Asia Credit Research

Earnings Review: City Developments Ltd ("CDL")

Issuer Profile: Positive (2)

Ticker: **CITSP**

Background

Listed in 1963, City Developments Ltd ("CDL") is an international property and hotel conglomerate. CDL has three core business segments – property development, hotel operations and investment properties. CDL's hotel operations are conducted through its ~65%-owned subsidiary, Millennium & Copthorne Hotels plc ("M&C"), while the investment and development property portfolio is Singapore-centric. CDL is a subsidiary of Hong Leong Group Singapore.

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Recommendation

- CDL is the direct beneficiary of the sharp recovery in the domestic residential market, given its existing inventory of residential units that have achieved TOP. This helps balance the expected increase in its currently-low leverage as it pays for the balance of the sizable land acquisitions made in recent times, as well as for the development of these sites. Performance at hospitality and its investment properties remain passable. We will retain our Positive (2) Issuer Profile.
- Though the shorter end of the CITSP curve looks tight, we believe that the longer end compares favourably against the CAPLSP curve (Neutral (3) Issuer Profile). For an outright pick up in spread though, we think that the recent SUNSP 3.4% '23s (Neutral (4) Issuer Profile) looks attractive as the spread more than compensates for the weaker credit profile (which is controlled by the 45% debt / assets cap on REITs).

Relative Value:

Bond	Maturity/Call date	Net Gearing	Ask Yield	Spread
CITSP 3% '20s	02/04/2020	12%	2.50%	44bps
CITSP 3.78% '24s	21/10/2024	12%	3.26%	68bps
CAPLSP 3.8% '24s	28/08/2024	49%	3.26%	68bps
SUNSP 3.4% 23s	10/05/2023	58%	3.31%	84bps

Indicative prices as at 16 May 2018 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Revenue spiked on Criterion EC revenue recognition**: CDL reported 1Q2018 results. Total revenue was up 35.0% y/y to SGD1.06bn. Performance was largely driven by property development (+88.3% y/y to SGD563.2mn). Segment performance was driven in part by the full recognition of the Criterion EC (achieved TOP in February, GFA: ~540,700 sqft, 70% stake, 99% sold). Due to how EC sales are accounted for, CDL can only recognize its sales of the Criterion upon TOP (and hence results can be lumpy). Sales of phase one of New Futura (54 of 64 units launched sold as of 31/03/18) have also contributed to performance (as the New Futura already achieved TOP, each sale is recognized outright rather than progressively). Residential sales value was up 66.1% y/y to SGD792.6mn across the 459 units sold during the quarter (1Q2017: 293 units). Aside from the 54 units at New Futura, the other major project was The Tapestry, which CDL sold 329 units of the 450 units released during the quarter (launch was March 2018). Other developments that sold well include 32 units at the Criterion and 13 units at Gramercy Park.

- **Residential pipeline healthy**: For the quarter, property development PBT fell 12.0% y/y to SGD81mn, as the margins of the Criterion are lower than the projects delivered in 1Q2017 (such as D'Nest) as well as absent the contribution from the Commonwealth Towers JV seen in 1Q2017. Management had also reflected that despite the strong sales at New Futura, some of these sales have not yet been legally completed and hence not recognized during the quarter. Like most of CDL's peers, launched inventory has depleted rapidly, with launched units (excluding New Futura and The Tapestry as they were launched in 1Q2018) falling to just 130 units (end-2017: 178 units). The reception for New Futura and The Tapestry were also very strong, with CDL having sold 62 of 64 launched units for the former, and 400 of 500 launched units for the latter (as of 06/05/18). For the balance of 2018, CDL would benefit from the launch of the balance of New Futura (a further 60 units) as well as the launch of South Beach Residences (190 units, 50.1% stake) in 3Q2018. As both these developments have achieved TOP, the complete revenue for each unit sale can be recognized immediately upon completion. Comparatively, units sold off-the-plan (like in the case of the Tapestry) will only see revenue recognized gradually based on the progress of the development. Aside from these, CDL intends to launch the West Coast Vale site (4Q2018) and the former Boulevard Hotel site (2H2018) for the balance of the year.

