**Issuer Profile: -**

Neutral (4)

↓

Neutral (5)

**Ticker:**

OUESP


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# OUE Limited ("OUE")

**Recommendation**

- **OUE's credit profile continues to be underpinned by its significant asset base, although we are still awaiting the monetization of larger assets such as US Bank Tower (which had been put up for sale since early 2019) amidst upcoming debt maturities. The recently effected merger of its Sponsored REITs, namely OUE Commercial Trust and OUE Hospitality Trust have improved the financial flexibility for OUE, in our view. Other assets that can potentially be monetised include remaining portion of OUE Downtown and the nursing homes held by its partly owned subsidiary OUE Lippo Healthcare.**
- **The company continues to lack sustainable EBITDA generation against its finance expenses while cash has dwindled to SGD266.5mn as at 30 June 2019 against short term debt of SGD783.3mn, despite selling significant assets in the Marina Square area in 1H2019. Additionally, we note that the company took SGD9.5mn in impairment, mainly on a financial asset during 1H2019.**
- **Post quarter end, OUE had gone on to acquire more stakes in Gemdale, a listed property developer focused on the China market, increasingly tilting OUE's geographical exposure away from its historically developed market profile. OUE is also buying prime land in South Jakarta which is intended to be developed into a 57-storey mixed development.**
- **Earlier we suspended our issuer rating and bond level recommendation on OUE due to OCBC's other business engagement. We have since resumed coverage on the issuer and lowering the issuer profile from Neutral (4) to Neutral (5).**
- **While we are turning cautious over the company's outlook, for now we remain comfortable with OUESP 3.8% '20s given the short maturity in April 2020 as OUE is set to receive ~SGD233mn in cash in the short term. As at 30 June 2019, secured debt was ~26% of key assets, indicating that assets can be further pledged to raise funding if need be.**
- **Given that the OUESP curve already trades wider against GuocoLand Ltd ("GUOL"), we are largely neutral the rest of the OUESP curve. We hold GUOL's issuer profile at Neutral (5).**

**Relative Value:**

| Bond | Maturity | Net gearing | Ask YTM | Spread |
|---|---|---|---|---|
| OUESP 3.8% '20 | 15/04/2020 | 0.58x | 3.11% | 142bps |
| OUESP 3.75% '22 | 17/04/2022 | 0.58x | 3.34% | 172bps |
| OUESP 3.55% '23 | 10/05/2023 | 0.58x | 3.62% | 200bps |
| GUOLSP 4.1% '20 | 13/05/2020 | 0.79x | 2.46% | 77bps |
| GUOLSP 3.62% '21 | 30/03/2021 | 0.79x | 2.84% | 119bps |
| GUOLSP 4.0% '22 | 31/01/2022 | 0.79x | 3.18% | 155bps |
| GUOLSP 3.85% '23 | 15/02/2023 | 0.79x | 3.29% | 167bps |

