Asia Credit Research

OCBC Bank

Shangri-La Asia Limited: New Credit Review

Tuesday, April 09, 2019

Recommendations Summary

Issuer Profile:	**Bond Recommendation:**	
Neutral (4)	SLHSP 4.5% '25s	Neutral
Fundamental Analysis Consideration • Substantial recurring income and asset base underpins credit profile • Associates are a key income contributor • Levered issuer • Strong access to diverse pool of liquidity	Technical Analysis Consideration • Household brand name with a sizeable issue amount amidst current light supply of high grade papers • Covenant-lite paper • No change of control nor delisting put	

Ticker: **SLHSP**

Treasury Advisory
Corporate FX & Structured Products
Tel: 6349-1888 / 1881
Interest Rate Derivatives
Tel: 6349-1899
Investments & Structured Products
Tel: 6349-1886

GT Institutional Sales
Tel: 6349-1810

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Key credit considerations

- **Significant Mainland China exposure with substantial recurring income:** 46% of SHANG's Adjusted Operating Profits ("AOP", operating profit after tax (inclusive of results from associates, after minority interest at subsidiaries where SHANG has no full ownership) came from Investment Properties in 2018, driven by rental income from office, commercial and residential properties (eg: serviced apartments) located in Mainland China. Hotel Properties contributed 27% to AOP, although more volatile versus rental income, we see SHANG's hotels to also provide a sustainable income stream. We see SHANG's rental income and hotel income as a credit positive given the stable and recurring nature. In 2018, Mainland China contributed a very significant 92.7% of the AOP from Investment Properties and 22.1% to Hotel Properties' Adjusted Operating Properties. Taking the Investment and Hotel Properties segments as a whole though excluding the lumpier Property Sales segment, we estimate that Mainland China contributed 40% to total AOP, followed by Hong Kong (14%) and Singapore (10%). Other important markets include Malaysia, Thailand and the Philippines.

- **An "asset heavy" hotel operator:** Hotel-by-hotel income and valuation is not provided although room numbers by property are provided. Adjusting for ownership stake, we estimate that SHANG owns 25,405 keys, which is significant in our view versus its asset-light competitors. While equity holders tend to favour asset-light hotel operators we like that SHANG owns their property as these assets can be monetised and/or used to secure financing in the event of a liquidity crunch. Crown jewels which SHANG still owns a majority or full stake in include Island Shangri-La (565 rooms), Pudong Shangri-La (946 rooms) and Shangri-La Singapore (792 rooms).

- **Associates are important income contributors:** Including fair value gains, share of profits from associates made up USD305.6mn in 2018, and helped to drive profit before tax higher to USD290.4mn (up 16% y/y), despite reported operating profit only rising 1% y/y. Investment Properties segment was the largest contributor to share of profits from associates making up 80% of the total (before non-operating items (eg: fair value gains). Bulk of SHANG's Investment Properties is held via associates, particularly in Mainland China. In 2018, Mainland China – Investment Properties associates collectively contributed 78% to total share of profits from associates (before non-operating items).

- **….though we are not overly concern over structural subordination issues:** One third (by gross floor area) of SHANG's Investment Properties adjusted for its proportionate stake is attributable to the China World Trade Centre in Beijing, held by a 50%-associate. China World Trade Centre located in Beijing's Chaoyang district is owned by a Shanghai-listed company which is in turned 50%-owned by SHANG. Other Mainland China properties are typically held with Kerry Properties Limited, a key property arm of the Kuok Group and a sister company to SHANG. In our view, SHANG is also a core part of the Kuok Group, which encourages tri-party alignment of interest. While associate stakes expose bondholders to structural subordination issues, we think this is not an unduly large concern in the case of SHANG.

- **Good revenue growth but pockets of weakness in hotel:** SHANG's revenue increased 15% y/y, driven by the increase across all of its business segments with gross margin relatively steady at 56%. 29% of the incremental revenue growth was attributable to general improvement in operations of its Hotel and Investment Properties. In 2018, SHANG reported USD123.2mn in provision for impairment losses, largely from three relatively new hotels while no hotel impairment was recorded in 2017.

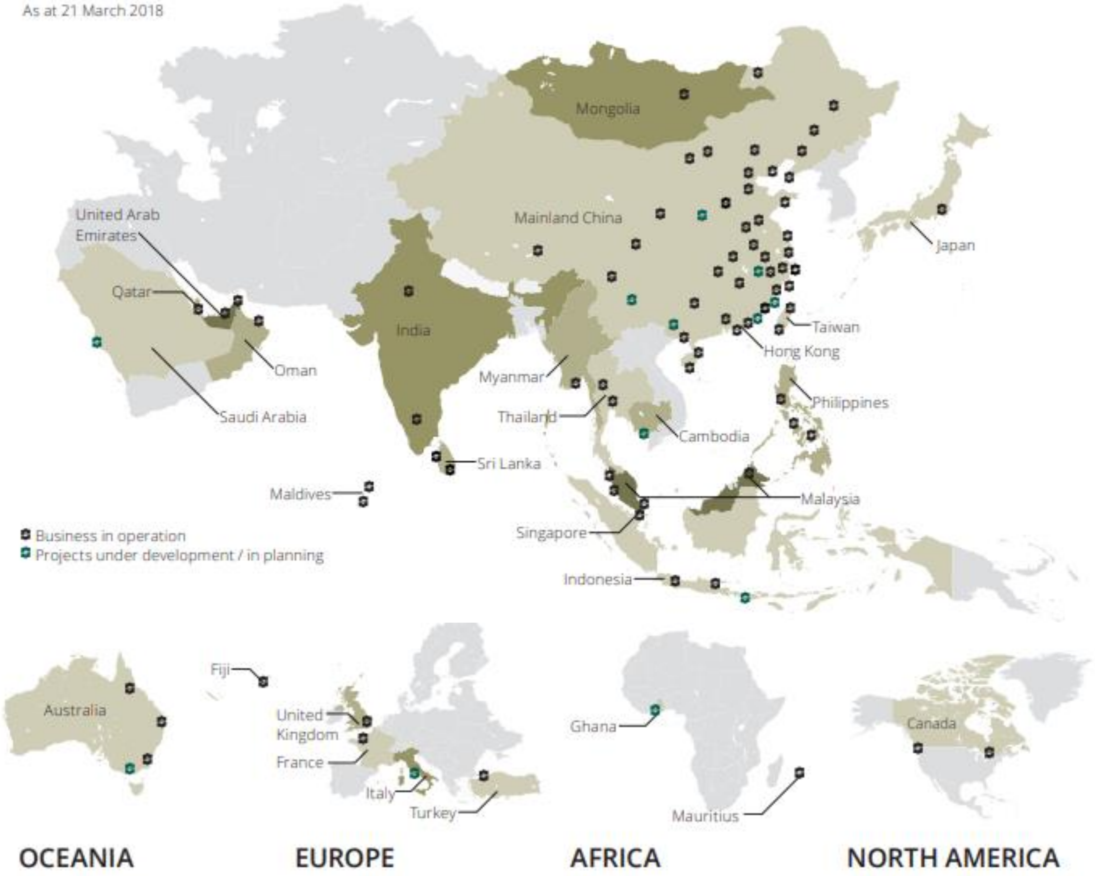
I) Company Background

Shangri-La Asia Limited ("SHANG"), incorporated in Bermuda, is an investment holding company focused on the ownership and management of hotels under the Hong Kong-based Shangri-La Hotels and Resorts, a leading luxury hotel group. In addition to hotels, SHANG also holds a portfolio of investment properties for rental and develops properties for sale. It has a primary listing on the Hong Kong Stock Exchange, with a secondary listing on the SGX-ST since 15 September 1999. Its subsidiaries, Shangri-La Hotels (Malaysia) and Shangri-La Hotel Public Company Limited are listed in Malaysia and Thailand respectively.

