Issuer Profile:

Neutral (5)

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Neutral (5)

Ticker:

OUESP

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OUE Limited ("OUE")

Recommendation

- **With EBITDA generation thin, OUE's credit profile continues to be underpinned by its significant asset base. In July 2020, the company announced the proposed sale of US Bank Tower for USD430mn (~SGD585mn) and below book value as at end-2019, taking a fair value loss of ~SGD310mn in the process which led to a net loss of SGD207.2mn in 1H2020. Today, OUE announced that the sale has been completed.**
- **We expect OUE's short term liquidity to be manageable based on its current cash balance and proceeds from the sale of the US Bank Tower and are therefore maintaining our issuer profile at Neutral (5). That said, we see longer term pressure on the issuer profile however, as we expect liquidity to be tighter from 2H2021 onwards assuming no improvement to the hospitality segment and will continue to monitor developments.**
- **Bond Recommendation: With OUESP 3.75% '22s and OUESP 3.55% '23s only yielding 3.42% and 3.68% respectively, we prefer the OLAMSP curve within the high yield space, even if the issuer is not in the same industry sector. Alternatively, investors may consider the bonds issued by OUE-CT instead.**

Relative Value:

Bond	Maturity / Call date	Net gearing	Ask YTM/YTC	Spread	Recommen-dation
OUESP 3.75% '22s	17/04/2022	0.60x	3.42%	319bps	UW
OUESP 3.55% '23s	10/05/2023	0.60x	3.68%	338bps	UW
GUOLSP 4.0% '22s	31/01/2022	0.91x	2.44%	222bps	OW*
GUOLSP 3.85% '23s	15/02/2023	0.91x	2.79%	251bps	N*
OLAMSP 6.0% '22s	25/10/2022	1.28x	3.57%	331bps	N*

Indicative prices as at 16 September 2020 Source: Bloomberg
Net gearing based on latest available financials
**Based on Monthly Credit View (03 September 2020)*

Background

- OUE Limited ("OUE")'s key business is as an investment holding company. OUE also owns investment properties and has increased its exposure to the healthcare segment and China property businesses. As at 16 September 2020, OUE's market cap was SGD1.0bn.
- OUE owns a ~48%-stake in OUE-Commercial REIT ("OUE-CT") that combined with OUE-Hospitality Trust ("OUE-HT") in September 2019, and a ~64.4%-stake in OUE Lippo Healthcare Ltd ("OUELH"), both of which it consolidates as subsidiaries in its financials.
- Additionally, OUE owns a deemed 100%-stake in First Real Estate Investment Trust ("First REIT")'s REIT Manager, a deemed ~19%-stake in First REIT and a ~23.8%-stake in Hong Kong-listed Gemdale Properties and Investment Corporation Limited ("Gemdale").
- OUE is ~69%-indirectly owned by Lippo ASM Asia Property Limited ("LAAPL"). Hong Kong listed Lippo Limited has a deemed 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. The remaining shareholding in OUE is dispersed.
- OUE is incorporated in Singapore. OUE's SGD-bonds are issued by OUE Treasury Pte Ltd, unconditionally and irrevocably guaranteed by OUE.

Key Considerations

- **Thin EBITDA/Interest coverage:** Consolidated EBITDA (based on our calculation which does not include other income and other expenses) was SGD91.0mn, down 13.3% y/y though managed to cover interest expense of SGD69.5mn by 1.3x in 1H2020. In 1H2020, OUE received SGD59.5mn in cash dividends, mainly received from its equity accounted investees (eg: Gemdale Properties & Investment Corp Ltd "Gemdale") which paid out final dividends for 2019 in 1H2020. Including these dividends into EBITDA, we find Adjusted EBITDA/Interest at 2.2x. Removing the contribution from OUE-CT which is consolidated into OUE's financials, we estimate that OUE (excluding OUE-CT) reported a loss before interest, tax, depreciation and amortization of SGD10.9mn and insufficient to cover its standalone interest expense of SGD24.4mn.

