Asia Credit Research

OCBC Bank

Olam International Ltd: New Credit Overview

Monday, 30 May 2016

S&P: Not rated

Moody's: Not rated

Fitch: Not rated

Ticker: OLAMSP

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

- **Work-in-progress:** Olam's cash flow performance year-on-year for each business segment tends to be volatile (after accounting for working capital needs), in line with the nature of the agri-commodity business. Nevertheless, the company's push towards diversification across the value chain and product groups has helped cushion overall volatility in cash flows. For a low margin business with high working capital needs, we take it as a positive sign that the company has been more deliberate in operating cash flow generation over the last few years (since events of 2012). However, our base case remains that the company's significant on-going debt service obligation (~SGD400-500m p.a) against cash generation from operations (taking working capital into account) leaves it with little buffer, especially as assets in the Upstream and Mid/Downstream are not yet fully contributing.

- **Inorganic expansion induces cash flow uncertainty:** In the 12 months ending December (12M2015) [1], based on our estimates which consider the impact of unallocated working capital, the company swung to a negative SGD935m in cash flow from operations against generating ~SGD1bn in 12M2014. This was largely driven by the transformational acquisition of ADM's Cocoa business which was completed in October 2015. The transaction added SGD1.6bn of working capital to Olam's balance sheet, without the corresponding full year impact of earnings. Taking out the effect of this acquisition, we estimate CFO (before interest and tax) would have been positive SGD691m. In Q12016, Olam managed to generate cash flow from operations of SGD252m. The company remains acquisitive, with SGD451m used for capital expenditure in Q12016. Of these, SGD312m went towards acquiring a wheat milling asset in Nigeria. Due to the company's track record in pursuing inorganic growth and volatility in agri-commodity prices, there is no certainty that Olam's working capital profile will stay constant.

- **Shorter term credit profile passes smell test but refinancing risk abound for intermediate bonds:** Olam's current asset base provides sufficient buffer against its shorter term debt obligations. Of the SGD5.5bn in short term borrowings as at 31 March 2016, we estimate ~SGD4.7bn to be "self-liquidating" and therefore can be rolled-over and/or refinanced by new working capital facilities. We view Olam to face heightened refinancing risk from 2019 onwards where there are significant competing claims. SGD2.7bn

[1] *Olam has changed its financial year end from June to December; for ease of comparison, we focus on the 12 month period ended December 2015 ("12M2015") and 12 month period ended December 2014 ("12M2014"). Latest statutory financials are provided for the 18 month period ended December 2015 ("18M2015")*

of bonds is set to mature in 2019 to 2022 while an additional SGD3.1bn of privately negotiated loans is repayable between 2017- 2022. Bonds maturing in 2017 and 2018 are likely to be refinanced by new intermediate debt, rather than being fully paid down; as such quantum of borrowings (excluding “self-liquidating” debt) is expected to remain elevated, in our view. Including its IPO, Olam raised SGD1.5bn in straight equity during its high earnings growth period between IPO to 2011, with bondholders having effectively funded the bulk of the growth bets.

- **Mitsubishi Corp equity much appreciated:** Since August 2015, Mitsubishi Corp became the second largest shareholder of Olam with 20% stake via a combination of new shares issued (injecting ~SGD915m in fresh equity to the company) and purchasing of existing shares from founding shareholders. Mitsubishi Corp has had a 20 year working relationship and in June 2014 bought an 80% stake in Olam Grains Australia, an Olam entity focused on the grains business. We see Mitsubishi Corp’s participation at the listed company level as a credit positive. Given Mitsubishi Corp’s dominance in the agri-commodity trading sector, we also see it as a standby natural buyer, should other significant shareholders decide to monetize investments in the company. We initiate our coverage of Olam with an issuer rating of Neutral. Within the Olam-complex, we are positive on the perpetuals which we think has a good chance to be called in March 2017 and recommend holders of the ‘18s and ‘19s to switch into the perpetuals. Despite the heightened risks, we are neutral on the ‘22s, on account of technical factors. There is limited supply of higher-yielding names within this tenor, and the ‘22s provide a reasonable yield for investors who need to hold bonds at the longer end of the curve.

Issue	Maturity	OAmount Outstanding (SGDm)	Ask Price	Ask YTW	I-Spread	Rating
OLAMSP 7.0 Perp	Perpetual	236	101	5.563	406.5	OW
OLAMSP 6.0 ‘18	10-Aug-2018	250	106	3.140	132.7	UW
OLAMSP 5.8 ‘19	17-Jul-2019	350	105	4.077	213.1	UW
OLAMSP 4.25 ‘19	22-Jul-2019	400	101	3.907	195.9	UW
OLAMSP 6.0 ‘22	25-Oct-2022	485	103	5.437	314.4	N

A) Olam International Limited Background

Early History

Olam is a diversified, vertically-integrated agri-commodities merchandiser, producer and trader. It also generates income from the sale of packaged food products, commodity financial services and holding minority stakes in longer term investments. Olam has its beginnings in 1989 as the agri-business division of the privately held Kewalram Chanrai Group (“KC Group”). The KC Group is an offshoot of a 150 year old Indian conglomerate. Between 1990 and 1995 the agri-business was headquartered in London, focusing on the export of cashews, cotton, ginger and sheanuts from Nigeria. Further expansion in the mid-1990s saw the business expand from a single country origin into multiple origins in Africa and India.

Formal Inception in Singapore

Recognizing sourcing opportunities in Asia and upon the invitation of the Singapore Trade Development Board (the predecessor of IE Singapore), operations was relocated from London to Singapore in 1996. Subsequently, the business was reorganized into Olam, whose legal entity was incorporated in Singapore in July 1995. During the next decade as a private company, Olam expanded into new products and countries, raising USD42m from AIF Capital (a private equity firm), Seletar Investments (wholly-owned by Temasek Holdings) and the International Finance Corporation (“IFC”), a member of the World Bank. Olam underwent an IPO on the SGX in January 2005 to strengthen its capital base for further expansion. Since IPO, Olam has made strategic plans to venture into market leadership positions within selected agri-commodity products. The later part of 2000s till 2011 saw Olam going through a period of massive earnings growth (FYE June 2005 profit before tax of SGD74m vs SGD510m in FYE June 2011), predominantly funded by external financing. During this time, Olam morphed from an agri-trader with an asset-light model into being invested in higher fixed assets as it expanded into other verticals within the value chain, conquering new product adjacencies and geographies along the way. In September 2010, there were talks about a merger between Olam and competitor Louis Dreyfus to form the world’s third largest agri-commodities trader, however a deal did not materialize. A serial acquirer, Olam was an integrated agri-business company operating across 65 countries with 16 business platforms by 2011. These comprise of 13 agri-commodity product platforms, a stake in a fertilizer project, a Special Economic Zone (in the Republic of Gabon (“RoG”) and had established a commodity financial services business by mid-2012.