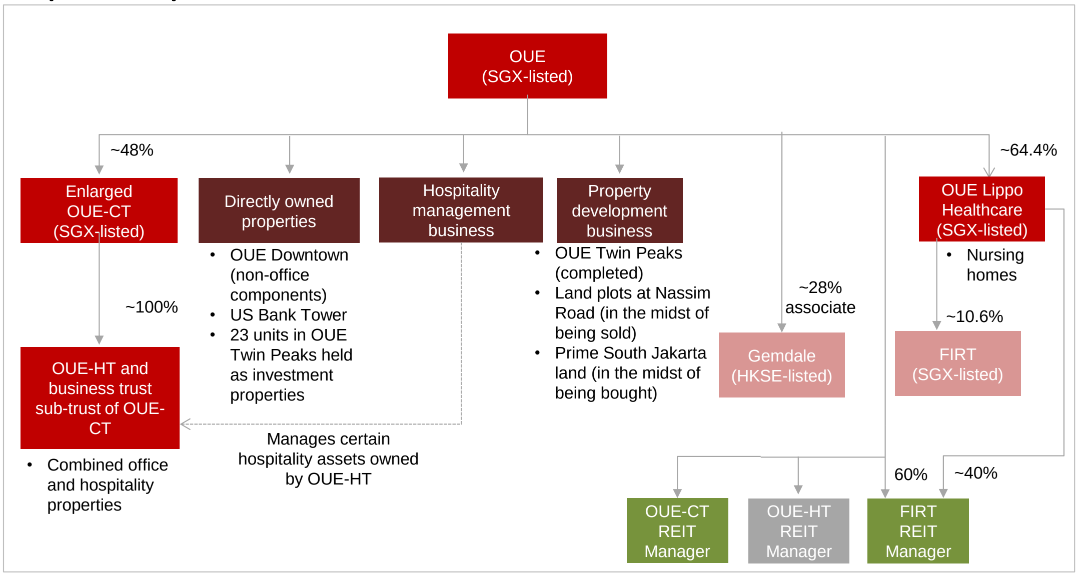
*Indicative prices as at 17 September 2019 Source: Bloomberg*
*Net gearing based on latest available quarter, not factoring in lease liabilities*

**Background**

- OUE Limited ("OUE")'s key business is as an investment holding company. It holds significant stakes in OUE-Commercial REIT ("OUE-CT"), which combined with OUE-Hospitality Trust ("OUE-HT") in September 2019. OUE also owns investment properties and has increased its exposure to the healthcare business and China property.
- OUE owns a ~64.4%-stake in OUE Lippo Healthcare Ltd, a 60%-stake in First REIT's REIT Manager and a ~28%-stake in Gemdale Properties and Investment Corporation Limited ("Gemdale").
- OUE is listed on the Singapore Stock Exchange with a market cap of SGD1.3bn as at 17 September 2019. OUE is ~68%-indirectly owned by Lippo ASM Asia Property Limited ("LAAPL"). A separate listed entity controlled by Lippo Limited holds 50% voting rights of

LAAPL although has ~94.3% of the profit share. Argyle Street Management Limited ("ASM") is deemed interested in OUE as well via its voting rights in LAAPL.

**Simplified corporate structure**




*Source: Company fillings, Bloomberg, OCBC Credit Research*

**Key Considerations**

- **1H2019 revenue boosted by units handed over at OUE Twin Peaks:** OUE reported 1H2019 revenue of SGD432.6mn, up 46.0% y/y mainly from revenue recognized from OUE Twin Peaks units sold under the project's deferred payment scheme ("DPS") while there were no properties recognized as sold in 1H2018. Aside from the 23 units held by OUE as investment properties, these are properties from OUE's only remaining residential development project that was previously fully sold (non-refundable downpayment received though full payment only to be received later at legal completion). The Investment Properties segment which is heavily skewed towards contribution from its Sponsored-REIT OUE-CT saw a slight decline in revenue of 1.1% y/y at SGD137.9mn. Since November 2018, revenue from the office components of the glistening OUE Downtown had also been attributable to OUE-CT as OUE had sold the office portions of this building into the REIT. There is though no change to revenue at the consolidated OUE-level since OUE-CT was ~56%-owned at time of sale and throughout 1H2019 with its numbers already consolidated into OUE. The remainder of OUE's revenue from Investment Properties is mainly attributable to OUE's US Bank Tower in Los Angeles, with the lower contribution from this building explaining the drop in segmental revenue.

- **Lower revenue from Hospitality and Healthcare:** OUE's Hospitality segment saw revenue decline 2.0% y/y in 1H2019 at SGD110.7mn. 2Q2019 numbers were in line with 2Q2018 though in 1Q2019, Hospitality segment revenue was down 4.5% y/y on the back of weaker operating results from Mandarin Orchard Singapore hotel which was insufficiently offset by contribution of Oakwood Premier serviced apartments located inside OUE Downtown. Healthcare segment (~64.4%-owned OUE Lippo Healthcare Ltd ("OUE-LH")) revenue is not comparable y/y given the deconsolidation of Wuxi New District Phoenix Hospital Co., Ltd ("Wuxi") since 3Q2018 as OUE-LH deemed that it has lost control over this asset. Revenue from OUE-LH's continuing operations was SGD9.5mn in 1H2019 (down 5% y/y), mainly from weaker China pharmaceutical distribution business while revenue from its Japan nursing homes were stable.

