OCBC Bank

Lai Fung Holdings Ltd: Recent Issue View

Thursday, 01 February 2018

Recent Issue View: Lai Fung Holdings Ltd ("LFH") priced a USD350mn 5-year issue at 5.65% with a USD700mn orderbook. This is LFH's second USD issuance since 2007. Most of the proceeds are expected to be used to refinance the existing RMB1.8bn LAIFNG '18s.

OCBC Credit Research currently does not cover LFH. We have presented this paper as a special interest commentary.

We compare LFH with Lai Sun Development Co Ltd ("LSD"), Yanlord Land Group Ltd ("YLLG") and Central China Real Estate Ltd ("CENCHI").

We find similarities between LAIFNG 5.65% '23s and LASUDE 4.6% '22s. In addition to tenor (~5Y), both LFH and LSD share the same ultimate controlling shareholder (Lam family), with investment properties as the largest contributor to revenue and assets. Though LAIFNG 5.65% '23s trade ~100bps wider than LASUDE 4.6% '22s, this looks fair given the difference in geography of LSD (mostly Hong Kong) and LFH (China). While LSD provides a keepwell and equity interest purchase undertaking in favour of LAIFNG 5.65% '23, we do not value this as an outright guarantee as LSD's effective stake in LFH is only 18.77%. For LSD, the keepwell obligations would also not be recorded as a corporate guarantee.

In our view, we think LAIFNG 5.65% '23 should trade between YLLGSP 5.875% '22s (5.12% YTW, 256.3bps Z-spread) and CENCHI 6.75% '21 (6.02% YTW, 347.8bps Z-spread). While not closely comparable, the trading levels of YLLGSP 5.875% '22 may set the lower bound given YLLG's significantly larger scale. We also compare with CENCHI 6.75% '21s, which should set the upper bound as CENCHI has a significantly higher net gearing and lower proportion of recurring income from investment properties. Similar to LFH, CapitaLand is a significant investor in CENCHI with 26.9% stake.

As such, **we think LAIFNG 5.65% '23s looks fair trading around 5.73% (Z-Spread: 312.4bps)**. That said, we see the potential for LAIFNG '23s to re-rate when the investment properties in the development pipeline (~3.4mn sq ft) begins to contribute. Meanwhile, we remain comfortable with LFH given the manageable net gearing levels and recurrent income from investment properties.

Figure 1: Relative Value

Bond	Net gearing	Issuer Rating	YTW (ask)	Z-Spread
LAIFNG 5.65% '23	0.22x	B+/B1/BB-	5.73%	312.4
LASUDE 4.6% '22	0.25x	NR/NR/NR	4.68%	208.3
YLLGSP 5.875% '22c20	0.17x	BB-/Ba2/NR	5.12%	256.3
CENCHI 6.75% '21c19	0.80x	B+/Ba3/BB-	6.02%	347.8

Source: Bloomberg, OCBC

Background: LFH is a real estate company with investment properties and property developments in China. The investment properties make up the majority of the portfolio by assets and totals 3.3mn sq ft, comprising retail, office and serviced apartments which are mainly located in Shanghai and Guangzhou. Meanwhile, LFH is undertaking developments (5.7mn sq ft) in Hengqin, Shanghai, Guangzhou and Zhongshan which will complete in FY2018-23. LFH intends to retain the commercial and retail portions of the developments, which will more than double the investment portfolio to 6.7m sq ft.