SHANG's footprint extends worldwide with a total of 102 owned and/or managed hotels and owned stakes in 23 investment properties across 27 countries. Its presence is mainly concentrated in the Asia Pacific, especially within Mainland China. However, it has also expanded to select strategic locations (capital cities or tourist destinations) in Europe, North America, Africa, Oceania and the Middle East, with development pipeline for hotels, office, commercial and residential developments focused in Mainland China.

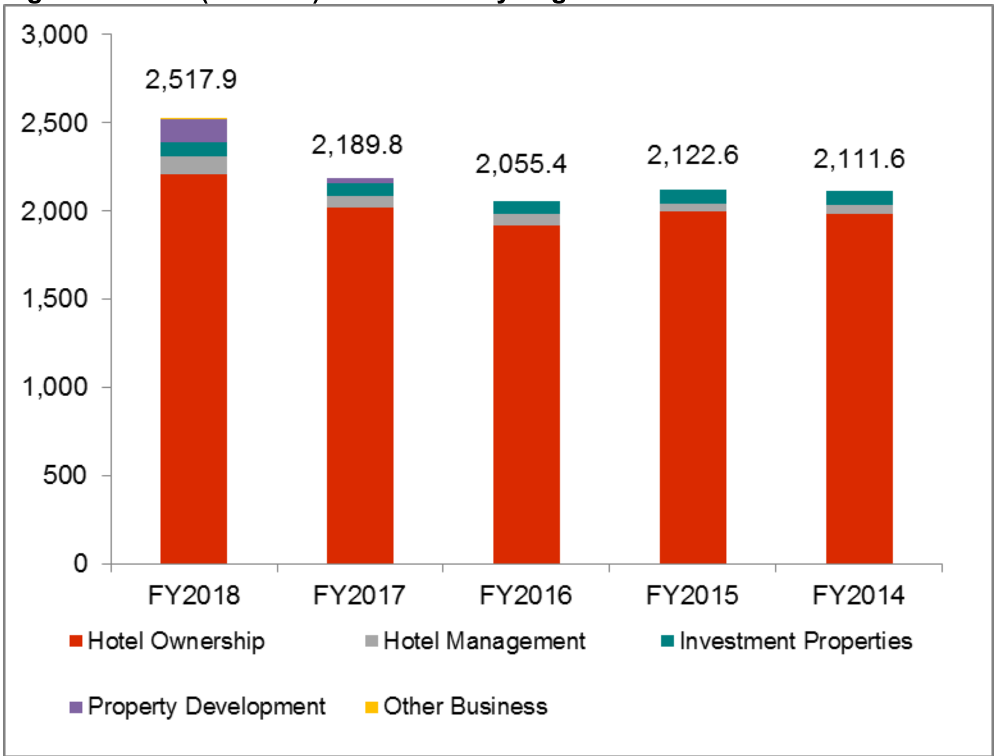
The SLHSP 4.5% '25 senior unsecured bonds with an amount outstanding of SGD825mn is issued by Shangri-La Hotel Limited, though unconditionally and irrevocably guaranteed by SHANG. Shangri-La Hotel Limited is an indirect wholly-owned subsidiary of SHANG.

Figure 1: Map of Group's Business Presence



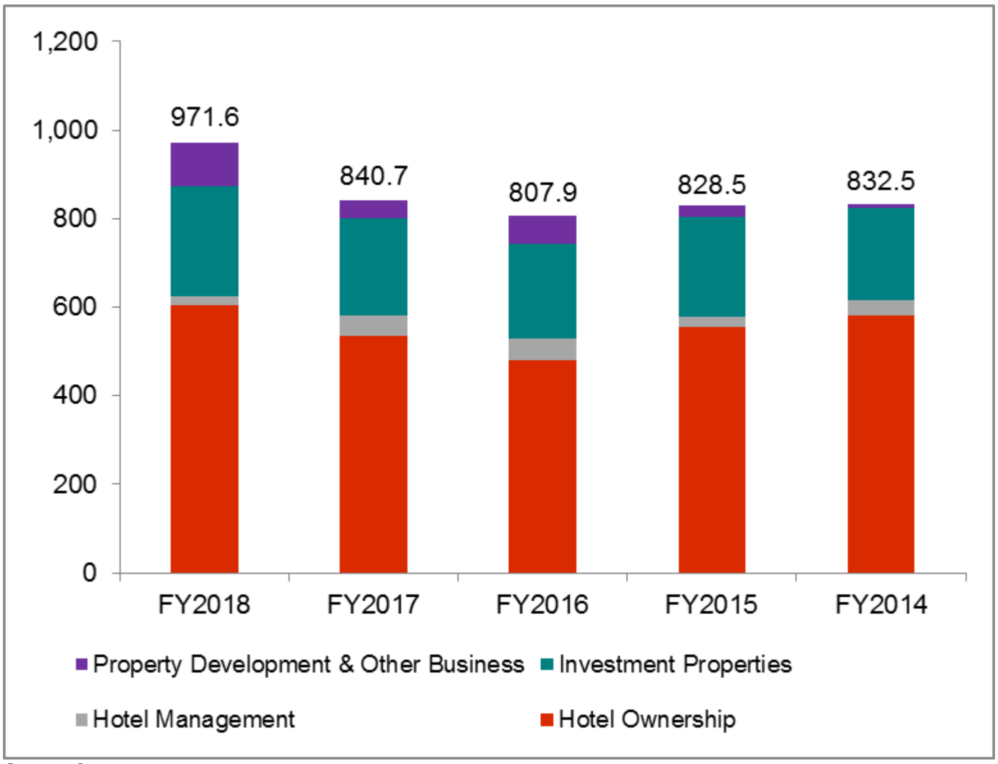
Source: Company

Figure 2: Sales (USD'mn) Breakdown by Segment – FY2014 to FY2018



Source: Company

Figure 3: Aggregate Effective Share of EBITDA[1] (USD'mn) Breakdown by Segment – FY2014 to FY2018



