First REIT

Challenging times

SINGAPORE | REAL ESTATE (REIT) | UPDATE

- FIRT will be re-positioned to identify more strongly with the new co-Sponsor, OUELH.
- No compromise on paying distributions to unitholders, against the backdrop of extended receivables days.
- Price overhang as fund-raising is likely in the near-horizon in order to execute portfolio diversification strategy of acquiring from new co-Sponsor, OUELH.
- De-rating catalyst: expiring leases likely to be re-negotiated with a lower quantum and/or on IDR-denominated terms (currently on SGD-denominated terms).
- Maintain Neutral; new target price of $0.88 (previously $1.30).

What is the news?

The Manager of First REIT (FIRT) hosted a briefing in Dec 2018 to provide updates on 1) the REIT's new co-Sponsor, OUE Lippo Healthcare Limited (OUELH), 2) receivables collection and 3) portfolio rebalancing strategy. In Oct 2018, OUELH and OUE Ltd acquired 40% and 60% respectively of the Manager of FIRT, Bowsprit Capital Corporation Limited (Bowsprit). OUELH and PT Lippo Karawaci (LPKR) each hold approximately 10.6% of FIRT. In Nov 2018, LPKR announced its intention to divest its remaining stake in FIRT.

Key takeaways

- **Re-alignment of partnership with co-Sponsor, OUE Lippo Healthcare.** The Manager explained that the REIT now has two co-Sponsors, namely, LPKR and OUELH. FIRT will be re-positioned to identify more strongly with the new co-Sponsor, OUELH.
- **No compromise on paying distributions to unitholders, against the backdrop of extended receivables days.** The Manager was resolute that distributions to unitholders would be declared and paid accordingly. There will not be any compromise to cut distributions. If necessary, short-term loan would be used to pay distributions; with OUE Ltd's backing of any such loans (OUE Ltd owns 64% of OUELH).
- **Upcoming expiries in 2021 with limited vacancy risk.** These are Sarang Hospital in Korea (August 2021) and four other properties in Indonesia: Siloam Hospitals Lippo Village, Siloam Hospitals Kebon Jeruk, Siloam Hospitals Surabaya and Imperial Aryaduta Hotel & Country Club (December 2021). These hospitals are doing well, and the Manager believes that even if LPKR does not renew the leases, the incumbent operator, Siloam Hospitals (Siloam) would – thus suggesting that vacancy risk is not particularly high. It was also communicated by the Manager that there could be the possibility of recording lower rents, should the latter scenario occur.
- **Portfolio diversification strategy via OUELH's pipeline.** The Manager intends to diversify its geographical and tenant concentration risk by acquiring assets from OUELH. This is likely to be from OUELH's stabilised Japan portfolio of 12 nursing homes. The intention is to lower the portfolio's income derived from Indonesia (96% of portfolio rental income) and from LPKR (82% of gross rental income). The Manager stressed that any acquisition will have to be DPU-accretive.
- **Acquisition likely to be a portfolio of properties and not piecemeal.** Acquisitions from OUELH pipeline would constitute as a related party transaction and an extraordinary general meeting (EGM) will have to be convened to seek unitholder approval. As such, it would make more sense to acquire a portfolio instead of piecemeal. Moreover, a larger acquisition portfolio is required to meaningfully minimise existing geographical and tenant concentration risk.

StocksBnB.com

16 January 2019

NEUTRAL (Maintained)

LAST DONE PRICE	SGD 1.04
FORECAST DIV	SGD 0.077
TARGET PRICE	SGD 0.88
TOTAL RETURN	-7.7%

COMPANY DATA

BLOOMBERG CODE:	FIRT SP
O/S SHARES (MN) :	788
MARKET CAP (USD mn / SGD mn) :	606 / 820
52 - WK HI/LO (SGD) :	142 / 0.92
3M Average Daily T/O (mn) :	11326

