Asia Credit Research

OCBC Bank

Lippo Malls Indonesia Retail Trust: New Credit Review

Friday, November 11, 2016

Recommendations Summary

Issuer Profile:	**Bond Recommendation:**	
Neutral	LMRTSP 4.48 '17	**Neutral**
	LMRTSP 4.5 '18	**Overweight**
	LMRTSP 4.1 '20	**Overweight**
	LMRTSP 7 '49c21	**Overweight**
Fundamental Analysis Considerations • Good track record • FX mismatch on balance sheet • Manageable credit metrics	Technical Analysis Considerations • IG-rated • High coupon for the short-dated papers • Exposure to Indonesia	

S&P: Not rated

Moody's: Baa3/Stable

Fitch: Not rated

Ticker: **LMRTSP**

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Key credit considerations

- **Decent historical performance:** Delivering consistent results, portfolio occupancy has not dipped below 94% since its IPO in 2007. Meanwhile, rental reversions from the previous lease have been positive (+11.8% on average) since 1Q11. We like that LMRT is well-diversified by gross rental income, with over 3000 tenants and a fairly well termed-out lease expiry profile of 4.67 years. The latest 3QFY2016 results are decent, with revenue and NPI rising 0.4% q/q to SGD47.0mn and SGD43.3mn respectively.

- **FX mismatch on the balance sheet**: The balance sheet is exposed to FX mismatch as assets are located in Indonesia but bonds and loans are in SGD. While large FX losses have been recorded, we are not overly worried as the equity will only be wiped out with another c.60% depreciation in the IDR against the SGD – compared to the c.33% depreciation of the IDR since LMRT's IPO in 2007 (which includes the Global Financial Crisis period). We do not view the hedging of the cash flows (which mitigates risks at the dividend level) to be an effective hedge for the balance sheet.

- **Manageable credit metrics with good access to financing**: After the issuance of SGD140mn perpetual bond in Sep 2016, debt/asset decreased to 0.33x, or 0.36x if we count the perpetual as half debt, half equity. If Lippo mall Kuta and Lippo Plaza Jogya are acquired, debt/asset may rise to 0.37x, which we view as still manageable. LMRT maintains good access to financing after obtaining committed unsecured term loan facilities of up to SGD350mn on 22 Aug 2016.

- **Technical Factors**: Amongst our coverage, LMRT is the only IG-rated company offering yields above 4% for a 2-4Y SGD paper. Notwithstanding the exposure to Indonesia, as LMRTSP curve was sold following the default of Trikomsel in Nov 2015, we see relative value in the LMRT's '18s, '20s and '49s. These offer higher yields than bonds of First REIT (Indonesia focused hospital REIT), other retail REITs and REITs with similar credit ratings (predominantly focused in Singapore). It is also interesting to compare LMRTSP '49c21 to LMRT's equity. LMRT perp at 6.57% yield looks relatively attractive as its coupon payments are in SGD, compared to the equity (LTM dividend yield: 8.25%) which pays out dividends that are subjected to IDR fluctuations. We note that the 168bps higher yield offered by the dividends from the equity is lower than the 544bps yield difference between Singapore's and Indonesia's 10Y govt LCL bonds.

I) Company Background

Listed in Singapore on 19 Nov 2007, Lippo Malls Indonesia Retail Trust ("LMRT") is a retail REIT with a SGD1.8bn portfolio of 19 retail malls and 7 retail spaces[1] in Indonesia, mostly located within Greater Jakarta, Bandung, Medan and Palembang. The malls are targeted at the middle to upper-middle class domestic consumers.

