Asia Credit Research

OCBC Bank

First Real Estate Investment Trust: Credit Update

Wednesday, 24 January 2018

Tenant in tow

- **Growth in FY2017 was driven by acquisitions and we expect further acquisitions at FIRT going forward.**
- **Aggregate leverage has inched up, though remains at moderate levels in our view.**
- **We think counterparty credit risk at FIRT has increased, though short term refinancing risk has declined significantly. FIRT has obtained syndicated bank facilities of up to SGD400mn.**
- **Lippo Karawaci (the "Sponsor") has reduced its stake in Siloam, the hospital operator for bulk of assets owned by FIRT, following Siloam's rights issue to fund expansion of its hospital portfolio and working capital.**
- **Recommendation:** We hold FIRT's issuer profile at **Neutral(5)** and are Underweight the FIRTSP 5.68%-PERP which has a YTC of 4.6%. We are Neutral the FIRTSP'18s. We ascribe a higher risk premium to non-traditional REITs such as FIRT over traditional REITs (eg: offices, industrial, retail assets) under our coverage.

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OCBC Credit Research
Ezien Hoo, CFA
+65 6722 2215
EzienHoo@ocbc.com

- **Background:** As at 31 October 2017, PT Siloam International Hospitals Tbk ("Siloam") announced that it had completed its second rights issue which helped raise IDR3.1 trillion (~SGD306.7mn) in equity. Immediately prior to the rights issue, Lippo Karawaci Tbk ("LK"), the Sponsor of FIRT held ~62% in Siloam. However, LK's stake in Siloam has been diluted to 51.05% following the rights issue. The second largest shareholder of Siloam, private equity firm CVC (via Prime Health Company)'s stake in Siloam has risen somewhat to 15.66%. We have factored in the impact of the ownership change at Siloam and FIRT's recently announced financial results for 4Q2017 and FY2017 for this credit update.

  FIRT is listed on the Singapore Stock Exchange ("SGX") with a market cap of SGD1.1bn as at 24 January 2018. FIRT is a REIT that invests primarily in real estate used for healthcare and healthcare-related industries. Investment properties totaled SGD1.3bn as at 31 December 2017 and in FY2017, 96% of gross revenue was attributable to properties in Indonesia. FIRT is ~28%-owned by LK and FIRT's REIT Manager ("FIRTM") is an indirectly owned wholly-owned subsidiary of LK. The majority of FIRT's Indonesian properties are Master Leased to LK though the properties are used by Siloam for its day-to-day healthcare operations.

Figure 1: FIRT SGD Bonds

Issue	Maturity / First Call Date	Outstanding Amount (SGDm)	Ask Price	Ask YTM / YTC (%)	I-Spread	Bond Rating
FIRTSP 4.125% '18s	22 May 2018	100	100.6	2.16	108	NR/NR/NR
FIRTSP 5.68%-PERP	8 July 2021	60	103.4	4.61	287	NR/NR/NR

Note: (1) Indicative prices as at 24 January 2018

- **Increase in FY2017 from acquisitions though trade receivables increasing:** FIRT's gross revenue increase 3.7% y/y in FY2017 to SGD111.0mn, mainly driven by the full year contribution from Siloam Hospital Labuan Bajo ("SHLB", which was acquired by FIRT in December 2016) as well as from two acquisitions in completed 4Q2017. Net property income ("NPI") and EBITDA increased 3.4% and 3.5%

respectively given that expenses as a percentage of revenues have held steady. Interest expenses for FY2017 decreased 0.3% y/y to SGD12.8mn following the debt pay-down using perpetuals raised in July 2016. Average debt between January and end-2017 was SGD432.8mn, somewhat lower versus average debt during the corresponding period in 2016. Nonetheless, we expect interest expenses to rise in FY2018 following the debt drawdown in 4Q2017 to fund acquisitions. Unadjusted EBITDA/Interest was 5.5x in FY2017 versus 5.3x in FY2016. Perpetuals make up 4.6% of FIRT's capital structure and FIRT pays SGD3.4mn in perpetual distribution per year. Assuming 50% of this distribution as interest, we find Adjusted EBITDA/Interest at 5.0x (FY2016: 5.3x). As at 30 September 2017, current trade receivables were SGD26.0mn, steadily increasing from SGD11.8mn in end-2016. We think this is due to slower rental payments from main tenants. LK has historically made up more than 80% of rental income and we expect FY2017 to have been similar. In part due to the accumulation of trade receivables, we find net cash flow from operating activities (before tax and interest) ("CFO") weaker at SGD89.4mn versus SGD98.4mn in FY2016. CFO/Interest paid was 5.5x in FY2017, lower than 6.1x in FY2016.