Ownership, management and controlling shareholder

LFH is the property development and investment arm of the Lai Sun Group. LFH (market cap: HKD4.3bn) is 50.77%-owned by eSun Holdings Ltd (HKD2.1bn), which is in turn 36.94%-owned by Lai Sun Development Co Ltd (HKD8.7bn), which is in turn 53.33%-

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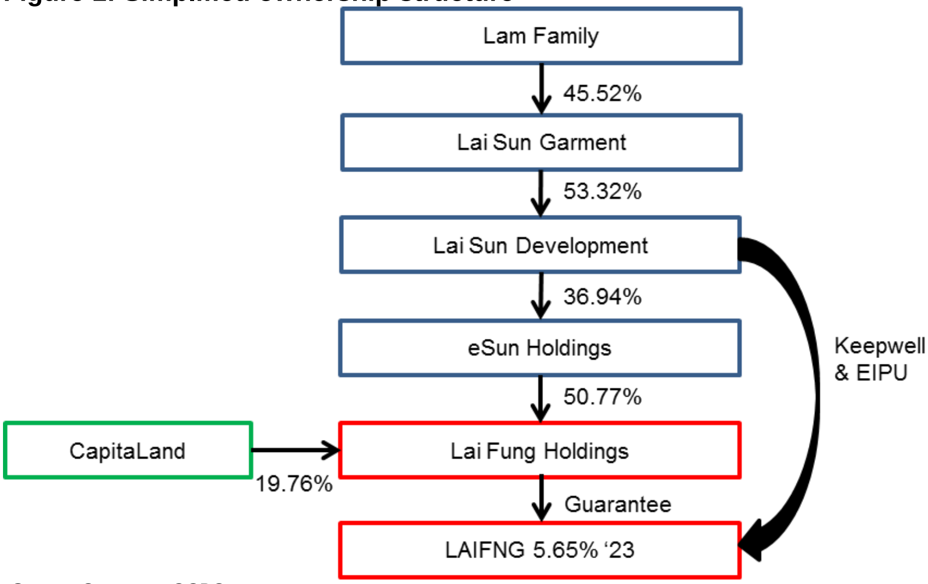
owned by Lai Sun Garment Ltd (HKD5.6bn). LFH is also 19.76%-owned by CapitaLand Ltd (SGD16.4bn), which became a key shareholder in June 2006.

Mr Chew Fook Aun is the Chairman of LFH's Board and is also the deputy chairman and executive director at Lai Sun Garment Ltd and deputy chairman and executive director of eSun Holdings Ltd. Prior to LFH, Mr Chew was an executive director and CFO of Esprit Holdings Ltd (Feb 2009 – May 2012) and CFO of the manager of Link REIT (Feb 2007 – Jan 2009).

Under the change of control covenant, the specific controlling shareholder is Dr Lam Kin Ngok. The Lam family (including Dr Lam Kin Ngok Peter) exerts control through 45.52% stake in Lai Sun Garment Ltd. Dr Lam is a member of the National Committee of Chinese People's Political Consultative Conference and the chairman of Hong Kong Tourism Board.

