OCBC Bank

Asia Credit Research

Earnings Review: Lippo Malls Indonesia Retail Trust (“LMRT”)

Issuer Profile: Negative (6)

Ticker: **LMRTSP**

Background

Listed on the SGX on 2007, Lippo Malls Indonesia Retail Trust (“LMRT”) is a retail REIT with a portfolio of 23 retail malls and 7 retail spaces in Indonesia. The malls are mostly located within Greater Jakarta, Bundung, Medan and Palembang, targeted at the middle to upper-middle class domestic consumers. LMRT is the largest retail S-REIT by floor space, with an NLA of 851,850 sqm. LMRT is ~30% owned by its sponsor, Lippo Karawaci (“LK”), as of 6th August 2018.

Wong Hong Wei, CFA
+65 6722 2533
wonghongwei@ocbc.com

Recommendation

- Credit metrics look manageable with 0.36x aggregate leverage. We also believe that LMRT may overcome the refinancing of SGD304.0mn of debt due within the next 12 months.
- Nevertheless, we maintain a Negative (6) Issuer Profile in view of the lackluster results and the potential deterioration in credit metrics if LMRT were to undertake significant acquisitions.
- We remain Overweight on LMRTSP 4.1% ‘20s and find it attractive with a short maturity and 6.25% YTM, which is the highest amongst all SREIT straight bonds.
- We also see the refinancing of LMRT’s near-term maturities as a potential catalyst to rerate the bond. We prefer LMRTSP 7% PERP over LMRTSP 6.6% PERP given its higher coupon and wider reset spread. We also think that LMRTSP 7% PERP looks favourable with YTC (8.09%) that is comparable to the annualized dividend yield on the equity (8.0%).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield	Spread (bps)
LMRTSP 4.1% 2020	22-Jun-2020	0.36x	6.25%	429bps
LMRTSP 7% PERP	27-Sep-2021	0.36x	8.09%	598bps
LMRTSP 6.6% PERP	19-Dec-2022	0.36x	7.97%	577bps
FIRTSP 5.68% PERP	08-Jul-2021	0.34x	5.86%	377bps

Indicative prices as at 6 Aug 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter

Key Considerations

- **Continued downtrend in earnings**: While 2Q2018 gross revenue increased 5.5% y/y to SGD52.7mn, this was mainly due to SGD5.7mn revenue from service charge and utilities recovery as LMRT is now collecting such charges directly from tenants after terminating all outsourced agreements with third party service providers. This resulted in a corresponding increase in property operating and maintenance expense of SGD4.2mn (2Q2017: nil). Beyond the headline increase in revenue, gross rental income fell 1.2% y/y to SGD41.4mn, mainly due to the weakening of IDR against SGD despite the acquisitions of Lippo Plaza Kendari (June 2017), Lippo Plaza Jogya and Kediri Town Square (Dec 2017) and average rental reversion of 4.2% in 2Q2018. NPI fell by 7.8% y/y to SGD43.2mn, more than gross rental income, due to increase in other property operating expenses of SGD2.8mn (2Q2017: 0.8mn) as a result of net allowance of doubtful debt of SGD1.2mn. Net income fell 20.8% y/y, more than NPI, to SGD18.3mn with income tax surging 45.7% y/y to SGD7.6mn due to the imposition of an income tax on land/building starting from 2 Jan 2018.

- **Tenants still falling behind payments:** Trade receivables from related party tenants still remain high at SGD14.5mn (though slightly decreased from 1Q2018’s SGD15.2mn) – we estimate related parties continue to fall about 1 quarter behind payments. The SGD1.2mn allowance of doubtful debt, according to management, is mainly due to major non-related party tenant(s) being more than 90 days late – which may also imply that LMRT has not collected sufficient rental deposits upfront. Late payments from non-related party have surged to SGD18.1mn q/q (1Q2018: SGD11.6mn), though we are not able to pinpoint the tenant(s) which has fallen short as LMRT has stopped disclosing the top 10 tenants by rental income since 4Q2017. If the late payments continue, we see the possibility that the tenant(s) in arrears may eventually move out and impact occupancy. For now, occupancy remains healthy at 93.6% (1Q2018: 94.0%) with 3.94 years weighted average lease expiry.

- **Heavy maturities ahead though refinancing may be around the corner:** Cash of SGD96.7mn is insufficient to cover SGD304.0mn of debt, though we understand from management that significant progress has been made to refinance this – there have been delays partly due to negative headlines from its sponsor LK. We are not overly concerned with LMRT's liquidity, given that all borrowings are unsecured which allow room for LMRT to pledge assets for funding. Management also remains confident that dividends will continue to be paid – which bodes well for perpetuals given the dividend stopper covenant.

- **Credit metrics may continue to deteriorate:** Aggregate leverage increased q/q to 36.0% (1Q2018: 35.05%), which is mainly due to the increase in short term borrowings to SGD304.0mn (1Q2018: SGD278.8mn). We were surprised that most of the increase in borrowings was kept in cash, which resulted in cash balance increasing to SGD96.7mn (1Q2018: SGD78.3mn) with the remaining cash raised use to repay interest (SGD7.7mn). Although credit metrics remain manageable for now, we are cautious if aggregate leverage would be pushed higher in order to fund sizeable acquisitions (e.g. Puri Mall). Thus far, LMRT has not signalled the desire to undertake capital recycling.

- **Changes in leadership:** Outgoing CEO and Executive Director Ms Chan Lie Ling continued to lead the 2Q2018 earnings analyst briefing with no official announcement on her successor. We will be monitoring the changes in management post her last day of leadership which will be on 31 Aug 2018.

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Treasury Advisory	Credit Research
Corporate FX & Structured Products Tel: 6349-1888 / 1881 **Interest Rate Derivatives** Tel: 6349-1899 **Investments & Structured Products** Tel: 6349-1886 **GT Institutional Sales** Tel: 6349-1810	**Andrew Wong** +65 6530 4736 WongVKAM@ocbc.com **Ezien Hoo, CFA** +65 6722 2215 EzienHoo@ocbc.com **Wong Hong Wei, CFA** +65 6722 2533 wonghongwei@ocbc.com

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Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

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To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

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Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

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