Figure 1: Property Portfolio

Retail Malls				
Property	**Location**	**NLA (sqm)**	**Net Property Income**	
			SGD mn	**% of Total**
Lippo Mall Kemang	South Jakarta	58,251	27.8	17.5%
Sun Plaza	Medan	64,613	15.7	9.9%
Plaza Medan Fair	Medan	54,776	13.1	8.3%
Pluit Village	North Jakarta	87,404	11.0	6.9%
The Plaza Semanggi	South Jakarta	64,212	10.9	6.9%
Bandung Indah Plaza	Bandung	30,288	10.1	6.4%
Pejaten Village	South Jakarta	42,116	10.1	6.4%
Istana Plaza	Bandung	26,859	8.2	5.2%
Cibubur Junction	East Jakarta	34,496	7.9	5.0%
Mal Lippo Cikarang	East Jakarta	30,247	6.0	3.8%
Gajah Mada Plaza	Central Jakarta	36,432	5.5	3.5%
Palembang Square	Palembang	31,641	4.7	3.0%
Lippo Plaza Kramat Jati	East Jakarta	32,628	2.9	1.8%
Palembang Icon	Palembang	35,750	2.8	1.8%
Palembang Square Extension	Palembang	17,392	2.7	1.7%
Tamini Square	East Jakarta	17,475	2.2	1.4%
Binjai Supermall	Medan	23,315	2.0	1.3%
Ekalokasari Plaza	East Jakarta	27,132	1.3	0.8%
Lippo Plaza Batu	Batu	12,333	1.1	0.7%
Subtotal (Retail Malls)		**727,360**	**146.0**	**92.1%**
Retail Spaces				
Plaza Madiun	Madiun	19,029	2.2	1.4%
Metropolis Town Square Units	West Jakarta	15,248	2.0	1.3%
Depok Town Square Units	South Jakarta	13,045	1.8	1.1%
Malang Town Square Units	Malang	11,065	1.8	1.1%
Java Supermall Units	Semarang	11,082	1.7	1.1%
Mall WTC Matahari Units	West Jakarta	11,184	1.5	0.9%
Grand Palladium Medan Units	Medan	13,417	1.5	0.9%
Subtotal (Retail Spaces)		**94,070**	**12.5**	**7.9%**
Total		**821,430**	**158.5**	**100.0%**

Source: Company

LMRT is the largest retail SREIT by floor space, with an NLA of 821,430 sqm, ranking ahead of CapitaLand Mall Trust (FY2015: 539,576 sqm). The top three tenants, by gross rental income, are related party Matahari Department Store (9.3%), Hypermart (6.7%) and Carrefour (2.5%). The remaining over 3000 tenants each contribute less than 1% of the gross rental income.

The LMRT management has been active in acquiring assets. LMRT has added 10 retail malls, growing from a portfolio of 7 retail malls and 7 retail spaces since IPO. Going forward, LMRT is

[1] The retail spaces are part of retail malls which are subdivided developments. These are master-leased to Matahari Department Store.

proposing to acquire Lippo Mall Kuta and Lippo Plaza Jogja, pending the finalisation of details, for SGD92.7mn[2] and SGD57.9mn[3] respectively. With the limit in approvals for new malls in Jakarta, we think that future assets will likely be sourced from other regions.

II) Ownership and Management

Figure 2: Major shareholder as at 11/11/16

Investor	Shares	Stake
Lippo Karawaci	822,061,761	29.33%
Tong Jinquan	224,938,500	8.02%

Source: Bloomberg, Company

PT Lippo Karawaci Tbk. ("LK") is LMRT's sponsor. LK is Indonesia's largest listed developer by total assets and revenue. As at end-2015, LK manages 43 malls in Indonesia with a NLA of 1.1m sqm. The majority are owned by LK (9) and related companies including LMRT (19) and First REIT (2). The remainder are strata titled malls (9) built by LK or owned by third parties (4). LK plans to develop 15 new malls in 2016-2021, and targets to increase the number of malls under management to 50 by 2017. LMRT has the Right of First Refusal to any retail properties in Indonesia that LK proposes to sell or transfer.