Figure 1: Simplified ownership structure



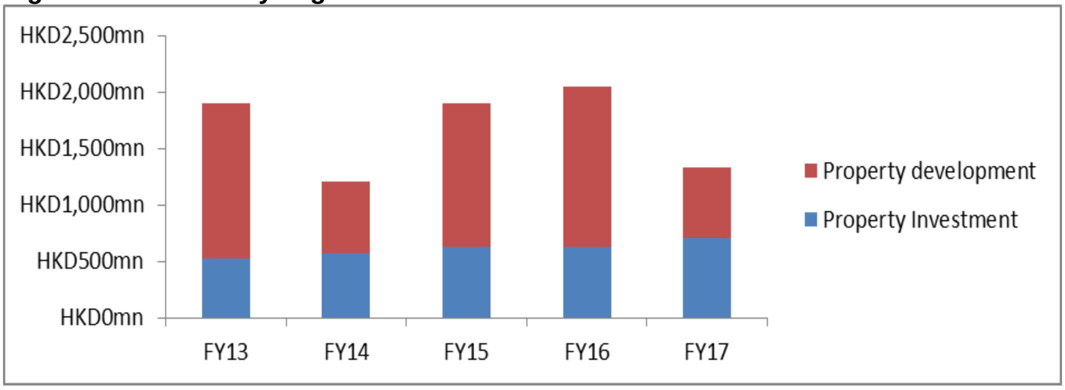
Source: Company, OCBC

Key credit considerations

- **Decent FY2017 results:** Revenue declined 35.1% y/y to HKD1.3bn despite the increase in revenue from property investment (+11.6% y/y to HKD702mn) as contribution from property development slowed (-55.8% y/y to HKD625mn). The increase in contribution from property investment was mainly due to Guangzhou Lai Fung Tower, with full year rental contribution in FY2017 following its completion in June 2016. The decline in property development revenue was due to fewer projects that were available for sale in FY2017 (Guangzhou Eastern Place Phase V, Zhongshan Palm Spring) compared to more projects that were sold in FY2016 (e.g. Guangzhou Eastern Place Phase V, Guangzhou King's Park, Shanghai May Flower Plaza). Nevertheless, net profit surged 77.2% y/y to HKD1.6bn, lifted by fair value gains on cross currency swaps (+HKD111.7mn y/y) and investment properties (+HKD272.1mn y/y). Excluding the fair value changes, net profit before tax and tax indemnity would have remained flattish at HKD741.0mn (FY2016: HKD757.6mn), with the surge in share of profits from joint ventures to HKD609.6mn (FY2016: HKD167.8mn) mitigating the decline in revenue. The surge in JV profits is due to the 47.5%-owned Guangzhou Dolce Vita, which recognised HKD1.8bn in sales. Separately, a tax indemnity of HKD493.9mn contributed to the full year net profit, which is due to indemnity by Lai Sun Development Co Ltd to indemnify LFH from corporate income tax and land appreciation tax which are due to the disposal of certain property interests as at 31 Oct 1997.

- **Steady contribution from investment properties:** Investment properties make up the majority of the assets (HKD16.5bn out of HKD25.2bn), contributing HKD616mn out of HKD1.2bn of revenue and HKD367.0mn out of HKD411.3mn of FY2017's segment results (before fair value changes). We like that the revenue growth has been consistent, growing from HKD523mn in FY2013. In addition, occupancy remains healthy for the retail and office segment, which are at 97.3% and 88.7% respectively on average in FY2017. Upon the completion of Guangzhou Lai Fung Tower post FY2017, the total rental portfolio has grown to ~3.3mn sq ft.