Source: Company
Note: (1) Per company, effective share of EBITDA is the aggregate total of the Company's EBITDA and the Group's share of EBITDA of subsidiaries and associates based on percentage of equity interests
(2) Prior to corporate and pre-opening expenses

SHANG operates 3 key business segments:

<u>Hotel Ownership and Management</u>

SHANG owns and/or manages a total of 102 hotels under its registered brand names of "Shangri-La Hotels and Resorts", "Kerry Hotels", "Hotel Jen" and "Traders Hotels". Properties under "Shangri-La Hotels and Resorts" are primarily 5-star deluxe city centre or resort hotels, with many city centre hotels having a capacity of over 500 guestrooms. "Kerry Hotels" cater to business travellers, combining a vibrant and relaxed environment with service and quality through integration of business, entertainment and recreation. "Hotel Jen" is a unique brand designed to appeal to a 'New Generation' of travellers via a mix of style and service delivery. Meanwhile, "Traders Hotels" properties owned by SHANG have been gradually redeveloped and rebranded as "Hotel Jen", with the only 3 remaining owned by third parties. As it stands, "Shangri-La Hotels and Resorts" remains the Group's most distinguished brand, being a household name regionally as a provider of 5-star deluxe hotel accommodations.

Figure 4: Hotel Brands under SHANG

Source: Company

Figure 5: Hotels and Rooms by brands as at 31 December 2018

Brands	Owned/Leased		Managed		Total Operating		Under Development	
	Hotels	Room	Hotels	Room	Hotels	Room	Owned	Contracts
Shangri-La Hotels and Resorts	71	30,900	15	4,700	86	35,600	4	8
Kerry Hotels	3	1,600	-	-	3	1,600	-	-
Hotel Jen	7	2,800	2	600	9	3,400	-	1
Traders Hotels	-	-	3	1,200	3	1,200	1	-
Other[1]	1	600	-	-	1	600	-	-
Total	**82**	**35,900**	**20**	**6,500**	**102**	**42,400**	**5**	**9**

Source: Company

Note: (1) Other hotel refers to the Portman Ritz-Carlton Hotel, Shanghai (where the Group has 30% equity interest)

Unlike competitors who have gone with an “asset-light” and/or “asset-right” strategy, SHANG has comparatively an asset-heavy strategy when it comes to the Hotel Properties segment, holding equity interests in 79 hotels. SHANG has a 51% or more ownership stake in 55 out of 79 of those properties. Of these, it has full ownership of 34 hotels. This accounts for a room inventory of 25,405 keys after adjusting for its proportionate ownership (from a gross total of 34,993 keys). Despite declining slightly from FY2017, due to the requested disposal of Hotel Jen Brisbane by the local government authorities to take the underlying land for redevelopment, hotel room inventory is expected to increase by at least 525 keys (adjusted for proportionate ownership) by 2022 with four hotel developments currently under construction and projected to open by then. The projected opening of an additional hotel under development, Shangri-La Hotel, Kunming, has yet to be determined. Shangri-La Hotel, Zhoushan, is the earliest hotel in the pipeline, projected to open in 4Q2019. The asset-heavy strategy has followed from its early days of swift expansion.

Hotel Properties (where SHANG owns a consolidating stake in the underlying hotels) contributed to 87.6% (USD2.2bn) of SHANG’s consolidated revenue in FY2018. This still represents the largest segment by far in terms of revenue. It is mainly anchored by revenue from Hotel Properties in Mainland China, Hong Kong and Singapore which in total already accounts for 65.7% (USD1.4bn) of SHANG’s revenue from Hotel Properties. However, the Hotel Properties segment only accounted for 26.7% (USD89.9mn) of SHANG’s disclosed operating profit after tax (inclusive of results from associates, after minority interest at subsidiaries where SHANG has no full ownership) (“AOP”) of USD336.5mn. This reflects low net profit margin of 4.1% at Hotel Properties, weighed down by operations in the red in locations such as the United Kingdom, France and Sri Lanka. Despite the low profit margin, we think the hotel ownership segment is a significant part of the Group’s business as the strong “Shangri-La Hotels and Resorts” brand drives revenue in the other segments, Hotel Management and Property Rental (with “Shangri-La Apartments” and “Shangri-La Residences”).

Hotel Management is operated via SHANG’s wholly-owned subsidiary, SLIM International Limited and its subsidiaries (“SLIM”). As at 31 December 2018, SLIM managed a total of 102 hotels and resorts, out of which 79 are owned, 3 are under operating lease agreements, and 20 are owned by third parties mainly across Asia and the Middle East (also under SHANG’s registered brand names). During FY2018, a new agreement was signed for the management and operation of a Shangri-La hotel owned by a third party situated in Bahrain Marina, an iconic waterfront complex under development in Manama, Bahrain, expected to open in 2022. In addition, SLIM is expected to add nine more new third-party owned hotels to its management, Nanning, Qiantan and Suzhou (Mainland China), Bali (Indonesia), Jeddah (Saudi Arabia), Phnom Penh (Cambodia), Melbourne (Australia) and Manama (Bahrain). SHANG’s strategy towards hotel management is aimed at third-party owned hotels which do not require capital injection as well as of locations of long-term strategic interest. This remains though a very small business for SHANG. In FY2018, Hotel Management made up only 4.0% (USD100.1mn) of SHANG’s total sales, after elimination of inter-segment revenues and contributed 2.5% (USD8.4mn) to AOP.

Figure 6: Hotels and Rooms Owned by SHANG as at 31 December 2018

Hotels	Group’s Equity Interest (%)	Available Rooms	Rooms Adjusted for Proportionate Interest[1]
Kowloon Shangri-La, Hong Kong	100%	682	682
Island Shangri-La, Hong Kong	80%	565	452
Hotel Jen Hong Kong	30%	283	85

