Asia Credit Research

OCBC Bank

First Real Estate Investment Trust ("FIRT") / Lippo Malls Indonesia Retail Trust ("LMRT"): Credit Update

Monday, 07 May 2018

Cutting too close for comfort

- There has been rising concerns by market participants over the credit profile of PT Lippo Karawaci Tbk ("LK"), being Sponsor, significant unitholder of both Lippo Malls Indonesia Retail Trust ("LMRT") and First Real Estate Investment Trust ("FIRT") and the owner of the respective REIT Managers.
- We think it necessary to consider this development and to assess the credit implications to FIRT and LMIRT.
- FIRT and LMRT bondholders and perpetual holders are structurally superior versus debtholders at LK with regards to the REIT assets. Nonetheless, the credit deterioration at LK accentuates various credit risk factors at both FIRT and LMIRT.
- For FIRT, our key concerns include (1) ability of FIRT to refinance the upcoming FIRTSP 4.125% '18s (2) heighted counterparty credit risk given that more than 82.4% of rents at FIRT in 2017 is attributable to LK and (3) tipping over of the tri-party relationship between FIRT / Siloam / LK.
- For LMRT, negative headlines for LK may weigh on the LMRTSP curve given that about a third of its revenue is contributed by Lippo-related entities. Given LK's tight liquidity situation, we think LMRT may acquire assets from LK, which may weigh on its aggregate leverage. In the worst case scenario, we expect occupancy, net property income and asset value to fall if the Lippo-related tenants pull out. That said, we expect LMRT would eventually survive.

Recommendation: <u>We are lowering the issuer profiles for both LMRT and FIRT to Negative (6) from Neutral (5)</u>. While 1Q2018 results indicate somewhat unchanged credit fundamentals for FIRT and LMRT, we believe that the high counterparty exposure of the REITs to LK increases the transmission risk to the REITs as LK's credit profile deteriorates. As for bond-level recommendations, we maintain our Underweight call for the FIRT 5.68%-PERP and downgrade LMRTSP 6.6% PERP and LMRTSP 7% PERP to Neutral in view of the potential overhang from the negative news flows. Nevertheless, we continue to Overweight LMRTSP '18s and LMRTSP '20s as they offer decent yields for short durations and we believe that the liquidity situation at LMRT should be resolved.

Figure 1: FIRT and LMRT SGD Bonds

Issue	Maturity/ First Call Date	Outstanding Amount (SGDmn)	Ask Price	Ask YTW (%)	I-spread
FIRTSP 5.68%-PERP	08-July-2021	100	100.47	5.52	333
LMRTSP 4.5% 2018	23-Nov-2018	100	100.40	3.75	209
LMRTSP 4.1% 2020	22-Jun-2020	75	99.00	4.60	255
LMRTSP 7% PERP	27-Sep-2021	140	100.05	6.97	475
LMRTSP 6.6% PERP	19-Dec-2022	120	98.31	7.03	471

Note (1): Indicative prices as at 4 May 2018
(2): The FIRTSP 4.125% '18 with an outstanding amount of SGD100mn comes due on 22 May 2018

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- **Background:** There have been rising market concerns over the credit profile of PT Lippo Karawaci Tbk ("LK"), a diversified property developer and investment holding company listed on the Jakarta Stock Exchange ("JSX"). LK is the Sponsor and significant unitholder of both FIRT and LMRT. Additionally LK owns 100% of the respective REIT Managers. We consider FIRT and LMRT as sister REITs. Bondholders and perpetual holders at both FIRT and LMIRT are structurally superior versus debtholders of LK with regards to the assets of the REITs. While OCBC Credit Research does not cover LK, it is instructive and timely to consider the credit implications to FIRT and LMRT, two S-REITs which we officially cover.

  First Real Estate Investment Trust ("FIRT") is listed on the Singapore Stock Exchange ("SGX") with a market cap of SGD1.1bn as at 3 May 2018, FIRT is a REIT that invests primarily in real estate used for healthcare and healthcare-related industries. In particular, FIRT owns assets that are utilised by PT Siloam International Hospitals Tbk ("Siloam"), a major hospital operator in Indonesia that is 51% owned by LK. As at 31 March 2018, investment properties at FIRT were valued at SGD1.3bn. FIRT itself is ~27.9%-owned by its Sponsor. On 27 July 2016, we first shared the view that FIRT's rental income is heavily concentrated with its Sponsor and that both Sponsor and Siloam were in aggressive expansion mode. Since then, we had successively become more concerned over the interdependency between FIRT, Siloam and LK and rising counterparty credit risks; though admittedly, the credit deterioration at LK looks to be faster than what we expected.

  Lippo Mall Indonesia Retail Trust ("LMRT") is also listed on the SGX with a market cap of SGD905.5mn as at 3 May 2018. LMRT is a retail REIT with a portfolio of 23 malls and seven retail spaces in Indonesia. The malls are mostly located within Greater Jakarta, Bandung, Medan and Palembang, targeted at the middle to upper-middle class domestic consumers. LMRT is ~30% owned by its Sponsor as of 4 May 2018.

