Asia Credit Research

Perennial Real Estate Holdings Ltd: Credit Update

Monday, 16 April 2018

Gearing up for growth ahead

- With the completion of OCBC's engagement, we resume coverage on Perennial Real Estate Holdings Ltd ("PREH") with an **Issuer Profile of Neutral (5)**.
- Following the acquisition of 33.7% stake in United Engineers (through a 45% interest in a JV), PREH is gearing up for growth ahead, including (1) up to USD540mn (SGD707mn) capital to be committed for further developments in China, (2) SGD501.2mn acquisition of the other 50% stake in Capitol Singapore and (3) development of a Singapore residential site (PREH's share of land cost: SGD244mn).
- Net gearing is expected to increase to ~0.9x (4Q2017: 0.57x) due to expansion plans while EBITDA and cashflow generation remains weak before the ramp up of the healthcare segment. Nevertheless, we think PREH's credit profile remains manageable, backed by recurring income from investment properties and hard assets from its development properties while its net gearing does not appear excessive compared to peers. As such, **we rate the new PREHSP 3.9% '21s (YTM: 4.0%) with a Neutral recommendation**.

S&P: Not rated
Moody's: Not rated
Fitch: Not rated

Ticker: PREHSP

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Background: Perennial Real Estate Holdings Ltd ("PREH") was formed from a reverse take-over of St James Holdings Ltd in October 2014. PREH is an integrated real estate owner and developer, focused primarily in China (65.2% by asset value) and Singapore (30.0%). PREH is developing large scale mixed-use developments in railway hubs of China while its portfolio of stabilised office and retail assets in both Singapore and China provide stable rental income. The company is 81.4%-owned by a group of shareholders. They include Mr Kuok Khoon Hong (35.7%), who is the Chairman/CEO/co-founder of Wilmar International Ltd, Mr Ron Sim (15.4%), who is the CEO/founder of Osim, Wilmar International (20.0%) and Mr Pua Seck Guan (10.3%), CEO of PREH. PREH has a market capitalisation of SGD1.43bn as at 13 April 2018.

Recent developments

(1) **Further investments (up to USD540mn) into China:** PREH will be leading a consortium to invest up to USD1.2bn (SGD1.6bn) in healthcare integrated mixed-use developments connected to high speed railway ("HSR") stations in China. PREH's 45% stake in the JV[1] will imply a capital commitment of USD540mn (SGD707mn). The initial contribution by the consortium will be USD500mn (PREH's share: USD225mn). While no specific details have been given, PREH looks to grow its HSR portfolio from 2 (Perennial International Health and Medical Hub, Chengdu Xiehe International Eldercare and Retirement Home) to 8 projects totalling over 4m sqm.

(2) **Resolution of deadlock at Capitol Singapore after buying over Chesham's stake:** PREH will gain full ownership of Capitol Singapore after buying over Chesham's 50% stake for SGD501.2mn, which includes SGD368.6mn to discharge Chesham's loans to Capitol Singapore and SGD129.6mn for the purchase of Chesham's shares in Capitol Singapore. PREH is expected to complete the purchase by the first half of May 2018. While Capitol Singapore generated only SGD0.4mn net profit in 2017, we note that the project had been in stasis due to impasse between PREH and Chesham – we note the 6-star 157 room hotel (The Patina) remains non-operational though it received TOP on 13 Oct 2015. Going forward, we expect higher contributions with the opening of the hotel, which may also benefit the mall (NLA: 131,170 sq ft).

(3) **Foray into Singapore's residential development:** PREH entered into a 40-60 JV

[1] JV partners include Shun Tak Holdings Ltd (30%), Bangkok Bank Public Co Ltd (10%), BreadTalk Group Ltd (5%), S1F Pte Ltd (4%), HPRY Holdings Ltd (4%) and Wilmar International Ltd (2%)

with Qingjian Realty ("CNQC") to develop a freehold residential site (max GFA: 554,605 sqft) where Goodluck Garden is located. The site was sold collectively for SGD610mn (PREH's share: SGD244mn) at SGD1,100 psf ppr. PREH's share of capital commitment is SGD96.5mn, while the remaining (est: SGD147.5mn) is likely to be funded by borrowings at the project level. Aside from the 39 units at Capitol Singapore, this marks PREH's first major foray into Singapore's residential development. Recently, PREH has also partnered CNQC to bid for a 642,767 sq ft mixed-use site at Holland Road.