- **More than meets the eye in 1H2019 reported profits:** EBITDA (based on our calculation which does not include other income and other expenses or share of associates) was up 5.8% y/y at SGD105.2mn, predominantly due to the increase in revenue which superseded the growth in administrative expenses (up 54.4% y/y) to SGD65.2mn. This was mainly due to provision for impairment loss on trade and other receivables (+SGD9.5mn impact), other reasons include higher legal and professional fees and administration fees from the REIT Manager of First REIT (Issuer profile: Negative (6)) which was acquired in October 2018. We think that the 1H2019 impairments losses may relate to a promissory note (current asset) owned by OUE. As at 30 June 2019, trade and other receivables amounted to SGD297.9mn, very similar to end-2018 numbers. While no breakdown of the trade and other receivables was provided as at 30 June 2019, the bulk, in our view, is still attributable to a promissory note held by OUE within current assets. Earlier in September 2018, OUE sold PT Alpha Sentra Prima group of entities ("PT Alpha") and received the promissory note as consideration from the buyers (effectively, an "I owe you" from the buyers). Subsequently, OUE entered into a conditional agreement to buy prime land in South Jakarta using part of the promissory note as consideration. While the South Jakarta land acquisition in itself is a non-cash deal, OUE would had earlier diverted ~SGD229mn to PT Alpha as shareholder's loans, where PT Alpha's obligation to OUE has been novated to one of the buyers of PT Alpha. A 10% refundable deposit had been paid to the South Jakarta land seller soon after deal announcement, though it appears that legal completion has not occurred as at 30 June 2019.

- **Gemdale became an associate:** In 1H2019, OUE reported higher share of results of associates at SGD29.8mn (1H2018: SGD17.4mn) as OUE had increased its 14.8% stake in Gemdale Properties Investment Corporation Limited ("Gemdale"), a small-cap listed property developer to 21.8%. Gemdale's land bank as at 30 June 2019 was 15.4mn sqm, 25% located in first tier cities of Beijing, Shanghai, Guangzhou and Shenzhen while 65% were located in second tier cities (eg: Wuhan, Nanjing, Qingdao, Hangzhou). Gemdale's largest shareholder is Gemdale Corporation, listed on the Shanghai Stock Exchange, with OUE being the second largest shareholder.

- **Thin sustainable EBITDA/Interest coverage in 1H2019:** Despite the higher EBITDA, OUE's finance expenses increased 30.4% y/y to SGD95.0mn, of which SGD17.2mn was attributable to lease expenses from SFRS(I) 16 – Leases given that OUE is the master lessee and operator of Mandarin Orchard Singapore and Crowne Plaza Changi Airport that is owned by OUE Hospitality REIT ("OUE-HT"). OUE-HT was still an associate company of OUE in 1H2019. Our 1H2019 EBITDA/Interest coverage calculation for OUE was thin at 1.1x (1H2018: 1.4x). That being said, we think OUE-HT would be consolidated into OUE post-merger with OUE-CT rather than continue to be accounted for as an associate. Using cash flow figures, which should be less impacted by the accounting impact from the merger, we find that in 1H2019, cash flow from operations (after tax but before interest) and dividends received from associates and other investments was sufficient to cover finance expense paid by 3.0x, significantly boosted by cash receipt from previously sold units under DPS. Removing the DPS impact, which is an important source of liquidity though not considered sustainably recurring, we find that coverage would fall to 1.2x.