A) Key Credit Considerations of LK

OCBC Credit Research currently does not cover LK and its subsidiaries, Siloam, PT Lippo Cikarang Tbk ("Lippo Cikarang") and PT Gowa Makassar Tourism Development Tbk ("Gowa"). We have presented this section to the extent that this helps us in assessing the implications for the credit profiles of LMRT and FIRT. Based on our credit framework, a hypothetical issuer profile of LK would be no better than a Negative (6). We have used LK's consolidated financial results (based on Indonesian Financial Accounting Standards) and other public disclosures in our assessment.

Stable top line: Net revenues were up by 0.9% y/y to IDR11.1 trillion driven by top line growth in its healthcare business. LK consolidates its 51%-owned subsidiary Siloam, a major hospital operator in Indonesia. In 2017, Siloam's gross revenue grew 13% y/y to IDR5.8 trillion, with outpatient segment growing faster at 15% y/y. Gross revenue growth was also seen in the retail malls, hospitality & infrastructure and portfolio management segments. These more than offset declines in LK's property development-oriented segments whose performance by nature tend be lumpier. Namely, urban development saw a 22% drop in gross revenue y/y while integrated development (eg: residential, commercial, education, retail, hotel projects located within a single location) saw an 8% drop y/y. Collectively, these two segments reported IDR3.5 trillion in gross revenue against IDR4.2 trillion in 2016.

……but profitability declined: LK's cost of revenues was 5% higher y/y, driven by a 15% increase in healthcare costs. Both inpatient and outpatient segments saw cost of revenues expand faster than gross revenue growth. Doctors' fees, salaries and employees' benefit make up 47% of cost of revenues at Siloam, followed by medicine and medical supplies at 34%. These costs grew at 15% y/y and 18% y/y respectively. This is an indication that although Siloam is capturing patient growth (eg: from its new, smaller hospitals

around Indonesia), the newer hospitals are less profitable and potentially loss-leaders. With revenue from property segments declining y/y amidst gross margin contraction in the other segments, reported gross profits at LK consequently declined 3% y/y to IDR4.6 trillion. Operating expenses expanded 4.9% y/y, primarily as advertising and marketing expenses have ballooned to IDR249.9bn (up 70% y/y). 2017's other income was missing a IDR248.9bn gain on foreign exchange while other expenses ballooned to IDR306.4bn mainly due to increases in penalty and amortisation. Net finance charges (not including capitalised interest) were lower at IDR132.9bn (2016: IDR240.9bn), primarily as interest expense in the integrated development and retail mall segments had declined. LK reported a IDR107.3bn gain on disposal of available for sale financial assets (gain from selling 19.8mn units (~2.5%-stake) in FIRT in 2017) while its associates helped generate a profit of IDR11.5bn (against a loss of IDR15.7bn). In aggregate, net profit for the year fell to IDR857.0bn against IDR1.2 trillion in 2016. Of this, net profit attributable to owners was IDR614.2bn (2016: IDR882.4bn). Other comprehensive income though increased starkly by 145% y/y to IDR1.0 trillion and was mainly due to increase in fair value of available-for-sale financial assets (eg: LMRT and FIRT).

Property market still slow: There is unmet demand for residential property in Indonesia as these demands are at the mass and lower end market. Property developers in Indonesia have historically not tackled these markets, and have been marred by a slowdown in the higher end of the market over the past few years (after a spike in 2013 till early 2014). A series of regulatory actions (eg: raising minimum down payment requirement, mortgage restrictions for second home purchases) were taken to cool the property market while interest rates were also increased around the same time. While some of these lending restrictions have been eased, we have yet to see a strong rebound in the market. According to Colliers' (a property consultancy and brokerage) 3Q2017 report, vacancy rates for apartments in Jakarta was 28.3% (down from 29.8% in 2Q2017). We think this is an indication that Jakarta apartment market's earlier sharp price escalation were driven by investment (and speculative) demand rather than owner-occupiers. We observe that five projects launched by LK in 2011 to 2013 and seven projects launched in 2014 are still under construction, indicating delays in handover.

Net gearing per book value stable though market value of LK has declined: As at 31 December 2017, net gearing was 0.4x (end-2016: 0.5x). While gross debt had only increased slightly by 1.3%, book value equity had ballooned by 35%, predominantly due to increase in non-controlling interests at Siloam and Lippo Cikarang. In 2017, a rights issue was carried out at Siloam to raise new equity though LK did not participate. We believe this is due to LK being unable to do so (perhaps to keep within its covenants). In fact, LK's cashflow statement shows net repayments of borrowings in 2017, a reversal to 2016 where on a net basis, IDR1.2 trillion of debt was drawn down. While we do not posit that market-based share price of LK (and its subsidiaries) reflects fair value, it provides an indication of what equity investors are ascribing to LK's shares currently. At a market cap of IDR9.6 trillion as at 3rd May 2018, net gearing-to-market cap is at 1.2x.

Obligations from pre-sales: LK has IDR7.2 trillion of sales in advances (end-2016: IDR4.6 trillion). 76% of these relate to customers who had provided advances on apartment purchases while the remainder is made up of residential houses, shophouses, shopping centres and land lots. While not a debt item, LK would need to deliver these apartments to customers. Certainly, LK is not the only Indonesian property developer to use pre-sales as a means of financing (this is common practice among developers in China), though it does mean that LK has been historically reliant on the continuity of pre-sales to fund working capital.

