Issuer Profile:

Neutral (5)

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Neutral (5)

Ticker:

OUESP

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OUE Limited ("OUE")

Recommendation

- **OUE's credit profile continues to be underpinned by its assets coverage which has been sold down, albeit still providing a manageable debt-to-asset coverage based on our preliminary asset coverage analysis. OUE faces little short term debt due though medium term liquidity looks more stretched without further asset sales.**
- **On a consolidated basis, OUE's unadjusted net gearing was lower at 0.52x as at 31 December 2020 (30 June 2020: 0.60x). While book value equity had taken a further hit from impairments, OUE received SGD591.3mn in cash proceeds from the sale of the US Bank Tower in 2H2020. OUE's market implied net gearing though remains high at 2.5x. In our view, OUE is more reliant on potential asset sales versus new equity raising as a means of funding.**
- **The challenging environment facing the Singapore hospitality sector has meant that instead of receiving dividend upstream from OUE-CT, OUE had paid a cash outlay to OUE-CT as part of the minimum rent on master lease agreements and also continues to bear the operating expenses on the two hotels in Singapore, rather than OUE-CT.**
- **With OUE undertaking to financially support its investments, we had been monitoring OUE for a potential downgrade through 1H2021 on the back of expectations of tighter liquidity in 2021. However, actual outcomes have thus far been more moderate while recent asset sales at OUE-CT had generated funds that boosted OUE's liquidity. We maintain OUE's issuer profile at Neutral (5) for now though continue to monitor developments at the company.**
- **Bond Recommendation: We are underweight both the OUESP bonds. On a relative value basis, we prefer the bonds of OUE Commercial Trust ("OUE-CT", Issuer profile: Unrated). OUE-CT is a diversified REIT (stapled with business trust), ~48%-owned by OUE and sits closer to key investment properties. OUE-CT has been able to raise external funding despite the still challenging outlook of the hospitality sector. The OUECT 4.0% '25s and OUECT 3.95% '25s provides a yield pick-up of ~105-170bps against the OUESP bonds, we think this more than compensates for the longer tenors and as such we recommend a switch. We do not officially cover the issuer profile of OUE-CT. Please refer to the special interest commentary dated 16 September 2020 on OUE-CT for further information.**

Relative Value:

Bond	Maturity / Call date	Net gearing	EBITDA/ Interest	Ask YTM	Spread	Recommen-dation
OUESP 3.75% '22s	17/04/2022	0.52x	1.5x	2.03%	175bps	UW
OUESP 3.55% '23s	10/05/2023	0.52x	1.5x	2.55%	218bps	UW
OUECT 4.0% '25s	24/06/2025	0.70x*	2.5x	3.61%	288bps	n.a
OUECT 3.95% '26s	02/06/2026	0.70x*	2.5x	3.70%	285bps	n.a

Indicative prices as at 11 June 2021 Source: Bloomberg
Net gearing based on latest available financials
**Reported aggregate leverage for OUECT was 40.4% as at 31 March 2021*

Background

- OUE Limited ("OUE") 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 11 June 2021, OUE's market cap was SGD1.2bn.
- OUE owns a ~48%-stake in OUE-Commercial REIT ("OUE-CT") that combined with OUE-Hospitality Trust ("OUE-HT") in September 2019 and increased its stake in in OUE Lippo Healthcare Ltd ("OUE-LH") to ~70.4% since 31 March 2021 (from 64.4% earlier). Both OUE-CT and OUE-LH are consolidated as subsidiaries of OUE.
- Additionally, OUE owns a deemed 100%-stake in the REIT Manager of First Real Estate Investment Trust ("First REIT", Issuer profile: Negative (7)), a deemed ~28.0%-stake in First REIT itself and a ~23.0%-stake in Hong Kong-listed Gemdale Properties and Investment Corporation Limited ("Gemdale").

