Asia Credit Research

OCBC Bank

GuocoLand Ltd: Credit Update

Thursday, 22 February 2018

Scaling greater heights?

- Following the completion of OCBC's engagement, we resume coverage on GuocoLand Ltd ("GUOL") with an **Issuer Profile of Neutral (5)**.
- Having completed the tallest building in Singapore (Tanjong Pagar Centre), GUOL will embark on another large commercial site at Beach Road (SGD1.6bn bid). GUOL may continue to expand its development portfolio, which could put further pressure on its net gearing (2QFY2018: 0.84x).
- That said, we remain comfortable with GUOL with recurrent income from Tanjong Pagar Centre and continued property sales supported by the rebounding property market. However, we rate the recent GUOLSP 4.6% PERP **with an Underweight recommendation as we see fair value around 5.0%**. For comparison, ESR-REIT's (OCBC Issuer Profile: Neutral (4) – refer to Singapore Credit Outlook 2018, Viva Industrial / ESR-REIT Credit Update) perpetuals trade around 5.0%.

S&P: Not rated

Moody's: Not rated

Fitch: Not rated

Ticker: GUOLSP

Background: Listed on the SGX in 1978, GUOL is a property developer headquartered in Singapore, with investments in residential properties, commercial properties and integrated developments. The group's properties are located in Singapore, China, Malaysia and Vietnam. GUOL is a 68.0%-owned subsidiary of Guoco Group, which is listed on the HKSE and is in turn, a member of the Hong Leong Group, one of the largest conglomerates in South East Asia.

Key credit considerations

- **Strong 2QFY2018 results:** 2QFY2018 revenue grew 60% y/y to SGD370.6mn, driven by stronger sales from residential projects. According to the URA caveats in 2QFY2018, GUOL moved a number of units at Sims Urban Oasis (71 units, SGD104.4mn), Martin Modern (71 units, SGD179.4mn) and Wallich Residence (5 units, SGD16.4mn). As a result, gross profit grew +93% y/y to SGD91.4mn. However, net profit fell 40% y/y to SGD40.3mn, mainly due to the increase in finance costs (+60% y/y to SGD30.2mn) as gross borrowings increased and GUOL no longer capitalise certain costs – which we believe to be Sims Urban Oasis which obtained TOP in Oct 2017. Administrative expenses also surged 97% y/y to SGD27.2mn with the opening of Sofitel Singapore City Centre & Sofitel Kuala Lumpur Damansara City – hotels can take ~3Y to stabilise after opening.

- **Recurring income from Tanjong Pagar Centre ("TPC"):** Rental income from investment properties surged to SGD69.6mn in FY2017 (FY2016: SGD20.6mn), with the increase likely largely attributable to TPC which achieved TOP in 2QFY2017. Both the office (890k sq ft) and retail component (100k sq ft) at Guoco Tower have more than 90% committed lease, which we estimate should contribute over SGD100mn p.a. – thereby increasing rental contribution from investment properties. The 223-room Sofitel Singapore City Centre at TPC was also launched in Aug 2017, which should increasingly contribute towards the revenue from hotel operations (FY2017: SGD36.5mn). According to CBRE, the office and retail components at Guoco Tower are valued at SGD2.3bn. The other major investment property is 20 Collyer Quay, which is valued at SGD455.4mn.

- **Benefiting from the rebounding property market:** Property sales continued in YTD CY2018, with 23 units (SGD38.2mn) sold at Sims Urban Oasis, 17 units (SGD46.7mn) at Martin Modern and 1 unit (SGD4.9mn) at Wallich Residence. With Frasers Property Ltd's SGD1,733 psf ppr bid for a site at Jiak Kim Street, we believe

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sales at the nearby Martin Modern (which GLL paid SGD1,239 psf ppr for the site) will continue to be supported. However, GUOL may raise asking prices due to higher price expectations, which may slow down property sales.

- **Next big developments aside from TPC:** A GuocoLand JV (70%-owned by GLL) has won a commercial site at Beach Road for SGD1.62bn. GLL intends to develop this with a work-live-play concept, with a max GFA of 950,592 sq ft (at least 665,424 sq ft for office use). In China, GLL was awarded 4 land plots in Chongqing, with plans for a 5.5mn sq ft GFA development with GDV of RMB16bn. GLL is also planning to develop Changfeng Business & Retail Park, with GDV of RMB6bn and GFA of 2mn sq ft. Meanwhile, in Malaysia, Damansara City is a flagship, MYR2.5bn 2.6mn sq ft integrated mixed-use development. The 19-storey office tower has secured ~100% commitment (including space to be taken up by Hong Leong Group's various companies) while the 312-room hotel has opened in Aug 2017.