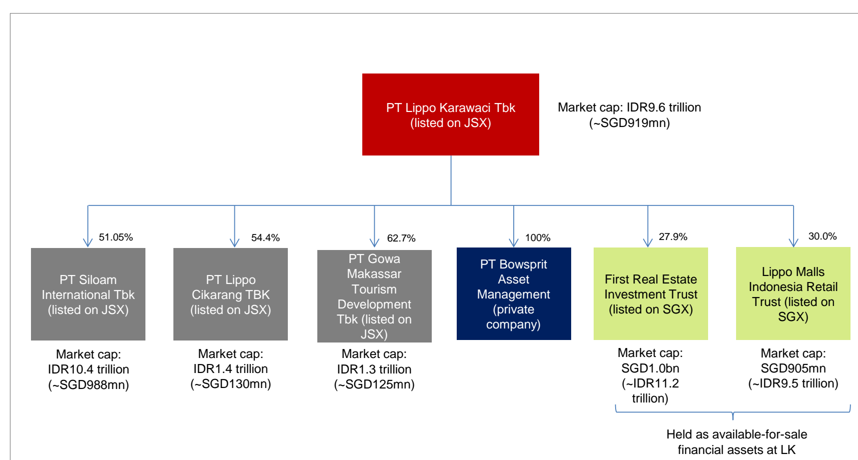
Operating cash flow insufficient to pay interest: EBITDA (based on our calculation which does not include other income and other expense) was IDR1.5 trillion (down from IDR1.8 trillion in 2016). Given that the income statement interest expense does not include capitalized interest (and understates interest obligations), we use cash interest paid as an indicator of

interest coverage. LK paid IDR1.2 trillion in cash interest paid in 2017 (2016: IDR 1.3 trillion), with resultant EBITDA/Cash interest paid of 1.3x (2016: 1.4x). After factoring working capital needs, LK's net cash flow from operating activities is negative. In 2017, this was an operating cash outflow of IDR2.9 trillion (before factoring in interest and taxes paid), against an operating cash inflow of IDR1.3 trillion in 2016. During the year, LK's investing outflow was significant at IDR2.1 trillion, largely on advances and acquisition of property, equipment and software. We note that a large part of these investing outflows was attributable to Siloam. In the meantime, deferred advertising and rental expenses (an asset item) had also increased to IDR887.7bn (2016: nil).

Short term debt due: As at 31 December 2017, LK faces short term debt of IDR1.9 trillion (bank loans, finance leases and factoring loan) against IDR2.5 trillion in cash. Short term debt represents 14% of its total gross debt. We assume that LK's operating cash burn continues at the same rate per day as 2017. Assuming negative operating cash of IDR957.1bn year-to-date, cash balance may have fallen to IDR1.6 trillion. Given the tight cash flow situation at LK, do not expect debt to be paid down, but rather refinancing would be required.

We do not preclude capital injection but has yet to happen: ~34.5% of shares in LK is owned by companies related to the broader Lippo Group. PT Metropolis Propertindo Utama ("PT MPU"), a lessee of FIRT (PT MPU is also known to have other business relationships with Lippo Group) holds ~5.3%. The Lippo Group is involved in an extensive range of businesses including (but not limited to) hypermarkets, department stores (under the Matahari brand), online retail (MatahariMall.com), securities brokerage (Ciptadana), insurance, banking, media and telecommunications. The main shareholders of the Lippo Group are also related to main shareholders of Singapore-listed OUE Ltd, OUE's related REITs and OUE Lippo Healthcare. Similar to all capital source providers, the main shareholders would need to weigh the capital allocation decision across all divergent business interests (some which are in a growth phase and capital intensive). While we do not preclude the possibility of capital injection by main shareholders, we do not factor this into our base case for FIRT and LMRT for conservative reasons.

Figure 2: Simplified corporate structure



Source: LK presentation, OCBC Credit Research
Note (1) LK records its stake in FIRT and LMRT as available-for-sale financial assets
(2) Market cap as at 3 May 2018

B) Our views on FIRT on a standalone basis

Optically, FIRT has healthy credit metrics. As at 31 March 2018, aggregate leverage, while having inched up, was manageable at 34%. Adjusting 100% of perpetuals as debt, adjusted aggregate leverage was 38%. Interest coverage measured by EBITDA/Interest was healthy at 5.4x in 1Q2018 (1Q2017: 5.6x). FIRT has SGD60mn in perpetuals at a distribution rate of 5.68% p.a. Assuming all of the perpetual distributions are considered as interest, we find

adjusted EBITDA/Interest of 4.5x. Until January 2018, FIRT had ready access to financing markets (eg: bank lending, equity and debt markets), providing financial flexibility. Structurally, all REITs tend to hold little cash and access to markets is crucial to function as an on-going concern. We had observed proper management succession at FIRT, despite the retirement of the previous CEO who has been with the REIT since the 2006 IPO. Notwithstanding the issues faced by LK, we continue to see alignment of interest between management and external capital providers.

As a recap, FIRT owns hospital and healthcare-related assets predominantly located in Indonesia. Specifically, FIRT owns shares in companies that hold the property assets. Property titles held by FIRT are largely *Hak Guna Bangunan* (akin to leasehold property) or Build, Operate and Transfer Schemes. Under foreign ownership restrictions of Indonesia, *Hak Guna Bangunan* is the common title used. While the property is owned by FIRT and the key tenants are LK and PT MPU, these properties are utilised by Siloam to run its business operations. We understand that sub-lease agreements are signed between LK and Siloam though FIRT is not a party to the agreements.