Kerry Hotel, Hong Kong	100%	546	546
Shangri-La Hotel, Beijing	38%	670	255
China World Hotel, Beijing	50%	584	292
China World Summit Wing, Beijing	40.32%	278	112
Hotel Jen Beijing	40.32%	450	181
Kerry Hotel, Beijing	23.75%	486	115
Pudong Shangri-La, East Shanghai	100%	946	946
Jing An Shangri-La, West Shanghai	49%	508	249
Kerry Hotel Pudong, Shanghai	23.2%	574	133
Portman Ritz-Carlton Hotel, Shanghai	30%	593	178
Shangri-La Hotel, Shenzhen	72%	522	376
Futian Shangri-La, Shenzhen	100%	528	528
Shangri-La Hotel, Xian	100%	393	393
Shangri-La Hotel, Hangzhou	45%	380	171
Shangri-La Hotel, Beihai	100%	362	362
Shangri-La Hotel, Changchun	100%	382	382
Hotel Jen, Shenyang	100%	407	407
Shangri-La Hotel, Shenyang	25%	383	96
Shangri-La Hotel, Qingdao	100%	702	702
Shangri-La Hotel, Dalian	100%	560	560
Shangri-La Hotel, Wuhan	92%	442	407
Shangri-La Hotel, Harbin	100%	403	403
Shangri-La Hotel, Fuzhou	100%	414	414
Shangri-La Hotel, Guangzhou	80%	690	552
Shangri-La Hotel, Chengdu	80%	593	474
Shangri-La Hotel, Wenzhou	75%	409	307
Shangri-La Hotel, Ningbo	95%	562	534
Shangri-La Hotel, Guilin	100%	439	439
Shangri-La Hotel, Baotou	100%	360	360
Shangri-La Hotel, Huhhot	100%	365	365
Shangri-La Hotel, Manzhouli	100%	235	235
Shangri-La Hotel, Yangzhou	100%	360	360
Shangri-La Hotel, Qufu	100%	322	322
Shangri-La Hotel, Lhasa	100%	289	289
Shangri-La's Sanya Resort & Spa, Hainan	100%	496	496
Shangri-La Hotel, Nanjing	55%	450	248
Shangri-La Hotel, Qinhuangdao	100%	328	328
Shangri-La Hotel, Hefei	100%	400	400
Shangri-La Resort, Shangri-La	100%	228	228
Shangri-La Hotel, Tianjin	20%	304	61
Shangri-La Hotel, Nanchang	20%	473	95
Shangri-La Hotel, Tangshan	35%	301	105
Midtown Shangri-La, Hangzhou	25%	414	104
Songbei Shangri-La, Harbin	100%	344	344
Shangri-La Hotel, Xiamen	100%	325	325
Shangri-La Hotel, Jinan	45%	364	164
Shangri-La Hotel, Singapore	100%	792	792
Shangri-La's Rasa Sentosa Resort & Spa, Singapore	100%	454	454
Hotel Jen Tanglin Singapore	44.6%	565	252
Shangri-La Hotel, Kuala Lumpur	52.78%	655	346
Shangri-La's Rasa Sentosa Resort & Spa, Penang	52.78%	303	160
Golden Sands Resort, Penang	52.78%	387	204
Hotel Jen Penang	31.67%	443	140
Shangri-La's Rasa Ria Resort & Spa, Kota Kinabalu	64.59%	499	322
Shangri-La's Tanjung Aru Resort & Spa, Kota Kinabalu	40%	492	197
Makati Shangri-La, Manila	100%	696	696
Edsa Shangri-La, Manila	100%	630	630
Shangri-La's Mactan Resort & Spa, Cebu	93.95%	530	498
Shangri-La's Boracay Resort & Spa	100%	219	219

Shangri-La at the Fort, Manila	40%	576	230
Shangri-La Hotel, Bangkok	73.61%	802	590
Shangri-La Hotel, Chiang Mai	73.61%	277	204
Shangri-La Hotel, Sydney	100%	565	565
Shangri-La Hotel, The Marina, Cairns	100%	255	255
Shangri-La Hotel, Paris	100%	100	100
Shangri-La's Villingili Resort & Spa, Maldives	70%	132	92
Hotel Jen Male, Maldives	100%	114	114
Shangri-La Bosphorus, Istanbul, Turkey	50%	186	93
Shangri-La's Fijian Resort & Spa, Yanuca, Fiji	71.64%	442	317
Sule Shangri-La, Yangon, Myanmar	59.16%	474	280
Shangri-La Hotel, Jakarta, Indonesia	25%	619	155
Shangri-La Hotel, Surabaya, Indonesia	11.4%	365	41
Shangri-La Hotel, Ulaanbaatar, Mongolia	51%	290	148
Shangri-La's Le Touessrok Resort & Spa, Mauritius	26%	203	53
Shangri-La's Hambantota Golf Resort & Spa, Sri Lanka	90%	274	247
Shangri-La Hotel, Colombo, Sri Lanka	90%	500	450
Total		**34,993**	**25,405**

Source: Company
Note: (1) OCBC Credit Research adjustment for proportionate stake

<u>Property Rental</u>

Under the property rental segment, SHANG holds equity interests in properties comprising office, commercial and residential spaces, with a total GFA of ~920,000 sqm after adjustment for proportionate share which it rents out (under the Investment Properties segment). The investment properties are located in strategic locations across Asia. Properties in Mainland China are situated in Tier 1 cities, Beijing, Shanghai, Tianjin, and Tier 2 cities, Dalian, Qingdao, Hangzhou, Chengdu. Meanwhile, properties in Singapore are located in prime locations near the famed shopping stretch, Orchard Road. The properties in other countries are located in capital cities or commercial centres, with the exception of the Cairns which is a popular tourist destination in Australia. While physical property assets, including properties held for property rental is a credit positive in our view, we had observed rising vacancy rates in Shanghai and Beijing since 2016, which is something we would watch out for going forward.

Even though the net property income contribution by properties is undisclosed, based on gross GFA, the operating income from property rentals is expected to be anchored by China World Trade Center which accounts for 32.2% of total GFA (after adjustment for proportionate interests). China World Trade Center, the largest up-market commercial mixed-use development in the world, along with Century Towers Beijing, are both owned by China World Trade Center Company Limited ("CWTC") (listed), in which SHANG owns a 50% equity interest. The remaining investment properties are either wholly or majority-owned by SHANG or held with its sister companies, Kerry Properties Limited and Allgreen Properties Limited (Kuok Group's Singapore real estate arm). In our view, SHANG is also a core part of the Kuok Group which encourages alignment of interest. For example, Kerry Group owns 36%-stake in SHANG and simultaneously own 59%-stake in Kerry Properties Limited ("KPL").

For FY2018, the property rental segment made up only 3.3% (USD82.6mn) of SHANG's consolidated revenue but is a main driver of operating profits, contributing 45.8% (USD154.2mn) to AOP, owing to large contributions from its associates.

Figure 7: The Group's Investment Properties for Rental by GFA

Investment Properties	Equity Interest (%)	Office Spaces (sqm)	Commercial Spaces (sqm)	Serviced Apartments (sqm)	Ownership
China World Trade Center, Beijing - Phase I - Phase II	 40.32-50% 43.23%	 88,433 76,536	 90,770 24,337	 80,124 -	Together with CWTC

