Asia Credit Research

Earnings Review: City Developments Ltd ("CDL")

Recommendation

- The impact of the recent property cooling measures should be largely manageable for CDL as the mass market units may still move (though at lower prices if need be). Meanwhile, CDL's credit profile remains anchored by 53.8% of assets from recurring income sources and this will likely grow further with a target to scale recurring EBITDA higher. Net gearing, which may increase further to near ~30% due to acquisitions and land settlement, looks still manageable for now. As such, we retain our Positive (2) Issuer Profile.
- In general, we think that the CITSP curve looks more attractive than the CAPLSP curve given that the former trades wider. In addition, we rate CDL with a higher Issuer Profile than CapitaLand Ltd (Issuer Profile: Neutral (3)).

Relative Value:

Bond	Maturity/Call date	Net Gearing	Ask Yield	Spread
CITSP 3% '20s	27/10/2020	22%	2.67%	71bps
CITSP 2.93% '21s	24/03/2021	22%	2.89%	89bps
CITSP 3.78% '24s	21/10/2024	22%	3.26%	98bps
CITSP 3.48% '26s	15/06/2026	22%	3.49%	111bps
CAPLSP 4.3% '20	31/08/2020	50%	2.62%	67bps
CAPLSP 3.8% '24s	28/08/2024	50%	3.17%	91bps
CAPLSP 3.08% '27s	19/10/2027	50%	3.36%	90bps

Indicative prices as at 17 Aug 2018 Source: Bloomberg
Net gearing based on latest available quarter

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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Key Considerations

- **Steady performance with results lifted by property development**: CDL reported 2Q2018 results. Revenue increased 59.2% y/y to SGD1.44bn, mainly due to surge in revenue from the property development segment (+170% y/y to SGD818.7mn). This was due to recognition from (1) 124-unit New Futura (92 units sold, representing 74% of units), (2) 174-unit Gramercy Park (now fully sold), (3) handing over of 248 units (representing 58% of total units) at Phase 2 of Hong Leong City Centre in China that was completed in May 2018 as well as (4) maiden contribution from Park Court Aoyama The Tower in Japan that was completed in 1Q2018 with 135 units handed over. Reported EBITDA and net profit for CDL surged by 55.7% y/y to SGD401.8mn and 48.9% y/y to SGD235.0mn respectively, lifted mainly by 192% y/y increase in PBT from property development to SGD254.9mn.

- **Lacklustre hospitality performance weighed by FX and lower UK contribution**: Hotel operations revenue in 2Q2018 declined by 2.7% y/y to SGD420.7mn due to London hotels seeing lower corporate business and the phased closure of Millennium Hotel London Mayfair (which had undergone refurbishment, and now fully closed). In addition, the weaker USD in the reporting period also impacted hotel revenue. In constant currency terms however, the hospitality segment's performance looks better. RevPAR would have been higher with higher contribution from Millennium Hilton New York One UN Plaza which was rebranded in Aug 2017. For 1H2018, RevPAR has increased in the US (+2.5%), Asia (+2.8%) and Australasia (+7.3%) though RevPAR in Europe (-8.2%) and Singapore (-0.4%) fell. Overall, pre-tax profits for hotels declined to SGD35.6mn (2Q2017: SGD68.6mn) though this was largely due to the writeback of impairment loans of SGD22mn on loans granted by M&C to Fena and impairment of goodwill from the acquisition of Lowry Hotel.

- **Calling half-time on Singapore property market:** With the announcement of further property cooling measures in early July 2018, CDL turned cautious on the property market, finding that buyers are embracing a wait-and-see approach which may impact overall sales volume and prices. We think that the overall

impact should be manageable for CDL. Firstly, only 584 units remain unsold from the launched projects as of 30 Jun 2018, which are largely accounted by The Tapestry (392 units) which has sold well (488 units sold out of 550 units released) while 80% of the buyers are Singaporean – 1st time Singaporean homebuyers are less impacted by the recent cooling measures. Although we estimate that more than 3000 units remain in the pipeline, the mass market units are still moving (albeit at a slower pace). As such, CDL may still move (if need be, at some discounts) the units at upcoming launches of Whistler Grand (4Q2018), Sumang Walk (EC, 2Q2019) and Sengkang Central (TBC). However, we understand that the buyers at the more luxurious projects (e.g. New Futura) are 80% represented by foreigners, who are harder hit by the cooling measures. As such, it remains to be seen how CDL would monetise Amber Park (acquisition cost: SGD906.7mn) and Handy Road (SGD212.2mn), which will launch in 1H2019 and 1Q2019 respectively. That said, we think CDL can manage this exposure, given that both projects account for just 5.5% of total assets. We also note that CDL has a good track record in moving units though it may be more difficult now to execute the more innovative methods (e.g. Profit Participation Schemes) due to changes in regulations.

- **Recurring income anchors the portfolio and more so in the future:** With reported EBITDA of SGD290mn in 1H2018 from recurring sources, mainly represented by hotel operations (SGD130mn) and rental properties (SGD146mn), CDL set a 10-year target to achieve SGD900mn recurring EBITDA p.a. This will be through an expansion in its fund management platform (which earns management & performance fees) as well as through ownership in rental properties and hotel properties. To fast track this process, we understand that CDL is looking to buy both listed and unlisted real estate platforms. Currently, the recurring income segments account for 53.8% of total assets – we think this will be pushed higher as a proportion given the ambitious target while we believe CDL may slow down its pace in the Singapore residential property market (which accounts for 30.4% of total assets).

- **Land banking has pushed net gearing higher though credit metrics remain healthy**: Net gearing surged q/q from ~12% to ~22%. While deposits for land have been paid in 1Q2018, another SGD1.5bn payment in 2Q2018 were made for development properties, which should be mainly due to further payments for Amber Park (purchase price: SGD906.7mn), Sumang Walk (SGD509.37mn), West Coast Vale (SGD472.4mn) and Handy Road (SGD212.2mn). We think net gearing may continue increasing to reach near 30% as CDL will need to settle for its recent land purchases and is acquiring an office asset (further details undisclosed) for SGD300mn, with SGD70mn AEI planned for Republic Plaza (commenced in Apr 2018, to complete by 2H2019) and USD80mn outlay to upgrade New York properties in the next 2 years. As mentioned, CDL is looking to buy real estate platforms. Meanwhile, CDL is still looking to increase exposure to Australia, as well as to investment opportunities in residential, office and hospitality segments in Japan. That said, we expect CDL to monetise certain properties, including Manulife Centre (40%-stake, transacted at SGD487.5mn in Dec 2015) and 7 & 9 Tampines Grande (40%-stake, transacted at SGD366mn in Dec 2015) which were put up for sale. Overall, credit metrics remain healthier than peers, such as CapitaLand Ltd (net gearing: 50%) and Frasers Property Ltd (91%).

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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.

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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.

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Analyst Declaration

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