Our key concerns:

Refinancing for the FIRT 4.125% '18s due in May 2018 requires bank lender support: In January 2018, FIRT obtained up to SGD400mn in new syndicated term loan facilities. The facility was drawn down in March 2018 to fully refinance existing bank loans (and not the FIRTSP 4.125% '18s). SGD100mn of bonds now come due on 22 May 2018 versus a cash balance as at 31 March 2018 of only SGD17.0mn. We understand that FIRT is in discussions with potential bank lenders with regards to refinancing. On the back of credit uncertainties and rising funding cost at LK, this may entangle the financing ability of companies linked to LK. We see the ability of a refinancing of the FIRT 4.125% '18s as high though this would require support from bank lenders to take on secured debt.

Counterparty credit risk: In FY2017, 82.4% of rental income at FIRT was attributable to LK and its subsidiaries. A further 12.9% of rental income is attributable to PT MPU while 0.4% of rental income was from Siloam directly. Non-traditional REITs typically own properties which are necessary to Sponsors and/or Sponsor-related entities' business operations (in this case Siloam's operations) and concentration of counterparty credit risk is common. In addition to FIRT, other non-traditional REITs include Parkway Life REIT, Religare Health Trust, Al-Aqar Healthcare REIT in Malaysia. Given the concentration of rental income at FIRT, it becomes more crucial for us to factor in tenant creditworthiness in reviewing FIRT's issuer profile. Additionally, assets owned by FIRT are highly specialised in nature and in our view, it is unlikely that replacement tenants can be found in a short period of time. It is also rare for hospital assets to be rented out on an asset-by-asset basis.

Tipping over of tri-party relationship between FIRT / Siloam / LK: At the beginning when FIRT was formed, Siloam was a privately held wholly-owned subsidiary of LK, with LK being a master lessee to FIRT. LK then leases the space to Siloam. Nonetheless, since Siloam's initial public offering in 2013, LK's shareholding in Siloam has declined steadily to only ~51% currently. While LK still holds a majority stake in Siloam, the liquidity strain at LK may force LK to start reducing stakes in its REITs: FIRT and LMRT. Siloam's cash flow generation has been thin (still in high growth phase) and it is likely that LK has been subsidizing rents paid to FIRT, despite Siloam now having third party equity investors. Should LK end up holding only a minority stake at Siloam, there is less economic incentive for LK to continue subsidising rents by being FIRT's master lessee.

Siloam has little ability to pay FIRT's full rents: We do not have the full picture of how cash movements between FIRT, LK and Siloam are recorded in LK and Siloam's financials. Though from the income statement, LK had received a total of IDR458.3bn in dividend income from the REITs (FIRT and LMRT collectively), LK would have paid SGD92.0mn (IDR965.1bn) in rents to FIRT in 2017. In return, LK receives (1) an estimated IDR184.7bn p.a from

FIRT as dividend income and (2) LK SGD10.9mn (IDR114.2bn) p.a from FIRTM as management fees. We estimate the per annum net outlay by LK to FIRT at SGD63.5mn (IDR666.2bn). In 2017, Siloam reported gross profit of IDR1.7 trillion and IDR219.3bn in operating profits. Rents that was paid by Siloam to LK in 2017 was only IDR111.9bn. Should the main tenant of FIRT be Siloam instead of LK, we estimate that Siloam would be facing an operating loss of ~IDR335.0bn instead. In 2017, Siloam's operating profit-to-total capital (a proxy for returns to capital providers) was 3.4%. Selling assets into REITs allows companies (who own assets) to recycle/unlock capital. If the seller leases the asset back, it is a form of financing for the seller. Dividend yield at FIRT is ~5-6% p.a and we see this as a gauge for the cost of equity financing of using the REIT as a financing vehicle. Should (1) the apparent liquidity strain at LK continue and/or (2) returns at Siloam continue to be lower than the cost of financing over the long term, there is heightened risk that lease terms at FIRT needs to be renegotiated with unitholders.

