114	114
Finance costs		
Amortisation of debt transaction costs	(263)	(263)
Interest expenses on lease liabilities	(265)	(265)
Interest paid/payable to banks	(12,122)	(12,122)
	(12,650)	(12,650)
Net finance costs	**(12,536)**	**(12,536)**

Source: FPA Financial

Other trust expenses

As noted on page 3, the Group incurred higher other trust expenses of US$2.6 million during FY2020, primarily due to professional fees accrued as a result of the Group's larger portfolio. For FY2021 and FY2022, we would assume the same amount of other trust expenses as incurred in FY2020.

Revaluation of PPE

As noted on page 3, the Group incurred a revaluation deficit of US$67.0 million in relation to property, plant & equipment (PPE) during FY2020. During FY2019, no revaluation deficit or surplus was incurred. For FY2021 and FY2022, we would assume no revaluation deficit or surplus.

Taxation

As noted on page 3, the Group recorded tax credits of US$8.8 million relating primarily to the recognition of deferred tax assets. While there could be tax credits recorded during FY2021 and FY2022, we would assume zero taxation for these periods.

REIT Manager's and Trustee-Manager's management fees

REIT Manager's and Trustee-Manager's management fees are based on 10% of the Group's distributable income before accounting for these management fees. Given the above projected income statement items, the projected distributable income, before accounting for REIT Manager's and Trustee-Manager's management fees, would be zero. Accordingly, there would be no management fees paid/payable to the Managers for these periods.

Net(loss)/income after tax

Given the above projections, we would estimate a net loss after tax of US$39.5 million and US$27.9 million for FY2021 and FY2022. Accordingly, a loss per share of 6.97 cents and 4.92 cents would be recorded for these periods. We have summarized our earnings projection for FY2021 and FY2022 in **Exhibit 21**.

Exhibit 21: Projected net (loss)/income after tax for FY2021 and FY2022

[US$'000]	FY2021 Forecast	FY2022 Forecast
Revenue	106,248	142,584
Operating expenses	(86,167)	(109,790)
Gross operating profit	20,081	32,794
Hotel management fee	(3,187)	(4,278)
Property taxes	(13,231)	(13,231)
Other expenses	(2,242)	(2,242)
Net property (loss)/income	1,420	13,044
Other income	-	-
Depreciation & amortisation	(25,582)	(25,582)
REIT Manager's & Trustee-Manager's management fees	-	-
Trustee-Manager's trustee fee	(120)	(120)
REIT Trustee's fee	(116)	(116)
Net finance costs	(12,536)	(12,536)
Other trust expenses	(2,605)	(2,605)
Net (loss)/income before tax and revaluation of PPE	(39,539)	(27,915)
Revaluation of PPE	-	-
Net (loss) income before tax	(39,539)	(27,915)
Taxation	-	-
Net (loss)/income after tax	(39,539)	(27,915)
Weighted average no. of stapled securities	567,286	567,286
EPS (cents)	(6.97)	(4.92)

Source: FPA Financial

(III) Dividends projection

With our projected figures for net(loss)/income after tax, we would now estimate the Group's distributable income. Following distribution adjustments as shown in **Exhibit 22**, we estimate no distributable income for FY2021 and FY2022.

Exhibit 22: Projected distributable income for FY2021 and FY2022

[US$'000]	FY2021 forecast	FY2022 forecast
Net (loss)/income after tax - [A]	(39,539)	(27,915)
Add/(less): Distribution adjustments		
Depreciation & ammortisation	25,582	25,582
Revaluation of PPE	-	-
Amortisation of upfront debt-related costs	263	263
Interest expenses on lease liabilities	265	265
Manager's fees paid/payable in stapled securities	-	-
Deferred tax credits	-	-
Others (1)	13,429	1,805
Net distribution adjustments - [B]	39,539	27,915
Distributable income = [A]+ [B]	-	-
DPU (cents)	-	-

(1) Relates to upward adjustment to arrive at NIL distributable income

Source: FPA Financial

VALUATION ANALYSIS

In our last company update, we derived an estimated target price of US$0.493 for ARA H-Trust based on a relative valuation approach. We now perform an updated peer comparison analysis to account for the changes in the financial position of the Group and ARA H-Trust's peer companies. **Exhibit 23** summarises the data for the updated peer comparison analysis.