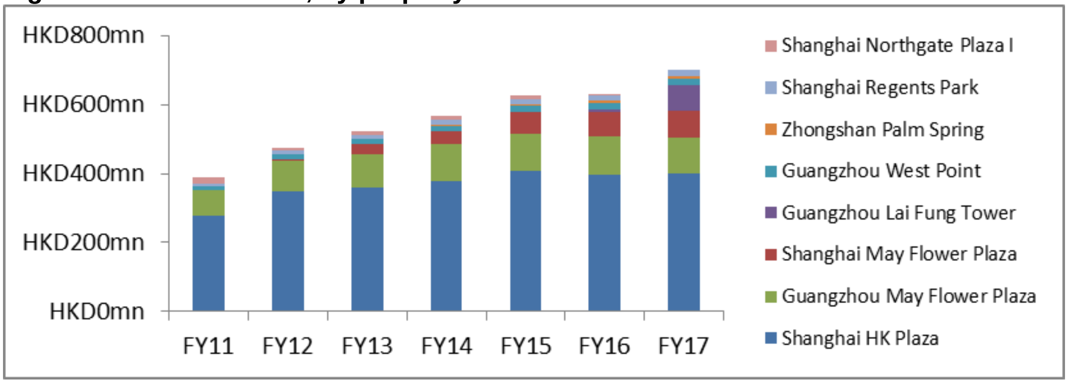
Figure 2: Revenue by segment



Source: Company

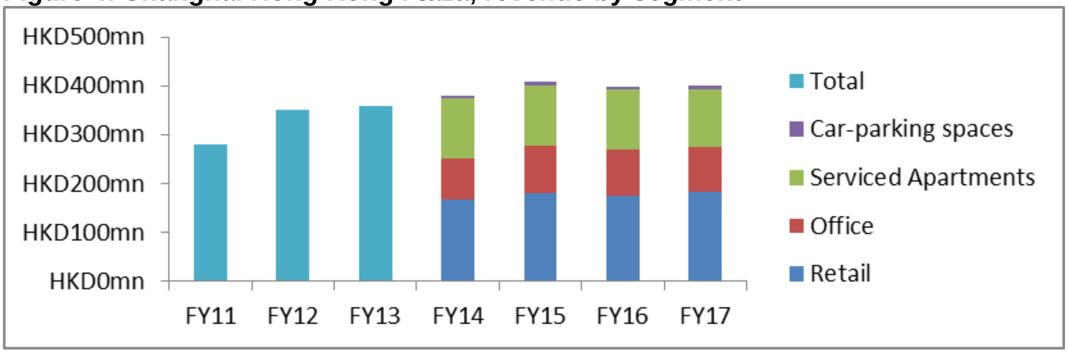
- **Good track record and diversification of use in space mitigates asset concentration:** Shanghai Hong Kong Plaza is the key asset, contributing HKD399.4mn out of HKD702.1mn of the rental revenue. Nevertheless, we are not overly worried as revenue contribution has been steady, while the use of asset is diversified across retail, office and hospitality. The property is also well-located on Hauihaizhong Road in Huangpu District in Shanghai, being directly above the Huangpi South Road metro Station. The anchor tenants include The Apple Store, Cartier, Coach, GAP and Tiffany. The other significant properties include Guangzhou May Flower Plaza (Revenue: HKD106mn), Shanghai May Flower Plaza (HKD75mn) and Guangzhou Lai Fung Tower (HKD75mn). While revenue looks somewhat concentrated, this should improve going forward as LFH intends to more than double its investment property portfolio to ~6.7mn sq ft via developing the existing projects over the next few years. LFH is planning the completion of (1) Hengqin Novotown Phase I (2.0mn sq ft) in 2019, (2) Northgate Plaza redevelopment, Haizhu Plaza, Commercial portion of Palm Spring Phase III (1.3mn sq ft) in 2021 and (3) the commercial portion of Palm Spring Phase IV in 2023 (0.1mn sq ft). The new additions should also help LFH diversify out of Shanghai and Guangzhou.

Figure 3: Rental income, by property



Source: Company

Figure 4: Shanghai Hong Kong Plaza, revenue by segment



Source: Company

- **Development pipeline ahead:** LFH as of FY2017 has contracted but not yet recognised sales of HKD143.1mn (HKD397.4mn including Guangzhou Dolce Vita). The unsold inventory of completed properties include car-parking spaces at Shanghai May Flower Plaza (carrying amount: HKD104.2mn), remaining residential units at

Guangzhou Eastern Place Phase V (HKD19.9mn) and remaining residential units at Zhongshan Palm Spring (HKD456.3mn). For Zhongshan Palm Spring, LFH is targeting to complete Phases III (GFA: 523,100 sq ft) and IV (1,576,100 sq ft) in 3Q2020 and 3Q2022 respectively, which will be mainly made up of residential units (1,967,670 sq ft). In the nearer term, Guangzhou Dolce Vita is expected to complete another 18,900 sq ft (attributable GFA: 8,988 sq ft) of commercial space by 1Q2018. In FY2019, the completion of Hengqin Novotown Phase 1 with an attributable GFA of 2.2mn sq ft, which is made up of retail (782,458 sq ft), office (634,400 sq ft) and serviced apartment (821,094 sq ft), should contribute to LFH's investment portfolio. Similarly, the developments at Northgate Plaza and Guangzhou Haizhu Plaza, which are mainly office, will expand the investment portfolio.

