Asia Credit Research

Olam International Ltd: Credit Update

Tuesday, 13 September 2016

Getting to know your beans and onions

- **1H2016 financial results:** Olam reported a 6.7% increase in revenue to SGD9.7bn (1H2015: SGD9.1bn) and a 2.1% increase in EBITDA to SGD648.4mn from SGD634.7mn in 1H2015 per company's calculation which excludes exceptional items. During 1H2016, overhead expenses and other operating expenses (unrealized foreign exchange losses from the depreciation of the Mozambican Metrical and Nigerian Naira) was larger at SGD516.4mn (1H2015: SGD452.6mn). Following a reduction in overall borrowing cost arising from the change in borrowing mix and the buyback of high cost debt, finance cost (excluding exceptional items) declined to SGD206mn from SGD236mn in 1H2015. Attributable to higher income generation, lower finance cost and the absence of large exceptional items, Olam generated healthier headline profits after tax of SGD220.9mn (1H2015: SGD124.5mn). However, foreign currency translation adjustment dragged Olam into reporting a comprehensive loss of SGD295.5mn (1H2015: comprehensive loss of SGD137.6mn). While this has a negative impact to book value of equity, the foreign currency translation loss has no immediate cash flow impact.

- **Foreign exchange drags:** In June 2016, the central bank of Nigeria removed the peg[1] on the Naira against the USD (fell ~30% against the SGD right after removal of peg)[2]. Per management, in terms of transaction risk, the currency depreciation is a positive to its export business. However, Olam's domestic package business in Nigeria is negatively affected as the company is unable to fully reflect the impact of devaluation on selling prices simultaneously as it happens (due to how per unit pack is priced). The depreciation of the Naira has also caused a translational impact on Olam's net assets. As long as the asset remains unrealized, this is a pure accounting impact and hence manageable. However, the severity of the depreciation also means that Olam will be getting less value in hard currency should a need for asset disposal arise, in our view.

- **Segmental performance:** Two segments saw EBITDA improved, namely Confectionery & Beverage Ingredients and Food Staples & Packaged Foods (collectively up SGD87.1mn). Confectionery & Beverage ingredients' performance was largely driven by the consolidation of the ADM Cocoa business, green coffee and instant coffee businesses which offset lower contribution from the supply chain business. We find that price volatility for both cocoa and Robusta coffee was lower in 1H2016 versus 1H2015. Food Staples & Packaged Foods was driven by growth in rice, sugar, palm and dairy, offsetting the underperformance in packaged foods due to currency volatility and disruption of business following a plant fire in April 2016. The remaining segments, namely Edible Nuts, Spices & Vegetable Ingredients, Industrial Raw Materials and Commodity Financial Services saw a decline in EBITDA (collectively down SGD73.4mn).

- **Stronger operating cash flow but consumed by growth:** Driven by lower working capital needs (positive SGD130.0mn in source of cash)[3], Olam managed to generate higher cash flow from operations in 1H2016 of SGD791.4mn (prior to interest and taxes). We think Olam also received some one-off working capital cash receipts as part of Olam's 2013 strategic plan initiatives to unlock cash (eg: sale and

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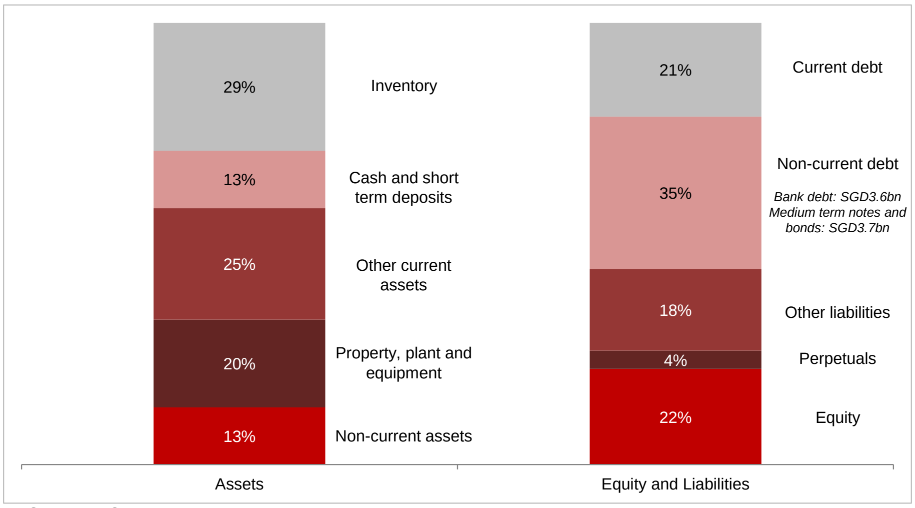
OCBC Credit Research
Ezien Hoo, CFA
+65 6722 2215
EzienHoo@ocbc.com