Exhibit 23: Updated peer comparison

Company	SGX code	Price (US$) as at 5 Apr 21	Market cap (US$ million)	EPS [1] (Cents)	P/E (x)	DPS [2] (Cents)	Dividend yield (%)	NAV [3] (US$)	P/B (x)
ARA US Hospitality Trust	XZL	0.525	297.85	(16.65)	n/m	-	-	0.62	0.85
Peer companies:									
Apple Hospitality REIT [4]	APLE	14.900	3,325.98	(0.78)	n/m	0.30	2.01	13.57	1.10
CDL Hospitality Trusts [5]	J85	1.280	1,569.91	(15.41)	n/m	4.95	3.87	1.32	0.97
Frasers Hospitality Trust [5] [6]	ACV	0.555	1,068.97	(6.12)	n/m	1.40	2.52	0.65	0.85
Far East Hospitality Trust [5]	Q5T	0.645	1,268.64	(4.78)	n/m	2.41	3.74	0.79	0.81
Peer average	**-**	**-**	**-**	**-**	**-**	**-**	**3.03**	**-**	**0.93**

Figures have been rounded. Companies are Singapore-listed, unless otherwise specified.
(1) 12-month trailing diluted EPS based on latest financial statements
(2) Based on 12-month trailing dividends
(3) As at 31 Dec 20, unless otherwise specified. On a per share/stapled securities basis.
(4) Listed on the New York Stock Exchange. DPS based on total dividends paid in 2020.
(5) Company reports in SGD currency
(6) NAV as at 30.09.20
Source: Respective company data, FPA Financial

Based on the results in **Exhibit 23** above, we note that ARA H-Trust's is currently trading at a P/B multiple of 0.85x which is lower than the peer average P/B of 0.93x, which may suggest that it is undervalued at the current share price of US$0.525. Adopting a relative valuation approach, we estimate a target price of US$0.577 if ARA H-Trust were to trade at the peer average P/B multiple of 0.93x as follows:

- Estimated target price = [peer average P/B] x [latest reported NAV] = 0.93 x US$0.62 = US$0.577

This estimated target price is an upgrade from our previous target price of US$0.493 and represents an upside of about 10% from the current price of US$0.525.

INVESTMENT RECOMMENDATION

Since our last company update on 29 August 2020, we note that ARA H-Trust's share price has rebounded strongly. While the share price has fluctuated, it recently reached a closing of US$0.555 which is above our target price of US$0.493 in our last company update.

On valuation terms, our peer comparison analysis shows that ARA H-Trust's current P/B ratio of 0.85x is lower than the peer average P/B of 0.93x. This could suggest that ARA H-Trust is potentially undervalued at the current share price of US$0.525. Adopting a relative valuation approach, we estimate a target price of US$0.577 if ARA H-Trust were to trade at the peer average P/B multiple of 0.93x. This current target price represents an upgrade from our previous target price of US$0.493 in our last company update.

Meanwhile, we note that the US hotel market is expected to rebound in 2021 with the re-emergence of leisure travel demand. At the same time, business travel is travel is expected to begin a slow return in the second half of 2021. The Group's portfolio is well-positioned to benefit from the recovery and we anticipate portfolio performance to improve going forward. Nonetheless, a full recovery in travel could take a few years and this could weigh on the recovery of the Group's portfolio performance.

Given the above, we will now issue a neutral recommendation on ARA H-Trust and our current target price is US$0.577. However, there are risks to our target price which we will highlight in the Risk section on the next page.

RISKS TO THE UPSIDE IN TARGET PRICE

We will highlight below risk factors that could limit the upside in our target price for ARA H-Trust.

Global economic slowdown due to continuation of control measures

With the progressive rollout of vaccines globally, the growth outlook for the global economy has improved. According to the International Monetary Fund (IMF), the global economy is projected to grow 5.5% in 2021 after contracting by 3.5% in 2020.

However, the global growth outlook is still largely dependent on the how effectively vaccines are being distributed. The pace of distribution is likely to vary across different countries and thus the recovery could be uneven. As it stands, COVID-19 health concerns remain elevated as new coronavirus strains are discovered in parts of the world like Europe and the Middle East. Thus, there is a possibility that control measures could remain in place for a prolonged period and limit international travel. Further, extended border control measures could also hinder the global economic recovery. This could limit the Group's earnings growth potential going forward.

Risk of weak US economic recovery

As noted on page 8, the US economy is expected to rebound strongly in 2021 on the back of additional stimulus and vaccine rollouts. Still, the economic outlook is susceptible to potential virus resurgence, and in turn renewed lockdowns. In addition, there could be a risk of delayed fiscal support despite the passing of the US$1.9 trillion package. As it stands, there is ongoing weakness in parts of the US economy, especially in the labour market. While unemployment has declined, many Americans are still unemployed as reflected by high unemployment claims as compared to pre-COVID times. While stimulus aid could boost consumption, this would also depend on the efficiency of stimulus distributions and how effectively they are allocated to different communities.

Concerns over the Group's debt situation

As noted on page 6, the Group's current leverage of 48.2% is relatively close to breaching the gearing limit of 50% set by the MAS. However, in view of potential liquidity pressure, the Group may have to take up additional debt in order to finance its working capital. While we do believe that the Group is likely able to receive further extension on financial covenant waivers, it could still depend on how the Group's financial position evolves over the coming months. To a large extent, this will be determined by the pace of recovery in the US hotel market, which is susceptible to negative turnarounds in COVID-19 developments and the state of travel.

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