- **High net gearing backed by investment properties:** Net gearing increased to 84% (1QFY2018: 74%) mainly due to SGD482.5mn payment of deposits for land, which is likely due to the Beach Road commercial site. While we expect GUOL to make further payments for land, headline net gearing may remain around 0.8x as GUOL has issued a perpetual and ongoing sales from the residential projects should support operating cashflows. The divestment of Tianjin Zhongxin Mingshi Real Estate Development for RMB581.4mn (SGD119mn) should also support GUOL's debt profile. We remain comfortable with GUOL, with over SGD100mn recurring income and SGD3.0bn asset value from investment properties. That said, we understand that GUOL remains on the lookout for more sites to expand its development portfolio, which could put further pressure on its gearing profile.

View on the recent GUOLSP 4.6% PERP

The recent SGD350mn PERP c'23 was priced at 4.6% on 15th Jan, tightening from an initial price guidance of 4.85% on the back of SGD450mn orderbook. Subsequently, on 2 Feb, GUOL did a SGD50mn retap of the perpetual at 100 + accrued. We see the fair value around 5.0%, using the following for our consideration.

There is no close comparable with the same PERP structure (5Y call, 7Y reset), so we compare to FPLSP 3.95% PERP (5Y call, 5Y reset). While GUOLSP 4.6% PERP has a longer reset, the step-up date (7Y) is shorter in comparison to FPLSP 3.95% PERPs (10Y). The yield spread of FPLSP 3.95% PERPs is 224bps. As we observe ~50bps difference in credit spread between the GUOLSP and FPLSP seniors, we assume a required yield spread of 275bps (YTC: 4.98%) for the GUOLSP 4.6% PERP - we did not assume a larger than 50bps increase in yield spread over its seniors, despite the subordinated structure of the PERPs (perpetuals from lower rated issuers should trade wider over their seniors than higher rated ones), as prices may be supported with the hunt for yield given the scarcity of high yield SGD papers.

Relative Value:

Bond	Maturity / First Call	Net gearing	Ask YTM / YTC	Spread
GUOLSP 4.6% PERP	23/01/2023	0.84x	4.63%	240.5
FPLSP 3.95% PERP	05/10/2022	0.85x	4.43%	224.3
GUOLSP 3.85% '23	15/02/2023	0.84x	3.89%	166.1
EREIT 4.6% PERP	03/11/2022	0.70x	5.00%	280.4
CACHE 5.5% PERP	01/02/2023	0.56x	5.18%	296.4
FPLSP 4.25% '26	14/04/2026	0.85x	3.87%	137.5
FPLSP 3.95% '21	07/10/2021	0.85x	3.12%	105.8
FPLSP 4.38% PERP	17/02/2023	0.85x	4.35%	212.5

Indicative prices as at 21 February 2018
Source: Bloomberg

We also observe ~112bps credit spread difference between the average of FPLSP PERPs and the FPLSP '21s, assuming ~7bps credit spread increase p.a (by comparing FPLSP 4.25% '26s to FPLSP 3.95% '21s). If we assume the same 112bps credit spread difference between GUOLSP 3.85% '23s and the new GUOL PERP, using this metric, the required yield spread is 278bps (YTC: 5.00%) for the GUOL PERP.

We also note that EREIT 4.6% PERP trades around 5.00% YTC, even though we rate ESR-

REIT with a stronger OCBC Issuer Profile rating: Neutral (4). As such, we think it may be **difficult for the new GUOL PERP to trade significantly tighter than EREIT PERP.** Though not strictly comparable as ESR-REIT is a REIT while GuocoLand is a developer, EREIT has a healthier net gearing with recurrent cashflows from investment properties. Although the EREIT PERP does not feature a step-up and is non-cumulative, its reset date coincides with its call date (unlike the new GUOL PERP). Aside from ESR-REIT, CACHE 5.5% PERP is also trading wider (5.18% YTC) compared to GUOLSP 4.6% PERP. We do not rate CACHE but we draw similar parallels with ESR-REIT – in comparison to GUOL, CACHE offers a healthier net gearing with recurrent cashflows from investment properties.

Separately, we see the potential for GUOL to continue issuing more debt given SGD2.2bn of loans and borrowings are due within 12 months while only SGD400mn of perpetuals have been raised in YTD2018 - which may cap the upside of the GUOL curve. That said, we remain comfortable with GUOL's credit profile, which is anchored by recurrent income from Tanjong Pagar Centre while property sales should continue to remain supported by the rebounding property market.

While FPLSP 4.38% PERP is a comparable, we think it appears mispriced as it trades at a tighter yield (4.35%) than FPLSP 3.95% PERP (4.43%) even though the latter has an earlier call date (Oct 2022) and wider reset spread (224.5bps) compared to the former (Jan 2023 call with 218.7bps reset spread). On a yield to reset basis, FPLSP 4.38% PERP only offers 34.7bps spread pickup over FPLSP '26s, which appears too tight.

