Asia Credit Research

OCBC Bank

First Sponsor Group Limited: Credit Update

Friday, 05 February 2016

Solid footing in 2015 but less firm in 2016

- **FY2015 performance was good:** First Sponsor Group Limited (FSG) reported solid FY2015 headline results with consolidated revenue up 40.3% y/y and gross profit up 62.4% y/y to SGD215.0mn and SGD92.7mn respectively. While property development was the main driver of revenue growth due to the on-going handover of units from the Millennium Waterfront project (Plot B and commencement of Plot C), gross profit performance was largely driven by growth in property financing which contributed 45% of the improvement in gross profit. Given the significantly stronger margins in property finance, consolidated gross margins improved to 43.1% for FY2015 compared to 37.2% for FY2014.

- **FY2016 though may not be better:** While earnings momentum should continue from property development (with a pipeline of units sold but yet to be delivered) as well as property holding (full year contribution from its Netherlands acquisitions), the outlook for property financing is more clouded. This is because of FSG's first experience with difficulties in loan servicing. Management disclosed that a total of 9 loans are currently in arrears for interest payments that were due in December and January. These loans comprise around 65% of FSG's entire loan portfolio as at 31 December 2015 with 8 of the loans to common corporate and personal guarantors with cross guarantees across the entire portfolio. FSG has exercised its legal rights under one loan agreement and is in discussion with the borrowers of the remaining 8 loans. Management is optimistic about a full recovery given low loan to value ratios (in the 50-54% range) and the existence of corporate and personal guarantees to support their exposures. Therefore, no provisions have been made so far. Nevertheless, this is a disappointing development in our view given 1) the structural challenges in this segment that we had previously mentioned[1]; 2) the quantum of the problem loans; and 3) the potential time it could take to resolve these loans. Currently, there is not much clarity on whether loan servicing will recommence or how long it may take for the legal process but given the sizeable contribution of these problem loans to the total portfolio, we expect property financing performance in 2016 to be compromised. We think it unlikely that the portfolio will grow until these loans are resolved or at least until there is clarity on the way forward and as such expect revenue and gross profit contribution from property financing to fall materially as a result. Using FY2015 results as a guide then we calculate that EBITDA would potentially fall by around 30% if we subtract the contribution from the loans in arrears.

- **Diverging dynamics for property development?** As previously mentioned, the pipeline of units sold but yet to be delivered in Chengdu's Millennium Waterfront project is solid. That said, management has acknowledged that sales volumes have slowed. This is reflective of Chengdu's oversupplied market, particularly for office and retail. While residential has fared better due to Chengdu's solid economic performance and the broader recovery in China's residential market due to policy easing, competition is increasing and developers have started to discount prices to stimulate sales volume. The situation in Dongguan is

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[1] OCBC Asia Credit – First Sponsor Group Ltd: New Credit Review 290715

different however with management guiding that property demand continues to be strong, primarily due to the overheated property market in Shenzhen which is pushing property demand towards the more affordable Dongguan. For this reason, FSG competed for and won the public land tender for East River Plot Two of the Star of East River Project and expects to commence construction during FY2016. Sales launch expected in late 2016.

- **Financial metrics could take a hit.** FSG's leverage has increased in line with the growth in its balance sheet due to its Netherland acquisitions. Gross gearing has increased from 9% in FY2014 to 49% as at end FY2015 with net gearing at 37% at end FY2015 as FSG turned from being net cash to net debt in 1Q2015. With on-going property development in Chengdu (Plot A and D), the commencement of property development work in Dongguan (Phase 1 of Star of East River) and potentially constrained cash flows from property financing, we expect leverage to increase further with borrowings needed to fund the likely negative operating cash flows from high working capital needs and capex. FSG's multicurrency debt programme does contain financial covenants to maintain a ratio of consolidated net debt to consolidated total equity of not more than 0.7:1. Assuming cash levels remain constant and using shareholder's equity as at 31 December 2015 then FSG's current net debt capacity is around SGD300mn. This is assuming no write-down in receivables in property financing.

- **Property holding acquisitions are now worth more than expected.** While financials have weakened from FSG's Netherlands acquisitions, we think the related business risk impact has more than compensated. These acquisitions have improved FSG's geographic diversification and provided FSG with a solid recurring cash flow stream to mitigate the potentially volatile cash flows in property development and (now) uncertain cash flow from property financing. These investments could also present FSG with additional avenues of growth through property development with redevelopment potential in some of its acquired properties including the Boompjes property in Rotterdam and asset enhancement potential for Mondriaan Tower. Management sees the Netherland's as a solid avenue for future growth given its improving economy which saw Standard & Poor's upgrade the rating on the sovereign to 'AAA' from 'AA+' in November 2015. Somewhat supporting this view is the strong demand for property as evidenced by FSG's ability to sell substantially all of the non-core assets from their DL portfolio at a 41% premium to cost.