- OUE is ~70.1%-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

- **EBITDA generation continues as an issue though receives dividend income:** Based on our estimation, OUE would have reported a loss before interest, tax, depreciation and amortization of SGD15.7mn for 2020, if the contribution from OUE-CT was excluded, bulk of the losses were from 1H2020. We estimate that interest expense, excluding OUE-CT ("OUE standalone") for 2020 was SGD49.1mn. In our view, y/y comparison is less useful, as OUE's Sponsored REIT, OUE Commercial Trust ("OUE-CT") only completed its combination with OUE Hospitality Trust ("OUE-HT") in September 2019. Prior to the combination, OUE-HT was historically recorded as an associate of OUE. OUE as an investment holding company is highly reliant on its subsidiary OUE-CT and associated company Gemdale for dividend upstreaming. In 2020, OUE-CT had paid out SGD113.5mn of cash dividends to unitholders (SGD54.3mn attributable to OUE) while Gemdale paid RMB1.2bn (~SGD244.7mn) of cash dividends to shareholders (~SGD56.3mn attributable to OUE). Cash dividends paid by Gemdale in 2020 represented 24% of Gemdale's 2020 net income.

- **Bears the brunt on hotel-level expenses:** OUE is the master lessee at the two hotel assets owned by OUE-CT (namely, Crowne Plaza at Changi and Mandarin Orchard which is being reflagged as Hilton). In 2020, OUE had paid SGD65.7mn (being the minimum rent) to OUE-CT. While OUE as the parent company of OUE-CT gets bulk of these back through dividend, a portion is attributable to other investors of OUE-CT. We estimate that net of equity dividends received, the cash outlay that OUE-standalone had paid to OUE-CT was SGD11.2mn in 2020. We understand that as master lessee, OUE bears all hotel-level operating expenses although cost containment measures had been carried out during the year. We had earlier estimated that excluding depreciation and amortization this number was between SGD76-96mn p.a. Based on OUE's actual 2020 segmental results, implied EBITDA for the hospitality segment was SGD34.5mn (11% of total implied EBITDA when share of results of equity-accounted investees are included) in 2020. On a revenue of SGD90.8mn, this meant that expenses (excluding depreciation and amortization, interest and taxes) were SGD56.2mn for 2020. Our base case though assumes a higher level of cash expenses in light of the still challenging pandemic environment for Singapore hotel owners.

- **Willingness to extend support to First REIT:** In February 2021, First REIT completed its equity rights issue (at 98 rights for every 100 units held), raising ~SGD158mn of gross proceeds. ~SGD140mn was used to repay part of an earlier SGD400mn bank loan facility, as required by First REIT's bank lenders. Prior to the rights issue, OUE had a deemed interest of ~19.7% in First REIT and an effective stake of 14.7%. In addition to undertakings from the First REIT's REIT Manager and OUE-LH, OUE had provided irrevocable undertakings to First REIT to subscribe for excess rights units, with OUE prepared to fund a maximum of SGD135.8mn of the rights issue. We estimate that minority investors took up ~65% of the rights issues (including excess applications), performing better than expected. Given the small undersubscription, OUE directly only took up 39.6mn units (~SGD7.9mn), with the remaining taken up by OUE-LH and First REIT's REIT Manager. In 1Q2021, First REIT's distributable income was SGD10.4mn, down 30.5% y/y, attributable to the restructured master lease agreements. Even if the amount was fully paid out as dividends to unitholders, we estimate this at ~SGD2mn for the quarter (~SGD8mn p.a), taking into account OUE's new effective stake of ~20% in First REIT.

- **Do not expect significant cash generation out of OUE-LH yet:** OUE-LH has yet to pay cash dividends to shareholders since OUE took control of OUE-LH in 2017. In February 2021, OUE-LH announced a recapitalization plan which saw OUE look to convert SGD165.4mn of existing shareholder loans to OUE-LH into SGD189.6mn worth of perpetual convertible bonds (comprising existing principal and unpaid interest accrued). The transaction was subsequently completed in March 2021 and indicatively allows OUE-LH to book a one-off non-cash gain of SGD112.3mn though we think this will be "net-off" at the OUE level. One stated rationale of the conversion was to allow OUE-LH to improve its capital structure and remove uncertainties over the going concern assumption of OUE-LH. In 2020, OUE-LH reported a net loss of SGD99.2mn (2019 net profit of SGD3.2mn), mainly dragged by impairment losses on property, plant and equipment, fair value losses on investment properties under development and share of losses at First REIT, where First REIT had been dragged by fair value losses from master lease restructuring and rental relief provided to tenants.

