OCBC Bank

Asia Credit Research

Earnings Review: Olam International Ltd ("Olam")

Issuer Profile: Neutral (5)

Ticker: **OLAMSP**

Background

Olam International Limited ("Olam") is a diversified, vertically-integrated agri-commodities merchandiser, producer and trader. It also generates income from the sale of packaged food products, commodity financial services and holding minority stakes in longer term investments. Temasek is the largest shareholder with a ~54%-stake followed by Mitsubishi Corp. with ~17%.

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Recommendation

- Despite the lower reported EBITDA generation in 1Q2018, Olam had reported a healthier EBITDA/interest coverage of 3.4x with lower finance costs and maintained net gearing stable at 1.5x versus end-2017 (significantly lower than the 2.0x a year ago) on the back of working capital optimisation, lower commodities prices, unlocking of cash through asset sales and conversion of warrants into equity. We maintain OLAMSP at Neutral (5).
- Within the OLAMSP curve, we prefer the OLAMSP 6.0% '22 which provides 120 bps more than the OLAMSP 5.8% '19 and more than compensates for the 3.3 year longer tenor.
- Comparing the OLAMSP 5.8% '19 to Sembcorp Industries Ltd's SCISP 3.7325% '20, the OLAMSP 5.80% '19 allows a spread pick up of 40 bps and matures 0.7 years earlier which more than compensates for its weaker credit profile.
- Sembcorp Industries Ltd shares the same major shareholders as Olam though we hold the SCISP's issuer profile at Neutral (4).

Relative Value:

Bond	Maturity/Call date	Net gearing (%)	Ask Yield	Spread
OLAMSP 5.80% '19	17/07/2019	149	3.00%	113 bps
OLAMSP 6.0% '22	25/10/2022	149	4.68%	235 bps
OLAMSP 5.5%-PERP	11/07/2022	149	5.71%	341 bps
SCISP 3.7325% '20	09/04/2020	89	2.73%	72 bps

Indicative prices as at 28 May 2018 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Lower EBITDA generation though interest coverage improved:** Revenue increased 8.5% y/y to SGD6.3bn driven by increased volumes from the Food Staples and Packaged Foods segment (mainly from Grains sub-segment) and Industrial Raw Materials, Ag Logistics & Infrastructure ("IRM"). Reported EBITDA was SGD368.1mn (down 7.7% y/y) with all segments except IRM showing lower EBITDA contribution compared to 1Q2017. Other expenses were 58.2% higher y/y at SGD332.6mn (this included a SGD24.0mn exceptional loss from sale of Nauvu Investments) though finance costs were 25.1% lower y/y at SGD109.7mn which helped lift profits higher. The decline was primarily due to Olam's average debt which had fallen to SGD11.7bn in 1Q2018 from SGD13.9bn in 1Q2017. Interest coverage as measured by reported EBITDA/Interest was 3.4x against 2.7x in 1Q2017.

- **Profit to owners still up though Olam reported comprehensive loss:** Additionally, Olam also recorded higher finance income at SGD22.3mn (1Q2017: SGD6.9mn) and higher share of profits from jointly controlled entities and associates (growth in Gabon Special Economic Zone where the port operations had commenced) at SGD12.3mn (up from SGD3.0mn). Overall, despite the decline in EBITDA, Olam reported a 9.8% y/y higher profit attributable to owners of the company of SGD158.0mn. Comprehensive loss was SGD133.4mn (driven net loss on fair value changes during the period and a foreign currency translation loss), wiping out much of the profits generated.

- **Segmental performance:** By segments (1) Edible Nuts, Spices & Vegetable Ingredients ("Edible Nuts, SVI")'s EBITDA showed a 2% y/y decline to SGD136mn following the continued challenging conditions in the tomato processing sub-segment. (2) Confectionary & Beverage Ingredients segment's EBITDA was down 18% y/y to SGD61mn due to the significantly lower contribution from the coffee sub-segment which had faced low volatility and margin pressures. (3) Food Staples & Packaged Foods saw higher volume growth though this was attributable to the low absolute EBITDA generating Grains trading sub-segment. EBITDA was down 15% y/y as wheat milling and sugar faced margins pressure (4) IRM was the only segment that saw a rise in EBITDA (6% up y/y) to SGD66mn from stronger contribution in Cotton and the Gabon Special Economic Zone while (5) Commodity Financial Services saw EBITDA decline 12% y/y to SGD4.5mn. Factoring in working capital changes, we estimate that Confectionary & Beverages and IRM was the largest cash contributors while Edible Nuts, SVIs and Food Staples and Packaged Foods saw an operating cash outflow. Per company, the first quarter is its seasonal peak procurement season and higher working capital needs is to be expected, though such needs was partly offset by a broad-based lower commodity prices in 1Q2018.

- **Unadjusted net gearing lower versus a year ago:** As at 31 March 2018, Olam's unadjusted net gearing was relatively stable at 1.5x against end-2017 and significantly lower versus the 2.0x as at 31 March 2017. Net gearing includes finance lease commitments (eg: from palm and almond plantations which had been sold for cash and leased back). Despite the 2% increase in gross debt, in 1Q2018, SGD71.8mn in proceeds from conversion of warrants into equity was received and this helped boost share capital of the company. In end-2017, non-cancellable leases (eg: rent on land, offices, warehouses, vessels) was lower versus end-2016 but still significant at SGD888.6mn respectively. Given the broad-base lower commodity prices in 1Q2018, working capital needs may increase for the rest of the year which could tilt short term debt higher. Net-net Olam is a price-taker and focuses on managing its cash flow via cash conversion cycle. In 1Q2018, the cash conversion cycle was 109 days (down from 139 days in 1Q2017) and within its internal target of 100-120 days).

- **Disposal helped increase cash flow:** In 1Q2018, OLAM reported an operating cash outflow (before interest and tax) of SGD290.8mn (versus SGD334.0mn in operating cash inflow in 1Q2017). Purchase of property, plant and equipment, intangible assets and investment/loans to associates and jointly controlled entities was SGD221.6mn. The cash gap at Olam was funded by (1) additional of borrowings of SGD334.1mn (2) the conversion of warrants (3) the drawing down SGD66.7mn of existing cash and (4) the disposal of Olam's 50%-stake in Nauvu Investments to Wilmar International for USD148mn (subject to adjustments). Prior to the sale, Olam and Wilmar International held Nauvu Investments on a 50:50 basis, with Nauvu Investments holding stakes in the SIFCA Group (a West African agri-business) among other investments.

- **Short term debt due:** Olam faces SGD250mn in bonds due in August 2018 (the OLAMSP 6.0% '18s). This high cost bond was issued in 2011 (prior to Olam being re-rated) and we think Olam will be able to secure refinancing at a lower cost. Similar to 2016, Olam targeted 25-35% of its working capital needs to be fulfilled by medium and long term sources of funds in 2017. Historically, 58% of working capital was funded by medium and long term sources of funding. We think the reduction in proportion of medium and longer tenured debt to fund working capital had helped reduce finance cost as longer tenured debt tends to cost more. As at 2 April 2018, free float of Olam's publicly listed equity was only ~10.3%. We continue to expect Olam to be debt reliant for its working capital needs though its bank debt and fixed income market access remains strong. Apart from the SGD250mn in bonds due, Olam has SGD3.9bn of short term debt due. Cash balance stood at SGD1.9bn and Olam has SGD8.4bn in unutilised bank loans (we understand ~15% committed) that can provide the liquidity needed to help refinance the short term debt coming due.

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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.

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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

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