The manager of LMRT is LMIRT Management Ltd, which is controlled indirectly by LK. Mr Alvin Cheng is the CEO, Executive Director and IR Officer of LMRT. He joined LMRT in 2010 and has more than 25 years of experience in banking, transportation, logistics and real estate investments as well as management experience in the business trust and REIT sectors.

III) Company Overview & Analysis

- **Riding on retail growth in Indonesia:** Recent macro-economic data looks encouraging. 3Q16 GDP growth, which declined to 5.02%, is still firmly in the positive zone. Indonesia retail sales are higher y/y by 15.7% in Sep 2016 and the Bank Indonesia Consumer Confidence Index surged to 116.8 in Oct 2016 (Sep 2016: 110). Our economist also views the Indonesian consumer sector in a positive light[4] despite reversals in government spending. LMRT's malls spans across a number of the biggest cities in Sumatra and Java, positioned to capture the growth in the middle and upper-middle income groups. While internet retailing is becoming widespread, according to Euromonitor, several retailers have plans to expand further. For example, Matahari, which is LMRT's largest tenant by gross rental income, forecasts 8 new store openings for 2016 and an additional 6-8 stores in 2017. Matahari has a bigger pipeline in the longer run with 57 stores in 2017 and onwards. Indomarco Prismatama, a retail company with a chain of minimarket stores, targets to open 1,600 new stores in 2016. As such, we are not worried about the upcoming c. 300,000 sqm p.a. supply in the Greater Jakarta region in 2018-2019[5].

- **Good historical operational performance with decent 3QFY2016 results:** LMRT has been delivering consistent results. Portfolio occupancy has not fallen below 94% since its IPO in 2007. We note that 3Q2016's portfolio occupancy of 94.8% appears healthy, outperforming the 84.3% occupancy rate of the retail market in Jakarta (Source: Cushman & Wakefield). LMRT has posted healthy positive rental reversions (+11.8% on average) since 1Q11, though the rate of increase has been declining. LMRT may continue to record rental reversions, with annual step-up provisions into renewed and new leases since late 2009. In the latest

[2] Purchase consideration (SGD81.6mn), VAT (SGD7.8mn), Others (SGD3.3mn)
[3] Purchase consideration (SGD51.0mn), VAT (SGD4.9mn), Others (SGD2.0mn)
[4] OCBC Inside Indonesia – Indonesia's GDP bears effects of government cutbacks (7 Nov 2016)
[5] Forecasts by Colliers

3QFY2016 results, total revenue and NPI both inched up 0.4% to SGD47.0mn and SGD43.3mn respectively, likely contributed by small gains in the IDR and rental reversion.

- **Diversified tenant profile:** LMRT is well-diversified by gross rental income, with over 3000 tenants while the top 10 tenants contribute 22% of the gross rental income in 3QFY16. We note that the top 2 tenants, Matahari and Hypermart, which contribute 16% of the gross rental income, are affiliated to LK and the Lippo Group. Despite a chunkier 23% of leases by NLA expiring in 2017, the lease expiry profile is fairly well termed-out with a WALE of 4.63 years (by NLA). However, we think that the WALE by gross income is likely to be lower, given that the longer-term leases tend to be the anchor tenants which pay lower rent per area.

- **Debt-fuelled growth:** As a REIT that pays out most of its earnings through dividends, we estimate that most of the revenue growth that LMRT has seen over the years was due to acquisitions, as gains from rental reversions were eroded by currency losses. Since 2011, LMRT has undertaken SGD1.16bn of acquisitions, boosting total assets to SGD2.13bn as of 3QFY16. The acquisitions were funded with a larger portion of debt, as LMRT only raised SGD467.6mn in equity and SGD140mn in perpetuals since 2011.

- **Moving the listing back to Indonesia?:** In Oct 2015, CEO of Lippo Group James Riady announced the intention to shift LMRT and First REIT from Singapore to Indonesia to benefit from new tax breaks, though there has been no concrete plan thus far. We continue to see LMRT's importance to LK as a vehicle for LK to recycle capital. As a testimony, in 2016, LMRT announced the acquisitions of Lippo Mall Kuta and Lippo Plaza Jogja from LK. Meanwhile, management has indicated no current plans to delist from the SGX and relist the assets elsewhere. In any case, we note that bondholders are protected by the change of control clause definition, which includes the sale of substantially all the assets of LMRT.