……on the hook to buy back Itochu's stake in OUE-LH: In March 2021, OUE entered into an agreement to buy a 6%-stake held by an indirect wholly-owned subsidiary of ITOCHU Corporation ("ITOCHU") in OUE-LH for SGD27.7mn. Itochu is the second largest shareholder of OUE-LH. Under a new memorandum of understanding and supplemental letter that has been entered into on 23 March 2021, OUE has undertaken that it will buy all the shares in OUE-LH owned by ITOCHU if certain financial and operational triggers are not met. Conceptually, we see this as a "contingent liability" from the perspective of OUE. Assuming a purchase price per share of SGD0.104 and if this is triggered, could amount to a ~SGD89mn payment from OUE, in our view. The specifics of trigger events are undisclosed. Our base case assumes that this payment will need to be made by OUE though manageable in view of the assets OUE hold.

- **Buying a stake in Matahari Department Store via a joint venture:** In May 2021, OUE announced that it has established a joint venture company known as Auric Digital Retail Pte. Ltd. ("Auric Digital") where Auric Digital has announced a voluntary tender offer to buy an up to 40%-stake in PT Matahari Department Store Tbk ("Matahari"). The current largest shareholder of Matahari is also the largest shareholder of PT Lippo Karawaci Tbk ("LK"). First REIT's rental income is mainly attributable to LK while certain LK and OUE's board members share familial ties. OUE will record its 40%-sake in Auric Digital as an associated company while 60%-stake in Auric Digital is indirectly owned by OUE's Chairman and his family. Subsequent to the voluntary tender offer, Auric Digital will purchase an additional 10.1% stake in Matahari (where 4.8% will be bought from OUE, 5.3% from another shareholder). The acquisition will be funded by a bank facility granted to Auric Digital and shareholder's funding amounting to SGD150mn. While the bank debt taken by Auric Digital will not be consolidated on OUE's balance sheet, OUE's proportionate share of this debt is SGD38mn. We think monies received on its Matahari-stake sale will reduce the amount OUE needs to make available to Auric Digital as shareholder to ~SGD43mn. We take 40% of SGD150mn (reflecting OUE's stake in Auric Digital), and reducing it by SGD17mn, assuming the same purchase price of ~SGD0.14 per share for OUE's 4.8%-stake in Matahari.

- **Elevated market implied net gearing though still have assets:** On a book value basis, unadjusted net gearing (including lease liabilities) was 0.52x as at 31 December 2020, lower than the 0.60x as at 30 June 2020 and within our expectations on the back of the sale of the US Bank Tower. OUE had taken a 3.1% hit to book value of equity h/h, among which was attributed to impairments at the First REIT's REIT Manager, two hotels and land held at OUE-LH. The US Bank Tower was sold at significantly below book value (equity hit taken in 1H2020), though the company had received cash proceeds from the sale amounting to SGD591.3mn in 2H2020. There was also a debt repayment (net of new borrowings) amounting to SGD324.5mn in 2H2021 based on our implied calculations from the full year numbers. As at 11 June 2021, OUE's market value of equity was SGD1.2bn, ~16% higher than our last credit update of the company (albeit OUE shares are tightly controlled with a low free float). Implied market net gearing based on this remains elevated at ~2.5x. OUE's credit profile continues to be underpinned by its asset coverage.

- **OUE-CT's sale of OUE Bayfront generated cash to OUE:** In March 2021, OUE-CT completed a sale in key assets OUE Bayfront, OUE Tower and OUE Link to a limited liability partnership which is 50%-held by OUE-CT and 50% by a fund managed by Allianz Real Estate Asia Pacific Pte Ltd ("Allianz"), effectively selling half of the property to Allianz. At time of announcement, we expected the SGD262.6mn of net proceeds to go towards paying down debt at OUE-CT. However, in May 2021, OUE-CT announced that SGD155mn of the net proceeds were used to redeem convertible perpetual preferred units ("CPPU") held by OUE. The CPPUs were issued to OUE as part of the purchase consideration when OUE-CT bought the beneficial interest in One Raffles Place from OUE in 2015 and recorded as equity in OUE-CT's financials. There is another 220mn units (~SGD220mn) of CPPU outstanding which may still be redeemed by OUE-CT. For the avoidance of doubt, CPPUs are not redeemable at the option of OUE. As of writing, the main properties which OUE-standalone owns include Downtown Gallery (retail portion at OUE Downtown), 23 units at OUE TwinPeaks and land in Jakarta (mixed development targeted for completion in 2026). OUE holds a remaining balance of promissory notes amounting to ~SGD115.8mn (held as a current asset) which is expected to be used to acquire additional land or properties.