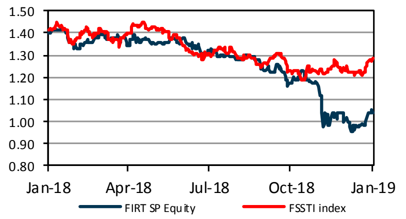
MAJOR SHAREHOLDERS (%)

LIPPO KARAWACI	28.5%
PT MENARA TIRTA INDAH	3.1%
VANGUARD GROUP INC	2.1%

PRICE PERFORMANCE (%)

	1MTH	3MTH	1YR
COMPANY	3.96	(8.65)	(20.53)
STI RETURN	3.32	3.71	(6.51)

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec	FY16	FY17	FY18e	FY19e
Gross Rev (SGD mn)	107.0	111.0	117.1	119.4
NPI (SGD mn)	105.8	109.5	115.4	117.7
Dist Inc. (SGD mn)	65.2	66.7	59.9	619
P/NAV (x)	103	102	102	102
DPU (cents)	8.47	8.57	7.68	7.94
Distribution Yield (%)	8.1%	8.2%	7.4%	7.6%

Source: Company Data, Bloomberg

Valuation Method

DDM (Cost of equity 9.68%, Terminal Growth 1%)

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How do we view this?

The Negatives

- **Lease renewals likely to be renegotiated with a lower quantum and/or on IDR-denominated terms, in our view; effectively killing the proverbial golden goose.** FIRT's current rentals are heavily reliant on Sponsor-tenant LPKR, which had been issued multiple credit rating downgrades in the past few months on concerns over its cash flow and liquidity. On the back of this, we believe that all Indonesia leases will likely be progressively renewed on IDR-denominated terms (currently on SGD-denominated terms) and/or with a lower quantum (should the leases be transferred to Siloam). Consequently, FIRT will have to bear currency exchange risk and hedging costs going forward. We have adjusted our revenue assumptions to account for a 80% currency hedge, with the remaining 20% exposed to IDR/SGD movements (for context, the IDR has depreciated c.44% relative to SGD since 2006 – when the four hospitals' leases commenced – to date (figure 2)). This has resulted in a c.6% drop in our revenue projections.
- **Current 34.9% gearing inhibits accretive acquisitions; a call for fresh equity capital is likely in the near-horizon.** We estimate a debt headroom of c.S$280mn assuming 45% gearing. To put this into context, this is just nearly sufficient to acquire OUELH's entire Japan portfolio of 12 nursing homes valued at S$287.8mn.
- **Substantial new capital will be dilutive.** We think that it would make sense to simultaneously lower the gearing with this fund raising. Assuming this acquisition of Japan nursing homes were to take place and were to be funded with a 20/80 debt/equity mix (lower debt to avoid stressing the balance sheet), this would result in a pro-forma gearing of c.33%. About c.S$230mn of fresh equity (c.258.8 million new units) would be required. There are currently 786.68 million units. NAV per unit will drop to $0.98, from the existing $1.01. Thus, there is an overhang of share price, on an impending equity fund raising (EFR).

Outlook

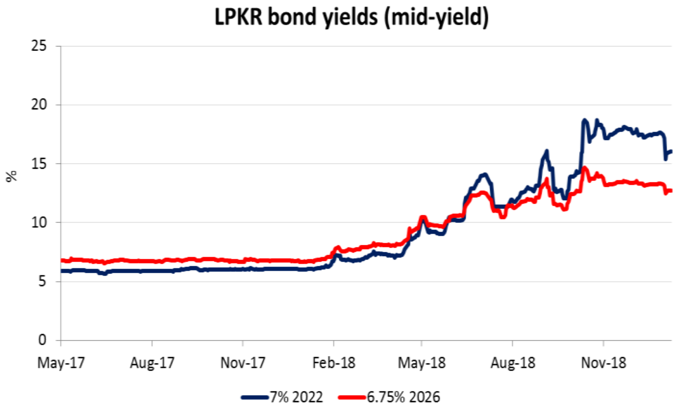
- **Acquiring yield-accretively into a developed market will be a challenge.** Net property income (NPI) yield in the existing Indonesia portfolio is higher, compared to that in Japan, which is a developed market. This will pose a challenge to conduct accretive acquisitions. Capitalisation rate for Indonesia investment properties is 10.0%, according to FIRT's FY17 annual report (Note 12). Meanwhile, the capitalisation rate for Japan investment properties range from 4.6% to 5.1%, according to OUELH's FY17 annual report (Note 7).
- **Manager's base fee structure will put pressure on margin and DPU-accretion when acquiring in lower-yielding market.** Bowsprit's base and performance fees are 0.4% of assets and 5.0% of NPI, respectively. The base fee component takes the same margin, even if acquiring a lower-yield asset. This will add further margin compression to unitholders and result in lower DPU-accretion.