- **OUE pays rent to OUE-CT as Master Lessee on hotels owned by OUE-CT:** OUE pays rental support to OUE-CT for OUE Downtown, amounting to SGD9.4mn in 1H2020. Additionally, OUE is the master lessee of two hotel properties owned by OUE-CT, namely the Mandarin Orchard Singapore and Crowne Plaza Changi Airport. These two hotel properties were acquired earlier from OUE where the Mandarin Orchard was part of the initial portfolio of OUE-HT at time of IPO and Crowne Plaza Changi was acquired by OUE-HT in January 2015. Under the master lease agreements, OUE-CT also receives total minimum rent of SGD67.5mn p.a. (SGD33.8mn for six months) on the two hotels from OUE. Without the rental support and the minimum rent from OUE-CT, OUE-CT is still able to cover its own interest expense. Any cash outlay from the OUE-level to OUE-CT represents a cash leakage from the OUE-level to OUE-CT's minority interest investors as well, given that OUE only owns ~48% of OUE-CT. Historically this was not a major issue in our view given that the underlying hotel properties at OUE-CT were contributing where OUE also benefitted from the dividend upstream from OUE-CT.

- **……receives dividends which offset some cash outlay though expect dividends to fall:** However, in 1H2020, OUE-CT announced that it will be withholding SGD13.8mn out of SGD68.3mn of amount available for distribution to unitholders in 1H2020 (ie: ~80% dividend payout ratio). Net of the dividend amount that was received as a unitholder, we estimate OUE (excluding OUE-CT) had paid ~SGD15mn to OUE-CT in 1H2020. We think 1H2020 though is not a full representation of the impact of the COVID-19 hit on the hospitality segment in Singapore as Singapore only started closing borders broadly since March 2020 while the underlying hotels are still benefitting from alternative sources of demand eg: guests serving stay home notices, medical and airport workers and more recently, staycations. These sources of demand while very useful are transient.

- **Expect hospitality segment to remain weak though some buffer from domestic guests:** While the two hotel properties are high quality and have performed well pre-COVID-19, like their competitors, operating performance is highly dependent on broader developments surrounding reopening of international borders. We do not expect material changes on this front in the near term. Discussions between governments to re-open international borders have happened, though appear to be still protracted. Where allowed, international travel is still an onerous activity (eg: quarantines, swab tests, risk of infection and associated healthcare availability and costs) which is likely to deter non-essential travel. Additionally, countries facing second waves have re-imposed restrictions on mobility. The International Air Transport Association ("IATA") in its latest views dated 28 July 2020 expects that air travel will not recover to pre-COVID-19 levels until at least 2024. As the hotel Master Lessee, OUE also bears operating expenses at the two hotels rather than OUE-CT as the landlord. Taking the higher end of a typical luxury hotel cost structure (excluding depreciation & amortization) of 75% of revenue, we estimate that OUE spends ~SGD96mn p.a. pre-COVID-19. Along with alternative sources of demand and following Singapore's domestic travel marketing campaign and allowing hotels to accept staycation guests, Singapore hotel occupancy should increase. For July 2020, the broad market occupancy was up sharply at 70% (June 2020: 53.3%) based on data from the Singapore Tourism Board. In our view, if this occupancy levels keep up, Singapore hotels would be breaking-even on a cash basis, excluding depreciation and amortization.

- **Sold US Bank Tower below book:** OUE recorded revenue of SGD311.4mn in 1H2020 and a large net loss to owners of SGD207.2mn in 1H2020 as the company took a SGD310.0mn fair value loss on investment properties following the announced sale of its USA Bank Tower building in Los Angeles for USD430mn (~SGD585mn). This was significantly lower than the book value as at 31 December 2019 of USD650mn (~SGD885mn) and represents a discount to last available book value of 34%. The buyer is USBT Property Owner LP, which has been reported by media outlets as an entity connected to New York-based Silverstein Properties, an unlisted real estate development, investment and management firm. The sale completed today. The property was bought in June 2013 for USD367.5mn (~SGD459.4mn) though has undergone a series of asset enhancement works amounting to USD50mn-100mn (~SGD62.5mn-125mn, using the historical exchange rate). The company disclosed that one reason for the lower valuation is due to the outbreak of COVID-19 which had affected occupancy and rental income from the property. While we understand that a post-COVID-19 environment would come with a markedly different price tag, it is worth noting that the property had been put on market at least as early as January 2019. It came as somewhat of a surprise that the company had decided to continue to push through a sale now rather than wait until the market improves. Per company, the sale allows the company to recycle capital and reduce its net gearing. In our view, the sale is important in assisting OUE to meet its near term liquidity needs.