Attack and Retaliation

A short-seller report by Muddy Waters in November 2012 led to a period of significant price uncertainty of Olam’s listed share price and a pause in rapid expansion. Temasek Holdings who at that time was a substantial shareholder with deemed interest of ~16% stake in the company decided to double down on their investment, raising their stake to ~24%. In addition to its review process undertaken annually, Olam also undertook a strategic review in 2013 to recalibrate its priorities for the next 3 years. These include the (i) acceleration of free cash flow generation (ii) reduction of gearing (net-debt to equity) to below 2.0x (iii) reduction of complexity surrounding its business portfolio and (iv) to promote better investor understanding of its businesses. Notable efforts have been seen in achieving these priorities, including unwinding previously less profitable/unprofitable business units, entering into sales and leaseback transactions to release cash and divesting stakes in certain projects with longer gestation periods to co-investors. There are at least two non-core assets which the company is still seeking to sell-down/monetize.

In March 2014, Temasek Holdings made a voluntary general offer for the company which saw it emerging as the largest shareholder with a ~58% stake. This stake was diluted to 51.4% in August 2015 following Mitsubishi Corp’s equity participation in Olam. 14 months prior, Mitsubishi Corp became a joint venture partner to Olam by acquiring an 80% stake in Olam Grains Australia (a wholly-owned subsidiary) which holds a strategic interest in Newscastle Agri Terminal, an independent grain logistics company focusing on the Australian eastern seaboard. Mitsubishi Corp is Japan’s largest general trading company (sogo shosha) and a member of the wider Mitsubishi kereitsu. Mitsubishi Corp is highly diversified and is organized into seven core business groups including infrastructure, industrial finance and logistics, energy, metals, machinery, chemicals and living essentials (consumer, retail and food).

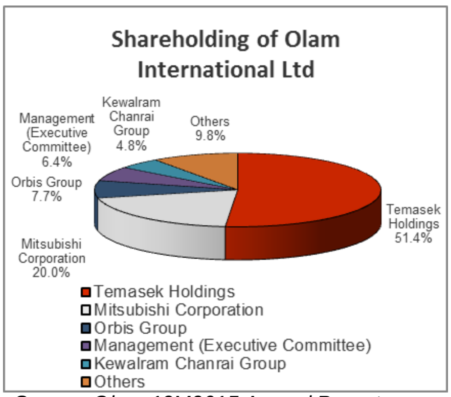
Figure 1: Timeline of Olam's Major Corporate Events

The Path Ahead

The company has reached a steadier footing since events of 2012 and has continued to focus on its growth path. In September 2015 (a month after Mitsubishi Corp's equity participation), Olam's CEO was reported by the media that the company is ready to deploy SGD2.72bn on acquisitions[2], with SGD100-200m being its sweet spot for each deal. The agri-commodity rout has intensified the reshaping of portfolios by agri-businesses globally, providing fertile ground for would-be buyers. In October 2015, Olam completed the acquisition of Archer Daniels Midland ("ADM")'s global cocoa division which it earlier announced in December 2014. Since the beginning of 2016, Olam has announced an acquisition with an enterprise value of USD275m and a greefield investment of USD150m (collectively, ~SGD575m). From IPO to date, Olam has announced more than 50 acquisitions/investments. Coming off the end of the 3 year period from its 2013 Strategic Review, Olam continues to focus on the four aims set out and has additionally announced a product portfolio prioritization plan for the next two three-year cycles for the 2016 to 2021 plan period. Under this plan, six product groups (edible nuts, cocoa, grains, spices and vegetable ingredients, coffee and cotton) will be areas for further investments for the company.

Our baseline for Olam is that the company will continue to be highly expansionary, modulated by higher discipline on how that growth is achieved in line with funding market demands. We see it as a credit positive that Olam's current major shareholders are "patient money" shareholders who are able to take a longer term view on the company. Temasek Holdings and Mitsubishi Corp collectively hold 71.4% in the company, with the founders and management team holding ~11%. Orbis Group, a fund management firm with a contrarian, long term value tilt holds ~7.7%. The remaining ~10% stake is dispersed. The company has recently announced a joint venture (with Mitsubishi Corp holding 70%) to import and distribute food products into Japan. The trend for tighter cooperation between Olam and Mitsubishi Corp is likely to continue.

Figure 2: Shareholding of Olam



Source: Olam 12M2015 Annual Report

[2] *The Straits Times "Olam is eyeing S$2.72b opportunity for acquisitions from commodity crisis, says CEO"*

B) Business Operations

Overview

There are four globally significant agri-commodities traders, who have traditionally focused on the agri-complex. These are ADM, Bunge, Louis Dreyfus and Cargill, (as a group nicknamed as the ABCDs). NYSE-Listed ADM and Bunge have a market cap of ~SGD35bn and SGD12.7bn respectively while Cargill and Louis Dreyfus continue to be privately held by members of its respective founding families. With total assets of USD59bn as at 31 May 2015, Cargill is the largest agribusiness company globally. Traditionally the ABCDs dominate ~90% of the grain trade market and concentration of trade can also be observed across other products (eg: soybeans, rice, maize). Olam is a smaller, global company who has opted to compete in distinct product types where the company was able to build global market leadership positions with minimal overlap to other major traders. In areas where Olam is a latecomer (eg: grains, palm, rubber, sugar), the company will focus on building on niche positions within the value chain, centered on its geographical strongholds (ie: West Africa). All five are active issuers in the bond market.

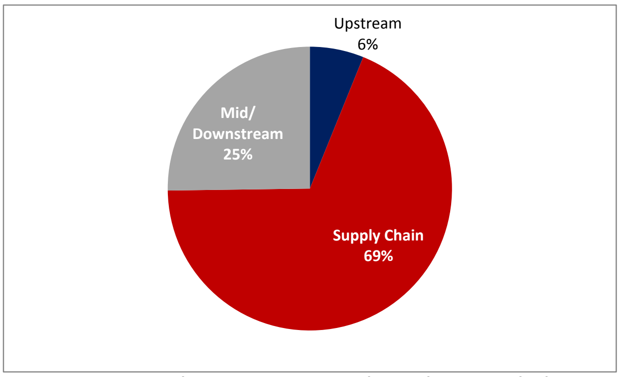
These global players have extensive product origination capabilities and also hold significant investments in other parts of the agri-food transformation value chain (ie: as landowners, farmers, processing, logistics and manufacturing of food products, commodities financial services). Other companies active in agri-commodities trading tend to focus only on a handful of geographies/products (eg: Wilmar, COFCO, Continental Grains) or have a significantly diversified profile beyond the agri-business (eg: CHS Inc, Glencore, Itochu, Marubeni, Mitsui, Mitsubishi Corp). In recent years the ABCDs too have expanded beyond agriculture.

Consolidations in the agribusiness is likely to intensify across the value chain, driven by (i) reshaping of portfolio by global players (ii) smaller companies finding it difficult to compete against larger groups (iii) liberalization of agribusiness towards foreign investors in traditional agricultural strongholds and (iv) heightened interest from financial investors (including sovereigns and pension funds).