Figure 5: Project pipeline

Project	Attributable GFA (sq ft)	Completion
Hengqin Novotown Phase 1 (80%)	2,238,000	4Q2018E
Northgate Plaza	693,600	2Q2021E
Shanghai Wuli Bridge	83,697	1Q2019E
Guangzhou Haizhu Plaza	602,785	1H2021E
Zhongshan Palm Spring	2,099,200	3Q2020-22E
Guangzhou Dolce Vita (47.5%)	8,988	1Q2018E

Source: Company

- **Decent credit metrics for now though gearing may increase:** Excluding HKD218.3mn non-interest bearing and unsecured loan from a fellow subsidiary, gross gearing and net gearing at 0.39x and 0.22x respectively looks decent. However, we expect net gearing to increase to 0.35x-0.40x in the coming years given the various developments LFH is undertaking. The expected development costs for Northgate Plaza, Shanghai Wuli Bridge and Guangzhou Haizhu Plaza is HKD4.1bn (2017 capital commitments for construction and development: HKD2.7bn). In addition, the development cost for Zhongshan Palm Spring Phase III and IV is ~HKD1.4bn, though we recognize that cashflows may be met by the completed residential units held for sale at this development (HKD456.3mn) and any subsequent pre-sales – though this may give rise to contingent liabilities (FY2017: HKD596.2mn) as LFH may provide guarantee to banks for loan facilities granted to end-buyers of property units developed by LFH. We also see the potential for LFH to monetise the 458 car-parking spaces at Shanghai May Flower Plaza (carrying amount: HKD104.2mn). Nevertheless, we think the credit metrics remains manageable, anchored by the recurring income from investment properties (FY2017 segment results, excl fair value gains: HKD367.0mn), with HKD1.7bn in future lease receivables. This should cover the gross interest expense (FY2017: HKD345mn). While interest expense may climb as debt is expected to increase, recurring income is also expected to grow following the completions of the developments.

- **Sufficient liquidity with termed-out debt profile:** LFH holds HKD2.6bn cash on hand, sufficient to meet HKD957mn liabilities from short-term payables and HKD82mn of interest-bearing loans. The recently issued USD350mn (HKD2.7bn) LAIFNG 5.65% '23 is also sufficient to cover the maturing RMB1.8bn (HKD2.2bn) LAIFNG 6.875% '18s. In addition, LFH has HKD3.5bn in undrawn facilities. Debt profile is termed out, with minimal near-term refinancing needs following the issuance of LAIFNG 5.65% '23s while the majority of the debt (HKD5.7bn, including LAIFNG 5.65% '23s) would be due only in 3-5Y. However, we note that a substantial portion of the assets have been pledged, including investment properties with HKD10.4bn carrying value.

- **Credit positive with CapitaLand as a shareholder:** LFH has tapped on CapitaLand's expertise in developing Guangzhou Dolce Vita, which is a large-scale project. In addition, the serviced apartments of the Shanghai Hong Kong Plaza development are managed by the Ascott Group, which is a subsidiary of CapitaLand. CapitaLand has been a key shareholder of LFH since June 2006, and holds two board seats, which may support the corporate governance of LFH. Mr Lucas Ignatius Loh Jen Yuh, Director and CEO of CapitaLand China Holdings, is a non-executive director of LFH and sits on its Audit Committee and Remuneration Committee. Mr Puah Tze Shyang, Chief Investment Officer and Regional Manager of Southwest China of CapitaLand China Holdings, is a non-executive director of LFH. As such, we think that CapitaLand's involvement partly alleviates the bond covenant-lite structure of the bond (without most of the customary HY covenants).