- **Recommendation**: We **retain FSG's issuer profile at Neutral** for now despite the challenges in FSG's property financing business. This is largely due to the better diversity in its property holding business and still solid net gearing (which would remain adequate in our view for our Neutral assessment assuming a worst case scenario involving write-off of overdue loans). We will continue to watch FSG's leverage given the capital needed to progress its property development projects and monitor the resolution of interest arrears in its property financing business. The FSGSP 4.0%'18s sold off more than the broader market in January likely due to its small size and the lack of liquidity and now trade at a yield of 6.35% (450bps over swaps). Given the sell-off and the recent developments, **we remain Neutral on the FSGSP 4.0%'18s** at the current pricing level. This compares well to other China focused property names such as CENCHI 6.5 '17, YLLGSP 6.2 '17, PREHSP 4.25 '18 and PREHSP 4.65 '18 considering the respective differences in the businesses.

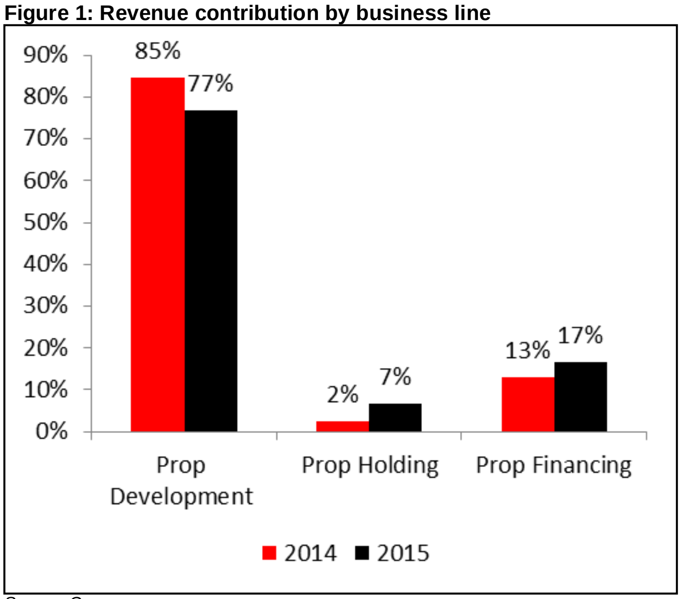
First Sponsor Group Limited

Table 1: Summary financials

Year ended 31st December	FY2013	FY2014	FY2015
Income statement (SGD' mn)			
Revenue	157.5	153.2	215.0
EBITDA	35.6	35.8	71.5
EBIT	59.5	40.5	90.9
Gross interest expense	0.0	-2.1	-4.6
Profit Before Tax	59.5	40.5	91.0
Net profit	47.6	21.7	68.3
Balance Sheet (SGD ' mn)			
Cash and bank deposits	311.2	131.8	112.0
Total assets	955.7	1,293.0	1,800.8
Gross debt	0.0	83.0	477.1
Net debt	-311.2	-48.8	365.1
Shareholders' equity	455.9	894.5	978.1
Total capitalization	455.9	977.5	1,455.2
Net capitalization	144.7	845.7	1,343.2
Cash Flow (SGD 'mn)			
Funds from operations (FFO)	49.5	23.1	69.0
CFO	131.5	-251.3	-62.3
Capex	23.8	33.0	33.7
Acquisitions	0.0	-0.2	-172.8
Disposals	51.1	14.9	4.9
Dividends	-2.0	0.0	-11.5
Free Cash Flow (FCF)	107.7	-284.3	-96.0
FCF adjusted*	156.7	-269.6	-275.4
Key Ratios			
EBITDA margin (%)	22.6	23.4	33.2
Net margin (%)	30.2	14.2	31.8
Gross debt to EBITDA (x)	0.0	2.3	6.7
Net debt to EBITDA (x)	-8.8	-1.4	5.1
Gross Debt to Equity (x)	0.0	0.09	0.49
Net Debt to Equity (x)	-0.7	-0.1	0.37
Gross debt/total capitalisation (%)	0.0	8.5	32.8
Net debt/net capitalisation (%)	-215.0	-5.8	27.2
Cash/current borrowings (x)	NM	NM	0.5
EBITDA/Total Interest (x)	NM	17.0	15.4