Global and Vertical Integration across the Value Chain

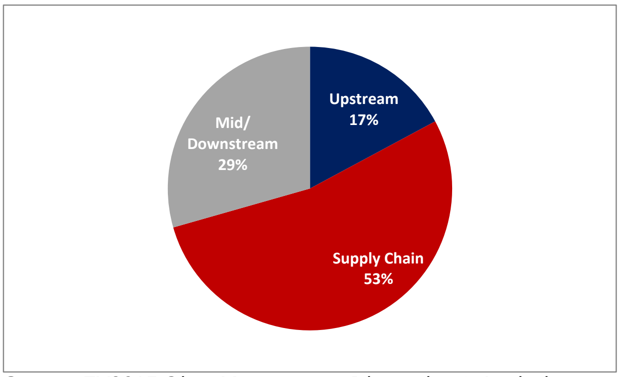
Olam has five business segments: (i) Edible Nuts, Spices and Vegetable Ingredients (ii) Confectionery and Beverage Ingredients (iii) Food Staples and Packaged Foods (iv) Industrial Raw Materials and (v) Commodity Financial Services. Each segment is further divided into "platforms" comprising of similar product/service offering. Currently, Olam operates 16 platforms across more than 70 countries to more than 16,200 customers. Within each of the 16 platforms, the companies focus on seeking margins from particular activities, rather than indiscriminately participating in the full value chain. Broadly, Olam sees three core areas within the value chain where activities can be grouped into: (i) Upstream (ii) Supply chain and (iii) Mid/downstream. Disclosures by value chain are provided on an annual basis.

Figure 3: Revenue Contribution by Value Chain



Source: FY2015 Olam Management Discussion & Analysis

Figure 4: EBITDA Contribution by Value Chain



Source: FY2015 Olam Management Discussion & Analysis

Figure 5: Olam Value Chain

Source: Olam 12M2015 Annual Report

Upstream

Since 2007, Olam has invested selectively into the Upstream section of the value chain. This refers to the management and ownership of farms and plantations. Upstream projects typically have multi-year gestation periods, with volume produced highly susceptible to weather and disease conditions which are beyond the control of management. While individual variations exist depending on product, in general price-swings of staple agricultural commodities are dominated by the supply side equation, rather than demand. SGD3.1bn of invested capital[3] has been allocated to upstream projects as at 31 December 2015. Of these, SGD1.8bn is still gestating and/or partly contributing. Further upstream projects are expected to be within edible nuts, spices and coffee. The Upstream business contributed 17% of EBITDA over the past four years. This business only consumes minimal working capital. Using EBITDA *less* change in working capital to gauge Cash Flow from Operations before tax and interest ("Implied CFO"), we find that Upstream Implied CFO was ~SGD138m in 12M2015 against SGD201m for 12M2014 period.

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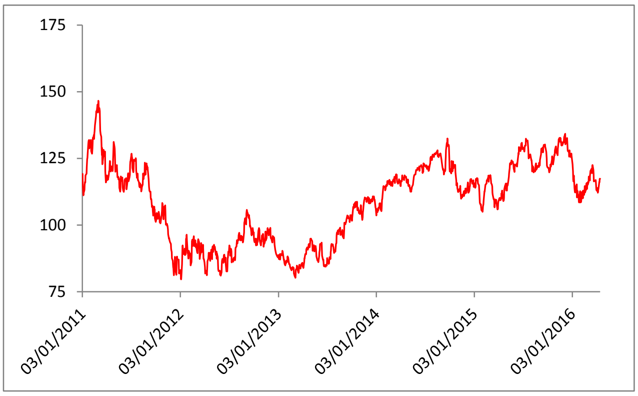
[3] *Invested capital as defined by Olam is a summation of fixed capital and working capital, taking into account capital that is allocable neatly into each of its business segments. Olam also incurs un-allocable working capital and un-allocable fixed capital as part of its operations. In 12M2015, un-allocable working capital was ~SGD664m. Olam has also spent SGD210m on an investment in a fertiliser project and SGD269m in other fixed capital which is not part of segmental fixed capital*

Supply Chain

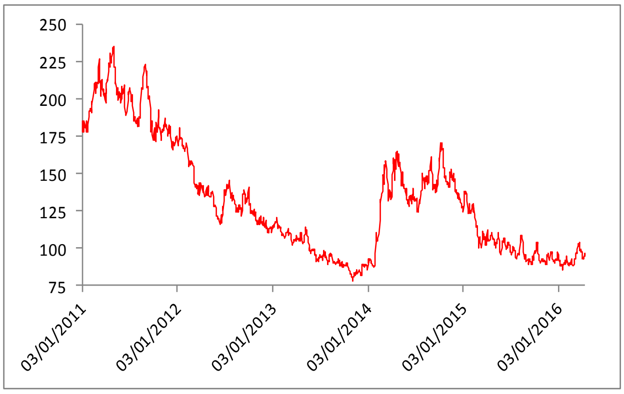
Olam's Supply Chain includes origination/sourcing which is a core competency of the company. Other activities include primary processing, logistics and merchandising. Broadly, Olam is akin to a "wholesale merchant" within this value chain, directing physical flows of products across borders. Higher prices (assuming constant volume) do not flow through to absolute EBITDA, which tend to be range-bound. This area of business is working capital intensive, where high revenue translates into higher working capital needs. The company may be able to pass through carry cost associated with working capital if its competitors are also doing so. Due to commercial sensitivity, Olam does not provide granular financial performance for each product type nor does it break-out value chain financial performance for each segment. However, we infer that Supply Chain EBITDA is driven by products where it has global leadership (ie: cocoa, coffee, almonds and rice). We note that in calendar year 2014, working capital rose in line with prices of coffee and cocoa. The major driver of profitability is volume flow which is affected by production and stockpile levels (Olam's platform products have a minimum 2 year shelf life). We believe that when there is a glut of supply with depressed prices, this has two major effects (i) dis-incentivizes growers to continue production, reducing volume traded (ii) hampers volatility required to make money from physical arbitrage of products. The Supply Chain contributed ~53-60% of EBITDA over the past four years. We expect the proportionate contribution from Supply Chain to fall in the coming years as Upstream assets mature. Implied CFO for the Supply Chain was SGD766m in 12M2015, rising from SGD369m in 12M2014, driven by lower working capital needs during the year.