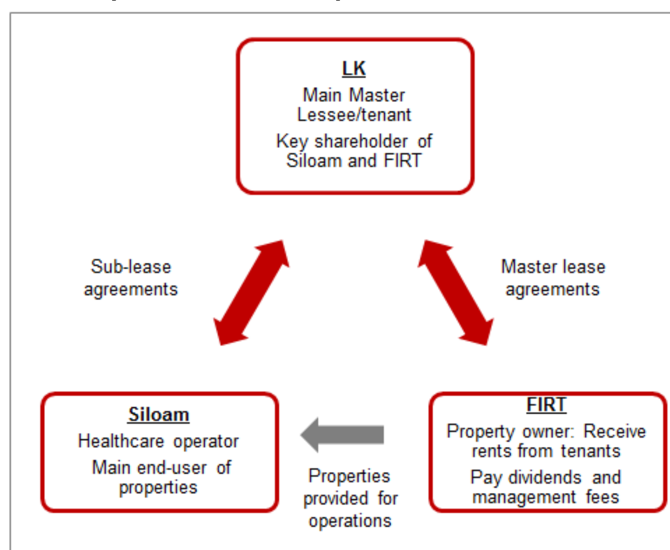
Figure 3: Estimated Income Flow

<table>
<tr><th>Income item</th><th>LK</th><th>Siloam</th><th>FIRT</th></tr>
<tr><td>Rental income/(expense) to FIRT</td><td>(-) SGD92.0mn</td><td>(-) SGD0.5mn</td><td>(+) SGD92.0mn</td></tr>
<tr><td>Dividend income (payments) to LK</td><td>(+) SGD17.6mn</td><td rowspan="2">NA</td><td>(-) SGD17.6mn</td></tr>
<tr><td>REIT Management fee income to LK (expense)</td><td>(+) SGD10.9mn</td><td>(-) SGD10.9mn</td></tr>
<tr><td>Net outlay</td><td>(-) SGD63.5mn</td><td>(-) SGD0.5mn</td><td rowspan="2">NA</td></tr>
<tr><td>Rental income/(expense) Siloam to LK</td><td>(+) SGD10.7mn</td><td>(-) SGD10.7mn</td></tr>
</table>

Source: OCBC Credit Research estimates

Note: (1) In 2017, FIRT's total gross revenue was SGD111.0mn. Siloam contributes 0.4% of rental income to FIRT

Figure 4: Tripartite relationship



Source: OCBC Credit Research

C) Our views on LMRT on a standalone basis

Softer results due to FX: LMRT reported 1Q2018 results for the quarter ending 31 March 2018. Revenue grew by only 1.1% y/y to SGD49.1mn, with additional income from the acquisition of Lippo Plaza Kendari (June 2017), Lippo Plaza Jogja and Kediri Town Square (Dec 2017) mostly offset by the IDR which weakened 9.1% y/y against the SGD. Net property income fell 4.6% y/y to SGD43.9mn mainly due to a new 10% tax introduced on service charges and utilities recovery charges in Jan 2018 and an increase in total operating property expenses.

Keep watch on receivables with delayed payments from sponsor: SGD15.2mn in receivables remain due from Lippo-related party tenants (likely from Matahari Department Store / Hypermart), though we think the amount is not alarming in comparison to 1Q2018 revenue of SGD49.1mn. We understand from LMRT that Hypermart, which contributed 9.2% of LMRT's gross rental income in 4Q2017 (fresh figures for 1Q2018 is not provided), is facing intense competition and we note the owner of Hypermart, Matahari Putra Prima Tbk PT ("MPP"), has recorded significant losses in 2017. Moody's has also placed MPP's "B3" credit rating on review for downgrade. Conversely, Matahari Department Store, which contributed 13.1% of 4Q2017's gross rental income, continues to report higher income and positive cash flows.

Stable composition of portfolio: LMRT owns a diversified portfolio of 30 retail malls and retail spaces across Indonesia. Portfolio occupancy remains high at ~94.0% (industry average: 84.8%) as of 1Q2018, though we acknowledge that the leases with LK has propped up the occupancy figures. By revenue, the trade sectors are well-diversified with the highest concentration being casual leasing (15%), F&B / Food Court (13%) and Fashion (12%). Average rental reversion in 1Q2018 was 5.3%.

Manageable credit metrics though FX remains a major risk: Aggregate leverage increased to 35.0% q/q (4Q2017: 33.7%), mainly due to a weaker IDR with assets mainly in IDR and borrowings mainly in SGD. We think that FX continues to remain a major risk as the balance sheet is not hedged.

Not overly concerned with the significant refinancing needs in the near term: LMRT holds SGD278.7mn of borrowings due in the coming 12 months, which comprise (1) SGD100mn LMRTSP 4.5% '18s, (2) SGD90mn in unsecured bank debt (3.0% p.a.) which previously used to be secured and (3) ~SGD90mm from revolving credit facilities. We believe LMRT will be able to eventually refinance given its low asset leverage and low asset encumbrance. However, with the LMRTSP curve trading lower, it may be more attractive to refinance via a bank loan (over a bond issue).

Potential for acquisition spree to continue: We note that LMRT has been active in acquisitions. The most recent acquisitions include Lippo Plaza Kendari (SGD32.2mn), Lippo Plaza Jogja and Kediri Town Square (for SGD98.1mn). LMRT has signalled that it is looking to acquire further, with Lippo Mall Puri (NLA: 122,595 sqm) that is located in West Jakarta likely to be considered. LMRT has not shared the property value of Lippo Mall Puri, though we think the acquisition could be in the tune of SGD300-500mn, judging from the value of LMRT's malls in Jakarta. LMRT holds the right-of-first-refusal to LK's pipeline of malls, which include 17 malls in Indonesia (not already owned by LMRT) and another 38 malls in the pipeline. We also understand that management may acquire from third party sources, including PT MPU.

D) Base case scenario: FIRT

Strong economic incentive at LK to keep FIRT value intact: LK still holds ~27.9% directly in FIRT and 100% of FIRTM. As at 3rd May 2018, LK's stake in FIRT is valued at SGD302mn by equity markets while LK's 51% stake in Siloam is valued at IDR5.3 trillion (~SGD504mn). Collectively, LK's stake in FIRT and Siloam represents ~90% of the market cap of LK. Major shareholders of LK hold their interest in FIRT and Siloam via LK. Our base case assumes willingness by major shareholders to preserve value at LK and by implication seek to preserve value at FIRT and Siloam. This is even more so if LK wishes to generate liquidity from selling stakes in the REITs. As an illustration, a sale of 2.9%-stake in FIRT may generate ~SGD31mn in the current market. Per FIRT's annual report in 2017, bank loan agreements contain terms where LK's interest in FIRT cannot be less than 25.0%. While secured bank loans have been refinanced by a new syndicated facility in March 2018 (terms are non-public), we would reasonably expect a change of

control clause to still exist.