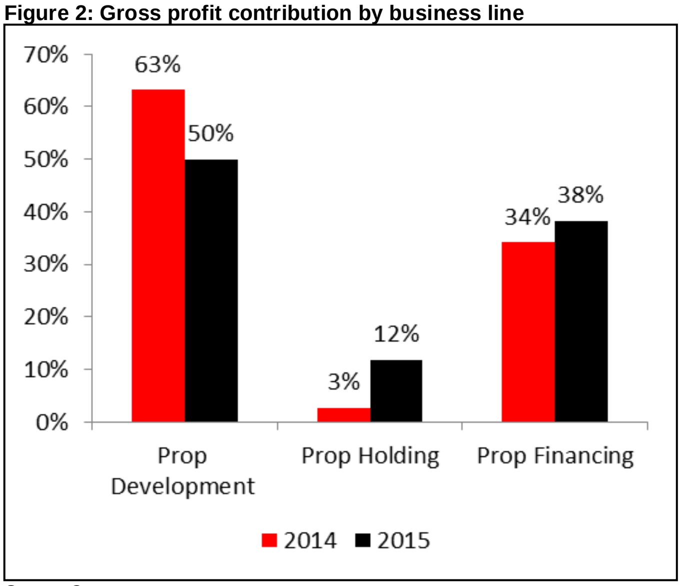
Source: Company, OCBC estimates
**Adjusted FCF = FCF –Acquisitions – Dividends + Disposals*

Figure 1: Revenue contribution by business line



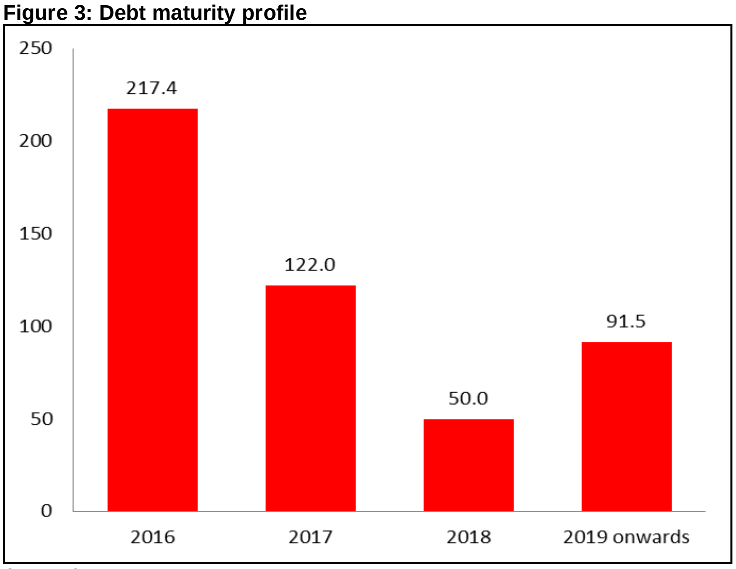
Source: Company

Figure 2: Gross profit contribution by business line



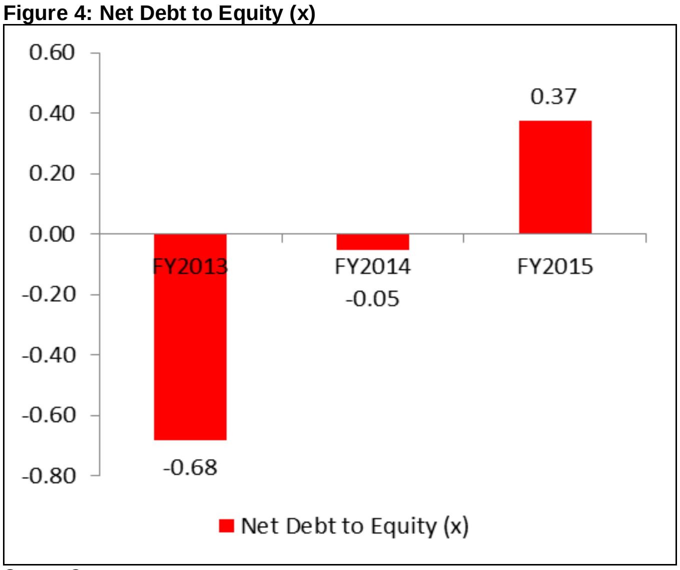
Source: Company

Figure 3: Debt maturity profile



Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company

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