Lai Fung Holdings Ltd

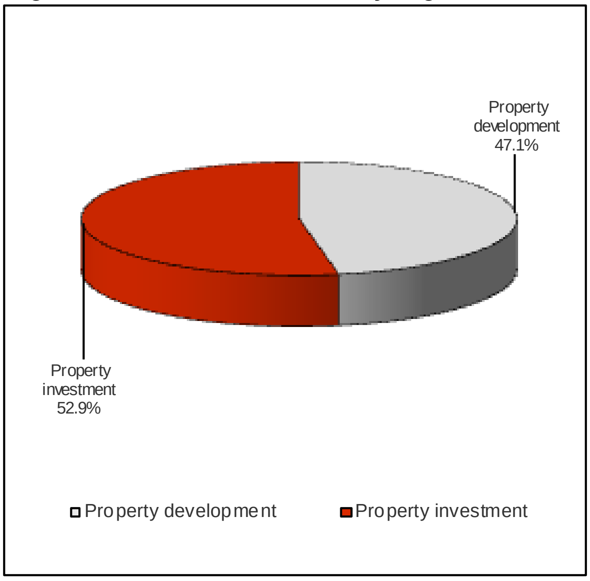
Table 1: Summary Financials

Year Ended 31st July	FY2015	FY2016	FY2017
Income Statement (HKD'mn)			
Revenue	1,901	2,044	1,327
EBITDA	767	809	342
EBIT	693	738	270
Gross interest expense	341	335	345
Profit Before Tax	1,579	1,286	1,653
Net profit	1,005	874	1,477
Balance Sheet (HKD'mn)			
Cash and bank deposits	2,864	3,613	2,628
Total assets	23,281	23,900	25,220
Gross debt	5,615	5,701	5,819
Net debt	2,751	2,088	3,191
Shareholders' equity	13,545	13,388	14,769
Total capitalization	19,160	19,089	20,588
Net capitalization	16,296	15,476	17,960
Cash Flow (HKD'mn)			
Funds from operations (FFO)	1,079	945	1,550
* CFO	-1	1,671	197
Capex	33	71	259
Acquisitions	414	705	663
Disposals	0	0	0
Dividends	46	45	49
Free Cash Flow (FCF)	-34	1,601	-62
* FCF Adjusted	-493	850	-774
Key Ratios			
EBITDA margin (%)	40.3	39.6	25.8
Net margin (%)	52.9	42.7	111.4
Gross debt to EBITDA (x)	7.3	7.0	8.5
Net debt to EBITDA (x)	3.6	2.6	4.7
Gross Debt to Equity (x)	0.41	0.43	0.39
Net Debt to Equity (x)	0.20	0.16	0.22
Gross debt/total capitalisation (%)	29.3	29.9	28.3
Net debt/net capitalisation (%)	16.9	13.5	17.8
Cash/current borrowings (x)	1.0	5.7	1.1
EBITDA/Total Interest (x)	2.3	2.4	1.0

Source: Company, OCBC estimates

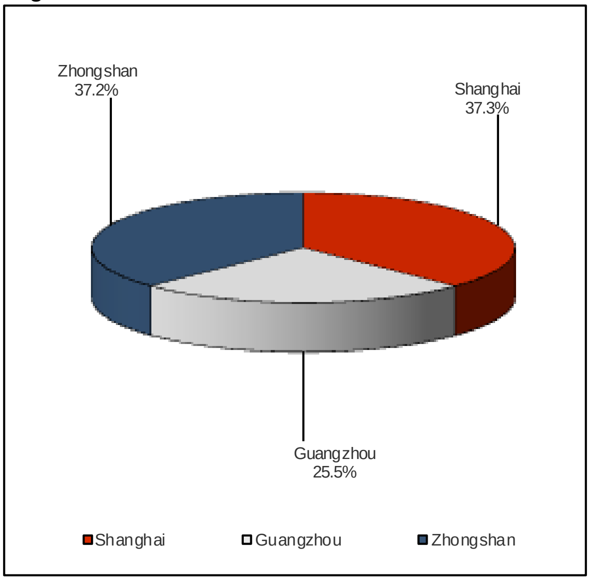
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