Figure 6: Commodity Prices – Cocoa Index



Source: Bloomberg, S&P GSCI – Cocoa Index

Figure 7: Commodity Prices – Coffee Index



Source: Bloomberg, S&P GSCI – Coffee Index

Mid/Downstream

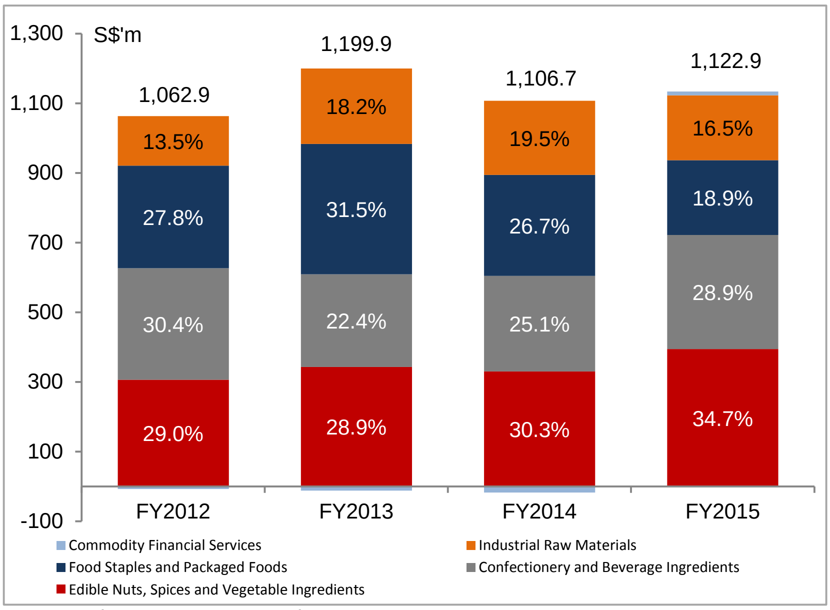
Olam's Mid/Downstream value chain covers manufacturing, branding and distribution of food products. The Mid/Downstream business benefits from low input prices. In February 2015, Olam completed the 25% stake sale of its African packaged food business (noodles, snacks, candies, juices and ingredients) to Sanyo, a Japanese food company for ~SGD227m. Notwithstanding the stake sale, we expect Olam's presence within Mid/Downstream to intensify across Africa given its competitive advantages in the region. Proportionately, Mid/Downstream contributes ~30% to total EBITDA, the accumulation of intensive investments over the last eight years. In 12M2015, this business achieved EBITDA of SGD330.4m (12M2014: SGD315.3m). The company's operations include wheat milling in Africa, coffee and cocoa processing, palm refining, spices, and vegetable ingredients and peanuts businesses in the US. Following its acquisition of ADM's cocoa business and McClesky Mills, Inc ("MMI"), a major peanut sheller in the US, invested capital of the Mid/Downstream increased from SGD3.8bn to SGD6.4bn as of 31 December 2015. Olam has disclosed that of the SGD6.4bn invested; only SGD3.3bn is fully contributing. Implied CFO for the Mid/Downstream was negative SGD1.4bn in 12M2015, largely on account of higher working capital from the ADM Cocoa acquisition. We estimate that the incremental EBITDA impact of ADM Cocoa to be ~SGD20m in 12M2015 and that the cash impact from increase in working capital was SGD1.6bn[4]. If we strip out these effects, Implied CFO would be ~SGD209m (12M2014: SGD360m). The company had also announced a ~SGD207m greenfield investment towards the animal feed manufacturing sector in Nigeria in April 2016, marking entry into a new growth area.

Figure 8: Olam's 16 Platforms across 5 Segments

Segments		Platforms	Upstream	Supply Chain	Mid/downstream
Edible Nuts, Spices & Vegetable Ingredients	1	Edible Nuts	■	■	■
	2	Spices & Vegetable Ingredients ("SVI")		■	■
Confectionary & Beverage Ingredients	3	Coffee	■	■	■
	4	Cocoa	■	■	■
Food Staples & Packaged Foods	5	Dairy	■	■	■
	6	Grains	■	■	■
	7	Rice	■	■	■
	8	Sugar/Sweeteners		■	■
	9	Palm	■	■	■
	10	Packaged Foods			■
Industrial Raw Materials	11	Natural Fibres/Cotton		■	
	12	Wood Products	■	■	
	13	Rubber	■	■	
	14	Fertilizer	■	■	
	15	SEZ			■
Commodity Financial Services	16	CFS		■	

Source: Olam Investor Presentation (March 2016)

Figure 9: Segmental EBITDA FYE December: By Product Categories



Source: Olam 12M2015 Annual Report

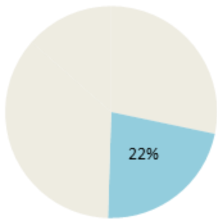
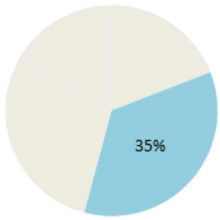
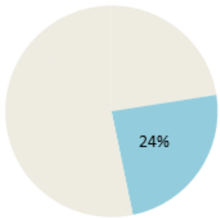
Note: (1) EBITDA as reported by company includes net changes in fair value of biological assets and share of results from jointly controlled entities and associates

(2) Proportion contribution has been adjusted for CFS, which had recorded a loss in FY2012 – 18M2014. In 12M2015, CFS Reported EBITDA of SGD10.6m, contributing 0.9% on an unadjusted basis

[4] *Management Discussion and Analysis ("MD&A") for the period ended 31 December 2015; based on information disclosed, overall working capital increased by SGD2.06bn, compared to end-December primarily on account of ADM Cocoa. Excluding the impact of the acquisition, working capital increased by SGD412m*

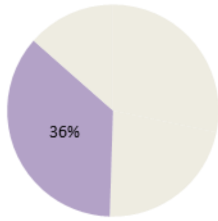
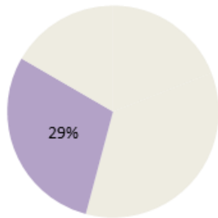
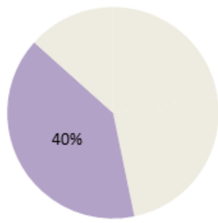
Edible Nuts, Spices and Vegetable Ingredients

Olam is the largest independent peanut blancher and ingredient manufacturer in the US and the top supplier of cashew, dehydrated garlic and onions globally. It also leases (under sale and leaseback arrangements) almond orchards in both the US and Australia. During the year, working capital decreased to SGD1.42bn from SGD1.59bn, despite the rise in prices across major products. This helped offset fixed capital which had rose from ~SGD1.8bn to SGD2bn as a result of the acquisition of MMI and increase acreage of almond and pistachio plantations. This is a fixed capital heavy business, making up 59% of its invested capital in 12M2015. Proportionately, the segment accounts for 30% of total allocable fixed capital and 18% of allocable working capital. Driven by reduction in working capital, Implied CFO for 12M2015 was SGD562m, higher than disclosed EBITDA of SGD390m.

Commodity	Origin	Upstream	Midstream	Downstream	12M2015
Cashews	Vietnam, India, West and East Africa		Largest Supplier – Supply chain and processing facilities in India, Africa, Nigeria, Cote d'Ivoire and Vietnam Downstream: Global marketing offices (including USA, Europe, Dubai, India, Russia and Singapore)		**Revenue:**  **S$4.23bn** **EBITDA:**  **S$390.2mn** **Invested Capital:**  **S$3.48bn**
Peanuts	China, Argentina, India, USA, South Africa and Mozambique	Plantation in Argentina. Otherwise partnerships with local farmers and suppliers	Blanching operations in the USA and India, Argentina and South Africa Downstream: Rotterdam, Atlanta, Geneva, Singapore, Qingdao, Moscow, Odessa and Dubai		
Almonds	USA, California, Australia	Second largest grower, operations in Australia, USA	Partnership with local operators. Almond processing facility in Northern Victoria Downstream: All major almond-consuming regions		
Hazelnuts	Turkey (accounts for >70% of the world's annual production)	Sourcing operations, developing products and practices to share with partners	Entered the industry in 2011 through Progida in Turkey, Progida Downstream: Main marketing office in Germany, other locations in Europe, America, East Europe, Singapore and Middle East		
Sesame	Nigeria, Africa	Initiated in Nigeria, and expanded into Tanzania and Mozambique	Number one supplier of sesame. Pioneer in processing edible-grade sesame in Africa, Nigeria Downstream: Japan, China, Dubai, Singapore, Rotterdam, India, Turkey and USA		
Spices & Vegetable Ingredients	USA, Peru, India, Vietnam, Egypt and China		Dehydrating facilities in California and Egypt, spice processing in India, **Downstream:** Leverages on existing business networks; sees increasing volumes and margins		