Continued collection delays: We have noted accumulation of trade receivables at FIRT and that receivable days have increased to 97 days in 1Q2018 from 40 days historically after climbing successively in 2017. We continue to expect rental collection delays at FIRT though with LK eventually finding ways to repay FIRT. This is crucial for FIRT to service its dividends, perpetual distributions and interest payments.

Upcoming bond due can be refinanced by secured debt: Secured debt as a proportion of total assets is 26% and as a proportion of investment properties at 28%. While this is on the high side versus REITs under our coverage, it indicates that FIRT still has flexibility to raise more secured debt. 11 property assets with a collective valuation of SGD976mn as at 31 December 2017 have been collateralised for secured bank debt of up to SGD400mn (representing 41% loan-to-value "LTV"). Nine other assets are unencumbered for various reasons and under our base case we assume (1) only existing encumbered assets are acceptable by lenders to be put up as collateral (2) secured debt can be raised at a loan-to-value of 70% (represents typical LTVs on commercial property) and (3) lenders holding these 11 properties as collateral are willing to extend additional secured debt on the same collateral package. Under these three assumptions, FIRT still has secured debt headroom of SGD283mn against SGD100mn in bond due, in our view. In the scenario where bank lenders are willing to only lend at a lower loan-to-value ratio of 50%, FIRT's remaining secured debt headroom would only be SGD88mn.

E) Base case scenario: LMRT

Mitigated risk with diversified tenant pool: While there has been concerns in the market as more than 30% of LMRT's revenue is related to the Lippo group, we think this is mitigated by the remaining tenants with diverse trades. In addition, Lippo group's Matahari Department Store is still profitable – which we think may continue to lease from LMRT. The weakness, in our view, would stem from Lippo group's Hypermart (9.2% of 4Q2017 revenue) which appears to be struggling. We understand from LMRT that Hypermart did not renew certain spaces from LMRT.

LMRT as an important vehicle for LK to recycle capital: We think LK will likely provide support to LMRT as LMRT is instrumental to recycle the pipeline of retail assets from LK. However, we will not rule out the potential for LK to partly divest the stake in LMRT (~30.0%) if need be to raise liquidity.

Raising of capital to acquire: LMRT's management has not ruled out the use of rights to fund further acquisitions. If Puri Mall were to be acquired, we surmise that this should be done with a mix of equity and debt so as not to reach the 45% aggregate leverage regulatory limit.

Successful refinancing of near-term debt: Already, LMRT has obtained a SGD40mn unsecured revolving credit facility from BNP Paribas, which follows a SGD80mn unsecured uncommitted revolving credit facility obtained in Nov 2017. This supports our view that LMRT will be able to refinance its borrowings due within the next 12 months.

Continued collection of receivables: Thus far, receivables at LMRT have not exceeded 90 days. While payments from the Lippo group of companies may continue to remain somewhat stretched, we believe the delay should not exceed a quarter or dividends (which are paid quarterly) may be affected and provisions may have to be made.

F) Worst case scenario: FIRT

FIRT misses its dividend / perpetual distribution / interest payments: Notwithstanding the broader issues at LK, we note that FIRT has been paying

prompt quarterly dividends to unitholders since IPO and that per management; FIRT has also not missed any interest payment. In a worst case scenario where ability of LK to pay rents on a timely basis to FIRT is jeopardized, FIRT may face deeper collection problems and in turn lead to delays in dividend payments, distribution to perpetual holders and/or interest payments.

Renegotiation of master leases to lower lease rates: In the event LK's liquidity situation turns for the worst, LK may attempt to renegotiate Master Leases with FIRT to lease terms which are more sustainable for LK. We think this would only be a last ditch attempt given that any downward change to lease terms would similarly negatively reduce the value of the equity stake held by LK in FIRT. LK and FIRT cannot unilaterally change its lease terms as this is considered interested party transactions and subject to unitholders' approval.

Second-order impact – rise in aggregate leverage: In the off-chance that unitholders approve a downward change in lease terms, it is foreseeable that asset values at FIRT would fall (given that lease terms is a main component that goes into the valuation methodology to derive values). This would in turn lead to a rise in aggregate leverage. Hospital assets if and when they are sold, tend to be part of broader transactions involving M&A of the healthcare operator using those assets. While we certainly do not expect FIRT to be active sellers of its assets, we have not seen its portfolio assets being sold to third parties. Given the lack of market-based transactions, we recognize higher uncertainty over FIRT's asset value compared to traditional REITs under our coverage. We estimate weighted average lease expiries ("WALE") by asset value at FIRT to be 8.3 years in end-2017. Organically, leases on 25% of FIRT's assets (the four from initial portfolio) would come due in December 2021 and we expect negotiations to begin 1-2 years prior.

