Asia Credit Research

Earnings Review: OUE Ltd ("OUE")

Issuer Profile: Neutral (4)

Ticker: **OUESP**

Background

Incorporated in 1964, OUE Ltd ("OUE") is a real estate developer and landlord with a real estate portfolio located at prime locations in Singapore (such as Orchard Road) and across the region. The group has diverse exposure across the office, hospitality, retail and residential property segments. A recent acquisition also caused OUE to enter into healthcare. OUE is the sponsor of OUE Hospitality Trust ("OUEHT") and OUE Commercial REIT ("OUECT"). The company is 68.6%-owned by the Riady family (Lippo Group).

Nick Wong Liang Mian, CFA
+65 6530-7348
NickWong@ocbc.com

Recommendation

- OUE had a relatively static quarter, given the lack of development income, and how the boost from some of its AEI-assets had started contributing in prior quarters. Credit profile has been stable, and though near-term borrowing looks high, efforts to refinance these have commenced. OUE is also supported by its unrecognized revenue from Twin Peaks, as well as sizable investment properties. We will retain our Neutral (4) Issuer Profile.
- In our view, OUE could potentially be affected by negative headlines relating to its controlling shareholders' other assets (specifically Lippo Karawaci). There has also been some recent transactions by OUE that involve long-term partners of Lippo Karawaci. As such, the OUESP curve could be pressured, trading wider versus its property peers despite decent credit fundamentals.
- We like the OUESP'19s and OUESP'20s which offer decent spread pick-up despite the short duration. The shorter duration also matches the near-term liquidity levers which OUE still has, such as its unrecognized sales at the Twin Peaks. OUE's stake in Gemdale Properties (535 HK), worth ~SGD370mn, may also be in the play given the recent JV termination which unlocked the stake.

Relative Value:

Bond	Maturity/Call date	Net Gearing	Ask Yield	Spread
OUESP 4.25% '19s	30/10/2019	65%	3.25%	131bps
OUESP 3.8% '20s	15/04/2020	65%	3.44%	141bps
FPLSP 3.95% '21s	07/10/2021	96%	3.17%	93bps

Indicative prices as at 15 May 2018 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Lack of development revenue dragged top line**: OUE reported 1Q2018 results. Revenue fell 25.8% y/y to SGD145.6mn, driven by the absence of development property income recognized for the quarter (development property income for 1Q2017: SGD72.6mn). This was largely due to OUE having completely sold its Twin Peaks condominium development by October 2017. That being said, some revenue is likely to be recognized in the future when units sold via Deferred Payment Schemes achieve transaction completion (with unrecognized revenue estimated at ~SGD480mn). The bulk of unrecognized revenue is not expected to be realized till after a year onwards.

- **Asset growth drove other segments**: OUE's other segments showed growth with investment properties income up 2.2% y/y to SGD69.5mn while hospitality income jumped 13.5% y/y to SGD69.5mn. Investment properties performance was driven by the incremental rental income from Downtown Gallery (opened May 2017) mitigating mixed results at OUECT. OUECT had seen its revenue decline 1.6% y/y to SGD44.1mn due to lower rental income, though lower expenses allowed OUECT to increase its NPI by 1.8% y/y to SGD35.3mn. Looking forward, the mall at One Raffles Place is expected to remain a drag, particularly given that it has commenced its AEI. The high committed occupancy at OUECT's offices will provide some buffer, though it should be noted that expiring rents remain higher than market rents. That being said, OUECT was able to secure committed rents above market rents, and given the rising office rental environment, OUECT may be able to exceed expiring rents for renewals in the future. On the hospitality side, performance was stronger at Mandarin Orchard Singapore and Crowne Plaza Changi Airport. OUE also enjoyed incremental revenue from Oakwood Premier at OUE Downtown (opened June 2017).

- **Lower SG&A boosted operating profit, lower WC boosted cash flow**: Operating profit increased 78.3% y/y to SGD44.6mn, driven by a 39.3% decline in SG&A expenses (absence the marketing and transaction expenses relating to Twin Peaks in the prior quarter). Net profit however plunged 50.5% y/y to

SGD8.3mn due to higher finance cost (+11.8% y/y to SGD35.6mn) on larger borrowings, mark-to-market losses on a mutual fund investment (-SGD8.1mn impact) and absent impairment reversal & fair value gains on Twin Peaks seen in 1Q2017 (-SGD18.3mn impact). Operating cash flow (including interest service) was fair at SGD49.4mn (1Q2017: SGD42.1mn), though it is noted that the improvement was driven in part by stretching payables (+SGD37.4mn impact).