Remain Neutral; new target price of $0.88 (previously $1.30)

We have: 1) lowered our revenue assumptions on the belief that the Indonesia leases would progressively be renewed with a lower quantum (if transferring leases to Siloam) and/or on IDR-denominated terms; and 2) raised our discount rate to factor credit risk associated with LPKR, referencing the spread between the latest mid-yields of LPKR's two outstanding (USD) bonds above the 10-year U.S. government bonds (figure 1).

Appendix

Figure 1: LPKR has two tranches of bonds, both yields of which have recently spiked in excess of 16% and 13% for its 7% 2022 and 6.75% 2026 bonds, respectively.



Source: Bloomberg

Figure 2: Bloomberg consensus forecasts show that the IDR/SGD exchange rate would come down to 0.88 by end-2021, which is when the most upcoming leases would be renewed.

	As of 15 Jan 2019	**End-2019**	**2020**	**2021**	**2022**
IDR/SGD	*0.96*	0.94	0.92	0.88	0.91

Source: Bloomberg

Financials

Statement of Total Return and Distribution Statement

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
Gross Revenue	**100.7**	**107.0**	**111.0**	**117.1**	**119.4**
Total Property expenses	(1.4)	(1.2)	(1.5)	(1.6)	(1.7)
Net Property Income	**99.3**	**105.8**	**109.5**	**115.4**	**117.7**
Net Finance (Expense)/Inc.	(16.3)	(16.6)	(16.4)	(21.6)	(21.6)
Manager's fees	(9.9)	(10.6)	(10.9)	(11.2)	(11.3)
Other items	(3.1)	(3.7)	(1.5)	(3.1)	(2.4)
Net Income	**70.0**	**74.9**	**80.7**	**79.5**	**82.4**
FV changes	26.3	(10.7)	12.8	-	-
Total Return Before Tax	**96.3**	**64.2**	**93.6**	**79.5**	**82.4**
Tax expense	(28.5)	(23.9)	(20.1)	(23.9)	(24.7)
Total Return After Tax	**67.8**	**40.3**	**73.4**	**55.7**	**57.7**
Distribution adjustments	(5.9)	24.9	(6.7)	4.2	4.2
Income available for distribution	**61.9**	**65.2**	**66.7**	**59.9**	**61.9**

Per share data

Y/E Dec	FY15	FY16	FY17	FY18e	FY19e
NAV (S$)	1.04	1.01	1.01	1.02	1.02
DPU (cents)	8.30	8.47	8.57	7.68	7.94

Cash Flow

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
CFO					
Total Return Before Tax	96	62	94	80	82
Adjustments	(2)	31	6	31	30
WC changes	(5)	3	(11)	6	(4)
Cash generated from ops	90	96	89	117	109
Others	(15)	(17)	(17)	(24)	(25)
Cashflow from ops	**74**	**81**	**72**	**93**	**85**
CFI					
Purchase of Inv. Property	(57)	(31)	(72)	-	-
Others	0	1	1	1	1
Cashflow from investments	**(56)**	**(30)**	**(71)**	**1**	**1**
CFF					
Share issuance, net	-	-	-	-	-
Loans, net of repayments	44	(31)	63	-	-
Distributions to unitholders	(50)	(57)	(63)	(60)	(62)
Distributions to perp. holders	-	-	(3)	(3)	(3)
Interest paid	(14)	(16)	(16)	(23)	(23)
Others	-	59	-	-	-
Cashflow from financing	**(19)**	**(45)**	**(19)**	**(86)**	**(88)**
Net change in cash	(1)	7	(18)	9	(2)
CCE, end	**27**	**34**	**16**	**24**	**23**