Confectionary and Beverage Ingredients

The Confectionary and Beverage Ingredients business has been historically driven by investments in working capital (accounting for ~80% of segmental invested capital over the last four years) and driven by activities in the Supply Chain. Following the acquisition and integration of ADM Cocoa, invested capital (inclusive of provisional goodwill of ~SGD500m) increased to SGD5.72bn from SGD3.25bn. We expect EBITDA/Invested Capital for this segment to improved going forward given that only 2.5 months of EBITDA contribution from ADM Cocoa was included in 12M2015 EBITDA. This segment accounts for 20% of total allocable fixed capital and 57% of allocable working capital in 12M2015. Olam's significant presence in West Africa should allow it better control over the supply and cost of sourcing cocoa beans (compared to ADM). Driven by the acquisition, Implied CFO was negative SGD1.3bn in 12M2015 (12M2014: negative SGD612m). Stripping out the acquisition, we estimate that Implied CFO would have improved to positive ~SGD366m on the back of better volume traded and strong performance of coffee.

Commodity	Origin	Upstream	Midstream	Downstream	12M2015
Coffee	Columbia, Peru, Honduras, Brazil, Africa, Asia, Mexico, Guatemala, Nicaragua	New plantings in Brazil, Tanzania, Zambia. Olam owns plantations in Laos too	One of the most vertically integrated coffee suppliers. Coffee manufacturing facilities in Vietnam, Spain, Italy and Columbia	**Downstream:** Key destination countries like USA, Europe and the Asia Pacific.	Revenue:  S$6.86bn EBITDA:  S$324.9mn Invested Capital:  S$5.72bn
Cocoa	Cote d'Ivoire, Ghana, Indonesia, Nigeria, Brazil, Cameroon, Republic of Congo, Tanzania, Uganda		Cocoa processing in Cote d'Ivoire, UK, Spain, Nigeria, Ghana, Germany, Netherlands, Singapore, Cameroon and Indonesia. R&D operations across key consuming countries	**Downstream:** Marketing offices in Australia, Belgium, France, China, Dubai, UK, Italy, Japan, USA, Russia, Ukraine, Spain, Singapore, Switzerland	

Food Staples and Packaged Foods

Investments for the Food Staples and Packaged Foods segment are largely concentrated on fixed capital (~72% of its invested capital). Despite significant headline volume traded (eg: grains, sugar and palm), margins per ton is lower vs. other products. Aside from animal feed, the Food Staples and Packaged Food segment contains products where Olam sees as attractive but is holding back on making further investments until its business models are proven. In 12M2015, the company incurred a one-time restructuring cost of ~SGD77m as it scaled down the number of dairy farms and reduced herd population in Uruguay. A global oversupply of dairy since 2014, lower contribution from sugar and palm also aggravated financial results. Implied CFO for 12M2015 was thin at SGD5.8m, declining from SGD674m in 18M2014. Food self-sufficiency in many Asian countries still center on rice, leading to only ~7-9% of rice production being traded globally. Olam is the second largest rice trader globally and is a grower in Nigeria.

Commodity	Origin	Upstream	Midstream	Downstream	12M2015
Grains	India, Australia, Black Sea region, Mitsubishi JV	Expanding into Russia: Rusmolco	Largest wheat miller in Africa, with operations in Nigeria and Ghana too. Recently announced expansion into animal feed in Nigeria		Revenue: S$5.39bn EBITDA: S$212.1mn Invested Capital: S$3.23bn
Rice	Africa, Vietnam, Indonesia, Americas, India	Owns fully mechanised farms in Nigeria	Taraori Mills in Indonesia, as well as milling operations from farms in Nigeria. Active in the Supply Chain business in India **Downstream:** Primarily Africa		
Sugar & Natural Sweeteners	Trading in Nigeria and Ghana		Milling operations in India and processing in Indonesia, Modandola sugar refinery **Downstream:** Key marketing activities in Southeast Asia and Middle East		
Dairy	Russia, Uruguay, New Zealand,	Dairy farms in Russia, Uruguay and New Zealand	Dairy processing in Europe, Malaysia and Uruguay. Reduced stakes in Open Country Dairy		
Palm	Gabon, Awala and Moulla (Africa)	Upstream partnership with Republic of Gabon, Olam Palm Gabon	Highest activity in India. Edible oil refining and distribution via Acacia Investments in UAE		
Packaged Food	All over the world		Products include tomato paste, pasta, biscuits, edible oil, instant noodles and instant beverages **Downstream:** Marketed mainly to South and West African markets		

Industrial Raw Materials

Excluding the ~SGD210m invested for fertilizer production (which Olam intends to sell down), investments made by Olam in this segment are split relatively evenly between fixed capital and working capital. Significant contributors for the segment are Cotton and Wood trading. Within Rubber, Olam holds a 60% in a joint venture with the Republic of Gabon to develop plantations in the country. Rubber remains a niche business for the company. Olam also holds a 40% joint controlling stake in the Gabon Special Economic Zone ("SEZ"), an area targeted for timber processing. This business is driven by prepared land sales and hence revenue/EBITDA contribution or cashflow is lumpy. In 12M2015, Implied CFO declined to SGD247m from SGD285m in 12M2014, driven by reduced land sales from SEZ, declines in Rubber and Fertiliser trading.

<table>
<tr><th>Commodity</th><th>Origin</th><th>Upstream</th><th>Midstream</th><th>Downstream</th><th>12M2015</th></tr>
<tr><td>Natural Fibres (Cotton)</td><td>Africa, Asia, USA, Australia</td><td></td><td colspan="2">Largest private ginner: Africa, Mozambique, Australia, India, China, USA
Downstream: Singapore, USA, China, India, Turkey and Vietnam</td><td rowspan="4">Revenue:

S$2.57bn
EBITDA:

S$185.1mn
Invested Capital:

S$1.92bn</td></tr>
<tr><td>Wood Products</td><td>Republic of Congo, West Africa, Latin America, Costa Rica</td><td>Forestry in Gabon (Africa) Contiguous forestry in Republic of Congo</td><td colspan="2">Timber processing facilities in Nkok
Downstream: India, China, Europe, Vietnam (countries that together account for 80% of wood consumption)</td></tr>
<tr><td>Natural Rubber</td><td>Cote d'Ivoire, Ghana, Liberia, Nigeria, Bitam, Indochina</td><td>Olam Rubber Gabon (ORG) joint-venture with Republic of Gabon</td><td colspan="2">Partnership with SIFCA, Wilmar for rubber/palm oil/sugar trading
Downstream: China, India, Europe and Singapore</td></tr>
<tr><td>Fertiliser (Urea and ammonia)</td><td>Gabon</td><td>Site development work for the Gabon fertiliser project is done</td><td colspan="2">Fertiliser trading business expanded to 11 countries</td></tr>
</table>

Commodity Financial Services ("CFS")

CFS comprises a risk management solutions, market-making and volatility trading businesses. Prior to 12M2015, CFS also included an asset management business – Ektimo Commodity which focuses on investments in commodities. However, Ektimo Commodity was wound down in 12M2015, with funds returned to clients. In 12M2015, EBITDA for CFS was SGD10.6m, making it the first year the business turned profitable since its expansion in FY2011 (18M2014: loss before interest, tax and depreciation of SGD17.9m). Working capital increased to SGD81.2m from SGD1.8m due to increase in margin requirements, rendering Implied CFO to be negative ~SGD69m in 12M2015.

