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Research Update:

Singapore-Based Frasers Logistics & Commercial Trust Assigned 'BBB+' Rating With Stable Outlook

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Rating Action Overview

- Frasers Logistics & Commercial Trust (FLCT) should deliver resilient operating performance and cash flow over the next 24 months, underpinned by its portfolio of high-quality and geographically diversified logistics and industrial (L&I) as well as commercial assets.
- We expect the Singapore-based REIT to continue its partially debt-funded acquisitions, while exercising financial discipline, as it has done in the past.
- On April 15, 2021, S&P Global Ratings assigned its 'BBB+' long-term issuer credit rating to FLCT.
- The stable outlook reflects our view that FLCT will maintain highly predictable cash flows and good asset quality over the next 12-24 months. We also expect the REIT to maintain a prudent approach to growth, with acquisitions funded with a mix of debt and equity.

Rating Action Rationale

In our view, FLCT's earnings will remain resilient due to good portfolio diversification across asset classes and geographies. The REIT's exposure to both L&I and commercial asset classes provides some earnings stability across market cycles. FLCT maintained a resilient portfolio occupancy rate of 97.2% (as of Dec. 31, 2020), despite the lingering effects of the COVID-19 pandemic. This occupancy rate is among the highest of similarly rated peers, and was supported by the steadfast performance of the L&I portfolio. We expect the L&I portfolio to account for 55%-60% of the REIT's total revenue through fiscal 2023 (year ending Sept. 30, 2023).

As economies recover at different paces from the pandemic, we expect FLCT's geographical diversification to lend stability to earnings. The REIT has meaningful exposure in Asia (Singapore, accounting for 20.1% of asset value as of Dec. 31, 2020), the Pacific (Australia, 47.0%), and Europe (Germany, 21.2%; the U.K., 7.0%; the Netherlands, 4.7%).

FLCT's lease structures will continue to support its high earnings predictability. More than 70% of the REIT's revenue stems from leases with annual rent escalations that are either fixed or pegged to consumer price index (CPI). The Australian leases, accounting for 50%-55% of revenue, have fixed annual rental escalations--the L&I leases have fixed escalations averaging 3.1% while the commercial leases have fixed escalations of 2.75%-4%. About 95.5% of the European L&I leases, accounting for about 20% of revenue, also have either CPI-linked indexation or fixed escalations.

We believe FLCT will preserve its solid portfolio and earnings quality, underpinned by management's strong expertise and leasing capabilities. The portfolio assets are well-located, with the L&I portfolio having a young average age. This strength bolsters FLCT's operating metrics and highlights its successful portfolio management. The REIT's L&I assets are in close proximity to major transportation infrastructure, while its commercial assets are in business districts and commercial hubs of major cities. The average age of FLCT's L&I portfolio is 8.2 years as of Sept. 30, 2020, lower than the average for peers. The young assets should help reduce maintenance capital expenditure (capex) and downtime. These have translated into high overall portfolio occupancy and an above-average tenant retention rate of 88.7% for fiscal 2020.

FLCT's asset enhancement initiatives and divestments should enhance its competitive advantage. For example, the REIT's rejuvenation of Alexandra Technopark (completed in January 2019) in Singapore improved the property's occupancy to 97.2% as of Dec. 31, 2020, from about 70% after the loss of a key tenant in late 2017. FLCT has also made calculated divestments to better position its portfolio, such as pruning of older assets and those in South Australia, a region that is not one of the REIT's core markets.

In our view, the management's proactive leasing strategy will allow it to maintain its strong operating metrics. Management actively engages existing tenants on renewals 12-18 months ahead of lease maturities. This proactive strategy should allow sufficient time to seek out new tenants if renewals are not expected, reducing potential earnings volatility.

In our view, FLCT will continue to benefit from its sponsor Frasers Property Ltd.'s (FPL) asset pipeline to grow its portfolio with high-quality assets. FPL has more than Singapore dollar (S$) 5 billion worth of assets that FLCT has the right of first refusal on. In our opinion, the asset pipeline is aligned with FLCT's expertise--76.2% (by lettable area) of the pipeline is from the L&I sector, as of Dec. 31, 2020. About 90% (by lettable area) of the pipeline assets are in Australia and Europe, key operating markets of FLCT. We believe the sponsor's 22.5% stake in the REIT provides good alignment of interests between the two parties.