GuocoLand Ltd

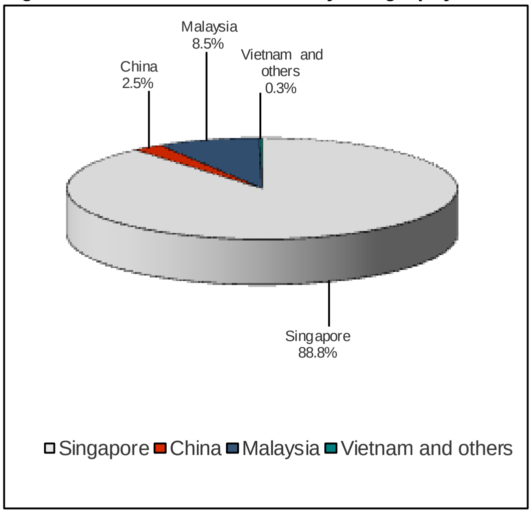
Table 1: Summary Financials

Year Ended 30th Jun	FY2016	FY2017	1H2018
Income Statement (SGD'mn)			
Revenue	1,059.8	1,113.2	732.5
EBITDA	223.0	185.8	111.3
EBIT	213.0	179.3	105.2
Gross interest expense	126.4	93.4	55.1
Profit Before Tax	773.2	455.8	229.8
Net profit	606.7	357.2	208.5
Balance Sheet (SGD'mn)			
Cash and bank deposits	1,430.2	1,118.5	852.3
Total assets	7,906.6	8,955.7	9,265.6
Gross debt	3,830.3	4,344.5	4,207.3
Net debt	2,400.0	3,226.0	3,355.0
Shareholders' equity	3,442.2	3,833.4	3,976.1
Total capitalization	7,272.5	8,177.9	8,183.4
Net capitalization	5,842.3	7,059.5	7,331.1
Cash Flow (SGD'mn)			
Funds from operations (FFO)	616.8	363.7	214.7
* CFO	389.7	-700.3	-221.2
Capex	286.9	157.7	5.0
Acquisitions	0.0	245.3	0.0
Disposals	2,251.6	130.7	0.5
Dividend	66.7	101.4	79.2
Free Cash Flow (FCF)	102.8	-857.9	-226.3
* FCF Adjusted	2,287.7	-1,073.8	-305.0
Key Ratios			
EBITDA margin (%)	21.0	16.7	15.2
Net margin (%)	57.2	32.1	28.5
Gross debt to EBITDA (x)	17.2	23.4	18.9
Net debt to EBITDA (x)	10.8	17.4	15.1
Gross Debt to Equity (x)	1.11	1.13	1.06
Net Debt to Equity (x)	0.70	0.84	0.84
Gross debt/total capitalisation (%)	52.7	53.1	51.4
Net debt/net capitalisation (%)	41.1	45.7	45.8
Cash/current borrowings (x)	0.7	0.5	0.4
EBITDA/Total Interest (x)	1.8	2.0	2.0

Source: Company, OCBC estimates

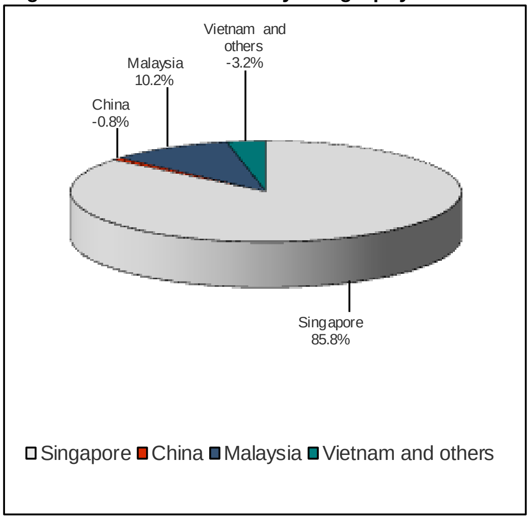
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

Figure 1: Revenue breakdown by Geography - FY2017



Source: Company

Figure 2: PBT breakdown by Geography - FY2017



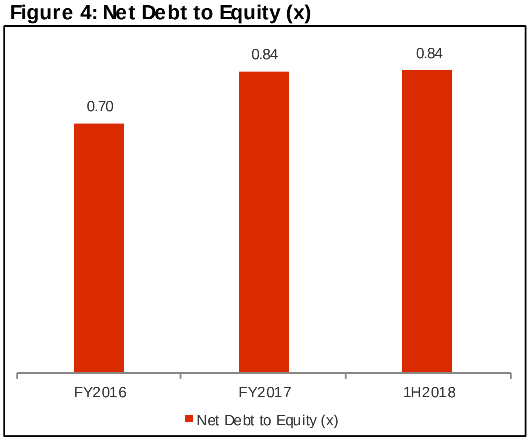
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 31/12/2017	% of debt
Amount repayable in one year or less, or on demand		
Secured	1,673.1	39.8%
Unsecured	527.7	12.5%
	2,200.8	**52.3%**
Amount repayable after a year		
Secured	778.6	18.5%
Unsecured	1,227.9	29.2%
	2,006.4	**47.7%**
Total	**4,207.3**	**100.0%**

Source: Company, OCBC estimates

Figure 4: Net Debt to Equity (x)



Source: Company

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.

Co.Reg.no.:193200032W