- **Land expiries and uncertainty over land regulations:** There are several land expiries within the next 5Y, including Java Supermall Units (2017), Mall WTC Matahari Units (2018) and Gajah Mada Plaza (2020). We are not overly concerned even if these are not renewed, as they comprise just 7% of LMRT's asset valuation. The remaining land titles are similar on leasehold structures with an average of 17 years remaining to expiry. They are held under varied land titles, and there is no guarantee that they may be renewed. However, we note that LMRT has faced no difficulties with its land titles since its listing in 2007.

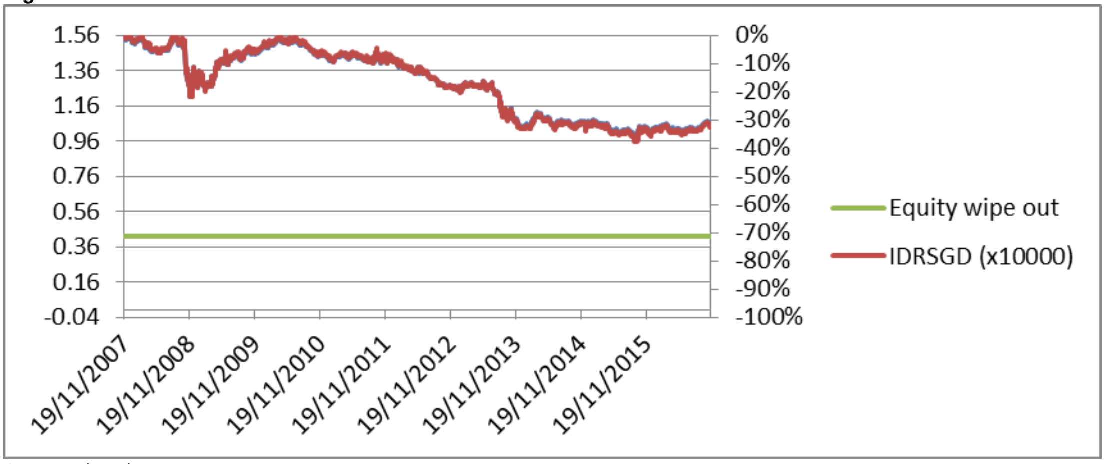
IV) Financial Analysis

- **Manageable credit metrics:** After the issuance of the SGD140mn perpetual bond in Sep 2016, debt/asset decreased to 0.33x (2Q16: 0.36x). However, if we count the perpetual bond as half debt and half equity, debt/asset would rise to 0.36x, comparable to retail REIT peers such as CapitaLand Mall Trust (0.35x), Mapletree Commercial Trust (0.37x), Starhill Global REIT (0.35x), and only significantly above Frasers Centrepoint Trust (0.28x). EBITDA/interest is also healthy at (3.4x). If Lippo Mall Kuta (SGD92.7mn) and Lippo Plaza Jogya (SGD57.9mn) are acquired using SGD60mn from the existing cash and the remainder from debt, debt/asset ratio may increase to 0.37x, or 0.40x after adjusting for perpetuals.

- **Further acquisition pressure from the sponsor likely to be credit neutral:** We think that it is likely for LMRT to acquire further assets given its rapid pace of acquisition. We also note that LK may potentially inject more assets into LMRT to recycle capital, given the credit downgrade by S&P to B+ in July 2016 (from BB-). Nevertheless, we think that LMRT may not fund further acquisitions (beyond Kuta and Jogya) with a larger proportion of debt, given the (1) 45% regulatory debt/asset limit and (2) risk of downgrade by Moody's if debt/asset (adjusted for perpetuals) exceeds 40%.

