OCBC Bank

Asia Credit Research

Earnings Review: CapitaLand Ltd ("CAPL")

Issuer Profile: Neutral (3)

Ticker: **CAPLSP**

Background

CapitaLand Ltd ("CAPL") is Singapore's leading real estate developer, operating across residential development, serviced residences, retail & office REITs and real estate fund management. Geographical segments include CL Singapore, Malaysia and Indonesia ("CLSMI"), CL China ("CLC"), CL Vietnam ("CLV") and CL International ("CLI"). CAPL reported SGD64.6bn in total assets as at 4Q2018 and it is 40.4%-owned by Temasek Holdings Ltd.

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Recommendation

- 1Q2019 results appear lackluster with revenue down 23.8% y/y, mainly due to fewer handovers of residential development projects in 1Q2019 from Singapore and China. 2H2019 results should be better though with more handovers in China and Vietnam while Pearl Bank (774 units) and Sengkang Central (680 units) in Singapore will launch in 2Q-3Q2019 and Jewel Changi Airport (opened Apr 2019) should begin contributing.
- The acquisition of Ascendas Singbridge ("ASB") will be the major shake-up to CAPL's profile. From 1 Apr 2019, CAPL will be reorganizing its SBUs, with 'CapitaLand Lodging' and 'CapitaLand Financial' as new SBUs. When ASB merges into CAPL, a new India SBU will be formed.
- Net gearing rose q/q to 57.9% (4Q2018: 55.8%) mainly due to changes in accounting rules. We expect net gearing to exceed 70% when ASB (enterprise value: SGD10.9bn) is acquired.
- We prefer switching into the CITSP curve given that City Developments Ltd ("CDL") has a lower net gearing, though both CAPL and CDL are on a leveraging path. Investors looking for rated papers can consider the CCTSP curve.

Relative Value:

Bond	Maturity/Call date	Net Gearing	Ask Yield	Spread
CAPLSP 4.35% '19	31/10/2019	58%	2.04%	9bps
CAPLSP 4.3% '20	31/08/2020	58%	2.32%	36bps
CAPLSP 3.8% '24	28/08/2024	58%	2.86%	85bps
CAPLSP 3.08% '27	19/10/2027	58%	3.29%	111bps
CCTSP 2.96% '21	13/08/2021	37%	2.66%	72bps
CCTSP 3.17% '24	05/03/2024	37%	2.97%	98bps
CCTSP 3.327% '25	21/03/2025	37%	3.11%	107bps
CITSP 3.00% '20	27/10/2020	33%	2.58%	63bps
CITSP 3.78% '24	21/10/2024	33%	3.05%	103bps
CITSP 3.48% '26	15/06/2026	33%	3.19%	108bps

Indicative prices as at 6 May 2019 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Reorganisation of strategic business units ("SBUs"):** From 1 Apr 2019, CAPL will be reorgnising its SBUs and the way results will be reported. Our reading is that the current SBUs of CLSMI, CLV and CLI will be merged into "CL SMI, Vietnam and International" as a single SBU. CLC will remain as a SBU. There will be 2 new SBUs, namely CapitaLand Lodging ("CL Lodging") and CapitaLand Financial ("CL Financial"). When Ascendas Singbridge ("ASB") merges into CAPL, a new India SBU will be formed. The business parks/logistics/industrial businesses under ASB will merge into CLC and CL SMI, Vietnam and International while the REIT managers and funds will merge under CL Financial.

- **Subdued 1Q2019 partly due to one-offs and timing issue:** CAPL reported 1Q2019 results. Revenue declined 23.8% y/y to SGD1.05bn mainly due to lower contributions from residential projects in Singapore and China (lower handovers in China to be elaborated in next paragraph), partly mitigated by higher handover of units in Vietnam and revenue from properties acquired in USA (e.g. multifamily) and Europe in 2018. Share of results from associates (-45.9% y/y to SGD76.0mn) and joint ventures (-29.6% y/y to SGD27.3mn) also fell. This is due to absence of gain from divestment of 20 malls recognized in 1Q2018 and lower contributions from development projects JVs. As a result, excluding fair value gains on investment properties of SGD190.3mn (1Q2018: SGD9.0mn), profit before tax fell 31% y/y to SGD429.8mn. We note that the sizeable fair value gains mostly relate to the divestment of Ascott Raffles Place Singapore and revaluation gains from reclassification of One iPark Office from development to investment property. We think 2H2019 results should be better with more handover of units, which we will elaborate more in the discussion on the various SBUs.