- **Focus on the outflows**: Investing cash outflow was high at SGD235.4mn, with SGD67.3mn and SGD159.4mn on acquisition in other investments and deposits placed for investments. Though there are no notes relating to "other investments" for the quarter, as disclosed in the annual report, some of these investments were IDR denominated debt securities. Some of OUE's investment outflows could be related the PT Alpha / Megafeat Internasional Indonesia transaction mentioned previously (refer to OCBC Asian Credit Daily (2 Apr)). It was disclosed previously that OUE had extended ~SGD228.9mn in shareholder loans to PT Apha (this amount ties closely with the investment cash flows mentioned earlier). Currently, PT Alpha is already accounted for as an asset-held-for-sale on OUE's balance sheet (with a net asset value of SGD349.2mn). As mentioned previously, the purchaser of PT Alpha will be making payment via the issuance of a promissory note. It has been noted (refer to OCBC Asian Credit Daily (12 Apr)) that Mr Mas Agoes Ismail Ning is involved in the PT Alpha transaction, and that Mr Ning has various on-going business relationships with the broader Lippo Karawaci group (also controlled by OUE's ultimate majority shareholders, the Riady family). Financing cash flows helped fill the cash gap with SGD96.6mn in additional borrowings (which includes SGD304.8mn in convertible bonds and exchangeable bonds issued during the quarter) as well as SGD78.8mn in fresh equity raised at the OUE Lippo Healthcare Ltd level (refer to OCBC Asian Credit Daily (10 May)).

- **Heavy short-term debt burden**: Net gearing had increased from 60% to 65% q/q as a result of the additional borrowings. OUE's short-term debt burden also looks heavy at SGD1.52bn versus SGD370.7mn in cash balance. In mitigation, SGD520.6mn worth are borrowings at the OUECT level (SGD483.2mn secured). These OUECT borrowings are due in 2H2018 and are in the process of being refinanced. Management indicated that of the ~SGD1bn of OUE HoldCo debt, SGD0.2bn worth has already been paid post quarter, and that the balance SGD0.2bn due for 2018 (in 4Q2018) are in the process of refinancing negotiations. A sizable amount of OUE HoldCo short-term debt, SGD0.6bn worth, will be due in 1Q2019. In our view, OUE should be able to refinance its near-term borrowings given its sizable unrecognized sales at the Twin Peaks, as well as investment properties directly held (such as the OUE Downtown, last valued at SGD1.59bn).

OCBC Global Treasury	
Treasury Advisory **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	**Credit Research** **Andrew Wong** +65 6530 4736 WongVKAM@ocbc.com **Nick Wong Liang Mian, CFA** +65 6530 7348 NickWong@ocbc.com **Ezien Hoo, CFA** +65 6722 2215 EzienHoo@ocbc.com **Wong Hong Wei** +65 6722 2533 wonghongwei@ocbc.com

Explanation of Issuer Profile Rating / Issuer Profile Score

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.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

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

Explanation of Bond Recommendation

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.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform 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.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

Disclaimer for research report
This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

This report is intended for your sole use and information. By accepting this report, you agree that you shall not share, communicate, distribute, deliver a copy of or otherwise disclose in any way all or any part of this report or any information contained herein (such report, part thereof and information, "**Relevant Materials**") to any person or entity (including, without limitation, any overseas office, affiliate, parent entity, subsidiary entity or related entity) (any such person or entity, a "**Relevant Entity**") in breach of any law, rule, regulation, guidance or similar. In particular, you agree not to share, communicate, distribute, deliver or otherwise disclose any Relevant Materials to any Relevant Entity that is subject to the Markets in Financial Instruments Directive (2014/65/EU) ("**MiFID**") and the EU's Markets in Financial Instruments Regulation (600/2014) ("**MiFIR**") (together referred to as "**MiFID II**"), or any part thereof, as implemented in any jurisdiction. No member of the OCBC Group shall be liable or responsible for the compliance by you or any Relevant Entity with any law, rule, regulation, guidance or similar (including, without limitation, MiFID II, as implemented in any jurisdiction).

Co.Reg.no.:193200032W