Asia Credit Research

Earnings Review: Lippo Malls Indonesia Retail Trust ("LMRT")

Recommendation

- Results continue to show significant deterioration with NPI falling 14.5% y/y to SGD38.4mn, hit by depreciation of the IDR, income tax on land/building and allowance for doubtful debts.
- The worst may not be over if more tenants fall further behind payments and the sponsor is not expected to renew the master lease at Lippo Mall Kemang (estimated ~SGD6.5mn revenue impact if no new tenants are found).
- That said, we think that LMRT should eventually survive as operating cashflows are sufficient to cover cash needs and we think LMRT can refinance successfully.
- We remain Overweight on LMRTSP 4.1% '20s which offers 12.8% YTM, which is the highest amongst all SREIT straight bonds.
- We think dividends will continue to be paid, which bodes well for the perpetuals as they have to be paid too. 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	0.34x	12.8%	1084bps
LMRTSP 7% PERP	27-Sep-2021	0.34x	11.2%	856bps
LMRTSP 6.6% PERP	19-Dec-2022	0.34x	10.1%	754bps

Indicative prices as at 26 Feb 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter

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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Key Considerations

- **Low can get lower**: LMRT announced 4Q2018 results. Core revenue (gross rental income and carpark income) fell 10.6% y/y to SGD41.0mn, mainly due to the weakening of the IDR against SGD and expiry of master leases over the 7 Retail Spaces, despite the acquisitions of Lippo Plaza Kendari (June 2017), Lippo Plaza Jogya and Kediri Town Square (Dec 2017). Net property income though fell by a larger 14.5% y/y to SGD38.4mn due to higher operating property expense with an income tax on land/building starting from 2 Jan 2018 and allowance for doubtful debts of SGD2.7mn. 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.

- **A significant proportion of tenants are still behind payments…:** Trade and other receivables amount to SGD40.5mn, which is nearly equivalent to 4Q2018's core revenue. That said, we see some improvements q/q. Without accounting for other receivables, trade receivables (net of allowance of doubtful debts) has fallen to SGD29.9mn (3Q2018: SGD40.1mn). A significant amount (SGD13.2mn) remains due from related party tenants (3Q2018: SGD20.3mn) while SGD16.7mn are due from non-related party tenants (3Q2018: SGD19.8mn). We may continue to see small improvements as LMRT disclosed that another SGD8.4mn in trade receivables have been collected after end-Dec 2018.

- **… and risk of tenants defaulting remains elevated:** Overall though, we think risks of tenants defaulting remains elevated given the late payments (as discussed in previous paragraph) and deteriorating industry trends. Occupancy rate has declined y/y to 92.9% (2017: 93.7%) though improved q/q (3Q2018: 92.6%). On this note, LMRT continues to affirm that there is no reason to believe that Lippo group of companies will not be able to fulfill their payment obligations to LMRT. According to LMRT, 25.8% of 2018's revenue are from related parties, which includes LK Master Leases (9.5%), Matahari (6.3%), Hypermart (4.3%) and Sky Parking (3.6%). In the worst case scenario that related parties pull out, occupancy may plunge below 70% though we should expect occupancy to recover over time to the industry average (83.2%).

- **Is the worst over?:** We think the worst is not over as significant uncertainties remain though we should not expect the same degree of q/q deterioration we saw in 2018. We elaborate in the following:
  - i) **FX will continue to be an uncertainty:** As long as borrowings are primarily in SGD and assets substantially in Indonesia (subject to IDR risks), we cannot be confident that things will stabilise.
  - ii) **Falloff in master lease:** Following the expiry of 7 Retail Spaces which impacted results, there will be another significant expiry of master lease with the sponsor - at Lippo Mall Kemang in 16 Dec 2019. That said, the impact on value of investment properties should be contained as Lippo Mall Kemang has already been revalued downwards to IDR3.14bn in 2018 (2014: IDR3.64bn). There should be some negative impact on revenue and NPI though. According to LMRT's announcement in 2014, the total rents related to the sponsor was IDR67.5bn (SGD6.5mn) – using this, we estimate such rents contributed ~21% to Lippo Mall Kemang's 2017 revenue of SGD30.5mn. The master lease may not be renewed and hence we should see a temporary dip in occupancy at Kemang going forward though this will be coming from a high base (Lippo Mall Kemang occupancy as of end-Dec 2018: 93.6%).
  - iii) **Portfolio (ex-master lease) should begin to stabilise:** Tenants are still behind on payments though the worst may be behind with trade receivables coming down somewhat in 4Q2018. Aside from risks of tenants defaulting, there are signs that the portfolio, in IDR terms, should begin to stabilise. Rental reversion of +3.6% was recorded in 2018 and LMRT expects the portfolio (in IDR terms) to see growth, excluding the impact from master lease. The income tax on land/building has impacted results in 2018 though it should not create further impacts on a q/q basis going forward.
  - iv) **More losses to be realised when more cash gets repatriated:** Higher exchange loss in 4Q2018 was realised from repatriation of excess cash held by Indonesian subsidiaries. If more cash continues to be repatriated, we think more FX realised losses will be recorded. Aside from SGD17.5mn cash in SGD that is held in trust, we understand from LMRT that the remaining SGD35.2mn cash held by the group but not in trust are largely denominated in IDR, which is recorded using a historical FX rate. Thus far, the repatriated cash has been used to repay debt, and we note that SGD120mn of revolvers is due in 2019 and SGD75mn LMRTSP '20s will be due next year.

- **LMRT should eventually survive:** Even if related party tenants default, we think LMRT should still eventually survive. Based on 2018's figures, we estimate that cash from operating activities may fall to ~SGD100mn (2018: SGD138.2mn) if related party tenants default. This should still cover (1) SGD11.7mn in capex, (2) SGD31.3mn in interest payments and (3) SGD17.7mn in distribution in perpetual security holders. However, the buffer may be reduced further if non-related party tenants simultaneously pull out.

- **Refinancing required ahead:** The free cash flow remaining to equity with cash on balance sheet of SGD52.7mn is still insufficient to meet SGD120mn of revolvers due in 2019 though LMRT is confident that this can be rolled over. We are similarly not overly worried over refinancing as LMRT has in 2H2018 obtained SGD67.5mn 4-year and SGD67.5mn 5-year term loans facilities while aggregate leverage remains moderate. As such, we think dividends will continue to be paid – which bodes well for perpetuals given the dividend stopper covenant.

- **Credit metrics still manageable:** Aggregate leverage improved to 34.3% (3Q2018: 36.8%) due to net repayment of debt which was partly financed using internal cash resources. Potentially, aggregate leverage can go down further if LMRT further utilises its cash to repay. However, we are cautious if LMRT looks to fund sizeable acquisitions (e.g. Puri Mall) though this may be a tall order as capital may not be easy to come by with bond markets looking unfavourable for LMRT while equity raising can be difficult given the depressed share price.

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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.

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 financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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