FLCT's modest scale and weaker market positioning in Australia and Europe temper its credit strengths. The REIT's portfolio value of S$6.3 billion (as of Dec. 31, 2020), is only 30%-35% that of peers Capitaland Integrated Commercial Trust and Prologis European Logistics Fund. FLCT's market presence is also less prominent in Australia and Europe, as compared to the property funds under Logicor Inc., Goodman Group, and Prologis Inc. We believe that a larger scale and stronger market presence could bring about benefits of economies of scale and flexibility to rotate tenants across assets in the same geography.

Subdued leasing conditions are likely in the office space owing to work-from-home arrangements. We believe negative sentiment and uncertainties in the office segment will persist as organizations review the need for large, physical office spaces. While occupancy for FLCT's commercial portfolio remained good at 93.6% as of Dec. 31, 2020, it weakened for almost all commercial assets as compared to Dec. 31, 2019. The Caroline Chisholm Centre in Australia was the only exception with full occupancy on both dates.

To some extent, FLCT's long and well-staggered lease maturity profile, with a weighted average lease expiry of 4.8 years as of Dec. 31, 2020, will shield it from these weaker leasing conditions for commercial leases. The REIT has a low proportion (8.1% of gross rental income [GRI]) of commercial leases maturing over the next 18 months to Sept. 30, 2022. This helps reduce FLCT's exposure to weaker leasing conditions. We expect occupancies to weaken further in fiscal 2021, and most renewals to have negative rental reversions (or reduction in rents) through fiscal 2022, before recovering in fiscal 2023.

We believe FLCT's L&I portfolio will continue to benefit from the acceleration of e-commerce. A significant 24% of the REIT's overall tenant base (based on GRI for December 2020), or an estimated 42% of the L&I tenant base, was from the third-party logistics and distribution sector. This segment will continue to benefit from the increasing adoption of e-commerce. FLCT's L&I portfolio therefore had a solid 100% occupancy rate as of Dec. 31, 2020; we expect occupancies to remain strong at over 98% over the next 24 months.

FLCT's rental collections should improve as some of its operating markets, particularly Singapore and Australia, are showing signs of recovery from the pandemic. Slower collections amid the pandemic, particularly in the commercial portfolio, led to higher-than-usual trade receivables for the REIT as of Sept. 30, 2020. Of the total trade receivables of S$10.4 million, 71% was past due and a significant 25% was past due for more than 90 days. In our view, FLCT may provide further rental concessions to retail tenants in its commercial portfolio to help them recover. Nevertheless, the financial impact is likely to be minimal because retail tenants contribute to only 2.4% of FLCT's GRI.

We expect FLCT to continue its partially debt-funded acquisitions, which may lead to temporary deviation in its credit metrics. The REIT has a record of growing through acquisitions; it made S$4.5 billion worth of acquisitions since its IPO in June 2016, which have more than tripled its portfolio value. FLCT's financial headroom could evaporate if it undertakes annual acquisitions of more than S$600 million, assuming these acquisitions are 50% funded by debt. In the past, FLCT's acquisitions have been 40%-60% funded by debt.

We expect FLCT to exercise financial discipline in its growth strategy and preserve its cash flow adequacy ratio. In our view, the REIT will balance the funding mix for future acquisitions in line with past transactions. FLCT has a good record of funding past acquisitions with a mix of debt and equity issuances or proceeds from asset disposals. This has kept its aggregate gearing below 38% over the last four years.

Outlook

The stable outlook on FLCT reflects the REIT's high cash flow predictability over the next 12-24 months supported by its strong operating metrics and diversification across various geographies and asset classes. We expect FLCT to also maintain a prudent approach to expansion, limiting sizable debt-funded acquisitions.

Downside scenario

We could lower the rating on FLCT if its ratio of FFO to debt falls below 9% with no prospect of recovery. This could happen because of highly debt-funded acquisitions or developments, or a moderate deterioration in performance of portfolio assets.

We could also lower the rating if the quality of FLCT's portfolio weakens.

Upside scenario

An upward rating movement is unlikely in the next 12-24 months. That would require FLCT to adopt and adhere to a more conservative financial policy such that its FFO-to-debt ratio is likely to sustain above 12%.

Company Description

FLCT is the sixth-largest Singapore-listed REIT. It was formed via the merger of Frasers Commercial Trust and Frasers Logistics & Industrial Trust, which was completed on April 15, 2020. The REIT owns and invests in income-producing assets across the industrial, logistics, and commercial (commercial in central business districts and business parks) sectors.

FLCT manages 97 properties across five key markets--Singapore, Australia, Germany, the Netherlands, and the U.K. It has a portfolio of S$6.3 billion as of Dec. 31, 2020.