Figure 5: Illustration of aggregate leverage under various asset valuation scenarios

SGDmn	As at 31-March-2018	Asset base required to keep within 45% cap	Encumbered assets only	Asset base discounted by 50%
Gross debt	479	479	479	479
Perpetual	60	60	60	60
Total asset	1,431	1,065	976	715
Unadjusted aggregate leverage	34%	45%	49%	67%
Adjusted aggregate leverage (assume 100% of perpetual as debt)	38%	51%	55%	75%

Source: OCBC Credit Research
Note: As of March 2018, secured debt was SGD378mn, secured against a portion of investment properties at FIRT. Secured debt are taken at the Trust level (similar level as FIRT's perpetuals and bonds which reduces structural subordination risk for the fixed income holders)

Second-order impact – Fall in financial flexibility from equity and perpetual markets: We maintain that the core attractiveness of REITs as an investment vehicle to equity investors lies in their dividend-paying nature (more so versus other equity investments). While missing dividend payments is not considered to be a default, it is foreseeable that equity investors would withdraw their support to FIRT in the off-chance that dividend payments start declining. This is similar for perpetual securities where non-payment of distribution is not an event of default but value of the perpetuals would fall.

G) Worst case scenario: LMRT

Net property income hit with exit by Lippo group of entities: If the entire Lippo group of companies do not continue the lease following the pull out by Hypermart, occupancy may fall to ~60% region given that a third of the revenue is Lippo-related. Consequently, net property income may fall to ~SGD100mn for the full year. This should be still sufficient to cover finance

expenses of ~SGD32mn p.a., management fees (~SGD12mn p.a.) and other expenses (SGD3.2mn p.a.).

Occupancy to rebuild, with time: The decline in NPI, if Lippo group were to pull out, should be partly mitigated over time though given that the industry average occupancy is ~84%. For the malls at Jakarta, we note that the moratorium on standalone shopping mall development has been in place since 2011, which limits supply and should support the occupancy at the existing malls.

Hit to asset values may result in breach of regulatory limit, though still manageable in our view: If property valuers were to mark down the asset values by 30%, aggregate leverage of LMRT would increase to 49.5%, thereby breaching the 45% regulatory limit. This should be still manageable though, as we believe there is room for LMRT to (1) raise equity and/or (2) divest assets.

H) Looking further ahead: FIRT

LK has not publicly indicated that they may sell a large stake in FIRT to raise liquidity. The following is merely our opinion on how the developing situation at LK can play out assuming value preservation remains important to LK and Siloam shareholders. Compared to the ad-hoc sell down and/or dilution of LK's stakes in FIRT and Siloam, we think value can be better preserved if LK opts to instead sell Siloam and FIRT as a whole business in a co-ordinated fashion. In our view, Siloam and FIRT are interdependent and their fair value is in large part driven by each other (ie: without the physical hospitals, Siloam cannot operate and without Siloam, FIRT has no end users to utilize its space). A re-coupling of FIRT/Siloam should be more attractive to strategic buyers. Should a whole-business sale be contemplated, we think the following are the main negotiation points which may complicate the situation (1) purchase price of Siloam/FIRT (against current market cap) (2) change of control clause in bank debt (3) rights which existing private equity investor at Siloam may have.

I) Looking further ahead: LMRT

Negative headlines on LMRT's sponsor (LK) may result in investors shunning the credit and shutting LMRT out of the bond market, losing access to financial resources for acquisitions. Meanwhile, we believe that LMRT will be instrumental to recycle capital for LK (and in so doing alleviate the liquidity situation at LK), which may result in a higher aggregate leverage. We also do not rule out that parts of the Lippo group of companies (especially Hypermart) may cease to lease at LMRT, which may pressure rentals and occupancy at LMRT. Nevertheless, we think LMRT will eventually survive even in the worst case scenario though pressures on its credit may develop.

- **Recommendation:** In view of the headwinds faced by LK, which is the sponsor, we are downgrading the issuer profiles for both LMRT and FIRT to Negative (6) from Neutral (5). For bond-level recommendations, we maintain our Underweight call for the FIRT 5.68%-PERP and downgrade LMRTSP 6.6% PERP and LMRTSP 7% PERP to Neutral in view of the potential overhang from the negative news flows. Between the LMRTSP perps though, we prefer LMRTSP 7% PERP over LMRTSP 6.6% PERP as the former has (1) 49bps wider reset spread and (2) a nearer call date. In addition, based on today's expectations of 5Y swaps in 2021 rising to 2.80%, the distribution of LMRTSP 7% PERP is expected to reset to ~8.0%, if it were not called. We compare this with the annualised dividend yield (based on the latest declared dividend) of 8.375% based on the equity of LMRT trading at SGD0.32 cts/share. As such, we continue to think that the probability of call for the LMRTSP 7% PERP remains high. We continue to Overweight LMRTSP '18s and LMRTSP '20s as they offer decent yields for short durations and we believe that the liquidity situation at LMRT should be resolved.