Key credit considerations

- **Boosted by divestment, re-measurement and revaluation gains, results lacklustre otherwise:** FY2017 revenue declined 32.4% y/y to SGD74.5mn. This is mainly due to the absence of revenue from TripleOne Somerset, as it is accounted as an associate after the disposal of a 20.2% stake (PREH still retains 30% stake). The remaining revenue contributors mainly include investment properties such as the 51.61%-owned CHIJMES, 100%-owned Perennial Jihua Mall and 100%-owned Perennial Qingyang Mall. Nevertheless, net profit surged to SGD138.8mn (FY2016: SGD45.4mn) due to divestment and re-measurement gains of SGD55.7mn (mainly from divestment of TripleOne Somerset) and fair value gain of SGD84.7mn (SGD45.5mn from the revaluation of Xi'an North High Speed Railway Integrated Development Plot 4 and SGD39.2mn from fair value gain on China investment properties). Without the divestment, re-measurement and fair value gains and FX gains, profit before tax would be a smaller SGD29.8mn (2016: SGD25.1mn). The lacklustre results are not surprising, given that PREH has yet to commence operations or recognise profits on a number of development projects in China with long completion periods.

- **Unlocking the portfolio through divestments:** Following the divestment of a 20.2% stake in TripleOne Somerset (announced in Jan 2017) which fetched SGD46.3mn in proceeds, PREH looks to make an en-bloc divestment at its 31.2%-owned AXA Tower. We estimate an attributable profit before tax of ~SGD109mn if AXA Tower were sold at the SGD1.65bn minimum asking price (for the entire building).

- **Recurring income from investment portfolio:** While the development portfolio takes time to gestate, the investment portfolio delivers recurring income. Occupancy is healthy at 51.6%-owned CHIJMES (95.9%), Perennial Jihua Mall (99.8%) and Perennial Qingyang Mall (99.4%) and 50.64%-owned Chinatown Point (93.4%). We expect contributions to increase from Chinatown Point (2017 profit: SGD6.8mn) as PREH acquired an additional 5.15%-stake in Nov 2017. While PREH is putting up AXA Tower for sale, the property still generates income for PREH (2017 profit: SGD3.3mn) prior to completion of a sale. PREH also owns a 50%-stake in Shenyang Longemont Shopping Mall (87.6% occupancy) and a 50%-stake in Shenyang Longemont Offices (65.6%). Income from the investment portfolio may expand when the 80%-owned Perennial International Health and Medical Hub (Committed occupancy: 84.6%) ramps up after soft-opening in 4Q2017.

- **Expect contribution from the development and healthcare portfolio:** Over 2018-21, we expect the development portfolio to contribute significantly with Beijing Tongzhou Integrated Development Phase 1 (40%-owned) & Phase 2 (23.3%-owned) with a total GFA of 8.4mn sq ft completing in 2020-21. The 51%-owned Xi'an North HSR Integrated Development Plot 4 & 5 will also be completing in 2018-19 and deliver 9.2mn sq ft. Meanwhile, PREH is still selling strata units at TripleOne Somerset. On the healthcare front, PREH acquired 49.9% of Renshoutang in 1H2017. Renshoutang is the largest private eldercare services operator in Shanghai with 3,577 operational beds. We think contributions will increase (PREH's share of profits in 2017: SGD1.3mn) with full year contributions in 2018 and Renshoutang is expected to grow with 7,750 beds committed in the pipeline. In addition, one out of 6 towers at the 40%-owned Chengdu Xiehe Home (est GFA: 914,932 sq ft) is expected to commence operations in 2Q-4Q2018.

- **Manageable credit metrics though liquidity appears somewhat stretched:** Net gearing remained relatively unchanged at 0.57x q/q, though this is expected to increase to ~0.9x as we expect significant capital outlay for further investments in China (SGD707mn), purchase of remaining 50% stake in Capitol Singapore (SGD501.2mn) and development of a freehold residential site in Singapore (SGD96.5mnmn). We also note sizeable financial guarantees of SGD1.3bn provided by PREH to banks in respect of banking facilities and securities drawn by subsidiaries, associates and joint ventures.