- **FX mismatch on the balance sheet:** The bulk of the assets comprise assets in Indonesia but most of the liabilities are bonds or loans in SGD. This creates FX risks when the IDR depreciates against the SGD. Currency translation reserve has deepened to SGD559mn as of 3QFY16, wiping out a significant amount of equity (3QFY16 equity, excluding perpetuals: SGD1.1bn). We do not view the hedging of the cash flows (which mitigates risks at the dividend level) to be an effective hedge for the balance sheet. Nevertheless, we are not overly worried as the IDR has stabilised since 4Q15, and we estimate that the IDR needs to depreciate by another c.60% against the SGD from current levels before wiping out the equity. While the IDR is an emerging currency, we note that the IDRSGD has only depreciated by 33% in the past 9 years since IPO (which includes the Global Financial Crisis period). In the other hand, interest rate risk is largely hedged as 87% of the borrowings are on fixed rates, as at end-3QFY16.

Figure 3: IDRSGD since IPO



Source: Bloomberg

- **Good access to financing:** Despite not holding a large cash balance, which is typical of REITs, liquidity is ample with LMRT obtaining committed unsecured term loan facilities of up to SGD350mn on 22 Aug 2016. Together with the loan facilities, LMRT's issuance of the SGD140mn perpetual bond was used to repay SGD150mn bonds which matured in Oct 2016.

V) Technical Considerations

Positives

- Issuer is IG-rated, though the perp is not rated and likely to be notched lower if rated
- Change of shareholding clause
- Good yield for the short-dated papers

Negatives

- Exposure to Indonesia

Relative Value

Issue	Maturity	Ask Price	Ask YTW	Bond Rating	Debt/Asset
LMRTSP 4.48 '17	28/11/2017	101.2	3.29	NR/NR/NR	0.33x
LMRTSP 4.5 '18	23/11/2018	100.85	4.06	NR/NR/NR	0.33x
LMRTSP 4.1 '20	22/06/2020	98.00	4.71	NR/NR/NR	0.33x
LMRTSP 7 '49c21	Perpetual	101.80	6.57	NR/NR/NR	0.33x
FIRTSP 4.125 '18	22/05/2018	101.6	3.04	NR/NR/NR	0.30x
FIRTSP 5.68 '49c21	Perpetual	100.35	5.59	NR/NR/NR	0.30x
FCTSP 2.9 '19	4/10/2019	100.75	2.58	BBB+/NR/NR	0.28x
FCTSP 3 '20	21/1/2020	100.25	2.92	BBB+/NR/NR	0.28x
CREISP 4.1 '20	04/29/2020	102.9	3.21	NR/Baa3/NR	0.37x
SBREIT 3.6 '21	04/08/2021	99.95	3.61	NR/Baa3/NR	0.36x

*Indicative spreads based on offer prices from Bloomberg on 11/11/16

The closest comparable to LMRT is First REIT, in our view. Both share the same sponsor, LK, and are highly exposed to Indonesia given their asset base. We prefer LMRTSP '17s and LMRTSP '18s over FIRTSP '18s (UW) given the 25bps and 102bps yield pickup respectively. Similarly, we prefer LMRTSP 7 '49c21 over FIRTSP 5.68 '49c21 (N) for 98bps yield pickup. In addition, we favour LMRT over First REIT's credit profile. The issuer is "Baa3" rated by Moody's while First REIT is unrated. We note that the latter's revenue stream is dependent on the master leases with LK and its affiliates, which has a credit rating of "B+/Ba3/BB-", lower than LMRT.