- Phase IIIA - Phase IIIB	40.32% 40.32%	143,088 83,419	45,851 62,498	- -	
Century Towers, Beijing	50%	-	-	43,445	Together with CWTC
Beijing Kerry Centre, Beijing	23.75%	92,723	12,831	36,161	Together with KPL
Shanghai Centre, Shanghai	30%	40,819	12,057	50,988	
Kerry Parkside Shanghai Pudong	23.2%	94,995	49,319	34,907	Together with KPL
Jing An Kerry Centre – Phase I, Shanghai	24.75%	38,611	13,009	17,812	Together with KPL
Jing An Kerry Centre – Phase II, Shanghai	49%	117,823	80,967	-	Together with KPL
Shangri-La Residences, Dalian	100%	-	-	54,004	Wholly-owned
Shangri-La Centre, Qingdao	100%	31,911	8,029	-	Wholly-owned
Tianjin Kerry Centre, Tianjin	20%	-	82,494	-	Together with KPL
Hangzhou Kerry Centre, Hangzhou	25%	12,583	98,886	-	Together with KPL
Shangri-La Centre, Chengdu	80%	41,519	4,097	-	Majority stake
Jinan Enterprise Square, Jinan City	45%	32,944	5,681	-	Together with KPL
Tanglin Mall, Singapore	44.6%	-	21,267	-	Together with AGPL
Tanglin Place, Singapore	44.6%	3,291	1,666	-	Together with AGPL
Shangri-La Apartments, Singapore	100%	-	-	13,794	Wholly-owned
Shangri-La Residences, Singapore	100%	-	-	10,941	Wholly-owned
UBN Tower, Kuala Lumpur	52.78%	45,175	8,530	-	Majority stake
UBN Apartments, Kuala Lumpur	52.78%	-	-	17,356	Majority stake
Central Tower, Ulaanbaatar	51%	23,114	4,510	-	Majority stake
Shangri-La Centre, Ulaanbaatar	51%	18,241	16,728	19,585	Majority stake
Sule Square, Yangon	59.28%	37,635	11,807	-	Majority stake
Shangri-La Residences, Yangon	55.86%	-	-	56,834	Majority stake
The Pier Retail Complex, Cairns	100%	515	11,370	-	Wholly-owned

Source: Company
Note: KPL: Kerry Properties Limited
AGPL: Allgreen Properties Limited, Kuok Group's Singapore real estate arm, through Cuscaden Properties Pte Ltd

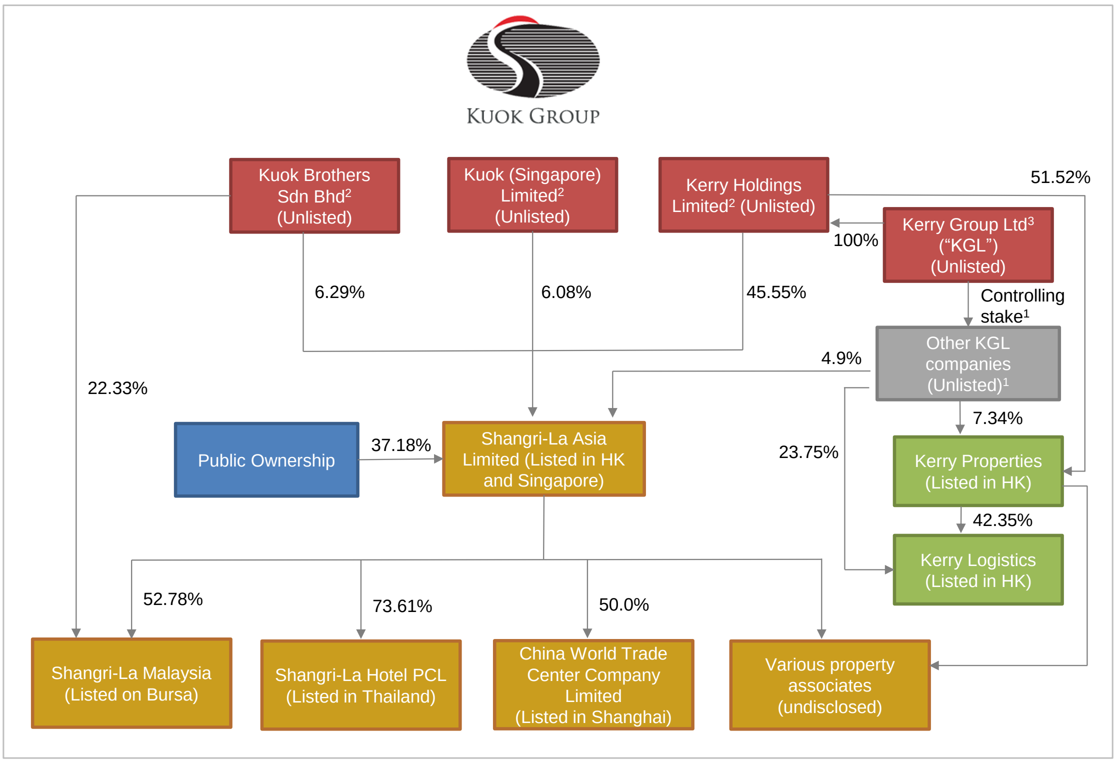
Property Sales

Under the Property Sales segment, as observed from past developments, SHANG traditionally held equity interests in composite developments in Mainland China, the Philippines and Sri Lanka with its sister company, KPL. Income from Property Sales is lumpy as revenue is recognised only upon the handover of units. For FY2018, Property Sales accounted for 5.1% (USD127.7mn) of consolidated revenue and 25.0% (USD84.2mn) of AOP.

The remaining pre-sold residential units of One Galle Face, Colombo, in which SHANG holds a 90% stake, will be handed over.USD100mn of operating profit is expected to be recognised from the handover of 171 apartments. The residential tower of the Shangri-La Hotel, Dalian Phase II project ("Yavis") will also see the recognition of 4 sold units in FY2019 upon handover. As at 31 December 2018, One Galle Face and Yavis had a remaining inventory of 108 and 83 apartments respectively unsold.

II) Ownership and Management

Figure 8: Simplified Corporate Structure



Source: OCBC Credit Research, SHANG, Kerry Properties and Kerry Logistics annual reports, exchange fillings
Note:
(1) We have grouped other holding companies together due to the lack of specific disclosures and for simplicity
(2) Shareholders include members of the Kuok family
(3) Kerry Group Ltd's deemed interested in the following:
- (a) *Kerry Properties: 58.86%*
- (b) *Kerry Logistics: 66.1%*
- (c) *Shangri-La Asia: 50.45%*

Figure 9: Major shareholders as at 8 April 2019

Shareholder	Shares	Stake
Kerry Group Ltd	1,305,778,353	36.42%
Baylite Co Ltd	218,008,907	6.08%
KS Ocean INC	95,537,377	2.66%
Kuok Brothers Sdn Bhd	84,441,251	2.36%
Kuok Hui Kwong	25,459,003	0.71%

Source: Bloomberg, Company

Kerry Group Limited ("KGL") is a subsidiary of Kuok (Singapore) Limited ("KSL"), which is an investment holding company with interests in maritime activities, agri-solutions, property and equity investments in numerous listed companies. KGL has the following subsidiaries, Caninco Investments Ltd, Paruni Ltd, Darmex Holdings Ltd and Kerry Holdings Ltd, through which KGL has a 36.42% deemed interest in SHANG. Baylite Co Ltd is a wholly-owned subsidiary of KSL, with a 6.08% stake in SHANG. Both KSL and Kuok Brothers Sdn Bhd were founded by members of the Kuok family. The two entities, along with Kerry Holdings Limited in Hong Kong, form the multi-national conglomerate, "Kuok Group".

Ms Kuok Hui Kwong is the Chairman of the Board of Directors of SHANG She is the daughter of Mr Robert Kwok, who is also the patriarch of the "Kuok Group". Ms Kuok Hui Kwong is also an executive director of China World Trade Center Company Limited (listed on the Shanghai stock exchange), which is an associate of SHANG.

KS Ocean INC, controlled by Dato' Ho Kian Hock, has a 2.66% stake in SHANG. Dato' Ho is the Deputy Executive Chairman of Keck Seng Investments Hong Kong Inc ("Keck Seng") and brother of Mr Ho Kian Guan, a non-executive director of SHANG. The remaining stakes are held by institutional and retail investors.

III) Company Overview & Analysis

Business concentrated in Mainland China: In FY2018, revenue from Mainland China contributed 38.2% (USD842.1mn) of revenue from Hotel Properties. While the contribution to Hotel Properties' AOP is less significant at 22.1% (USD19.9mn), Mainland China made up 92.7% (USD142.9mn) of Investment Properties' AOP. Moreover, given the concentration of both hotel and investment properties located in Mainland China, exposure to the region is substantial. Foreign currency stability against the USD (which is SHANG's reporting currency) is important to SHANG's performance, as seen by the net foreign exchange losses of USD25.4mn in FY2018. Although the breakdown by currency is undisclosed, due to the large volume of operations in Mainland China and the recent weakening of the RMB against the USD, we assume it to be largely contributed by RMB exchange losses. However, the Chinese hospitality market still sees growth due to China travel, as local and regional demand from increased connectivity in railway and flights. With the intent to build up even more presence in Mainland China, it appears that SHANG is banking on the structural growth from rising middle class consumers in Asia and strong domestic consumption growth in Mainland China, which amidst the US-Sino trade war, should remain strong for the near future. While Investment Properties are concentrated in Tier 1 and Tier 2 cities, SHANG's Hotel Properties has a broader geographical exposure. It has 10,704 rooms in Tier 1 and 2 cities and 4,090 rooms in Tier 3 and 4 cities in Mainland China, adjusting for its proportionate stake. Weighted average selling prices was USD173 and 100 for Tier 1 and Tier 2 respectively and USD92 for Tier 3 and Tier 4. Outside of Tier 1 and Tier 2, occupancy rates tend to also be lower at 52% (compared to 79% for Tier 1 and 67% for Tier 2).

Significance of the "Shangri-La" brand: The "Shangri-La Hotels and Resorts" brand is positioned as a leading luxury hotel group providing 5-star deluxe hotel accommodation. The brand is collectively owned by Shangri-La International Hotel Management Limited and Shangri-La International Hotel Management BV, both of which are wholly-owned by SHANG. Complementary to SHANG's other segments (hotel management and property rental), the brand goodwill of "Shangri-La Hotels and Resorts" invariably weighs in on proposals from third-parties for hotel management opportunities (reiterated by the third-party owned hotels currently managed by SHANG) as well as tenant base for "Shangri-La Apartments", "Shangri-La Residences" and "Shangri-La Centre" in its investment property portfolio. SHANG also derives sizeable revenue from Food and Beverage (FY2018: USD941.3mn, 43% of total Hotel Properties consolidated revenue). This is in part due to SHANG's focus on the overall hospitality experience including fine dining (eg: Shang Palace restaurants) and banqueting. However, SHANG has also expanded beyond the luxury tag and entered into the mid-market segment, with its brands "Kerry Hotels" and "Hotel Jen" targeting the business and younger travellers respectively, who would be unwilling to pay a premium price for a "Shangri-La Hotels and Resorts" room. Intangible assets had a book value of USD100.1mn in end-2018, however, we estimate that only 6% was attributable to trademark and licenses, which appears low in our view. Per Brand Finance, a brand valuation consultancy, the "Shangri-La" brand has a brand value of USD2.2bn in 2018, up 35% y/y.

An "asset-heavy" hotel operator: Adjusting for ownership stake, we estimate that SHANG owns 25,405 keys, representing an attributable 73% (ie: 25,405 out of 34,993 keys), which in our view is significant versus its asset-light competitors. Importantly, apart from Beijing, crown jewel "Shangri-La" hotels in key Asian gateway cities of Shanghai, Shenzhen, Hong Kong, Singapore, Kuala Lumpur and Manila are majority owned and can be monetised if need be. As a ballpark figure, we think Shangri-La Singapore itself could fetch ~USD760mn in the market. SHANG has ownership stakes in 79 hotels, including those where it only holds a minority stake. Some of these hotels with less than majority control are also owned by entities within the Kuok Group (eg: Allgreen Properties Limited, Kerry Properties Limited), although identity of the controlling shareholders of the other hotels are undisclosed. Hotels as an asset class are in a unique position where the brand and day-to-day management are important income drivers. In our view, this reduces the risk that other shareholders may unilaterally take actions contrary to SHANG's interest, despite its minority ownership stake in the underlying hotels. Hotel-by-hotel income and valuation are not provided although number of rooms by property is provided. Unlike equity holders who tend to prefer asset-light hotel operators for faster growth, ceteris paribus, we like hotel operators who own their property. In our view, SHANG's retention of its underlying properties supports its credit profile as these assets can be monetised and/or used to secure financing in the event of a liquidity crunch.

Associates are important income contributors: In 2018, SHANG reported share of profit of associates at USD305.6mn (2017: USD203.7mn) though these amounts include non-cash fair value gains on investment properties held by associates. SHANG does not disclose profit by each associate although helpfully, the company discloses share of profit from associates before non-operating items (eg: before fair value gain) ("Adjusted Share of Profits from Associates"). Noticeably, associates from the Investment Properties segment is the largest contributor to Adjusted Share of Profit from Associates, making up USD150mn out of USD187.7mn in total. Adjusted Share of Profit from Associates from Hotel Properties associates make up USD14.1mn and the lumpier Property Development associates contributed USD23.3mn in 2018. Only three of SHANG's Investment Properties in Mainland China are more than 51% owned (collectively, 139,560 sqm), the remaining properties with 1.7mn sqm are held by associated companies, typically with KPL, a key property arm of Kuok Group as the major shareholder. It is not directly revealed how much control SHANG has over these associates although we assume for those associates where SHANG holds a minority stake, the majority shareholder has larger control. While associate stakes expose bondholders to structural subordination issues, we think this is not an unduly large concern in the case of SHANG.

IV) Financial Analysis

Good revenue growth but pockets of weakness in hotel: SHANG's revenue increased 15% y/y to USD2.5bn in 2018, driven by the increase in all of its business segments. In particular, hotel room and food & beverage revenue (eg: banquets, in-room dining, on-site restaurants) grew 9.5% y/y while property development grew 2.8x as sales was recognised post-handover from residential units in Sri Lanka and continued residential property sales in China. Per company, USD94.8mn (29% of the incremental growth) can be attributable to general improvement in operations in Hotel and Investment Properties. We continue to expect SHANG's underlying businesses to grow, given its development pipeline. Despite gross margin being relatively steady at 56% in 2018 and proportionate operating expenses relatively in line with the previous year, reported operating profit only grew 1% y/y. This was dragged by large other losses - net of USD126.4mn versus other losses of only USD16.2mn in 2017. In 2018, SHANG reported a USD123.2mn in provision for impairment losses, largely from three less than 5 years old Hotel Properties in London, Shangri-La City and Ulaanbaatar. No hotel impairment was recorded in 2017. While UK and Mongolia hotel performance has been observably weak, it came as a surprise that impairments were taken for Shangri-La at The Shard, London as this is a property under an operating lease rather than owned by SHANG like the other two. Despite the stagnant reported operating profit and higher net finance costs, share of profits from associates helped boost reported profit before tax to USD290.4mn (2017: USD250.2mn). Share of profits from associates had increased by or to USD101.7mn from 2017, driven by fair value gains of Investment Properties. In particular, the China World Trade Centre fully opened in April 2017 while Jinan Enterprise Square was completed in 4Q2017. Large foreign exchange translation losses though led SHANG to report a total comprehensive loss of USD248.5mn (2017 total comprehensive income of USD685.7mn).

Substantial recurring income from Investment Properties: SHANG's AOP was USD336.5mn in 2018. The Hotel Properties segment which SHANG is better known for contributed 27% to that number. The lion's share came from Investment Properties at USD154.2mn (46% contribution). In 2017, this USD136.7mn Investment Properties income was driven by rental income from office, commercial and residential properties (eg: serviced apartments) located in Mainland China. While insufficient to fully cover total interest costs of USD179.5mn (including capitalised interest), in our view, SHANG's rental income is a credit positive given its stable and recurring nature. We consider Hotel Properties income as recurring too (especially for well-appointed hotels) although this is more volatile versus rental income, in our view SHANG is also reliant on Food & Beverage (43% of Hotel Properties revenue) which adds to the variability. We take comfort though that on a weighted average basis, SHANG's portfolio of hotels reported higher revenue per available room of USD115 in 2018 (2017: USD109) with consolidated Hotel Properties revenue growing 4.2% y/y on a like-for-like basis.

Adjusted net gearing relatively significant: As at 31 December 2018, unadjusted net gearing at SHANG was optically moderate at 0.61x, in line with 30 June 2018 and end-2017 figures. However, SHANG receives cash in advanced of services and is liable for unredeemed loyalty points and refunds (end-2018 contract liabilities of USD286.9mn) while it provides USD129.2mn in financial guarantees for certain associates. Adjusting net debt for these, we find adjusted net gearing at 0.67x. The new accounting standard for leases HKFRS16 Lease has not kicked in yet for SHANG's 2018 results. Non-cancellable operating leases for end-2018 have not been disclosed although this was USD1.6bn in end-2017, largely from hotels which are leased. Simplistically, if we add these as debt (we think this is reasonable as it is a liability in a liquidation scenario), we find net gearing at 0.91x.

Interest coverage healthy: Consolidated EBITDA (based on our calculation which does not include other income and other expenses) was USD659.6mn, up 26% y/y while Interest expense including capitalised interest increased 20% y/y despite the lower average debt in 2018 versus 2017. This is indicative of higher interest costs, especially from bank loans as these were the main source of SHANG's debt for 2018. SHANG also disclosed that the SGD bonds allowed it to reduce refinancing cycle. Net-net, we think SHANG was able to get better rates for a long term of seven years to keep its interest cost in check. We find EBITDA/Interest coverage healthy at 3.7x (2017: 3.5x). Using company's disclosed consolidated EBITDA, the more recurring Hotel Properties and Investment Properties made up 91% of total (2017: 99%).

Low short-term liquidity risk: In end-2018, capex commitment was USD439.6mn 72% of capex commitment in end-2018 was planned for development projects. This was lower than 2016 and 2017. For 2019, the targeted spent is USD202.8mn.. Cash and short-term deposits though totalled USD1.1bn, which covers both short term debt due of USD431.2mn and capex commitment of in end-2018 of USD439.6mn comfortably if SHANG so chooses to use full cash. While some of the cash were received upfront for services yet to be provided, we do not envisage disruption to the business with new sales continuing to replenish cash balance. Rather than drawdown full cash, we think it is likelier for SHANG to refinance and partly utilise debt for its capex needs. Committed but unutilised facilities were USD969.3mn. Adding to financial flexibility, in end-2018, SHANG has USD11.4bn of investment properties, property, plant and equipment (eg: hotels), land use rights and interest in associates (largely property based). Few assets have been mortgaged for funding; only USD319.6mn in property net book value has been mortgaged.

V) Technical Considerations

Positives

- Sizeable issue from a household name
- Negative pledge (limited to principal subsidiaries, though excluding listed subsidiaries and their respective subsidiaries)

Negatives

- Lack of external credit rating
- No change of control clause
- No delisting put
- No financial covenants

Relative Value

Bond	Maturity Date	Net gearing	YTW (SGD)	I-spread
SLHSP 4.5% '25s	12 November 2025	0.61x	3.56%	156
WINGTA 4.7% '24s	28 February 2024	Net cash	3.83%	191
ARTSP 4.0% '24s	22 March 2024	0.55x	3.08%	116
KERPRO 5.875% '21s (USD)	06 April 2021	0.17x	3.10%[1]	120[1]

Source: Bloomberg
Note: (1) Swapped from USD to SGD, unhedged
(2) Unadjusted net gearing per latest available financial statements
(3) Excluding perpetuals issued by Wing Tai Holdings

In our view, given the unique positioning of SHANG as a major hotel owner who concurrently own investment properties across Mainland China, there are no direct comparable for SHANG. In the SGD market, we find Wing Tai Holdings ("WTH") and Ascott Residence Trust ("ART") to be the closest peers, albeit imperfectly.

WTH, listed on the SGX with a net cash position has its core businesses in property investment and development, retail and hospitality management across Asia-Pacific cities, although its scale is smaller and unlike SHANG, WTH is less exposed to Mainland China. WTH is also reliant on share of income from associates (SGD32.1mn contribution to profit before tax versus reported operating profit of SGD0.2mn in 1HFY2019) and we similarly hold WTH at an issuer profile of Neutral (4). The WINGTA 4.7% '24s which matures 1.7 years earlier than the SHLSP 4.5% '25s is trading 35bps wider (50bps wider adjusting for tenor in our view) and this bond looks attractive against the SHLSP 4.5% '25s which had traded 6ppt up post issuance.

ART, sponsored by CapitaLand Ltd (Issuer Profile: Neutral (3)) is the largest hospitality REIT listed on the SGX though it has a somewhat smaller scale versus SHANG. ART owns a portfolio of hospitality assets (SGD3.2bn of its SGD5.3bn in total assets are located in the Asia-Pacific region) although ART has no commercial and retail properties exposure. As a REIT aggregate leverage (gross debt-to-total asset) for ART is capped at 45%. We find ART's net gearing somewhat lower than SHANG at 0.55x. We similarly hold ART at an issuer profile of Neutral (4). The ARTSP 4.0% '24s which matures 1.6 years earlier than the SHLSP 4.5% '25s is trading 35bps tighter (20 bps tighter adjusting for tenor in our view).

There is only one sole bond issued by KPL, SHANG's sister company whom it hold certain Investment Properties together. This bond is short-dated and matures in two years which makes it less useful as a comparable. That being said, we think versus the KERPRO 5.875% '21s, we think the SHLSP 4.5% '25s is at best fair. SHANG's bond which matures 4.6 years later is only trading 36bps wider versus an implied-SGD spread on KERPRO 5.875% '21s.

Net-net, we think the **SHLSP 4.5% '25s is trading at fair value against its peers** although bondholders who are willing to take on risk with a smaller scale company would be able to get a spread pick up of ~35bps by switching into the WINGTA 4.7% '24s instead.

VI) Conclusion & Recommendation

SHANG is an established hotel owner and operator, focused on the Asia-Pacific region. Its predecessor and related entities set up the first "Shangri-La" in Singapore in 1971, Hong Kong in 1981 and was an early entrant into the Mainland China luxury hotel market in 1984. SHANG's credit profile is underpinned by its recurring income stream from the Hotel Properties segment and Mainland China-focused Investment Properties segment with an asset base that is largely unencumbered. Constraining its credit profile is its' leverage levels (adjusted net gearing of 0.91x, assuming non-cancellable operating leases taken as debt) and extensive holdings of properties via associates. We are initiating SHANG with an issuer profile of Neutral (4).

Shangri-La Asia Limited

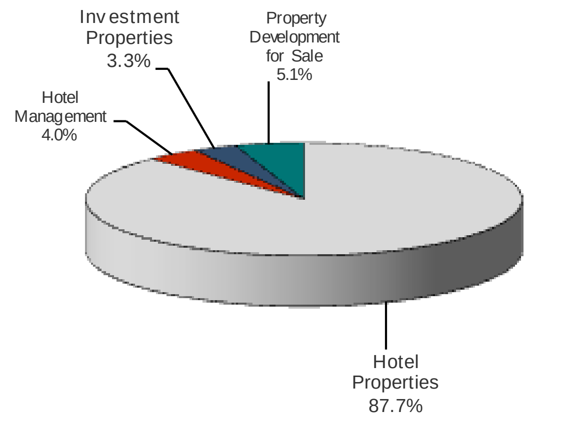
Table 1: Summary Financials

Year Ended 31st Dec	FY2016	FY2017	FY2018
Income Statement (USD'mn)			
Revenue	2,055.4	2,189.8	2,517.9
EBITDA	505.0	522.8	659.6
EBIT	179.7	194.1	307.0
Gross interest expense	130.6	131.4	195.5
Profit Before Tax	149.6	250.2	290.4
Net profit	62.0	144.0	183.8
Balance Sheet (USD'mn)			
Cash and bank deposits	944.2	921.9	1,059.4
Total assets	12,993.8	13,675.2	13,170.6
Short term debt	808.6	234.8	431.2
Gross debt	5,295.5	5,184.7	5,134.8
Net debt	4,351.3	4,262.8	4,075.5
Shareholders' equity	6,412.4	7,042.0	6,676.9
Cash Flow (USD'mn)			(1)
CFO	533.2	625.7	—
Capex	479.1	374.6	—
Acquisitions	116.2	55.4	—
Disposals	1.5	62.4	—
Dividends	76.6	85.9	—
Free Cash Flow (FCF)	54.1	251.1	—
Key Ratios			
EBITDA margin (%)	24.57	23.87	26.20
Net margin (%)	3.02	6.58	7.30
Gross debt to EBITDA (x)	10.49	9.92	7.78
Net debt to EBITDA (x)	8.62	8.15	6.18
Gross Debt to Equity (x)	0.83	0.74	0.77
Net Debt to Equity (x)	0.68	0.61	0.61
Gross debt/total assets (x)	0.41	0.38	0.39
Net debt/total assets (x)	0.33	0.31	0.31
Cash/current borrowings (x)	1.17	3.93	2.46
EBITDA/Total Interest (x)	3.87	3.98	3.37

Source: Company, OCBC estimates

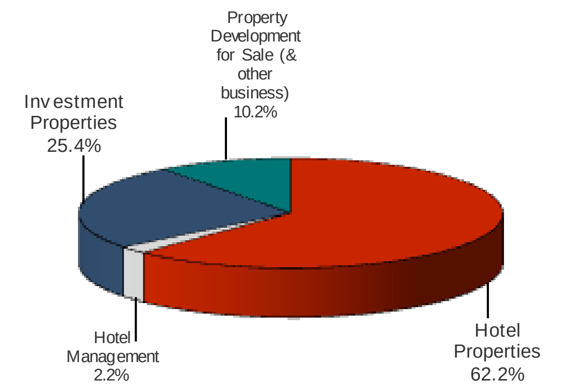
Note: (1) Statement of Cashflows has not been reported for FY2018

Figure 1: Revenue breakdown by Segment - FY2018



Source: Company | Excludes Other Business

Figure 2: EBITDA breakdown by Segment - FY2018



Source: Company

Note: (1) EBITDA: per company, Aggregate Effective Share of EBITDA

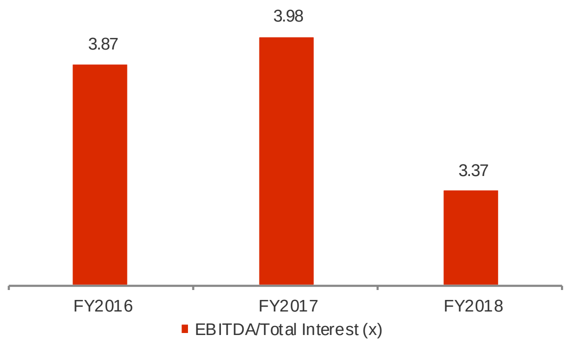
(2): Prior to corporate & pre-opening expenses

Figure 3: Debt Maturity Profile

Amounts in (USD'mn)	As at 31/12/2018	% of debt
Amount repayable in one year or less, or on demand		
Secured	91.0	1.8%
Unsecured	340.2	6.6%
	431.2	**8.4%**
Amount repayable after a year		
Secured	18.0	0.4%
Unsecured	4,685.6	91.3%
	4,703.6	**91.6%**
Total	**5,134.8**	**100.0%**

Source: Company, OCBC estimates

Figure 4: EBITDA/Total Interest (x)



Source: Company

OCBC Global Treasury	
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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 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.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

The credit research team would like to acknowledge and give due credit to the contributions of Ng Yong Jie

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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