- **London RevPar plunged**: Hotel operations performance was more modest (+3.1% y/y to SGD377.8mn). Segment results were aided by the stronger GBP, as M&C reported a 2.7% y/y decline in revenue to GBP217mn. The declines were driven by the fall in RevPar (-3.1% y/y to GBP68.5) seen across most of M&C's markets due to part to the strengthening of the GBP against major currencies in 1Q2018. In constant currency terms, RevPar increased 3.2% y/y with gains seen across various regions. For example, the US reported 4.7% y/y increase in RevPar, boosted in part by the Millennium Hilton New York One UN Plaza (which reopened in September 2016 after refurbishment). Asia also saw RevPar increase of 3.0% y/y (with Singapore finally turning positive). Finally, Australasia saw strong RevPar growth of 11.1% y/y (potentially due to the M Social Auckland, which opened in October 2017). London however was badly hit with RevPar down 9.4% y/y with slower trading seen at London hotels. Other hospitality peers have commented that F&B spending in London had been affected by weaker consumer sentiment. Segment PBT jumped to SGD20.8mn (1Q2017: SGD5.1mn) on higher revenue and better performance at JW Marriott Hotel South Beach (held in a JV).

- **Weaker office returns offset by divestments**: Rental properties reported softer (-1.2% y/y to SGD84.2mn) revenue. Performance was potentially affected by the AEI at Republic Plaza, with CDL's office portfolio occupancy declining q/q to 92.7% (4Q2017: 94.8%). For CDL's retail portfolio, occupancy also eased q/q to 97.0% (4Q2017: 97.4%). Looking forward, the Le Grove Serviced Apartments (closed since December 2016 for renovation) is expected to contribute from July 2018 onwards when it reopens. The PBT at rental properties surged to SGD61mn (1Q2017: SGD28mn), with the incremental gains largely driven by the divestments of the Mercure Brisbane and Ibis Brisbane by CDLHT, as well as the absence of FX losses seen by CDLHT in 1Q2017. Specifically, divestment gains of SGD29mn were booked by CDL.

- **Land banking consumes cash flow**: Operating cash flow (including interest service) worsened to an outflow of SGD61.1mn (1Q2017: SGD47.8mn inflow), in part driven by deposits paid for the land sites at Amber Park and Sumang Walk. The progressive billings for the Criterion EC also caused trade and other receivables to jump, while CDL had also paid down SGD182.9mn in payables. Coupled with SGD53.7mn in capex, free cash flow was negative SGD114.8mn, mitigated in part by the SGD80.6mn received from the two Brisbane hotel divestments. CDL had also paid down debt by SGD237.6mn during the quarter. As a result, cash balance fell by SGD368.3mn to SGD3.41bn. That being said, existing liquidity is more than enough to repay short-term debt of SGD1.01bn. Though net gearing inched higher q/q to 12% (4Q2017: 11%), it remains very manageable.

- **Sizable development commitments balanced against residential sales**: CDL still has large capital commitments for various land purchases: The Sumang Walk EC site (60% stake) was purchased via GLS for SGD509.4mn (or SGD583 psf ppr) in February 2018. Handy Road / Mount Sophia site was purchased via GLS for SGD212.2mn in February 2018. West Coast Vale site was purchased via GLS for SGD472.4mn (SGD800 psf ppr) in February 2018. Amber Park site (80% stake) was acquired via en-bloc for SGD906.7mn (SGD1,515 psf ppr), with the transaction expected to be completed in 2Q2018. For these land purchases, it would seem that only deposits / progress payments were made, with the balance due in the near future. As such, leverage is likely to inch higher. This is mitigated by residential properties that CDL can monetize quickly (New Futura, South Beach Residences) as these have already achieved TOP, as well as by CDL's current conservative credit profile.

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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.

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.

Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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