- **Aggregate leverage inched higher from acquisitions:** As at 31 December 2017, unadjusted aggregate leverage at FIRT was 33.6%, higher versus 31.1% in end-2016. Including 50% of the SGD60mn perpetuals as debt, we find adjusted aggregate leverage at 35.7%. In October 2017, FIRT completed the acquisition of Siloam Hospitals Buton and Lippo Plaza Buton ("Buton") for SGD28.5mn (excluding value-added tax). Also in October 2017, FIRT re-initiated the joint acquisition of Siloam Hospitals Yogyakarta and Lippo Plaza Jogja ("Jogja"), an integrated development comprising a hospital with retail component. The transaction was subsequently completed in December 2017, with FIRT paying SGD27.0mn for the hospital portion while Lippo Malls Indonesia Retail Trust ("LMIRT") purchased the retail portion. LMIRT is separately listed on the SGX and shares the same Sponsor as FIRT. It is worth noting that the transaction was first mooted in February 2016 at a proposed purchase consideration of SGD40.8mn (for the hospital portion). The actual purchase price though was lower due to renegotiation of terms.

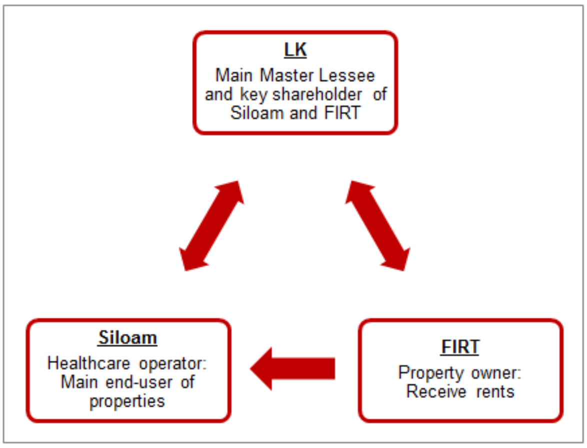
- **The making of a non-traditional REIT:** Traditional REITs include those that hold offices, shopping malls and industrial properties. In most (but not all) traditional REITs, properties are leased to third parties with leasing rates tied to actual leasing market conditions. In contrast, non-traditional REITs tend to own properties which are necessary to Sponsors and/or Sponsor-related entities' business operations (eg: FIRT, Parkway Life REIT, certain assets of Ascott Residence Trust). Prior to the formation of the REIT, the Sponsor and/or related entities own both business operations and the underlying premises are used to conduct business operations. When Sponsor and/or its related entities have decided to create a REIT, a carve-out process is carried out to legally separate the premises from the underlying business operations. The REIT then ends up as the legal entity holding a steady cashflow stream while the remaining business operations sits under a separate legal structure. As the premises are now owned by the REIT, the entity owning the business operations becomes the Master Lessee(s) and is obligated to pay a rent to the REIT. In other words, a stream of synthetic cash flow is created from the asset base now owned by the REIT. Under a Master Lease, the Master Lessee bears the risk of obtaining and managing underlying sub-tenants (including risk of non-payment and rental in arrears).

- **Counterparty credit risks accentuated:** Income is concentrated at FIRT as LK/Sponsor is the dominant credit counterparty to the REIT, this is especially more so, as Siloam is still in a high-growth phase, generating limited operating cash flow and hence unlikely to be paying LK adequate rent (nor dividends) for LK to cover its master lessee obligations. Whilst LK is not within our official coverage universe, we had observed that in December 2017, Standard & Poors ("S&P") downgraded LK's credit rating by a notch to "B" after placing the credit rating on Credit Watch since August 2017. Healthcare real estate assets tend to be purpose-built and there is a narrower range of alternative uses. Additionally, due to the lack of comparable market transactions, we recognize higher uncertainty over FIRT's asset value compared to traditional REITs under our coverage.

- **LK's shareholding in Siloam has fallen progressively though tripartite**

relationship still intact: Since Siloam's listing in 2013, LK's shareholding in Siloam had declined. Siloam completed a rights issue in 4Q2017 and LK's shareholding in Siloam had been diluted to ~51% (from 62% immediately prior to the rights issue). We still see strong economic alignment between the shareholders of Siloam and LK that should help keep the tripartite relationship between FIRT, Siloam and LK intact. As at 24 January 2018, FIRT and Siloam are the key drivers of LK's market value (ie: LK's stake in FIRT and Siloam is worth ~USD790mn against LK's market value of ~USD883mn). Nonetheless, we caution that a further dilution of LK's stake in Siloam signifies the tripartite relationship tipping over, leading to higher uncertainties over future lease terms.

Figure 2: Tripartite relationship



Source: OCBC Credit Research

- **Short term refinancing risk reduced:** As at 31 December 2017, FIRT's short term debt was SGD198.3mn, of these, SGD100mn relates to FIRT's SGD bond, the FIRTSP'18s which is coming due in May 2018. The remainder relates to term loan facilities due in December 2018. As at 31 December 2017, secured debt represented 26% of total assets. In January 2018, FIRT tied-up syndicated secured loan facilities of up to SGD400mn to part refinance term loans, fund property investments and meet working capital requirements. While it was not stated upfront that this new facility would be used to refinance the SGD bond due, in our view, FIRT's short term refinancing risk has been significantly reduced, given the fungibility of funds. We think there are still five properties at FIRT (out of 20) which remains unencumbered, though the capacity to raise secured financing from these are limited for various reasons. FIRT continues to have a strong access to equity capital markets, providing FIRT with financial flexibility.

