Asia Credit Research

Earnings Review: OUE Ltd ("OUE")

Issuer Profile: Neutral (4)

Ticker: **OUESP**

Background

OUE Limited ("OUE")'s key business is as an investment holding company. It holds significant stakes in two Singapore-listed REITs (namely, OUE-Hospitality Trust ("OUE-HT") and OUE Commercial REIT ("OUE-CT"), owns investment properties and is increasingly focused on its healthcare businesses outside of Singapore. It holds a 64.4%-stake in OUE Lippo Healthcare Ltd ("OUE-LH") and a 60%-stake in First REIT's REIT Manager. OUE is 68.6%-owned by Lippo Group.

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Recommendation

- OUE's already thin EBITDA/Interest coverage in 4Q2018 was partly dragged down by one-off transaction costs in 4Q2018 (2018 EBITDA/Interest of 1.2x). The company though is set to receive cash within 24 months from units sold at OUE Twin Peaks on deferred payment schemes. OUE is also in the midst of selling US Bank Tower (valued at USD650mn as at 31 December 2018 (~SGD881mn)) which may improve liquidity and unadjusted net gearing further.
- The OUESP curve has "decoupled" from its property peers since September 2018. At the short end, OUESP is trading ~80-90bps wider and more than 100bps differential for other bonds. This is likely due to overhang from its relationship with the Lippo Group (eg: via Lippo Group's ownership in OUE and OUE's stake in First REIT).
- In our view, OUESP 4.25% '19s and OUESP 3.8% '20s are relatively insulated from such overhang given the higher visibility of liquidity in the short term and provide a decent spread pick-up over GuocoLand Ltd's GUOLSP 4.1% '20s and an implied Frasers Property Ltd bond maturing in 2020 based on its existing curve. We hold GuocoLand Ltd and Frasers Property Ltd at an issuer profile of Neutral (5) and Neutral (4) respectively. We maintain OUE's issuer profile at Neutral (4), though would adjust this downwards should the expected monetisation of OUE assets does not happen.

Relative Value:

Bond	Maturity/Call date	Net gearing	Ask Yield to Maturity	Spread (bps)
OUESP 4.25% '19	30/10/2019	0.60x	3.89%	187
OUESP 3.8% '20	15/04/2020	0.60x	4.08%	207
OUESP 3.75% '22	17/04/2022	0.60x	5.15%	311
OUESP 3.55% '23	10/05/2023	0.60x	5.23%	315
GUOLSP 4.1% '20	13/05/2020	0.77x	3.17%	116
GUOLSP 3.62% '21	30/03/2021	0.77x	3.57%	156
FPLSP 3.95% '21	07/10/2021	0.87x	3.38%	136
FPLSP 3.65% '22	22/05/2022	0.87x	3.45%	141

Indicative prices as at 4 March 2019 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Top line down due to lack of Development Property activities:** 2018 revenue declined 14.7% y/y to SGD642.9mn. While 4Q2018 numbers were not directly provided, backing them out, we find total revenue in 4Q2018 to have declined 13.4% y/y to SGD163.3mn. By segment, the Development Property segment saw a 48% y/y decline (from less recognized revenue) to SGD22.3mn. OUE owns freehold land at 28 Nassim Road, but no project has been announced yet. Apart from 23 units held as investment properties, units at OUE TwinPeaks have been sold (included via deferred payment schemes). Revenue from the Healthcare segment (ie: from 61%-owned OUE-LH) saw a 59% y/y decline to SGD4.6mn. Lower revenue was recorded by its China operations as OUE-LH had deconsolidated Wuxi New District Phoenix Hospital Co. Ltd ("Wuxi") since 3Q2018 as OUE-LH was deemed to have lost control over Wuxi. For 4Q2018, revenue from the Investment Properties and Hospitality segments held up at SGD67.5mn (down 2% y/y) and SGD61.8mn (up 1% y/y) respectively. OUE ended 4Q2018 with profit before tax of SGD55.2mn (4Q2017: SGD113.1mn). Nonetheless, a SGD16.7mn other comprehensive loss was recorded.