LMRTSP '18s and LMRTSP '20s offer higher yield than the bonds of Singapore's retail REITs with similar maturity, with a 148bps and 179bps yield pickup over FCTSP '19s (OW) and FCTSP '20s (OW) respectively. The yield pickup is higher when compared to the bonds of other retail REITs including CapitaLand Mall Trust, Mapletree Commercial Trust and Starhill Global REIT. While we acknowledge that the other Singapore retail REITs generally have higher credit ratings, we note that Baa3-rated bonds[6] of other REITs (Cambridge Industrial Trust, Soilbuild REIT) generally trade at 3.2%-3.6% yield for a 4-5 year paper. LMRTSP '20s look very attractive in comparison, with a yield of 4.71% that offers over 100bps pickup.

Finally, we compare LMRTSP '49c21 to LMRT's equity. The former offers 6.57% yield while the latter's LTM dividend yield is 8.25%. We think that the LMRT perp looks relatively attractive with coupon payments in SGD while the stock pays out dividends that are swapped from IDR to SGD – subjecting the dividends to IDR fluctuations. While the stock offers 168bps higher yield, we note the 544bps difference in yield between Singapore's and Indonesia's 10Y govt LCL bonds.

VI) Conclusion & Recommendation

LMRT has demonstrated a good track record with strong underlying performance (occupancy, rental reversions) since its listing in 2007. We view FX as the biggest source of risk for bondholders as a c.60% depreciation of the IDR against the SGD may wipe out the book value of equity. However, we are comforted that (1) the IDR has largely stabilised over the recent quarters, and (2) a limit on debt/asset at 45% due to MAS regulation would likely trigger LMRT to do fund-raising before the gearing limit is exceeded. We initiate coverage on LMRT with a **Neutral Issuer Profile**.

On the other hand, we note large spreads on LMRT's bonds over its peers and similar-rated REITs. We initiate coverage on **LMRTSP '18s and LMRTSP '20s with an Overweight recommendation**. We are **Neutral on LRMTSP '17s** as we prefer the '18s and '20s for 77bps and 142bps pickup respectively. We are similarly **Overweight on LMRTSP '49s** as we find it to be the most interesting, which trades at a wider yield than FIRTSP '49s and offers a yield which appears relatively attractive compared to the dividend yield of the equity.

[6] We excluded Ascott Residence Trust in our comparison due to its strong sponsorship backing.