Figure 1: Revenue breakdown by Segment - FY2017



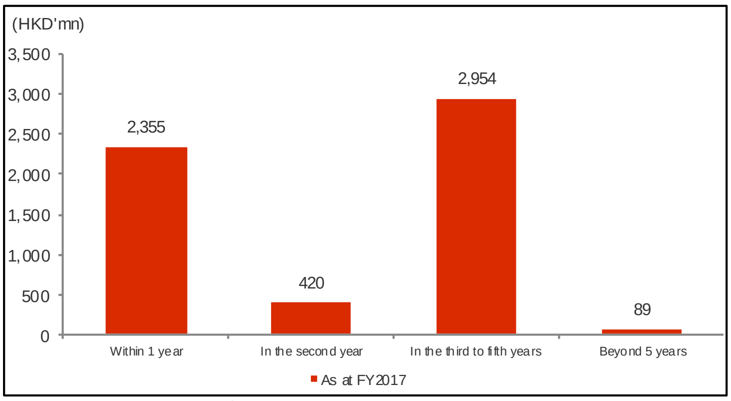
Source: Company

Figure 2: Revenue within China - FY2017



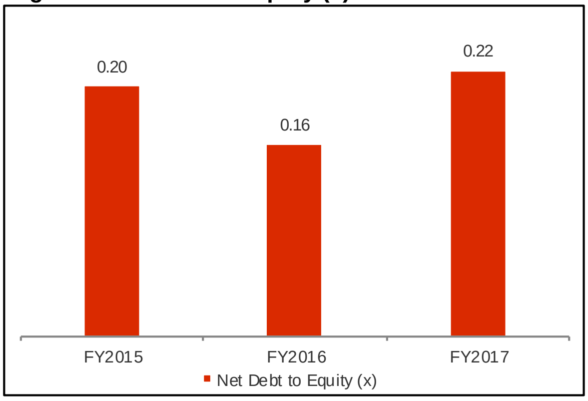
Source: Company

Figure 3: Debt Maturity Profile



Source: Company, OCBC estimates

Figure 4: Net Debt to Equity (x)