- **Profits driven by Investment Properties:** For 2018, income from Property Investments was SGD178.3mn (88% of total segment profit). ~56%-owned OUE-CT is consolidated into OUE and provides bulk of Property Investments profits while directly held US Bank Tower provided SGD27mn in income (representing

15% of Property Investments income). In 2018, share of results from Investment Properties associates were SGD23.5mn, predominantly due to 39%-owned OUE-HT, held as an associate. The rest of the key operating segments was profitable although Others (comprising of restaurant and investment trading) continued to see a segmental loss of SGD13.2mn (2017: loss of SGD15.9mn).

- **Gemdale market value up YTD:** Encouragingly, Gemdale saw a 25% increase in share price since end-2018 which should bode well for asset values, should OUE want to monetize this stake. As at 1 March 2019, OUE's market value in Gemdale was worth ~SGD364mn (end-2018: SGD295mn).

- **4Q2018 EBITDA insufficient to cover interest expense:** Based on our calculation which does not include other income and other expenses, we find EBITDA to have declined 71% y/y to SGD15.7mn in 4Q2018, which was insufficient to cover finance expense of SGD32.0mn. Per OUE's disclosures for the full year, Property Investments and Hospitality segments covered its interest expense comfortably, with the gap coming from elsewhere. On a y/y basis, 2018 borrowing costs increased 14%, which we think was due to both average debt balance rising as well as higher market interest rates. The increase in interest expense in 4Q2018 was more muted at SGD32.0mn (up 4% y/y). For 4Q2018, administrative expenses ballooned significantly to SGD46.4mn (SGD13.4mn in 4Q2017) and some of the increase can be attributable to SGD18.8mn of one-off transaction costs stemming from the injection of OUE Downtown office components to OUE-CT. Adjusting EBITDA upwards for this one-off, adjusted EBITDA/Interest may have been at 1.1x (4Q2017 was 1.8x while 9M2018 was 1.4x).

- **Short term liquidity boost to come**: We expect OUE to receive cash from units at the OUE TwinPeaks project that was sold under deferred payment schemes previously within the next 24 months. While the exact number yet to be collected is undisclosed, we estimate this at ~SGD300-350mn, which should boost OUE's near term liquidity, despite the stretched interest coverage profile. OUE has begun marketing US Bank Tower since January 2019 and a sale could help generate further liquidity to OUE. As at 31 December 2018, the property, which is located in Los Angeles was independently valued at USD650mn (~SGD877mn) as at 31 December 2018.

- **OUE benefited from sale of asset to 56%-owned subsidiary OUE-CT:** For the most recent 6 months, OUE-CT had announced ~SGD37.2mn in dividends to unitholders (assumed at SGD74.3mn on an annualized basis), of which ~SGD42mn is attributable to OUE. In 2018, the REIT paid out dividends of SGD69.3mn (SGD39mn attributable to OUE). In September 2018, OUE announced the sale of the office components of OUE Downtown to OUE-CT, which was taken gloomily by equity investors (eg: rights issue priced at a large 31.5% discount). Despite the REIT's larger asset base, as of 1 March 2019, the market value of OUE's stake in OUE-CT had dropped to SGD805mn (down ~SGD150mn before the transaction). Net-net though we see the sale as credit positive for OUE as OUE pocketed ~SGD580mn in cash, net of the pro-rata rights units that OUE subscribed to. We are not overly concerned over structural subordination of the asset as OUE-CT being a REIT is subject to an aggregate leverage cap of 45% (31 December 2018: 39.3%).

- **Lower unadjusted net gearing:** As at 31 December 2018, unadjusted net gearing was 0.60x (30 September 2018: 0.68x). The purchase of the office components of OUE Downtown by OUE-CT was 61%-equity funded, including by minority investors of OUE-CT. ~44% of OUE-CT is owned by minority investors. As at 31 December 2018, minority interest was higher at 23% of total equity versus 18% on 30 September 2018. While the effect is not broken out given that OUE like most companies report cash flow on a consolidated basis, we infer that OUE (excluding OUE-CT) had paid down debt on a net basis, mainly from cash that it received from the asset sale.

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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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