- **Significant asset sales in Marina Square area:** In end-2018, OUE held an effective 30%-stake in the 575-room Marina Mandarin Singapore hotel, which it also manages and indirect stakes in the Marina Square Shopping Mall and certain hotels in the Marina Square area via its 10%-stake in Marina Centre Holdings Private Limited ("MCH"). In April 2019, OUE completed the sale of its 10%-stake in MCH and its 25%-stake in Aquamarina Hotel Private Limited ("Aquamarina") which holds Marina Mandarin to United Industrial Corporation Limited (subsidiary of UOL Group). Following the exit of OUE, its hotel management subsidiary had also terminated the hotel operating agreement in relation to Marina Mandarin. The sale was significant and generated SGD391.4mn in cash for OUE which was received in 1H2019. However, in May 2019, the increased in stakes in Gemdale, the first of two increases year to date, cost OUE SGD207.8mn in cash (~HKD977mn). Overall, OUE reported net investing inflow of SGD158.0mn.

- **……despite that, cash balance dwindled:** Cash balance reduced to SGD266.5mn as at 30 June 2019 from SGD409.4mn in end-2018 (31 March 2019: SGD459.5mn) following a large dividend payout of SGD131.3mn (includes special dividend from selling the office component of OUE Downtown) and net repayment of debt, excluding lease payments of SGD232.9mn. This included SGD150mn early redemption of an exchangeable bond issued by OUE-HT and exchangeable into OUE-HT units held by OUE. We think this "clean-up" was part of the OUE-HT and OUE-CT merger as OUE-HT as a sub-trust of OUE-CT would be delisted from the SGX. As at 30 June 2019, OUE's unadjusted net gearing was 0.58x, including lease liabilities as debt, this would be 0.79x as at 30 June 2019 (31 March 2019: 0.60x and 0.81x respectively).

- **Busy August:** In August 2019, in addition to various meetings in relation the proposed merger of OUE-CT and OUE-HT, OUE entered into an agreement to sell a residential asset on Nassim Road, to the company's Chairman and deemed major shareholder for SGD95.0mn. 60% of the sale price (SGD57mn) has been paid at signing with the remaining to be paid in two tranches. While this transaction is small, it was consistent with 1H2019 where OUE overall saw net inflow from asset sales. More recently though on 28 August 2019, OUE announced that it had paid cash of HKD815.9mn (~SGD143.4mn) to buy a further 6.0%-stake in Gemdale, brining its stake of this associate to ~27.9%. While there could be strategic rationale in its' Gemdale investment (per company this is to maintain exposure to the real estate market in China), it comes at a puzzling timing in our view in light of the compressed internal liquidity at OUE.

- **……resulted in increased short-term refinancing risk:** Excluding lease liabilities, OUE faces short term debt of SGD783.3mn as at 30 June 2019 (representing 24% of its gross debt). We estimate SGD605.6mn relates to OUE-debt (i.e. excluding debt at the OUE-CT and OUE-LH level). Against OUE-cash (excluding cash at OUE-CT and OUE-LH) of SGD199.0mn, this implies a cash-to-short term debt of 33% as at 30 June 2019. Simplistically, if we assume no change to debt and cash levels at OUE-CT and OUE-LH, SGD57mn cash receipt from Nassim Road sale and SGD143.4mn cash outlay for Gemdale would bring the ratio down to 19% (25% assuming full cash receipt from Nassim Road sale which is expected by end-2019). Based on our estimates, OUE is also set to received cash of ~SGD180-200mn, from previously sold units at OUE TwinPeaks via DPS, likely in 2H2019 and 2020, though the exact timing of such receipt is undisclosed.