Balance Sheet

Y/E Dec, SGD mn	FY15	FY16	FY17	FY18e	FY19e
ASSETS					
Investment properties	1,268	1,273	1,349	1,349	1,349
Others	3	19	28	28	28
Total non-current assets	**1,271**	**1,292**	**1,378**	**1,378**	**1,378**
Trade receivables	15	12	26	20	24
Cash	27	34	16	24	23
Others	3	4	5	5	5
Total current assets	**44**	**49**	**46**	**49**	**51**
Total Assets	**1,315**	**1,341**	**1,424**	**1,427**	**1,429**
LIABILITIES					
Borrowings	44	142	198	235	45
Trade payables	17	17	18	19	19
Others	22	23	25	25	25
Total current liabilities	**84**	**182**	**241**	**278**	**89**
Borrowings	398	272	278	242	431
Others	42	49	52	52	52
Total non-current liabilities	**440**	**321**	**330**	**294**	**483**
Total Liabilities	**524**	**503**	**572**	**572**	**573**
EQUITY					
Unitholder Equity	**791**	**778**	**791**	**795**	**799**
Perpetual Securities	**-**	**61**	**61**	**61**	**61**

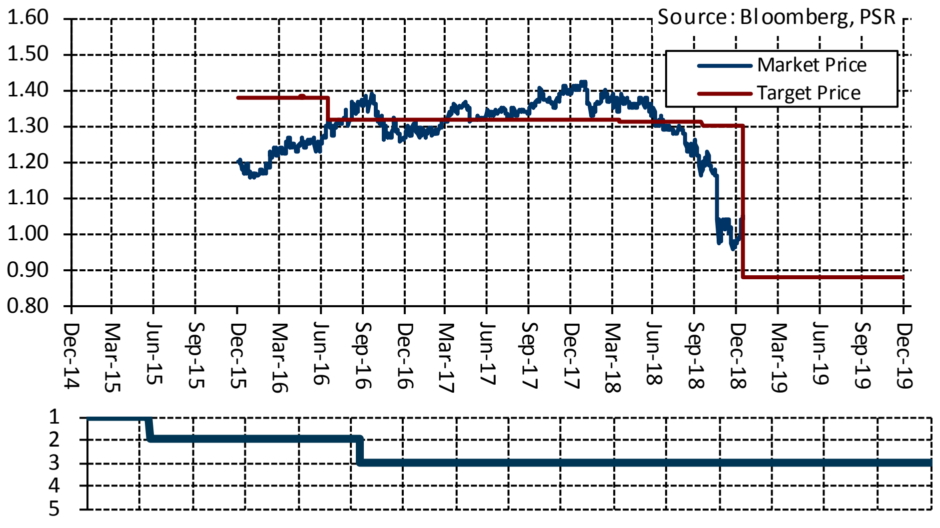
Valuation Ratios

Y/E Dec	FY15	FY16	FY17	FY18e	FY19e
P/NAV	1.00	1.03	1.02	1.02	1.02
Distribution yield (%)	8.0%	8.1%	8.2%	7.4%	7.6%
NPI yield	7.8%	8.3%	8.1%	8.6%	8.7%
Growth & Margins					
Growth					
Revenue	8.0%	6.3%	3.7%	5.5%	2.0%
Net property income (NPI)	8.1%	6.6%	3.4%	5.4%	2.0%
DPU	3.1%	2.0%	1.2%	-10.4%	3.3%
Margins					
NPI margin	98.6%	98.9%	98.6%	98.6%	98.6%
Operating Income Margin	69.5%	70.0%	72.8%	67.9%	69.0%
Key Ratios					
Net Gearing	33.7%	30.8%	33.5%	33.4%	33.3%

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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