[1] Oil export-reliant Nigeria had been defending its currency peg (ranging from NGN197-199 per USD since March 2015), dwindling foreign reserves in the process. To stem flow of USD out of Nigeria, the central bank had in mid-2015 imposed foreign exchange controls, limiting importers from purchasing a range of items, among other control measures
[2] Further 10% decline between 20th June 2016 and date of this report
[3] Previously, we took the change in balance sheet figures in determining working capital due to the significant acquisitions made by the Company (eg: ADM Cocoa). However, for the purpose of this credit update, we have used company's reported change in working capital per cash flow statement. According to the company, differences in balance sheet changes vs. cash flow statement were due to certain changes in fair value for inventories and translational impact (from movements in currency) which affected the balance sheet but not cash flow.

lease back of palm plantations). In contrast, change in working capital used up SGD275.0mn in cash in 1H2015, resulting in operating cash flows of SGD379.5mn (against EBITDA of SGD634.7mn). The higher cash flow from operations in 1H2016 comfortably covered interest paid by 3.7x. While we are heartened that Olam being a debt-dependent company was able to generate healthy cash flows from operations, we remain hesitant to extrapolate this for the full year given that working capital needs are volatile period-to-period. As a "wholesale merchant" for certain products, Olam has no direct control over price movements. Investing outflows continued to be significant during the period, with the company ploughing SGD555.4mn into new acquisitions and capex, thus, wiping out cash generated from operations. Olam paid out the following in 1H2016 (i) SGD100mn dividends to common equity investors (ii) SGD8.2mn to perpetual holders (iii) bond buy back of SGD318.4mn to lower overall cost of debt and (iv) SGD31.6mn share buyback. These were funded by new borrowings of SGD634.7mn. Taking into account of a negative SGD147.7mn net effect of exchange rate changes, cash and cash equivalents as at 30 June 2016 was SGD1.94bn, around the levels at the beginning of the year.

- **Movements in capital structure:** Olam's gross debt stayed relatively constant at SGD11.9bn as at 30 June 2016 against SGD12.0bn as at 31 March 2016 and lower than the SGD12.3bn as at 31 December 2015. Nevertheless, book value equity took a hit to SGD4.9bn from SGD5.3bn as at 31 March 2016 largely on account of negative foreign exchange impact, dividends and share buybacks, offsetting incremental retained profits. As at 30 June 2016, gross debt-to-equity was 2.4x (31 March 2016: 2.3x) while net debt-to-equity was 2.00x (31 March 2016: 1.96x). Assuming 70% of inventory as readily marketable, adjusted net debt-to-equity is also relatively stable at 1.1x (31 March 2016: 1.1x). In July 2016, Olam raised USD500mn (SGD673.4mn) in perpetuals. As these perpetuals are accounted for as equity, on a pro-forma basis, Olam's net debt-to-equity would have been 1.75x. Olam has been paying dividends consistently since IPO; the dividend stopper on the perpetuals discourages a deferral in practice.

Figure 1: Pro-forma total assets and financial structure



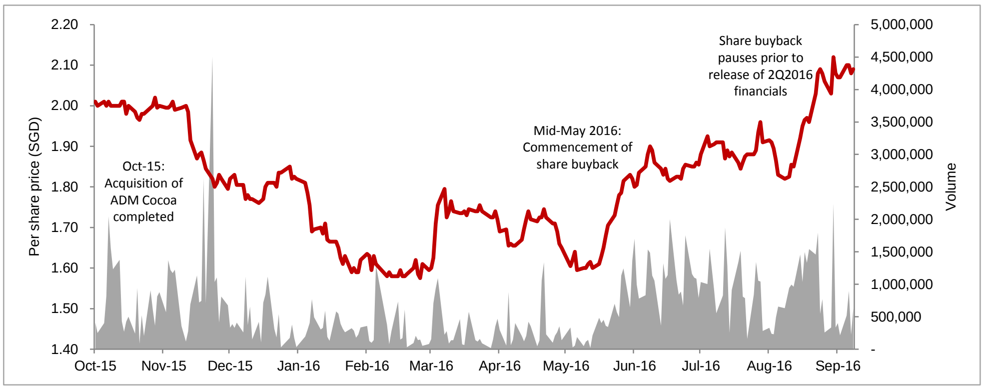
Source: Company's balance sheet as at 30 June 2016
Note: (1) OCBC adjusted for perpetual raised in July 2016. Assumes funds from perpetual is retained as cash and short term deposits
(2) Pro-forma total assets of SGD21.4bn