Gearing may increase further as PREH is bidding for a land site at Holland Road (59,715 sqm), though we understand from PREH that its internal threshold for net gearing is 1.0x. Following the redemption of SGD100mn PREHSP 4.25% '18s, which we believe was refinanced with the issuance of SGD120mn PREHSP 3.9% '21s, another SGD875.0mn borrowing remains due in 2018. This comprises SGD326.0mn in secured bank loans, SGD249.7mn in unsecured bank loans and SGD299.3mn retail bonds. Assuming the secured bank loans would be rolled-over, we think liquidity appears somewhat stretched with only SGD111.7mn in cash. PREH has other potential sources of liquidity, for example when its 31.2%-stake in AXA is divested – proceeds which we estimate to be over SGD240mn. Meanwhile, PREH still maintains access to the capital markets, as demonstrated by the issuance of PREHSP 3.9% '21s. While PREH requires more capital as it gears up, in the worst case scenario if other funding sources were not available, we believe that PREH may sell-down some of its SGD1.7bn in investment properties (e.g. Perennial Qingyang Mall in Chengdu is worth SGD255mn, Perennial Jihua Mall in Foshan worth SGD194mn). This is not unusual for PREH, which had recycled capital by divesting 20.2% stake in TripleOne Somerset in 1Q2017 and its entire stake in 112 Katong in 2016. However, we acknowledge that sizeable portions of these assets are located in China and may not be readily available to be liquidated.

View on PREHSP 3.9% '21s

PREHSP 3.9% '21s was priced on the back of a SGD150mn orderbook, tightening from an initial price guidance of 4%. **We believe the market has priced it fairly as we see the fair value around 4.0%**, using the following for our consideration:

The closest comparable is the older PREHSP 3.85% '20s, which we prefer over PREHSP 3.9% '21s as the former trades at a wider spread despite ~6months shorter maturity.

We prefer PREHSP 3.9% '21s over CHIPEN 4.75% '21s as the former provides 10bps yield pickup while PREH's net gearing (forecast: 0.9x) should remain healthier than Chip Eng Seng Corp Ltd (1.58x).

While PREHSP 3.9% '21s offers 42bps pickup over GUOLSP 3.62% '21s, we think this looks fair as GuocoLand ("GUOL") has a larger scale (Total assets: SGD9.3bn) compared to PREH (Total assets: SGD6.7bn). GUOL also has a higher recurring income base and better interest coverage (2.0x) compared to PREH (0.2x). While PREH's interest coverage is weak, we remain comfortable as PREH may divest assets in the worst case scenario. In addition, PREH's EBITDA may improve with increased contributions from the development and healthcare portfolio upon their completion/commencement.

Meanwhile, investors looking for property companies with higher yield and lower net gearing can consider bonds trading around the 6% handle, including HTONSP 6.1% '20s which look attractive compared to PREHSP 3.9% '21s with 189bps yield pickup. However, note that PREH has a larger exposure to China while Heeton Holdings Ltd has a larger exposure to Singapore.

Relative Value:

Bond	Maturity	Net gearing	Ask Yield	Spread
PREHSP 3.9% 2021	12/01/2021	0.9x (forecast)	4.00%	201.1
PREHSP 3.85% 2020	03/07/2020	0.9x (forecast)	3.97%	205.8
CHIPEN 4.75% 2021	14/06/2021	1.58x	3.90%	186.2
GUOLSP 3.62% 2021	30/03/2021	0.9x (forecast)	3.58%	156.9
HTONSP 6.1% 2020	08/05/2020	0.8x (forecast)	5.89%	400.2

