

Earnings Review: Olam International Ltd (“OLAM”)

Recommendation

- Overall 4Q2018 was a weaker quarter from higher interest expenses, absence of one-off gains, and lower share of results from jointly controlled entities and associates.
- Given 4Q2018’s reported EBITDA was boosted by fair value gains of biological assets, we find adjusted EBITDA/Interest of 1.6x as more representative of Olam’s interest coverage in 4Q2018.
- Notwithstanding the lower profitability in 4Q2018, we view the company’s stated goals of keeping net gearing at below 2.0x as credible. As at 31 December 2018, this was 1.36x.
- Olam is planning to orderly exit certain businesses on a partial or full basis as part of its strategic plan for 2019-2024 with a targeted cash release of USD1.6bn (~SGD2.17bn). While this would reduce diversity in its product offerings, net-net we like the refocus on its strengths vis-à-vis throwing good money after businesses which it does not have an edge in.
- There are no direct perpetual comparables within the same industry sector in the SGD space and as such we use GuocoLand Ltd and Frasers Property Ltd, respectively Neutral (5) and Neutral (4) who both have perpetuals with comparable first call dates.
- The SGD-denominated OLAMSP 5.5%-PERP has a first call date in July 2022 and step-up margin of 200bps at first call. At current market expectations, we think the distribution rate may rise to ~8.1% if the perpetual is not called and we think Olam is likely to call this perpetual at first call. We are overweight on the OLAMSP 5.5%-PERP. In our view, the OLAMSP 5.5%-PERP has a lower non-call risk at first call versus the FPLSP 3.95%-PERP and GUOLSP 4.6%-PERP.
- We are overweight the OLAMSP 6% ‘22s seniors which matures in October 2022 (senior-sub spread of ~100bps, adjusted for tenor).

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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Relative Value:

Bond	Maturity/Call date	Net gearing	Ask Yield to Maturity	Spread
OLAMSP 6% ‘22s	25/10/2022	1.36x	4.33%	234bps
OLAMSP 5.5%-PERP	11/07/2022	1.36x	5.49%	351bps
GUOLSP 4.6%-PERP	23/01/2023	0.77x	5.46%	347bps
FPLSP 3.95%-PERP	10/05/2022	0.87x	5.48%	350bps

*Indicative prices as at 8 March 2019 Source: Bloomberg
Net gearing based on latest available quarter*

Key Considerations

- Confectionary and Beverage up though other segments down:** Revenue grew 16.9% y/y to SGD8.5bn in 4Q2018 while reported EBITDA was up by 5.7% y/y to SGD330.7mn, driven by increase in EBITDA in the Confectionary and Beverage segment which more than offset the decline in the other four segments. In 4Q2018, Confectionary and Beverage EBITDA was SGD165mn (versus SGD79mn in 4Q2017) and made up half of total EBITDA. Segmental growth was predominantly driven by cocoa while the coffee supply chain business continued to be a drag. In end-2017, Arabica coffee prices were at USD130/lb though by end-2018 this had fallen to ~USD99/lb per Bloomberg data. Robusta coffee similarly saw a declining trend. Edible Nuts and Spices (contributed 19% to total EBITDA in 4Q2018) saw reported EBITDA declining 37% y/y to SGD62.9mn in 4Q2018, while full year 2018 saw a 23% y/y decline. Per company this was mainly due to lower contribution from the segment’s upstream peanut business in Argentina which was affected by drought and argentine peso’s depreciation against USD. Underlying demand growth for peanuts though remains robust.