As at 30 June 2016, perpetuals represented 1.1% of total assets, this would have increased to 4% post balance sheet date. We view this as credit neutral and may adjust such view downwards should perpetuals rise disproportionately as a percentage of total equity. While Olam's efforts to lower overall cost of borrowing is commendable (strengthens coverage), we maintain that Olam is unlikely to meaningful pare down debt levels in the near-term and therefore remains highly reliant on funding from both banks and debt capital markets for refinancing. While there are no explicit guarantees by its major shareholders, debt markets have imputed shareholder support on Olam's credit profile, with the bonds re-rated since

1Q2014. Temasek (rated at AAA/Aaa/NR) has a 52%-stake in the company while Mitsubishi Corp (rated at A/A2/NR with a Negative outlook)[4] holds a 20.2% stake.

Olam's share buyback mandate was also renewed by shareholders in April 2016. Per management, there are two main reasons for the share buy-back (i) prices in their view were at a discount to fair value (ii) has outstanding obligations under its performance share awards plan. As part of the mandate, the company can buy-back a max of 138.7mn shares (representing 5% of 2.8bn issued shares, excluding treasury shares at time of the 2016 AGM). Nevertheless, Olam's limited free float (~460mn shares prior to the share buyback) and low daily trading volumes means that the buyback have had an outsized impact to the company's share price (up 30% since mid-May 2016 to 6 September 2016)[5]. To date, 35.9mn shares have been bought back, with SGD67.9mn spent. While the actual quantum spent is thus far contained, we see this as a signal that the company's balance sheet remains skewed towards rewarding shareholders.

Figure 2: Share Price Chart and Volume Post Mitsubishi Corp Investment



- **Recommendation:** We think there is a good chance for the perpetual OLAMSP 7.0 '49c17 to be called in March next year and continues to be our top pick within the Olam SGD curve. Among Olam's USD bonds, the '21s is currently trading at a SGD-equivalent yield of 4.26%. In contrast, the SGD '22s is trading at 5.61%, which more than compensates for the extra 1.5 year tenure; as such we recommend a switch into the SGD '22s. However, do note that in recent months, Olam's USD securities are more widely traded. We retain our Neutral issuer profile on the company.

SGD Issues	Maturity / First Call Date	Outstanding Amount (SGDm)	Ask Price	Ask YTW (%)	I-Spread
OLAMSP 6.0 '18	10/08/2018	250.0	103.61	4.00	259
OLAMSP 5.8 '19	17/07/2019	350.0	103.00	4.65	313
OLAMSP 4.25 '19	22/07/2019	400.0	99.43	4.46	293
OLAMSP 6.0 '22	25/10/2022	485.0	101.97	5.61	380
OLAMSP 7.0 '49c17	01/03/2017	235.8	100.51	5.91	487

Note: Indicative prices as at 13 September 2016.

[4] *Moody's actual rating assigned of A2 incorporates uplift from Mitsubishi Corp's underlying credit profile (indicated rating from grid: Baa2) due to expectation of continuous funding from Japanese banks*

[5] *Prior to the share buyback, market volume per day was on average 301,000 shares (from 1 January 2016 to 15 May 2016). On average, Olam bought back 437,300 shares per trading day between 16 May 2016 to 6 September 2016)*