Our Base-Case Scenario

Assumptions

- Australia (FLCT largest market, accounting for 50%-55% of revenue) to have GDP growth of 4% in 2021 and 3.3% in 2022. Singapore (about 20% of revenue) to have GDP growth of 5.8% in 2021 and 3.7% in 2022. Germany, which accounts for about 20% of revenue, to see GDP rise by 3.2% in 2021 and by 3.7% in 2022, and CPI rise by 2% in 2021 and by 1.3% in 2022.
- We believe macroeconomic conditions influence the performance of FLCT's L&I portfolio to a limited extent because the REIT's Australian L&I rents (accounting for 35%-40% of revenue) carry fixed annual escalations averaging 3.1%. Only its European L&I leases, accounting for about 20% of revenue, which typically have annual escalation, have majority of them indexed to CPI.
- The commercial portfolio is more correlated to the specific supply and demand conditions of each operating market. However, leases on Australian commercial assets, accounting for about 15%-20% of revenue, carry fixed escalations of 2.75%-4%.
- New leases on L&I assets to have positive rental reversions averaging 2%, underpinned by acceleration of e-commerce. We expect the L&I portfolio to remain stable and resilient, with occupancies between 98% and 100%.
- Rental reversions for new leases on commercial assets to be broadly negative at -5% to -1% in fiscal 2021. We expect the difficult leasing conditions to persist with milder negative reversions in fiscal 2022, as the mismatch between commercial space demand and supply continues following protracted work-from-home arrangements due to the COVID-19 pandemic. Occupancies of commercial assets to dip by 1%-5% in fiscal 2021 and recover slightly in fiscal 2022.
- Revenue to grow by 35%-37% in fiscal 2021 due to full-year contribution from the commercial portfolio, following the merger completion on April 15, 2020. Annual growth to be mild--in low-single digits--in fiscals 2022 and 2023.
- EBITDA margins to contract to 66%-69%, from 74.1% in fiscal 2020. This is due to the lower

margins of the commercial portfolio, which will see full-year contribution in fiscal 2021. We expect EBITDA margin to be weaker in fiscal 2022, as compared to fiscal 2021, as pandemic-related government aid tapers off.

- Capex to be S$55 million-S$65 million in 2021 and S$40 million-S$50 million in 2022.
- Adjusted debt to reduce in fiscal 2021 due to contracted divestment proceeds, and remain at S$2.3 billion-S$2.5 billion through fiscal 2023.

Key metrics

Based on these assumptions, we arrive at the following credit measures:

- FFO-to-debt ratio of 9.6%-9.8% in fiscal 2021, and 9.7%-10% over fiscals 2022 and 2023.
- Debt-to-EBITDA ratio of 7.5x-8.0x through fiscal 2023.
- EBITDA interest coverage to be 6.0x-6.5x over the same period.

Liquidity

We assess FLCT's liquidity as adequate. We estimate sources of liquidity will be about 1.4x liquidity uses over the 12 months ending Sept. 30, 2021. Sources of liquidity should exceed uses even if EBITDA decreases by 10%.

In our view, FLCT has sound banking relationships with a diverse pool of international and domestic lenders. Including its sub-trust Frasers Commercial Trust's, FLCT's key banking relationships span over 10 years. While FLCT does not have a record of accessing debt capital markets, Frasers Commercial Trust has a record of successful bond issuances. FLCT also has relatively low debt maturities annually through 2023, giving it the ability to absorb high impact, low probability events.

Principal liquidity sources include:

- Cash equivalents of S$169 million as of Sept. 30, 2020.
- Undrawn committed bank lines of S$144 million expiring beyond the six months to March 31, 2021.
- Consolidated cash FFO that we estimate to be S$260 million-S$270 million over the 12 months to Sept. 30, 2021.
- Proceeds of S$172 million from sale of 99 Sandstone and 3 South Australian assets.
- Refinancing proceeds of about S$195 million completed to date.

Principal liquidity uses include:

- Short-term debt maturities of about S$360 million over the six months to March 31, 2021.
- Negative working capital outflow that we estimate to be S$20 million-S$25 million over the 12 months to Sept. 30, 2021.
- Maintenance and committed capex that we estimate to be S$35 million-S$40 million over the period.
- Dividends that we estimate to be about S$250 million during the period.

Covenants

Financial covenants are imposed on debt held by FLCT and its subsidiaries. We believe FLCT has ample headroom in the financial covenants through fiscal 2023.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Stable/--

Business risk: Strong

- Country risk: Very Low Risk
- Industry risk: Low Risk
- Competitive position: Strong

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb+

Related Criteria

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry, Feb. 26, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

New Rating; CreditWatch/Outlook Action	
Frasers Logistics & Commercial Trust	
Issuer Credit Rating	BBB+/Stable/--