- **Elevated market implied net gearing, though still have large asset base:** While the fair value loss on investment properties was a noncash item, it drove a 5% hit to OUE's book value of equity, pushing unadjusted net gearing (including lease liabilities) somewhat higher to 0.60x (31 December 2019: 0.58x). Ceteris paribus, with the proceeds from the sale, we expect unadjusted net gearing to fall to 0.50x. As of writing, OUE's market value of equity was SGD1.0bn, with market implied net gearing at 3.4x, which is elevated. This is despite OUE's ~48%-stake in OUE-CT, valued at SGD962mn and its ~23.8%-stake in Gemdale valued at SGD930mn, based on their respective market cap as at 16 September 2020. While the equity markets are inputing a large holding company discount on OUE, in our view, stakes in these companies can be sold to generate liquidity if required. In 1H2020, OUE sold a ~4.0%-stake in Gemdale (completed on 14 January 2020) which raised ~SGD100mn in cash proceeds for OUE. Other assets that OUE (excluding OUE-CT) still owns include non-office components from OUE Downtown, nursing homes held at the OUE-LH level, OUE TwinPeaks units held as investment properties, and cash to be collected from remaining OUE TwinPeaks sold earlier under deferred payment schemes (though we do not expect this to be too significant by now).

- **Short term liquidity is manageable:** As at 30 June 2020, OUE on a consolidated basis faced short term debt of SGD720.3mn, though SGD577.3mn relates to short term debt coming due at OUE-CT, which means only SGD143.0mn at OUE (excluding OUE-CT), against SGD271.0mn of cash at OUE (excluding OUE-CT). On 5 September 2020, OUE-CT had redeemed SGD150mn of its bonds which matured. In 1H2020, OUE (excluding OUE-CT) paid out SGD23.6mn of dividends, though did not declare any dividends with the financial statement announcement in a bid to conserve cash. In 2021 OUE-CT faces SGD792mn of debt that is coming due. As a REIT that directly holds underlying investment properties, we think there is a good chance for the REIT to source refinancing, including some remaining unencumbered assets that can be used to raised secured financing, if need be.

- **……though longer term uncertainty persists:** While we do not have the specific debt breakdown by maturity date for OUE (excluding OUE-CT) in 2021, we know that long term debt at OUE (excluding OUE-CT) was SGD986.4mn as at 30 June 2020. Out of these, an aggregate SGD554.8mn consists of two tranches of bullet bonds and one tranche of convertible bonds with low probability of being converted (conversion price of SGD1.855 versus SGD1.14 share price as at 16 September 2020). This leaves SGD431.6mn of long term bank debt, which we assume as amortising debt. Assuming a three-year equal amortization schedule, this implies a debt repayment of SGD143.9mn per year. Even if the SGD431.6mn of bank debt at OUE (excluding OUE-CT) is due in 2021 or earlier, OUE's cash balance with the proceeds from US Bank Tower is sufficient to cover these debts and one year of hospitality operating expenses, rental support and master lease payments to OUE-CT. All in, we see OUE's liquidity risk as manageable for the remainder of 2020 and 1H2021, though may be tight from 2H2021 onwards assuming no improvement in the Hospitality segment. Other possible uses of cash include financial assistance to its Sponsored REIT, First Real Estate Investment Trust ("FIRT", Negative (6)). OUE has an effective 85.7%-effective stake in the REIT Manager and a deemed 100%-stake in the FIRT REIT Manager and a 19%-deemed interest in FIRT. YTD, FIRT's market value of equity has also fallen by 50%, suggesting that OUE may need to impair its investment in FIRT. Neither FIRT nor OUE has indicated that OUE would need to financially assist FIRT, although the main Master Lessee of FIRT has announced that it wants to restructure the leases. OUE has also completed the acquisition of a piece of land in Indonesia which is planned to be a mixed development property although the project is still under evaluation.