C) Financial Review

Pulling it altogether

12M2015 vs. 12M2014 Income Statement

Olam's most recent statutory financials has been stated for the 18 months ending December 2015 ("18M2015"). For better comparison, we have used the information for 12 months as provided in Olam's MD&A Analysis, with reference to the annual report. Given the nature of Olam's Supply Chain activities (which contributed more than 50% to EBITDA) and where prices do not necessary flow through earnings, the correlation between revenue and profitability is somewhat muted. As such, we focus our analysis of the income statement from EBITDA onwards. In 12M2015, Olam's consolidated EBITDA[5] posted a marginal growth of 1.5% to SGD1.12bn from SGD1.11bn in 12M2014, driven by the Edible Nuts, Spices and Vegetable Ingredients, Confectionary and Beverage Ingredients and Commodity Financial Services (collectively, up ~SGD130m). At the same time, Food Staples & Packaged Foods and Industrial Raw Materials saw a decline (collectively, down ~SGD114m). ~SGD30m - 50m in EBITDA was attributable to inorganic acquisitions made during the year.

A combined increase in interest income and debt funding optimization saw contributed to a decline in net finance expense of 5.4%. During the year, borrowing cost declined to 4.8% (from 5.2%). The year saw a number of significant one-off items (eg: change in presentation method of fair value gain/loss from equity investment in PureCircle Limited, restructuring of dairy and herd business, transaction expenses in relation to debt buyback and ADM Cocoa) amounting to negative SGD397m (against a gain of SGD303m in 12M2014). Putting aside exceptional items, profit after tax[6] was SGD331m against SGD327m in 18M2014). Going forward, Olam estimates that including synergies ADM Cocoa will be able to contribute SGD180m - 200m in EBITDA by 2018.

During 18M2015, Olam reported profit after tax of SGD96.5m, against SGD641m reported for the 12 months ending June 2014 ("FYE June 2014"). Apart from the one-off reasons stated above, in 18M2015, Olam reported higher allowance for doubtful debts of SGD60.7m (representing 4.4% of trade receivables balance). In contrast in FYE June 2014, allowance for doubtful debts was SGD34.2m (2.3%) of trade receivables. Employment benefit expenses increased significantly to SGD516m[7] on a proportionate 12M basis from SGD475m in FYE June 2014, partly attributable to the addition of 1,500 staff from ADM Cocoa.

Q12016 vs. Q12015 Income Statement

With effect from January 1, 2016, accounting standard 16 and 41 have been amended and now require biological assets that meet the definition of bearer plant to be accounted for as property, plant and equipment. Olam has also early adopted SFRS 109 which reclassifies SGD192.6m impairement from PureCircle Limited into fair value adjustment (previously under revenue reserve). We have considered the effect of these accounting changes and are of the view that these have no material impact on our credit view of Olam. Olam's numbers presented in this paragraph is based off its Q12016 unaudited statements, compared against restated Q12015.

During Q12016, Olam reported a ~3% drop in EBITDA to SGD332.8m (Q12015: SGD342.9m) on the back of a SGD3.5m loss on CFS (Q12015: positive SGD11m), reduced contribution from Edible Nuts, Spices and Vegetable Ingredients (down ~SGD30m). These have offset the stronger performance in Confectionary and Beverage Ingredients, Food Staples and Packaged Foods and Industrial Raw Materials (collectively up by SGD34.2m). Headline finance costs reduced by 42% to SGD120.4m from SGD206m, however this was driven by significant one-off cost incurred on buyback of convertible bonds in Q12015. Taking out the effect of these one-off cost, finance costs reduced by ~15% on the back of lower financing cost and overall reduction in debt levels. During the quarter, Olam's cash balance declined by SGD531m to SGD1.4bn (31 Dec 2015: SGD1.9bn), mainly driven by the incurrence of capex for the acquisition of wheat milling asset in Nigeria and the buying back of convertible bonds.

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[5] *Inclusive of gains/losses from biological asset and share of results from associates*
[6] *Assume no tax impact from exceptional items*
[7] *18M2015: SGD774m*

Liquidity / Cash Flow

In line with the nature of the agri-commodity sector, Olam's cash flow performance year-on-year for each segment tend to be volatile, after factoring in the effects of working capital. Over the last few years, there has also been some change in individual product strategy as the company continues its effort in optimizing its portfolio. Nevertheless, Olam's diversification benefits (from operating across various product types) help cushion overall volatility. Excluding the effect of ADM Cocoa, we estimate that allocated working capital contributed ~SGD10m source of cash while unallocated working capital used up cash of SGD422m. Overall leading to an Implied CFO in 12M2015 of ~SGD691m (12M2014: SGD1.1bn) and an Implied CFO/Gross interest of 1.2x, excluding the transaction. Crucially for a low margin business with high working capital needs, we take it as a positive signal that the company has been more deliberate in operating cash flow generation since 2012.

On an actual basis where impact from ADM Cocoa is considered, we find Implied CFO in 12M2015 to be negative SGD935m (driven by additional cash used for working capital from the acquisition), and insufficient to cover its gross interest expense of SGD494m and tax obligations of SGD127.8m during the year. This gap along with the acquisition tag for ADM Cocoa was funded primarily via borrowings.

However, on a "like-for-like" basis, we are of the view that Olam is able to generate positive Implied CFO and this has been observed in Olam's Q12016 results. The company's Implied CFO during the quarter had swung positive to SGD252.3m, driven by positive cash generation at all segments except Confectionary & Beverage Ingredients. Given that Q12016 typically contributes 35-40% to earnings, Olam may generate up to SGD720m in Implied CFO for 12M2016, ceteris paribus. Due to the company's track record in pursuing inorganic growth and volatility in agri-commodity prices, there is no certainty that Olam's working capital profile will stay constant during the remaining period of the year. Our base case remains that the company's significant on-going debt service obligation against cash flow from operations leaves it with a thin buffer (especially as assets in the Upstream and Mid/Downstream are not yet fully contributing). Olam's SGD bonds maturing 2018 (issued under the SGD800m MTN Programme dated 26 January 2010) stipulates three financial covenants which provide some mitigation. In addition to heavy interest burden, Olam has ~USD246m (SGD319m) perpetual outstanding with a 7% p.a coupon. Whilst it is allowed to defer distributions, the perpetuals contain a dividend stopper, which discourages a deferral. Nevertheless, SGD184.5m from the sale and leaseback of palm plantation and milling assets in RoG expected to be received in 12M2016 would help alleviate some of the near term pressure. Furthermore, the company has stated it has SGD5.9bn in unutilised bank lines as at 31 March 2016.

