OCBC Bank

Asia Credit Research

Earnings Review: Perennial Real Estate Holdings Ltd ("PREH")

Issuer Profile: Neutral (5)

Ticker: **PREHSP**

Background

Perennial Real Estate Holdings Ltd ("PREH") is an integrated real estate owner and developer, focused primarily in China (69.6% by asset value) and Singapore (28.9%). PREH is developing large scale developments in railway hubs of China while its portfolio of office and retail assets in Singapore and China provide stable rental income. The company is 81.9%-owned by a group of shareholders, including Mr Kuok Khoon Hong (36.5%), Chairman/CEO/co-founder of Wilmar International Ltd, Mr Ron Sim (15.5%), CEO/founder of Osim, Wilmar International (20.0%) and Mr Pua Seck Guan (10.3%), CEO of PREH.

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Recommendation

- PREH's 4Q2018 results look lackluster, with the estimated EBIT (less fair value changes) falling 22.2% y/y to SGD18.9mn due to increases in operational costs. However, we are not overly worried as revenue should catch up given the ramp up of the 157-room luxury Capitol Kempinski Hotel and Perennial International Health and Medical Hub.
- We expect PREH to rollover a substantial part of the bank debt and refinance the upcoming SGD125mn PREHSP '19s with bank borrowings. In any case, we believe PREH may obtain liquidity from divestments (e.g. AXA Tower, stakes in United Engineers Ltd and other investment properties).
- We think the PREHSP curve looks interesting, favouring the PREHSP 3.85% '20s, PREHSP 5.95% '20s and PREHSP 3.9% '21s which offer high yield for limited tenors.

Relative Value:

Bond	Maturity/Call date	Net gearing	Ask Yield	Spread (bps)
PREHSP 4.55% 2020	29-Apr-2020	0.73x	4.37%	244bps
PREHSP 3.85% 2020	03-Jul-2020	0.73x	5.69%	372bps
PREHSP 5.95% 2020	28-Aug-2020	0.73x	5.60%	363bps
PREHSP 3.9% 2021	12-Jan-2021	0.73x	6.35%	439bps

Indicative prices as at 14 Feb 2019 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Results impacted by rise in costs though revenue should catch-up**: PREH reported 4Q2018 results. Revenue increased 43.6% y/y to SGD23.0mn due to revenue from Capitol Singapore (which PREH fully acquired in May 2018 after the resolution of the deadlock) and Perennial International Health and Medical Hub ("PIHMH") which started contributing since 2Q2018. However, operational costs increased by a larger amount, which resulted in 40.3% y/y fall in gross profit to SGD5.3mn due to (1) staff hired for Capitol Kempinski Hotel, (2) operation of PIHMH and (3) marketing and promotional expenses to market the 39-unit luxury Eden Residence. As a result, net profit fell by 38.2% y/y to SGD25.5mn. Correspondingly, we estimate that reported EBIT (without fair value changes) fell 22.2% y/y to SGD18.9mn. That said, we expect underlying results to improve following repositioning of Capitol Singapore when the malls at Capitol reopen and the ramp up of occupancy at the newly opened hotel (likely ~2 years ramp up period). In addition, 30%-owned TripleOne Somerset has obtained TOP at the new retail podium and will commence operations progressively from March 2019.

- **Credit underpinned by assets**: Although profitability is weak, PREH owns significant investment properties which total SGD3.35bn in value. Investment properties in Singapore include 51.61%-owned CHIJMES (property value: ~SGD334mn), 100%-owned Capitol Singapore (~ SGD497mn) and 50.6%-owned Chinatown Point (~ SGD477mn). We believe these can be divested for liquidity, if needed. In China, the investment properties include 50%-stake in Shenyang Longemount Shopping Mall (~ SGD785mn), 50%-stake in Shenyang Red Star Macalline Furniture Mall (~ SGD491mn), 50%-stake in Shenyang Loungemount Offices (~ SGD445mn), 100%-owned Perennial Qingyang Mall (~ SGD255mn) and 100%-owned Perennial Jihua Mall (~ SGD186mn). Meanwhile, the investment properties which PREH developed or is developing include 80%-owned PIHMH which is valued at ~SGD762mn, 40%-owned Beijing Tongzhou Phase 1 valued at ~SGD and 50%-owned Xi'an North High Speed Railway Integrated Development Plot 4 valued at ~SGD502mn.