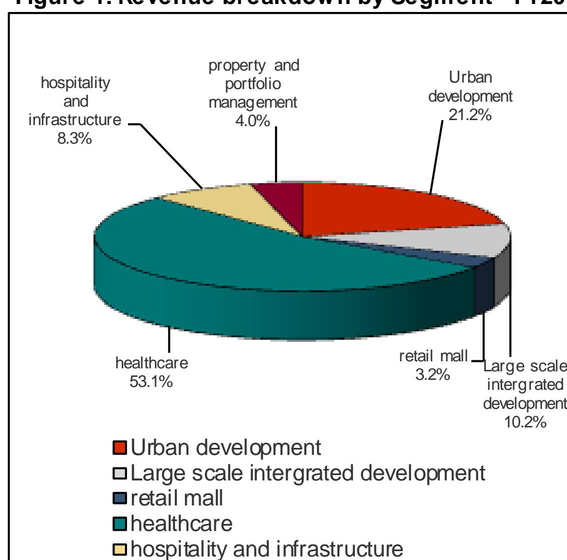
PT Lippo Karawaci Tbk

Table 1: Summary Financials

Year End 31st Dec	FY2015	FY2016	FY2017
Income Statement (Rp'mn)			
Revenue	8,703.7	10,749.3	10,902.9
EBITDA	1,694.1	1,910.3	1,675.3
EBIT	1,520.9	1,735.6	1,427.5
Gross interest expense	260.7	318.2	215.5
Profit Before Tax	1,284.8	1,557.7	1,167.1
Net profit	535.4	882.4	614.2
Balance Sheet (Rp'mn)			
Cash and bank deposits	1,839.4	3,249.7	2,538.2
Total assets	41,326.6	45,603.7	56,772.1
Gross debt	12,365.2	13,535.6	13,663.5
Net debt	10,525.9	10,285.9	11,125.4
Shareholders' equity	18,916.8	22,075.1	29,860.3
Total capitalization	31,282.0	35,610.8	43,523.8
Net capitalization	29,442.6	32,361.1	40,985.7
Cash Flow (Rp'mn)			
Funds from operations (FFO)	708.6	1,057.1	861.9
CFO	-2,835.0	-408.6	-4,507.2
Capex	0.0	0.0	0.0
Acquisitions	553.9	593.9	1,347.8
Disposals	1,199.0	1,373.1	782.2
Dividend	517.5	86.8	45.3
Free Cash Flow (FCF)	-2,835.0	-408.6	-4,507.2
* FCF adjusted	-2,707.3	283.7	-5,118.1
Key Ratios			
EBITDA margin (%)	19.5	17.8	15.4
Net margin (%)	6.2	8.2	5.6
Gross debt to EBITDA (x)	7.3	7.1	8.2
Net debt to EBITDA (x)	6.2	5.4	6.6
Gross Debt to Equity (x)	0.65	0.61	0.46
Net Debt to Equity (x)	0.56	0.47	0.37
Gross debt/total capitalisation (%)	39.5	38.0	31.4
Net debt/net capitalisation (%)	35.8	31.8	27.1
Cash/current borrowings (x)	1.8	2.3	1.3
EBITDA/Total Interest (x)	6.5	6.0	7.8

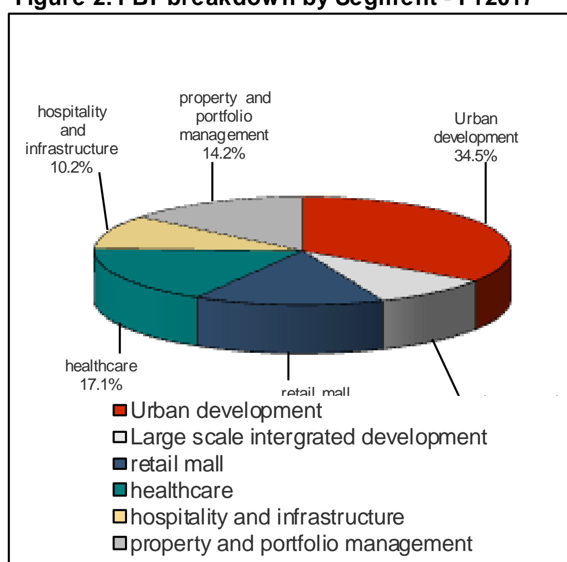
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Segment - FY2017



Source: Company

Figure 2: PBT breakdown by Segment - FY2017



Source: Company

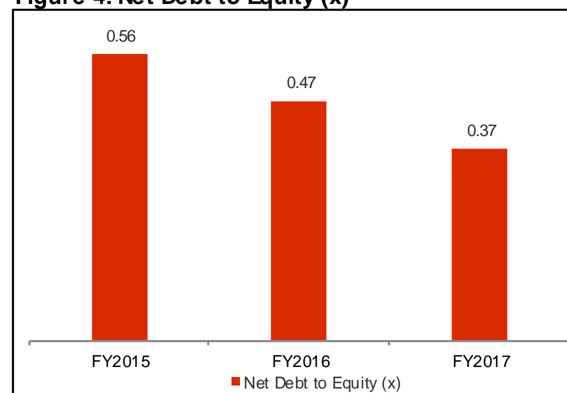
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals*

Figure 3: Debt Maturity Profile

Amounts in (Rp'mn)	As at 31/12/2017	% of debt
Amount repayable in one year or less, or on demand		
Secured	1,893.9	13.9%
Unsecured	25.2	0.2%
	1,919.1	**14.0%**
Amount repayable after a year		
Secured	914.1	6.7%
Unsecured	10,830.3	79.3%
	11,744.4	**86.0%**
Total	**13,663.5**	**100.0%**

Source: Company, OCBC estimates

Figure 4: Net Debt to Equity (x)



Source: Company

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