In 18M2015, Olam paid out SGD24.8m in distributions to perpetual owners and SGD247.3m to equity holders. On an annualized 12M2015 basis, we assume SGD181.4m was paid out to equity holders and perpetual holders (effectively, funded by borrowings). Ordinarily, this would be a cause of much concern, however, in the case of Olam, we think the dividend yield is within reasonable boundaries (12M Dividend Yield of ~2.1%, using Mitsubishi Corp's entry share price of SGD2.75 per share and ~2.6% using Temasek's general offer price of SGD2.23 per share).Without the on-going support of its major shareholders, it is highly likely that Olam will incur higher cost of debt from debt markets.

Gearing up for something better?

Olam's leverage level is significant, with debt holders providing bulk of the funding. In 12M2015, net-debt to EBITDA was 9.0x and gross debt to equity of 2.3x. Net-debt to EBITDA could reach ~11x-13x for FY2016 on the back of lower full year EBITDA and lower cash balance by the end of the year. As at 31 March 2016, gross debt to equity was kept at 2.3x. Olam has historically funded significant amounts of working capital using medium/longer term borrowings, which in its view is not cost-effective but provided certainty of financing. Over the past year, the company has started replacing such borrowings into lower cost working capital facilities. In 2014, more than half of working capital was funded via higher-cost medium/long term borrowings; this has come down to ~34% in 2015, within the company's targeted range of 25-35%. We take this as a positive sign as this will lower down overall debt servicing but caution that the replacement into secured working capital facilities could push senior unsecured bondholders further in the priority of claims in a default scenario.

Olam views that bulk of its inventories is readily marketable and hence can be treated as “near-cash”. We opine that for inventories to be considered as readily marketable, the monetization of such inventory should not adversely impact profitability. Since inventories are inputs for the Mid/Downstream value chain, we exclude such inventory in our calculation for solvency purposes. Using contribution to EBITDA as a gauge of how much inventory need to be set aside for Mid/Downstream, we exclude about 30% of inventory (ie: SGD2bn) as being readily marketable.

As at 31 March 2016, Olam has SGD5.5bn in short term borrowings. However, a bulk of this relates to “self-liquidating” borrowings to finance inventories and in our view can be rolled-over and/or refinanced by new working capital facilities. We put the figure of such borrowings at ~SGD4.7bn, representing inventory of SGD6.7bn (as at 31 March 2016) *less* the amount set aside for Mid/Downstream. Of the remaining ~SGD890m in short term debt, the company still has SGD1.4bn as cash and cash equivalents as at 31 March 2016 (31 December 2015: SGD1.9bn) having shored up cash in 12M2015 from ~SGD915m equity issuance to Mitsubishi Corp and borrowings. As of 31 March 2016, the company also has SGD1.1bn in trade receivables which are secured by letters of credit/documentation from banks, enhancing the saleability to factors, if required. Taking into account short term and capital guaranteed deposits (SGD213m) and minority interest of ~SGD231m; we find net-debt to equity to be 1.96x as at 31-March-2015 (and 1.4x, adjusting downwards for “self-liquidating” debt). As at 31 December 2015, net-debt to equity was slightly lower at 1.9x with adjusted net-debt to equity also at 1.4x. We take some comfort that the company has continued its 2013 Strategic Review commitment to keep net-debt to equity at less than ~2.0x.

The past will catch up

Since the beginning of 2016, Olam has repurchased USD186.2m (SGD252m) and redeemed outstanding balance of USD44.3m (SGD60m) of convertible bonds denominated in USD that would have come due in 2016, removing near-term refinancing risk. In April 2016 (after the cut-off period for Q12016 results), Olam has also (i) secured USD175m (SGD237m) in loans from the IFC to support investments in facilities in India and Nigeria (ii) issued a USD300m (SGD406m) bond paying 4.5% with a maturity in 2021 and (iii) issued a JYP5.5bn (SGD67m) bond paying 1.427%.

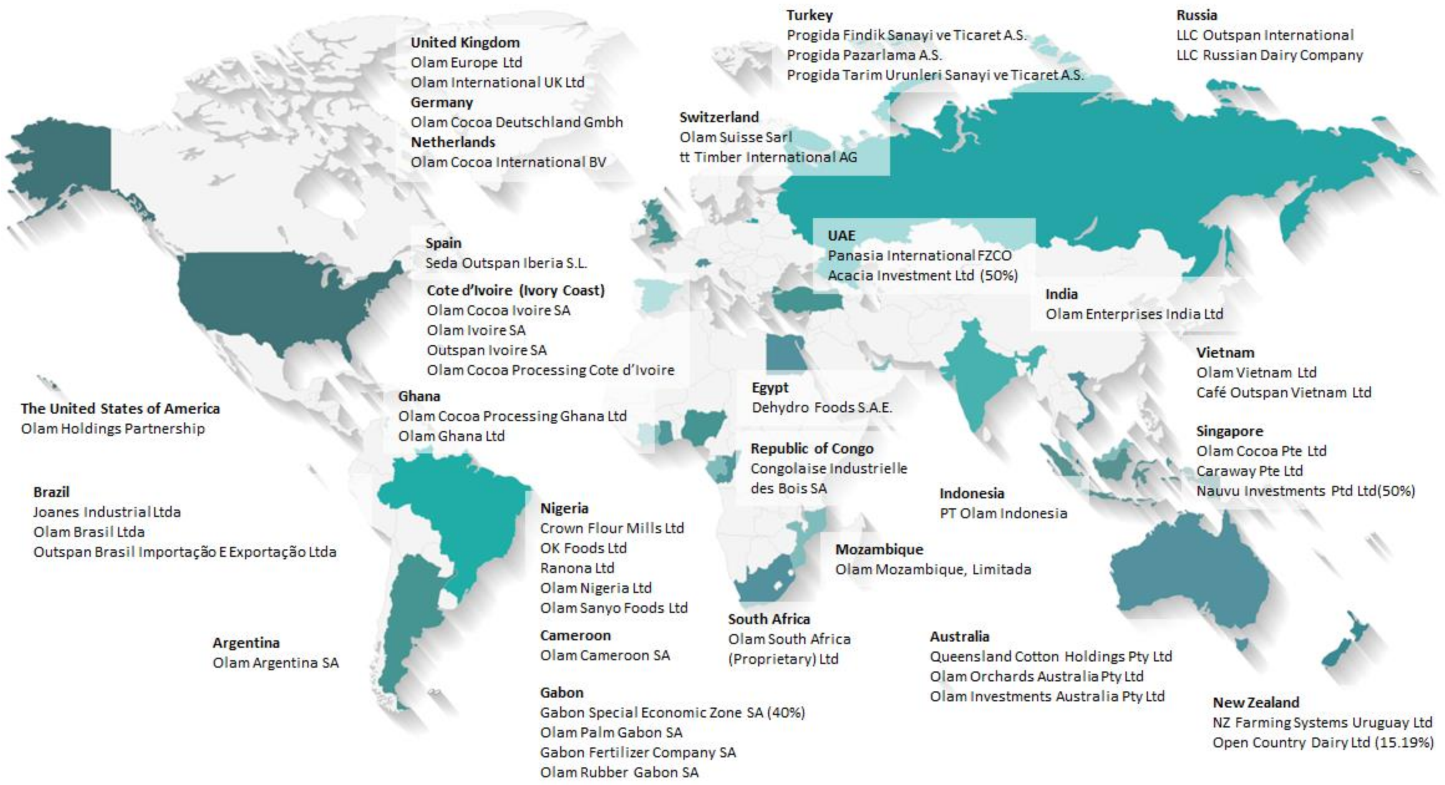
Overall, we are comfortable with the company’s credit profile for the next 12-18 months (assuming no major changes in strategic direction beyond that announced to date), but caution that Olam faces heightened refinancing risk on its intermediate bonds. There is yet sufficient visibility whether growth bets taken historically is able to generate enough cash flow to pay down debt. Olam has ~SGD3.1bn term loans from banks and SGD237m from IFC maturing in 2017 - 2022, a timeframe that coincides with maturities on all its outstanding bonds (~SGD3.6bn). We expect shorter tenor bonds maturing in 2017 and 2018 to be refinanced, rather than fully paid down, rendering quantum of debt to stay at elevated levels.