- 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	1,043
Nursing homes owned by OUE-LH	309
Retail portion of OUE Downtown Gallery	230
Market value of 23%-stake in Gemdale	668
23 units of OUE TwinPeaks held as investment properties	66
Land in Jakarta for mixed development project	132
Total	**2,448**
(-) Gross debt as at 31 December 2020 (excluding debt at OUE-CT but including debt at OUE-LH)	781
(-) Agreement to buy ITOCHU's stake in OUE-LH (we assume this is a contingent liability)	89
Asset-to-debt coverage	**2.8x**

Source: Company financials, notice of valuation, Bloomberg and OCBC estimates
Note: (1) Market value based on Bloomberg data as at 11 June 2021 while property values based on annual reports as at 31 December 2020
(2) We exclude the promissory notes amounting to SGD115.8mn; in our view this is less marketable until it gets exchanged into land or properties
(3) We exclude amounts to be collected from OUE TwinPeaks sold under deferred payment schemes as there are no details on how much more remains to be collected however, with deferred income amounting to SGD6.9mn, we think less than SGD40mn remains to be collected as at 31 December 2020
(4) We exclude the CPPU as these are not redeemable at the option of OUE
(5) We exclude cash as we expect cash balance would be needed to fund outlays in 2021 and beyond
(6) We exclude the value of OUE's stake in First REIT and OUE-LH as access to external financing of both have been supported by OUE year-to-date. We take full value of OUE-LH's nursing homes.

- **Short term debt at OUE highly manageable although medium term looks more stretched without further asset sales:** As at 31 December 2020, OUE at the consolidated level only faces SGD420.9mn of short term debt coming due (representing 12% of total debt), significantly lower than the SGD720.3mn as at 30 June 2020. Additionally, bulk of the short-term debt coming due is at the OUE-CT level. In our view, OUE-CT is likely able to source for refinancing as a REIT that directly hold decent quality assets. On 25 May 2021, OUE-CT had priced a new bond, raising SGD150mn. Two hotels and Mandarin Gallery (a retail mall attached to the Mandarin Orchard hotel which will be rebranded as Hilton in 2022) in Singapore make up ~32% of OUE-CT asset value. Through the pandemic though, there has been no observable fire sale of hotel assets in key gateway cities such as Singapore. The short-term debt for OUE (excluding OUE-CT) was only SGD48.6mn vis-à-vis SGD471.0mn in cash as at 31 December 2020, where cash would have increased also in recent weeks from the CPPU. Beyond 2021, OUE (excluding OUE-CT) faces SGD592.0mn of debt, excluding SGD140mn of convertible bond that has been redeemed as of writing, while capital expenditure is expected to rise as its progresses on the development project in Indonesia. Of the SGD592mn, SGD400mn consists of two SGD-bonds maturing in April 2022 and May 2023 respectively.