Indicative prices as at 13 April 2018
Source: Bloomberg, OCBC

Perennial Real Estate Holdings Ltd

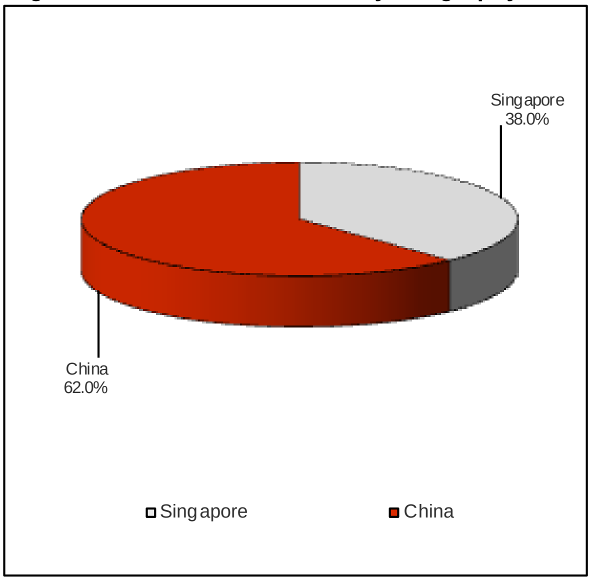
Table 1: Summary Financials

Year Ended 31st Dec	FY2015	FY2016	FY2017
Income Statement (SGD'mn)			
Revenue	117.7	110.2	74.5
EBITDA	60.0	46.8	23.2
EBIT	56.2	42.8	22.6
Gross interest expense	74.8	98.4	94.2
Profit Before Tax	86.1	53.9	170.2
Net profit	58.1	35.1	100.3
Balance Sheet (SGD'mn)			
Cash and bank deposits	162.0	226.2	111.7
Total assets	6,450.3	7,046.4	6,704.7
Gross debt	2,055.6	2,859.5	2,344.8
Net debt	1,893.6	2,633.3	2,233.1
Shareholders' equity	3,882.4	3,781.9	3,915.9
Total capitalization	5,938.0	6,641.4	6,260.6
Net capitalization	5,775.9	6,415.2	6,149.0
Cash Flow (SGD'mn)			
Funds from operations (FFO)	61.9	39.1	100.9
* CFO	-166.5	-172.1	-216.0
Capex	59.4	65.4	34.6
Acquisitions	232.5	122.3	163.4
Disposals	0.0	3.9	73.1
Dividends	0.9	7.5	6.7
Free Cash Flow (FCF)	-225.9	-237.5	-250.5
* FCF Adjusted	-459.3	-363.4	-347.5
Key Ratios			
EBITDA margin (%)	51.0	42.4	31.1
Net margin (%)	49.4	31.8	134.6
Gross debt to EBITDA (x)	34.3	61.1	101.2
Net debt to EBITDA (x)	31.6	56.3	96.4
Gross Debt to Equity (x)	0.5	0.8	0.6
Net Debt to Equity (x)	0.5	0.7	0.6
Gross debt/total capitalisation (%)	34.6	43.1	37.5
Net debt/net capitalisation (%)	32.8	41.0	36.3
Cash/current borrowings (x)	1.0	0.3	0.1
EBITDA/Total Interest (x)	0.8	0.5	0.2

Source: Company, OCBC estimates

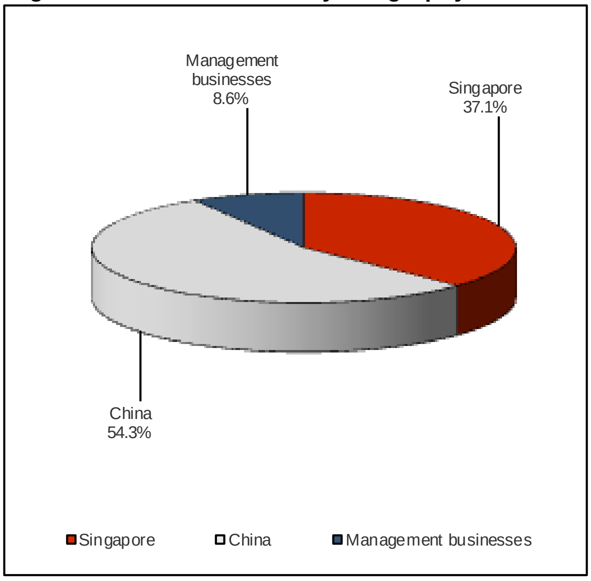
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

Figure 1: Revenue breakdown by Geography - FY2017



Source: Company

Figure 2: EBIT breakdown by Geography - FY2017



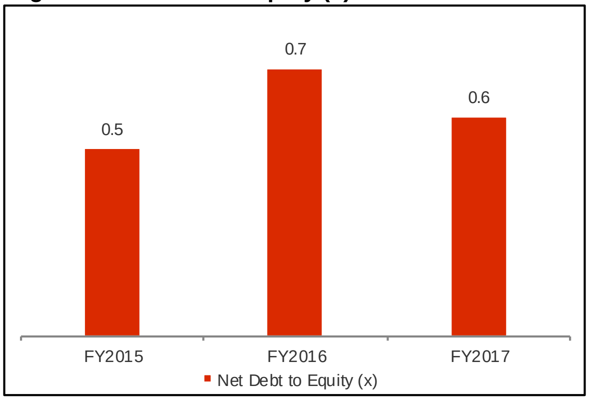
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 31/12/2017	% of debt
Amount repayable in one year or less, or on demand		
Secured	326.0	13.9%
Unsecured	649.0	27.7%
	975.0	**41.6%**
Amount repayable after a year		
Secured	792.4	33.8%
Unsecured	577.4	24.6%
	1,369.8	**58.4%**
Total	**2,344.8**	**100.0%**

Source: Company, OCBC estimates

Figure 4: Net Debt to Equity (x)



Source: Company

Explanation of Issuer Profile Rating / Issuer Profile Score

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 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.

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.

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