- **Confident to refinance tower of short-term borrowings:** SGD762.0mn of borrowings will be due within the next 12 months, which include SGD125mn PREHSP 4.9% '19s due in Mar 2019, SGD410mn unsecured loan and SGD227mn secured loan. We do not expect cash of SGD76.9mn and operating cashflows to cover the shortfall. However, we expect PREH to rollover a substantial part of the loans and refinance PREHSP 4.9% '19s with loans, as the loan market looks cheaper. In any case, we remain comfortable as PREH may obtain liquidity from divestments. This includes 31.2%-stake in AXA Tower, though no transaction has taken place since PREH's announcement in Jul 2017 as PREH is likely holding out for better offers than its original asking price (SGD1.65bn at SGD2,333 psf) due to a stronger office market. If liquidity is required, we think PREH can also divest certain investment properties, especially those in Singapore (detailed in previous paragraph), as well as ~11% effective stake in United Engineers Ltd worth ~SGD174mn.

- **Progress on Chinese portfolio though contribution remains to be seen:** PREH disclosed that PIHMH's (GFA: 3,153,387 sq ft) committed occupancy reached 91% as at 31 Dec 2018 and anchor tenant Gleneagles Chengdu Hospital will commence operations in 2H2019. At Xi'an North HSR Integrated Development Plot 4 (GFA: 4,412,556 sq ft), interior decoration works are progressing for 3 towers that topped out while the remaining 2 towers are being constructed. Despite the progress, PREH has yet to disclose the financial performance (e.g. revenue, EBITDA) of the Chinese portfolio though contribution is likely to be limited for now given just SGD11.8mn in revenue was recognised from China as of 4Q2018. PREH holds other projects which include 50%-owned Plot C (GFA: 5.6mn sq ft) and 50%-owned Plot D2 (3.1mn sqft) at Chengdu East HSR Integrated Development, as well as 20%-owned Zhuhai Hengqin Integrated Development. That said, we believe the contribution can be significant given the size of the developments and will await further clarity on the contribution of these projects.

- **Growth through joint ventures:** Aside from the earlier discussed projects, PREH has formed a number of joint ventures. In Singapore, PREH is in a 40-60 JV with Qingjian Realty ("CNQC") to redevelop Goodluck Garden (554,605 sq ft). PREH has yet to release details on the launch though we note that the project had been delayed due to protests by minority owners prior to the grant of the sale order in Nov 2018. Meanwhile, PREH is leading a consortium (45%-stake) for China High Speed Railway, which include Tianjin South High Speed Railway Integrated Development (which will be progressively completed from 2022) and Kunming South HSR Integrated Development. On the healthcare front, PREH owns 49.9%-stake in Renshoutang which added 61 beds over 4Q2018 and operates 5,927 beds. This is expected to grow further with a committed pipeline of 9,650 beds.

- **Expected slide in credit metrics:** Net gearing inched down to 72.7% (3Q2018: 76.0%) due to loans and capital injection from joint venture and non-controlling interests of SGD60.4mn, which we think is due to the PREH's consortium for China High Speed Railway. We expect net gearing to increase further to ~90% when (1) PREH funds its 40%-share in the development with Qiangjian Realty and (2) when further capital is deployed to its 45%-share (USD540mn) in the China High Speed Railway consortium. That said, we understand that management is exploring capital recycling opportunities as a source of capital if funds are required.

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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

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.

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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.

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