D) Recommendation

As the shorter term bonds ‘18s and ‘19s are now trading at a premium to par of ~500-600bps. We are advocates for investors to take profit at these levels and make a switch. Within the Olam-complex, we see better value in Olam’s perpetual securities, which was issued in February 2012 with a SGD275m deal size. The company has bought back ~SGD39m in January 2014 via on-market purchases. The company is able to fully redeem the perpetual securities from March 2017 onwards. We think there is a good chance that the company will redeem this given the high distribution rate of 7% p.a. A step-up beginning in March 2022 will add 100bps to the distribution rate.

Given the risk-shifting to bondholders during Olam’s high-growth period, we view that holders of ‘22s (denominated in SGD) are taking on high risk of uncertainty as to whether the growth bets pay off. As such, would need to question if YTM of ~5.4% is sufficient compensation. Olam has paid dividends in all the 11 years it has been listed, and therefore we take the dividend yield as a floor. At 2-3% dividend yield for its major shareholders and downside price risk consequential (eg: share price has declined ~33% since Mistubishi Corp’s entry price of SGD2.73), we see YTM of ~5.4% as acceptable but without further upside potential relative to other instruments in Olam’s capital structure.

Appendix A: Olam's Key Subsidiaries Globally



Source: Olam 12M2015 Annual Report

Olam International Ltd

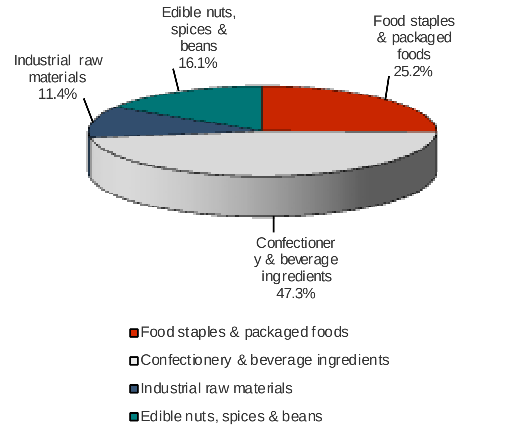
Table 1: Summary Financials

Year End 31st Dec	FY2014	FY2015*	1Q2016
Income Statement (USD'mn)			
Revenue	19,421.8	28,230.6	4,761.4
EBITDA	999.5	1,308.0	327.5
EBIT	783.9	966.0	247.1
Gross interest expense	519.2	738.0	120.4
Profit Before Tax	747.8	238.0	140.4
Net profit	608.5	98.7	105.2
Balance Sheet (USD'mn)			
Cash and bank deposits	1,590.1	2,143.2	1,600.5
Total assets	16,306.6	20,792.4	20,341.4
Gross debt	9,339.9	12,293.9	11,977.4
Net debt	7,749.8	10,150.7	10,376.9
Shareholders' equity	4,222.3	5,359.1	5,281.8
Total capitalization	13,562.2	17,653.0	17,259.2
Net capitalization	11,972.2	15,509.8	15,658.7
Cash Flow (USD'mn)			
Funds from operations (FFO)	824.1	440.7	185.7
CFO	-298.7	-518.7	160.6
Capex	567.5	565.9	120.5
Acquisitions	13.2	2,043.3	311.7
Disposals	374.8	446.8	6.8
Dividend	99.3	247.3	0.0
Free Cash Flow (FCF)	-866.2	-1,084.7	40.0
FCF adjusted	-603.9	-2,928.6	-264.9
Key Ratios			
EBITDA margin (%)	5.1	4.6	6.9
Net margin (%)	3.1	0.3	2.2
Gross debt to EBITDA (x)	9.3	9.4	9.1
Net debt to EBITDA (x)	7.8	7.8	7.9
Gross Debt to Equity (x)	2.21	2.29	2.27
Net Debt to Equity (x)	1.84	1.89	1.96
Gross debt/total capitalisation (%)	68.9	69.6	69.4
Net debt/net capitalisation (%)	64.7	65.4	66.3
Cash/current borrowings (x)	0.4	0.4	0.3
EBITDA/Total Interest (x)	1.9	1.8	2.7

Source: Company, OCBC estimates

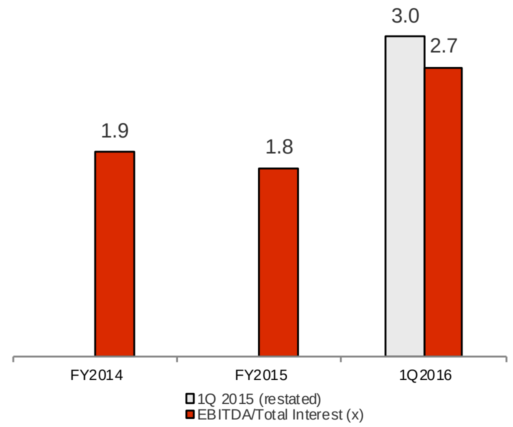
** FCF Adjusted = FCF - Acquisitions - Dividends + Disposals*

Figure 1: Revenue breakdown by Segment - 1Q2016



Source: Company

Figure 2: Interest Coverage Ratio



Source: Company

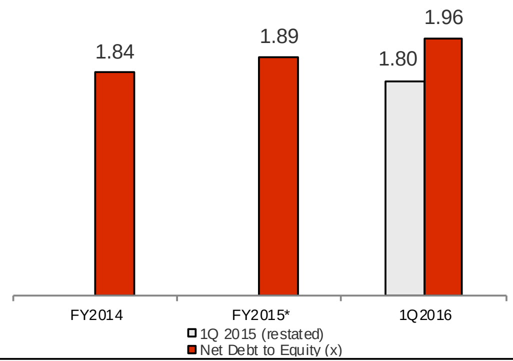
Figure 3: Debt Maturity Profile

Amounts in (USD'mn)	As at 31/3/2016	% of debt
Amount repayable in one year or less, or on demand		
Secured	18.6	0.2%
Unsecured	5546.0	46.3%
	5564.6	**46.5%**
Amount repayable after a year		
Secured	83.2	0.7%
Unsecured	6329.5	52.8%
	6412.7	**53.5%**
Total	**11977.4**	**100.0%**

Source: Company

**FY 2015 figures are based on 18 months earnings (July 14 - Dec 15)*

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates