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 910,582 sqm. LMRT is ~30% owned by its sponsor, Lippo Karawaci ("LK"), as of 26th February 2018.

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Recommendation

- 1Q2019 results were a positive with NPI coming in stronger by 5.5% q/q, following consecutive quarters of decline. We also saw aggregate leverage improve to 33.7% (4Q2018: 34.3%).
- However, tenants are still falling behind payments. While there have been some improvements from the related-party tenants, non-related party tenants have fallen further behind payments.
- That said, we think that LMRT should eventually survive as operating cashflows are sufficient to cover cash needs. We are also not overly worried over LMRT's refinancing risks.
- We remain Overweight on LMRTSP 4.1% '20s which offers 7.3% YTM, which is the highest amongst all SREIT straight bonds. However, we are Neutral on both perpetuals as it is uncertain if LMRT will call come the first call dates.

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield to Worst	Spread (bps)
LMRTSP 4.1% 2020	22-Jun-2020	33.7%	7.3%	532bps
LMRTSP 7% PERP	27-Sep-2021	33.7%	8.8%	623bps
LMRTSP 6.6% PERP	19-Dec-2022	33.7%	8.8%	619bps

Indicative prices as at 29 Apr 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter

Key Considerations

- **Stronger q/q results**: While NPI fell 7.8% y/y to SGD40.5mn, q/q trends reflect that the worst is likely over with NPI higher by 5.5% q/q, largely due to higher gross rental income (+2.4% q/q to SGD37.4mn) while property operating expenses remained largely unchanged q/q. The stronger NPI is likely due to the recovery of the IDR against SGD in 1Q2019 (SGDIDR: 10421) versus end-Dec (10648) as well as 6.3% rental reversion in 1Q2019.

- **A significant proportion of tenants are behind payments still**: Trade receivables (net of allowance for doubtful debts) is SGD24.5mn, somewhat improved q/q (4Q2018: SGD25.5mn) though this still represents ~65% of 1Q2019's gross rental income (implying that significant proportion of tenants are still behind payments). If we include allowance for doubtful debts, trade receivables would have increased to SGD30.6mn q/q (4Q2018: SGD29.9mn). This is partly accounted for by related party tenants (SGD12.7mn), which has shown some improvements over the past 2 quarters (4Q2018: SGD13.2mn, 3Q2018: SGD20.3mn). Again, LMRT has reiterated that it has no reason to believe that the Lippo group of companies will not be able to fulfill their payment obligations to LMRT. The build-up in receivables is also related to non-related party tenants (SGD17.9mn), which increased q/q (4Q2018: SGD16.7mn). According to LMRT, the profile of the non-related tenants in arrears is diverse and there is no concentration to a single tenant. We understand from LMRT that allowance is made when tenants are more than 90 days late, though it may not necessarily mean that late payments cannot be collected eventually.

- **Occupancy dipped though this is not necessarily a bad sign**: Portfolio occupancy fell to 91.5% q/q (2018: 92.9%), which we think is due to the drop off of certain LK Master Leases, with its share of gross revenue (less utilities) falling to 9.4% q/q (4Q2018: 10.3%). We think this reduces the reliance of LMRT on the Lippo group of tenants, which account for a disproportionate amount of rents in arrears. As an example, the Lippo group of tenants comprise 41.5% of the trade receivables (including allowance for doubtful debt) though they contribute just 27.3% of the gross revenue (less utilities). In addition, LMRT mentioned that some spaces held by Hypermart are being converted. The freed up spaces are generally converted to specialty stores, which should command higher rentals than the anchors from the Lippo group of tenants. LMRT explained that the significant fall in industry average occupancy to 80.7% in 1Q2019 (2018: 83.2%) is likely due to the difference in methodology used in computation. The figure in 1Q2019 was provided by Cushman & Wakefield while the figure in 2018 was provided by Colliers.

- **Significant uncertainties ahead, including Lippo Mall Puri in the pipeline:** We reiterate from our earnings review on 26 Feb 2019 that significant uncertainties will remain. This will include swings in FX, as long as borrowings continue to be denominated in SGD while assets are based in Indonesia (which are subject to IDR risks) and falloff in LK master lease which may leave occupancy challenged. The bigger uncertainty in the near-term though is the acquisition of Lippo Mall Puri. Completion of the transaction may be challenging given the size; the total transaction cost is expected to be SGD430mn while financing for this has yet to be obtained. We think there is some headroom to borrow given that aggregate leverage is only 33.7% though we estimate that only up to SGD258.4mn of debt can be raised while the rest (SGD171.6mn) will need to be raised from the equity markets. We think the amount required is large relative to the market cap of LMRT (SGD622.4mn, at 21.5 cts per share).

- **We still see LMRT as a going concern:** We think LMRT may eventually survive still. Based on 1Q2019's figures, cash of operating activities of SGD45.5mn still covers by around 3x of (1) SGD8.0mn of interest payments, (2) ~SGD4.5mn per quarter distribution to perpetual securities holders and an estimated (3) ~SGD2-3mn in capex. However, the buffer may be reduced if tenants fall a lot more behind payments or if occupancy dips significantly, as we note the pressure from both related and non-related tenants.

- **Not overly worried about refinancing:** The current borrowings of SGD120mn relates to revolving credit facility, which we think LMRT can likely rollover. Even if the facility were to be discontinued, we think LMRT can meet the cash shortfall with (1) cash of SGD74.7mn and (2) cash from operating activities, assuming that LMRT opts to halt dividends (estimate: ~4.5mn per quarter to perp holders and ~SGD8.7mn per quarter to equity holders) in such a scenario.

- **Decent credit metrics:** Aggregate leverage improved to 33.7% (4Q2018: 34.3%) mainly due to an increase in total assets with (1) cashflows from operations and (2) SGD22.2mn favourable translation difference. That said, we expect aggregate leverage to climb if LMRT were to fund sizeable acquisitions (e.g. Puri Mall). Meanwhile, EBITDA/Interest is manageable at 4.5x (4Q2018: 4.0x).

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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

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 ("IPR") into a 7 point Issuer Profile Score ("IPS") 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.

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

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