Olam International Ltd

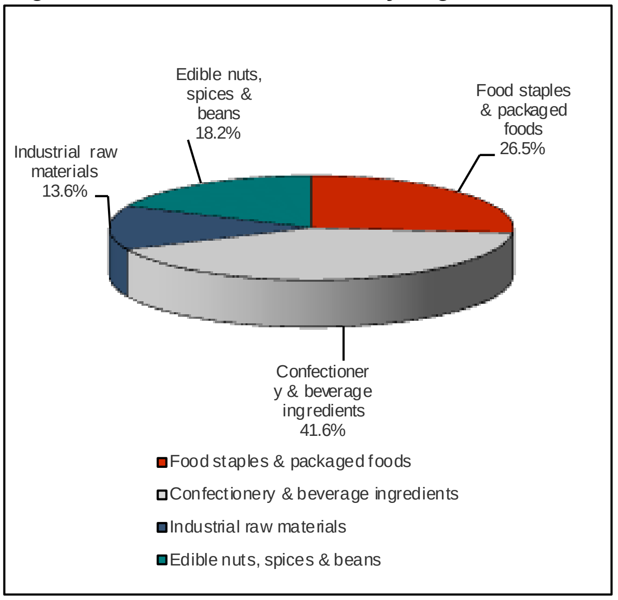
Table 1: Summary Financials

Year End 31st Dec	FY2014	FY2015	1H2016
Income Statement (SGD'mn)			
Revenue	19,772.0	19,052.6	9,742.8
EBITDA	1,061.5	1,034.0	629.2
EBIT	851.7	796.9	464.9
Gross interest expense	492.2	494.0	218.8
Profit Before Tax	728.6	40.0	280.7
Net profit	591.0	-64.3	228.6
Balance Sheet (SGD'mn)			
Cash and bank deposits	1,236.0	2,143.2	2,152.0
Total assets	15,522.8	20,736.6	20,781.9
Gross debt	9,113.3	12,293.9	11,942.2
Net debt	7,877.2	10,150.7	9,790.2
Shareholders' equity	3,901.6	5,319.7	4,887.2
Total capitalization	13,014.9	17,613.6	16,829.4
Net capitalization	11,778.9	15,470.4	14,677.4
Cash Flow (SGD'mn)			
Funds from operations (FFO)	800.8	172.8	392.8
CFO	-95.0	-451.2	550.4
Capex	442.8	369.8	288.8
Acquisitions	82.6	1,969.7	326.3
Disposals	512.6	244.5	8.8
Dividend	190.0	61.0	100.4
Free Cash Flow (FCF)	-537.9	-821.1	261.6
FCF adjusted	-297.9	-2,607.3	-156.2
Key Ratios			
EBITDA margin (%)	5.4	5.4	6.5
Net margin (%)	3.0	-0.3	2.3
Gross debt to EBITDA (x)	8.6	11.9	9.5
Net debt to EBITDA (x)	7.4	9.8	7.8
Gross Debt to Equity (x)	2.34	2.31	2.44
Net Debt to Equity (x)	2.02	1.91	2.00
Gross debt/total capitalisation (%)	70.0	69.8	71.0
Net debt/net capitalisation (%)	66.9	65.6	66.7
Cash/current borrowings (x)	0.4	0.4	0.5
EBITDA/Total Interest (x)	2.2	2.1	2.9

Source: Company, OCBC estimates

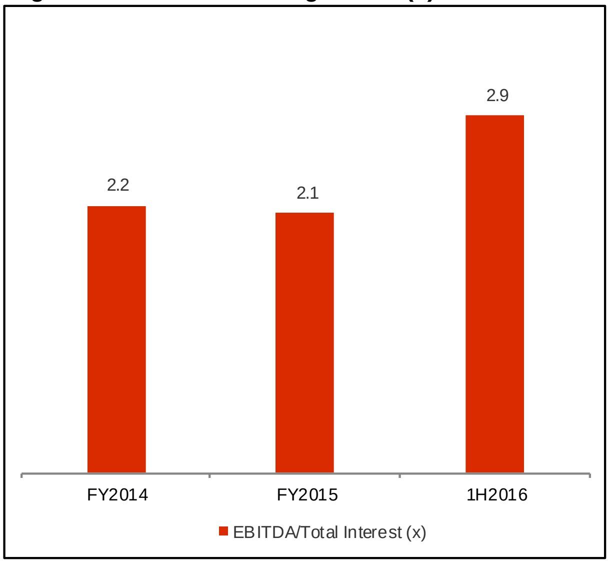
* *FCF Adjusted = FCF - Acquisitions - Dividends + Disposals*

Figure 1: Revenue breakdown by Segment - 1H2016



Source: Company

Figure 2: Interest Coverage Ratio (x)



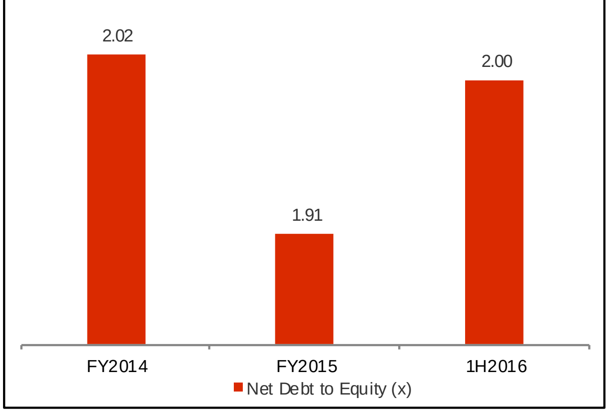
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 30/6/2016	% of debt
Amount repayable in one year or less, or on demand		
Secured	21.6	0.2%
Unsecured	4,521.0	37.9%
	4,542.6	**38.0%**
Amount repayable after a year		
Secured	82.7	0.7%
Unsecured	7,316.9	61.3%
	7,399.6	**62.0%**
Total	**11,942.2**	**100.0%**

Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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