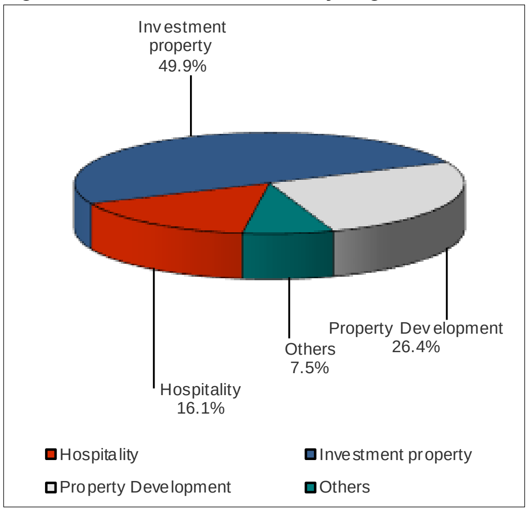
OUE Ltd

Table 1: Summary Financials

Year Ended 31st Dec	FY2018	FY2019	FY2020
Income Statement (SGD'mn)			
Revenue	642.9	930.8	530.5
EBITDA	167.9	224.7	195.1
EBIT	160.0	173.4	146.3
Gross interest expense	139.4	170.1	134.4
Profit Before Tax	103.6	369.7	-445.3
Net profit	56.6	321.8	-404.8
Balance Sheet (SGD'mn)			
Cash and bank deposits	409.4	477.7	559.5
Total assets	9,265.8	10,734.5	9,623.4
Short term debt	471.7	1,310.4	420.9
Gross debt	3,496.3	4,015.7	3,502.5
Net debt	3,086.9	3,538.0	2,943.0
Shareholders' equity	5,139.2	6,117.1	5,656.8
Cash Flow (SGD'mn)			
CFO	119.4	396.6	180.7
Capex	7.2	11.4	12.7
Acquisitions	842.5	520.4	103.4
Disposals	508.0	851.4	730.5
Dividend	64.9	168.0	111.1
Interest paid	130.2	126.0	128.7
Free Cash Flow (FCF)	112.2	385.2	168.1
Key Ratios			
EBITDA margin (%)	26.11	24.14	36.78
Net margin (%)	8.81	34.57	-76.31
Gross debt to EBITDA (x)	20.83	17.87	17.95
Net debt to EBITDA (x)	18.39	15.74	15.08
Gross Debt to Equity (x)	0.68	0.66	0.62
Net Debt to Equity (x)	0.60	0.58	0.52
Gross debt/total assets (x)	0.38	0.37	0.36
Net debt/total assets (x)	0.33	0.33	0.31
Cash/current borrowings (x)	0.87	0.36	1.33
EBITDA/Total Interest (x)	1.20	1.32	1.45

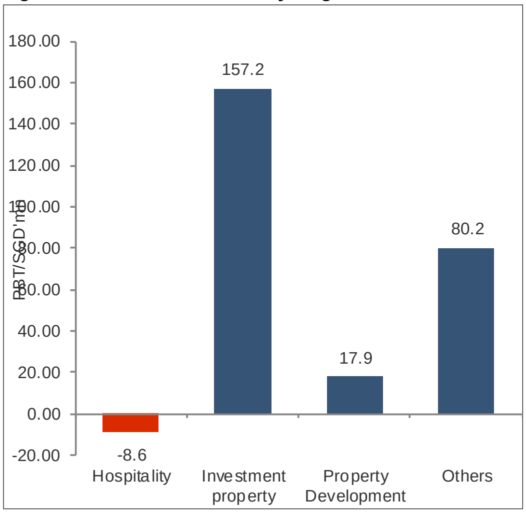
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Segment - FY2020



Source: Company

Figure 2: EBIT breakdown by Segment - FY2020



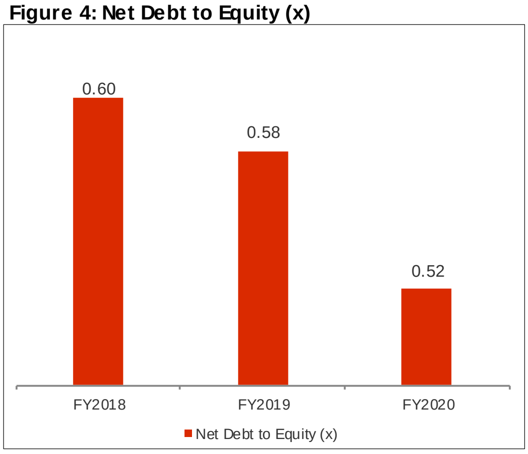
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 31/12/2020	% of debt
Amount repayable in one year or less, or on demand		
Secured	51.0	1.5%
Unsecured	369.9	10.6%
	420.9	**12.0%**
Amount repayable after a year		
Secured	1,712.4	48.9%
Unsecured	1,369.3	39.1%
	3,081.6	**88.0%**
Total	**3,502.5**	**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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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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