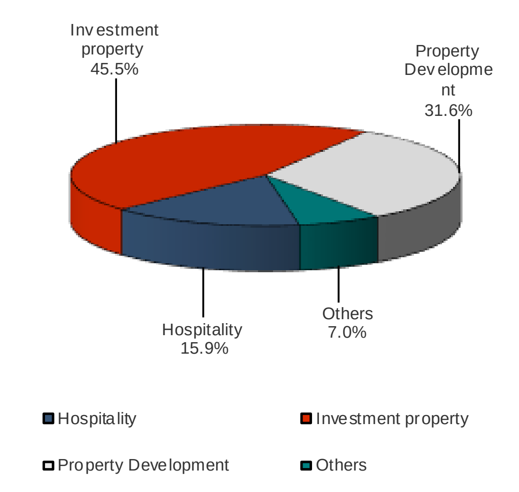
OUE Ltd

Table 1: Summary Financials

Year Ended 31st Dec	FY2018	FY2019	1H2020
Income Statement (SGD'mn)			
Revenue	642.9	930.8	311.4
EBITDA	167.9	224.7	91.1
EBIT	160.0	173.4	67.2
Gross interest expense	139.4	170.1	69.5
Profit Before Tax	103.6	369.7	-233.8
Net profit	56.6	321.8	-186.4
Balance Sheet (SGD'mn)			
Cash and bank deposits	409.4	477.7	335.9
Total assets	9,265.8	10,734.5	10,212.8
Short term debt	471.7	1,310.4	720.3
Gross debt	3,496.3	4,015.7	3,836.9
Net debt	3,086.9	3,538.0	3,501.0
Shareholders' equity	5,139.2	6,117.1	5,839.8
Cash Flow (SGD'mn)			
CFO	119.4	396.6	78.1
Capex	7.2	11.4	14.8
Acquisitions	842.5	520.4	65.4
Disposals	508.0	851.4	132.5
Dividend	64.9	168.0	82.9
Interest paid	130.2	126.0	64.6
Free Cash Flow (FCF)	112.2	385.2	63.3
Key Ratios			
EBITDA margin (%)	26.11	24.14	29.24
Net margin (%)	8.81	34.57	-59.84
Gross debt to EBITDA (x)	20.83	17.87	21.07
Net debt to EBITDA (x)	18.39	15.74	19.22
Gross Debt to Equity (x)	0.68	0.66	0.66
Net Debt to Equity (x)	0.60	0.58	0.60
Gross debt/total assets (x)	0.38	0.37	0.38
Net debt/total assets (x)	0.33	0.33	0.34
Cash/current borrowings (x)	0.87	0.36	0.47
EBITDA/Total Interest (x)	1.20	1.32	1.31

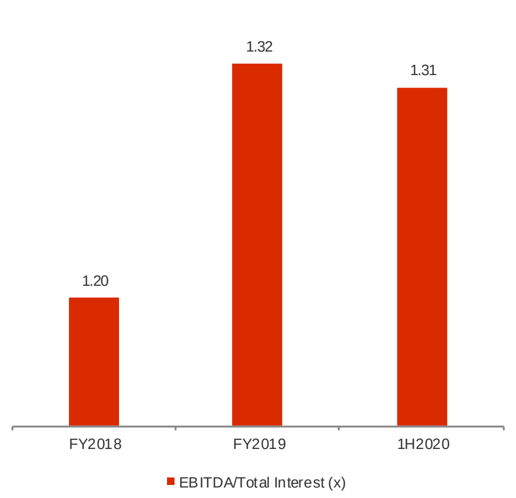
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Segment - 1H2020



Source: Company

Figure 2: EBITDA/Total Interest (x)



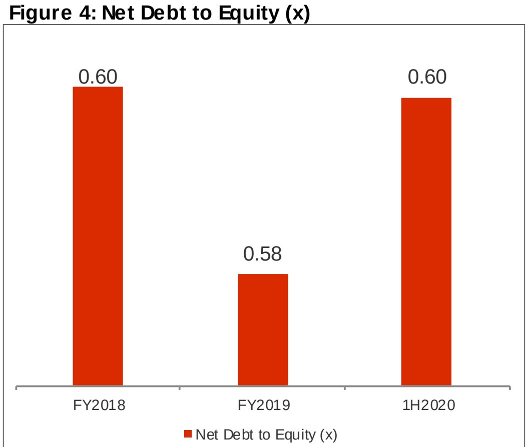
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 30/06/2020	% of debt
Amount repayable in one year or less, or on demand		
Secured	464.5	12.1%
Unsecured	255.8	6.7%
	720.3	**18.8%**
Amount repayable after a year		
Secured	1,518.0	39.6%
Unsecured	1,598.6	41.7%
	3,116.6	**81.2%**
Total	**3,836.9**	**100.0%**

Source: Company, OCBC estimates

Figure 4: Net Debt to Equity (x)



Source: Company

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 bond represents **better relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Neutral (“N”) – The represents **fair relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Underweight (“UW”) – The represents **weaker relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

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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