- **Recommendation:** We hold FIRT's issuer profile at Neutral(5) and are Underweight the FIRTSP 5.68%-PERP which has a YTC of 4.6% with the first call date in July 2021. We are Neutral the FIRTSP'18s.

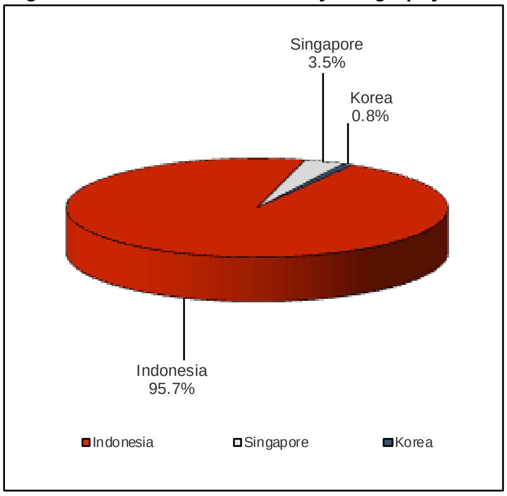
First Real Estate Investment Trust

Table 1: Summary Financials

Year Ended 31st Dec	FY2015	FY2016	FY2017
Income Statement (SGD'mn)			
Revenue	100.7	107.0	111.0
EBITDA	88.0	94.9	98.2
EBIT	88.0	94.9	98.2
Gross interest expense	16.5	17.8	17.8
Profit Before Tax	96.3	64.3	93.6
Net profit	67.8	38.7	70.0
Balance Sheet (SGD'mn)			
Cash and bank deposits	26.8	33.6	15.7
Total assets	1,315.2	1,341.3	1,423.8
Gross debt	442.6	413.6	476.4
Net debt	415.7	380.0	460.7
Shareholders' equity	791.1	838.6	852.3
Total capitalization	1,233.7	1,252.2	1,328.8
Net capitalization	1,206.8	1,218.6	1,313.0
Cash Flow (SGD'mn)			
Funds from operations (FFO)	67.8	38.7	70.0
* CFO	74.3	81.5	72.3
Capex	0.0	0.0	0.0
Acquisitions	56.5	39.2	72.2
Disposals	0.0	8.2	0.0
Dividends	50.0	56.7	66.4
Free Cash Flow (FCF)	74.3	81.5	72.3
* FCF Adjusted	-32.3	-6.4	-66.3
Key Ratios			
EBITDA margin (%)	87.4	88.6	88.5
Net margin (%)	67.3	36.2	63.1
Gross debt to EBITDA (x)	5.0	4.4	4.9
Net debt to EBITDA (x)	4.7	4.0	4.7
Gross Debt to Equity (x)	0.56	0.49	0.56
Net Debt to Equity (x)	0.53	0.45	0.54
Gross debt/total capitalisation (%)	35.9	33.0	35.9
Net debt/net capitalisation (%)	34.4	31.2	35.1
Cash/current borrowings (x)	0.6	0.2	0.1
EBITDA/Total Interest (x)	5.3	5.3	5.5

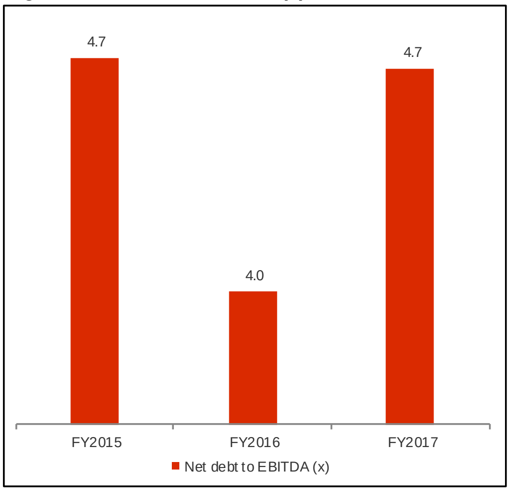
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Geography - FY2017



Source: Company

Figure 2: Net debt to EBITDA (x)



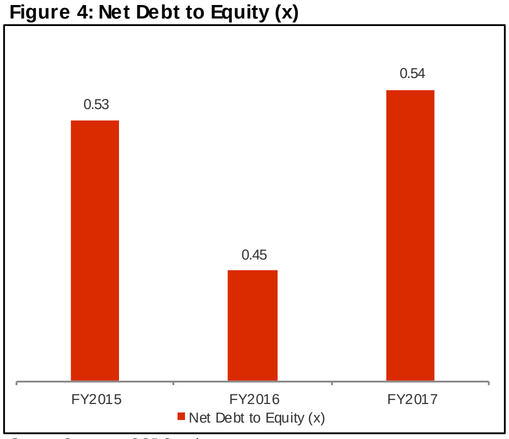
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 31/12/2017	% of debt
Amount repayable in one year or less, or on demand		
Secured	269.6	56.6%
Unsecured	8.6	1.8%
	278.1	**58.4%**
Amount repayable after a year		
Secured	99.0	20.8%
Unsecured	99.3	20.8%
	198.3	**41.6%**
Total	**476.4**	**100.0%**

Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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

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