Lippo Mall Indonesia Retail Trust

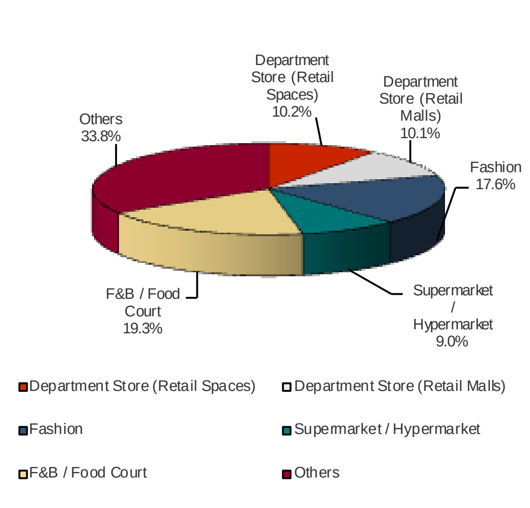
Table 1: Summary Financials

Year Ended 31st Dec	FY2014	FY2015	9M2016
Income Statement (SGD'mn)			
Revenue	137.0	173.0	139.4
EBITDA	117.0	148.1	119.0
EBIT	116.3	147.1	118.2
Gross interest expense	34.4	44.4	34.7
Profit Before Tax	89.9	44.3	75.7
Net profit	63.8	26.4	52.1
Balance Sheet (SGD'mn)			
Cash and bank deposits	103.9	80.6	213.9
Total assets	2,017.5	1,987.7	2,126.1
Gross debt	624.4	689.0	683.9
Net debt	520.4	608.4	470.0
Shareholders' equity	1,149.7	1,075.1	1,237.2
Total capitalization	1,774.1	1,764.1	1,921.1
Net capitalization	1,670.2	1,683.5	1,707.2
Cash Flow (SGD'mn)			
Funds from operations (FFO)	64.5	27.5	52.8
* CFO	102.2	125.3	109.6
Capex	7.9	9.9	7.8
Acquisitions	317.0	79.4	0.0
Disposals	0.0	0.0	0.0
Dividends	64.2	80.5	69.7
Free Cash Flow (FCF)	-286.9	-44.3	32.1
* FCF Adjusted	-668.1	-204.2	-37.6
Key Ratios			
EBITDA margin (%)	85.4	85.6	85.4
Net margin (%)	46.6	15.3	37.4
Gross debt to EBITDA (x)	5.3	4.7	4.3
Net debt to EBITDA (x)	4.4	4.1	3.0
Gross Debt to Equity (x)	0.54	0.64	0.55
Net Debt to Equity (x)	0.45	0.57	0.38
Gross debt/total capitalisation (%)	35.2	39.1	35.6
Net debt/net capitalisation (%)	31.2	36.1	27.5
Cash/current borrowings (x)	0.5	0.3	1.4
EBITDA/Total Interest (x)	3.4	3.3	3.4

Source: Company, OCBC estimate

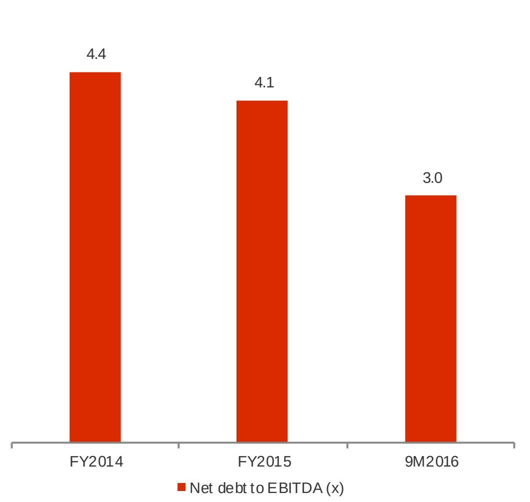
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO before deducting interest expense*

Figure 1: Trade Sector by Rental Income - 9M2016



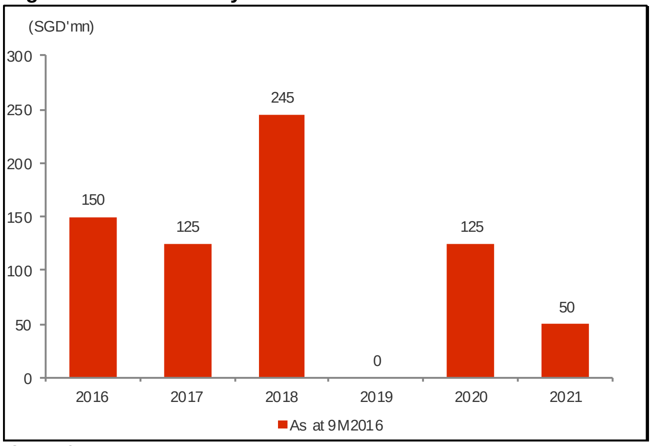
Source: Company

Figure 2: Interest Coverage Ratio (x)



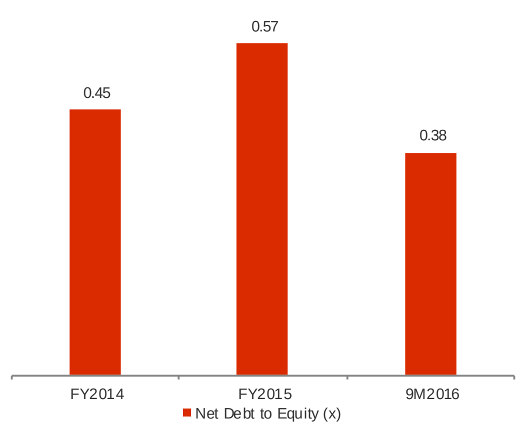
Source: Company, OCBC estimates

Figure 3: Debt Maturity Profile



Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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