

CMBI Credit Commentary - LIHHK

LIHHK '22: our preferred short-term pick for carry. Initiate Buy

We initiate a Buy on LIHHK 4.3 '22 at 98.7 (YTM 6.5%), and Hold for rest of LIHHK curve (YTM 7.1% - 7.8%). LIHHK '22 is one of our preferred short-term pick for carry, given management's plan to repay in full by Oct 2022, backed by its current high cash balance. Nonetheless, we recommend Hold for LIHHK '24, '25 and '26 as the company's leverage will continue to edge up these 2 years, before its Kai Tak project's revenue contribution comes in by 2024.

Mixed 2021 result

Lifestyle reported 2021 result with revenue/EBITDA of HKD 2,290mn and HKD 1,211mn, up 14% and 17% yoy. This was on the back of 9.9% increase in sales proceeds at its department stores in 2021 (vs HK retail sales growth of 8.1%), plus incremental rental income of HKD 120mn after acquiring a London investment property in late 2020. However, it recorded a net loss of HKD1,305mn in 2021 (vs net profit of HKD 138mn) after booking HKD 1.9bn fair value loss on its financial investment, following plunge in bond/stock prices of various Chinese developers it invested.

Lackluster outlook for 2022

In view of current 5th wave of Covid in HK, management commented its 1H2022 operating performance can potentially be worse than 1H2020 (amid 1st wave of covid in HK). Lifestyle reported Revenue/EBITDA/CFO of HKD 942mn/ 365mn/ 116mn in 1H2020.

Financial Investment Portfolio... damage largely priced in

Lifestyle's total financial investment lowered to HKD 3,065mn (vs HKD 6,151mn at Dec'20) after a large fair value write-off (HKD1,900mn) and redemption of its money market fund for bank loan repayment. Post impairment, its Chinese property bonds/equity investment was reduced to HKD 741mn/ 157mn at Dec'21, according to its profit warning announcement.

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Other key holdings in its investment portfolio include 2 London listed property developers' stocks (HKD 1.4bn), non-Chinese property bonds (c. HKD 600mn – 700mn) according to management in 2021 result presentation. Its financial investment has already been pledged for short-term bank loan and so it is unlikely to serve as additional liquidity source.

High leverage only to improve after the commencement of Kai Tak project starting 3Q23

As of Dec'21, its net debt modestly lowered to HKD 15bn, (vs HKD 16.4bn at Dec'20) after repayment of some bank loan. Cash balance remained stable at HKD 3.8bn (vs HKD 4.2bn at Dec'20). Leverage remains relatively high with Net Debt/EBITDA at 12x (vs 16x at Dec '20) as Lifestyle spent a hefty sum in a large greenfield Kai Tak project since 2016. The Kai Tak project costs HKD 13 -14bn in total (land premium HKD 7.4bn and construction cost HKD 5.8bn). The company has fully paid up land premium and spent HKD2.3bn on construction in total by Dec'21. Remaining capex will be HKD 1.5bn – HKD 2bn in 2022 and HKD 2bn in 2023, and it targets commencement of Kai Tak project in 3Q2023. As such, Lifestyle's leverage will remain high (Net Debt/EBITDA > teens level) and its net leverage continues to increase before Kai Tak's rental contribution kick in by 2024.

Notwithstanding its high Net Debt/EBITDA, Lifestyle's crown jewel property – SOGO Causeway Bay is booked at cost at HK1.3bn as at Dec'21; compared to its market value of at least HKD 16bn (based on HKD 8bn mortgage it obtained in July '21 and 50% debt-servicing ratio limit for commercial property mortgage under HKMA). If adjusting for SOGO Causeway Bay at market value, Lifestyle's asset/equity base will increase by HKD14.7bn to HKD37.7bn/HKD 17.4bn, and its net debt/total assets and net gearing will lower to 39.8% and 86% on a proforma basis, from 65% and 566% as at Dec'21, respectively. We consider its asset based leverage not excessive.

Liquidity is adequate

Lifestyle's major capex outlay for next 2 years (Kai Tak) can be financed by its undrawn committed facility (HKD 4.25bn, pledged by its Sogo building). Moreover, the company is seeking to extend its Kai Tak project loan (HKD 9bn, in which HKD 5.1bn undrawn) by 18 months (from July 2022 to Jan 2024) to match Kai Tak's project construction. We expect it to be able to rollover the project loan which is secured by the land parcel of the Kai Tak project. The management plans to repay LIHHK '22 USD notes (O/S USD 205.4mn) with internal resources including cash on hand of HKD3.8bn as at Dec'21.

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