Source: Company

Lai Sun Development Co Ltd

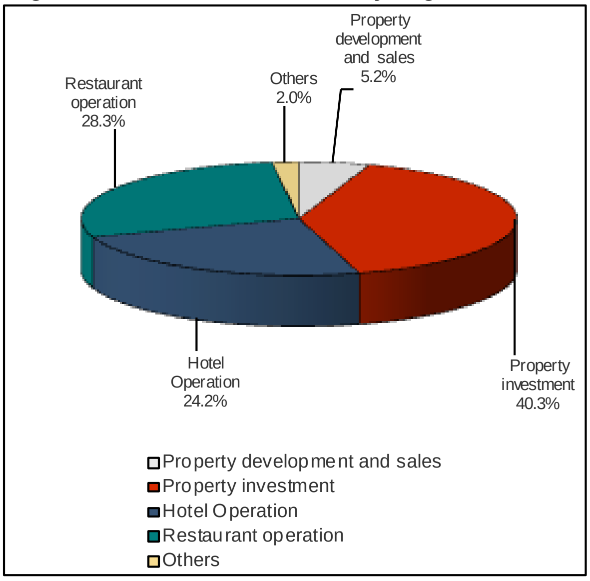
Table 1: Summary Financials

Year Ended 31st July	FY2015	FY2016	FY2017
Income Statement (HKD'mn)			
Revenue	1,542	1,868	1,704
EBITDA	680	790	729
EBIT	631	728	652
Gross interest expense	274	312	332
Profit Before Tax	2,128	1,237	2,204
Net profit	2,018	1,148	2,094
Balance Sheet (HKD'mn)			
Cash and bank deposits	1,254	2,355	2,878
Total assets	31,607	34,553	38,441
Gross debt	6,987	8,112	9,637
Net debt	5,733	5,757	6,759
Shareholders' equity	23,104	24,892	27,104
Total capitalization	30,090	33,004	36,742
Net capitalization	28,837	30,649	33,864
Cash Flow (HKD'mn)			
Funds from operations (FFO)	2,067	1,211	2,171
* CFO	397	-22	385
Capex	1,632	554	1,020
Acquisitions	1,389	271	356
Disposals	2	0	8
Dividends	111	109	110
Free Cash Flow (FCF)	-1,235	-577	-635
* FCF Adjusted	-2,732	-956	-1,093
Key Ratios			
EBITDA margin (%)	44.1	42.3	42.8
Net margin (%)	130.9	61.5	122.9
Gross debt to EBITDA (x)	10.3	10.3	13.2
Net debt to EBITDA (x)	8.4	7.3	9.3
Gross Debt to Equity (x)	0.30	0.33	0.36
Net Debt to Equity (x)	0.25	0.23	0.25
Gross debt/total capitalisation (%)	23.2	24.6	26.2
Net debt/net capitalisation (%)	19.9	18.8	20.0
Cash/current borrowings (x)	1.2	18.6	1.0
EBITDA/Total Interest (x)	2.5	2.5	2.2

Source: Company, OCBC estimates

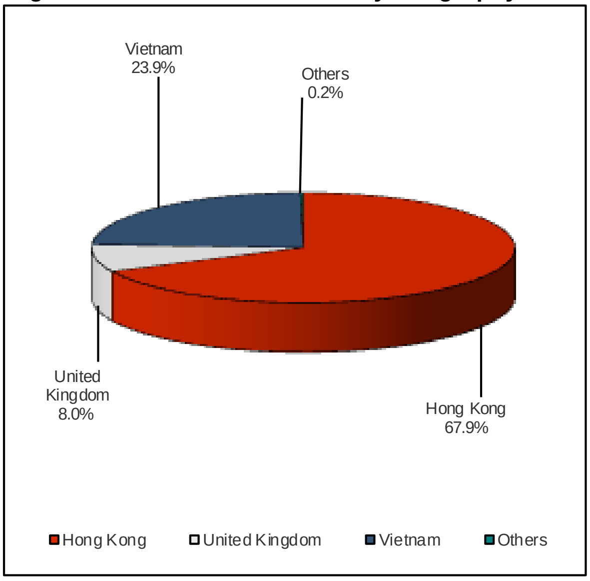
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

Figure 1: Revenue breakdown by Segment - FY2017



Source: Company

Figure 2: Revenue breakdown by Geography - FY2017



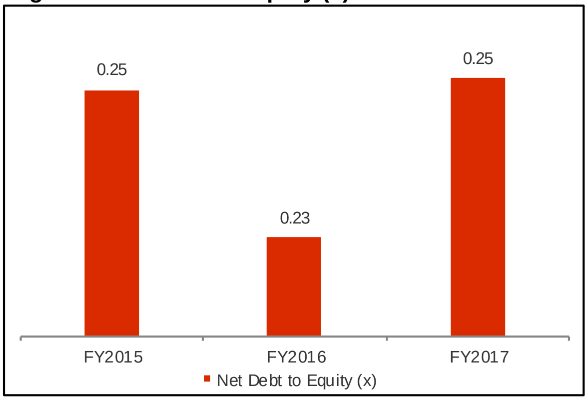
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (HKD'mn)	As at 31/07/2017	% of debt
Amount repayable in one year or less, or on demand		
Secured	157.6	1.6%
Unsecured	2,731.2	28.3%
	2,888.8	**30.0%**
Amount repayable after a year		
Secured	6,748.4	70.0%
Unsecured	0.0	0.0%
	6,748.4	**70.0%**
Total	**9,637.2**	**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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