- **Weaker 4Q2018:** OLAM ended the quarter with profit before tax (“PBT”) of only SGD75.1mn versus SGD282.5mn in 4Q2017. 4Q2017 was boosted by a large SGD121.2mn gain on disposal of 50% stake in a sugar refining company to Mitr Phol and SGD27.7mn gain in disposal of property, plant and equipment and intangible assets. Such gains were small in 4Q2018. Further curtailing 4Q2018 profits, share of results from jointly controlled entities and associates was down by 37% y/y to SGD29.3mn. In March 2018, Olam had sold its 50% joint venture stake in Nauvu Investments to Wilmar Resources. Additionally, contribution from Olam’s ~40% stake in Gabon Special Economic Zone was likely also lower y/y. Other comprehensive losses of SGD97.0mn (largely due to foreign currency translation losses) though wiped out profits and negatively impacted book value of equity by SGD24.9mn.
- **Adjusted EBITDA/Interest lower y/y:** Despite reduction in average debt balance in 4Q2018 at SGD11.5bn versus 4Q2017’s SGD11.9bn, interest cost increased by 28.4% y/y to SGD159.3mn. The increase in interest rates was due to higher floating rates on working capital as well unwinding of structured deposit positions per company. Together with the lower reported EBITDA, EBITDA/Interest coverage was thus lower at 2.1x versus 2.5x in 4Q2017. Reported EBITDA though was boosted by a SGD70.9mn in gain of fair value of biological assets (largely from palm plantations, dairy farming and almonds) versus a fair value loss on biological assets of SGD14.2mn in 4Q2017. Taking away these non-cash items, adjusted EBITDA would be lower at only SGD259.8mn in 4Q2018 (down 20.6% y/y). We find adjusted EBITDA/Interest of 1.6x to be more representative of interest coverage at Olam for 4Q2018.
- **Low unadjusted net gearing and committed to keep below 2.0x:** As at 31 December 2018, unadjusted net gearing was 1.36x versus 1.42x as at 30 September 2018, mainly due to the decline in net debt. During the quarter, OLAM’s net repayment of debt was SGD602.5mn. In 2018, net investing outflow at Olam was only SGD417.0mn, lower than 2017’s SGD637.4mn and significant lower than 2016’s SGD1.4bn. This has been a marked departure against Olam’s earlier debt-funded bets (not all which were successful). The more disciplined approach in the past two years towards investments had helped the company constrain its net gearing in our view. As at 31 December 2018, cash conversion cycle at Olam was 76 days, which also helped reduced net gearing. This though is more likely a blip in our view from low commodity prices, with company guiding 90-100 days as a more sustainable level. As at 31 December 2017, this was 97 days and as at 31 December 2016, this was 150 days. By value chain, Olam’s supply chain business contribution has declined successively in the past three years, both in terms of absolute value of EBITDA and also in proportion to total EBITDA generation. In 2018, the supply chain contributed 33% to total EBITDA while in 2016 this was 42% (above 50%-60% in the years leading to 2016). This is indicative of the company reducing its reliance on this working capital intensive business in our view. Notwithstanding the lower profitability in 4Q2018 which had reduced OLAM’s interest coverage during the quarter, we view the company’s stated goals of keeping net gearing at below 2.0x as credible.
- **Refocusing on strengths is a credit positive:** In January 2019, Olam announced its 2019-2024 strategic plans (two three-year plans). As part of the plan, Olam has announced USD3.5bn (~SGD4.75bn) in capex including maintenance capex over the next 6 years and this would be in core businesses. Olam would prioritise the following: Edible Nuts & Spices, Grains & Animal Feed, Confectionary & Beverages (Coffee and Cocoa), Cotton, Edible Oils, Infrastructure & Logistics, Dairy, Rice, Packaged Food Businesses and Commodity Financial Services (excluding fundamental funds). While it continues investing in core businesses (eg: February 2019’s [proposed investment of an Indonesian cocoa processor](#)), the company would also look to orderly exit certain businesses on a partial or full basis. The targeted cash release is USD1.6bn (~SGD2.17bn). The businesses Olam would like to sell down are Rubber, Sugar, Wood Products and Fertiliser. Some of these businesses have been de-emphasised since the previous strategic plan, though the company now appears to be more resolute to exit. While Olam’s business would be less diversified, the remaining businesses are still quite diverse and driven by different demand-

supply factors. We see having a variety of product type as underpinning Olam's credit profile as it has little control over variables such as weather, political and regulatory risk and prices of agri-commodities.

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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

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 ("IPR") into a 7 point Issuer Profile Score ("IPS") scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to

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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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