- **Merger OUE-CT and OUE-HT effective:** In April 2019, OUE's subsidiary OUE-CT announced its intention to merge with OUE-HT via a trust scheme of arrangement. To effect the merger, OUE-CT would acquire all stapled securities issued by OUE-HT from its stapled securityholders (OUE-HT comprise of a REIT and Business Trust stapled together, though the Business Trust is dormant). The merger which was legally completed in 4 September 2019 was a 95% equity deal, with 1.3583 new units in OUE-CT issued for each OUE-HT stapled security. The remaining 5% consideration cash consideration (SGD0.04075 per unit) amounted to ~SGD75mn while transaction costs were assumed at SGD15mn. Both OUE-CT and OUE-HT are Sponsored by OUE, though immediately prior to the announcement, OUE-CT was ~56%-owned and consolidated as a subsidiary while OUE-HT was a ~37%-owned associate of OUE.

- **What does the OUE-CT / OUE-HT combination mean to OUE?** Post combination, OUE's stake in the enlarged OUE-CT REIT has reduced to ~48% (ie: higher proportion of minority interest in OUE-CT), although we expect OUE to continue consolidating OUE-CT as a subsidiary. In addition, given that OUE-HT would be 100% held as a sub-trust of OUE-CT, in effect, we think OUE would also be consolidating OUE-HT, leading to certain accounting changes as to how Hospitality segment is being recorded in OUE financials. In our view, OUE-HT would also be consolidated into OUE financials with lease payments from OUE to OUE-HT cancelled out. In 2018, OUE and its subsidiary OUE Airport Hotel Pte Ltd were the largest revenue contributor to OUE-HT, contributing ~75% of OUE-HT's gross rental income (ie: OUE's historically pays lease payments to OUE-HT as OUE-HT owns certain properties which OUE manages). We expect the enlarged REIT to provide higher financial flexibility to OUE as OUE has a larger vehicle for asset monetization (eg: remaining components of OUE Downtown and US Bank Tower, which OUE had been trying to sell since early 2019), subject to minority investors approval. The media had reported that the US Bank Tower could fetch more than USD700mn (~SGD961mn). Common to S-REITs, OUE-CT and OUE-HT initial portfolio when it listed were from OUE and OUE's related parties. Already we saw the office components of OUE Downtown injected into the REIT in November 2018. The enlarged OUE-CT now has a total asset of ~SGD6.9bn, making it one of the largest REITs by asset size in Singapore. Per its unitholder circulars, the enlarged REIT has an acquisition headroom of SGD1.0bn, assuming that the pro-forma aggregate leverage of 40.3% is maintained. Net-net, we see the merger as a credit positive for OUE.

- We present an updated asset coverage analysis table below post the major asset movements.

**Preliminary asset coverage analysis for debt holders:**

| Key assets | SGD'mn |
|---|---|
| Market value of OUE's 48%-stake in the enlarged OUE-CT | 1,368 |
| Nursing homes owned by OUE-LH | 341 |
| US Bank Tower, Los Angeles | 892 |
| Non-office components of OUE Downtown (Oakwood Premier serviced apartments and retail gallery) | 560 |
| Market value of 27.9%-stake in Gemdale | 709 |
| Assumed amounts to be collected from OUE TwinPeaks sold under deferred payment schemes | 190 |
| 23 units of OUE TwinPeaks held as investment properties | 69 |
| Remaining cash to be received from Nassim Road land | 95 |
| Cash OUE (excluding cash at OUE-CT, after paying 6%-stake in Gemdale) | 84 |
| **Total** | **4,308** |
| (-) Gross debt as at 30 June 2019 (excluding lease liabilities, excluding debt at OUE-CT but including debt at OUE-LH) | 1,559 |
| (-) Short term debt at FIRT (we assume this is a contingent liability) | - |
| Asset-to-debt coverage | 2.8x |

*Note: (1) We exclude the South Jakarta land as the acquisition has not completed*
*(2) We exclude Other Investments as no breakdown was provided as at 30 June 2019*
*(3) No short term debt coming due at FIRT in the next 12 months from 30 June 2019*
*(4) Conservatively given that OUE-LH only reported SGD0.3mn in net profit (FY2018: net loss of SGD8.8mn from continuing operations), we assume that the entity is reliant on parent company for its external financing, we take full value of its nursing homes.*

## 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 |

**Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.**

## 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.

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