- **Weighed by dry Singapore landbank though results expected to improve:** For the CL SMI, Vietnam and International segment SBUs, EBIT fell 9.0% y/y to SGD327.4mn mainly due to declines in CL SMI (-5.7% y/y to SGD295.0mn) because of lower revenue from Singapore development projects. CL Vietnam also saw a decline (-93.6% y/y to SGD2.0mn) with handover value falling to SGD33mn (1Q2018: SGD55mn) though we think this is a timing issue as 2,371 units have been sold with a value of SGD732mn, of which CAPL is guiding for SGD227mn to be recognized in the rest of 2019 – we note that launches have been delayed which CAPL attributes to the change in regulatory environment. Meanwhile, CL International (+92.2% y/y to SGD30.4mn) saw a strong uplift in results, mainly due to the acquisition of a multifamily portfolio in USA. For Singapore, we think results may trend up from here as Pearl Bank (774 units) is expected to launch in 2Q2019 while Sengkang Central (680 units) may launch in 3Q2019. Meanwhile, Jewel Changi Airport (~577k sq ft) opened on 17 Apr 2019 with 98% occupancy, which may contribute to results in the subsequent quarters.

- **Blip in results likely just temporary:** CL China SBU saw EBIT falling 21.8% y/y to SGD257.0mn mainly due to lower handover of units, with just RMB1.2bn handed over (1Q2018: RMB1.9bn) due to fewer units completed compared to 1Q2018. However, we think this is a timing issue. ~RMB10bn of value in units is expected to be recognized over the remainder of 2019 upon handing over. Meanwhile, residential sales by value surged to RMB2.6bn (1Q2018: RMB1.7bn) with 91% of launched units sold as of 31 Mar 2019. CAPL is guiding for another 5,259 units to be launched over the remainder of 2019. According to CAPL, price caps may be relaxed going forward.

- **Seeking to significantly grow the Lodging segment:** For the CL Lodging SBU, EBIT grew 328.0% y/y to SGD193.2mn, mainly due to fair value gains from the divestment of Ascott Raffles Place (SGD134mn gain). Excluding the gain, EBIT would still have grown by 31.3% y/y to SGD59.2mn due to higher revenue from Synergy Global Housing (acquired in Jul 2017) and contribution from Tauzia (acquired in 3Q2018). Overall, RevPAU is up 4% y/y to SGD114, mainly from Singapore (+15% y/y to SGD234) and North Asia ex China (+14% y/y to SGD139). The CL Lodging segment is expected to grow strongly with ~43k.k units under development in the pipeline, with the target to achieve 160k units by 2023 (YTD2019: 101.5k).

- **Growing CL Financial:** For CL Financial, EBIT fell 42.7% y/y to SGD26.5mn. This is mainly due to the operating expenses for structure of new funds, such as CREDO I China Fund, which raised USD556mn in Feb 2019. We understand that CAPL intends to expand this real estate debt fund.

- **Expect credit metrics to weaken due to significant acquisitions:** Net gearing rose q/q to 57.9% (4Q2018: 55.8%) though this is mainly due to changes in SFRS (I) 16 which included lease liabilities (SGD548.8mn) as part of debt. When CAPL completes the acquisition of ASB (with an enterprise value of SGD10.9bn), which is expected to take place some time in 2H2019, we expect net gearing to increase to over 70%. Excluding REITs from the balance sheet, we estimate that net gearing of CAPL standalone (less listed REITs) may exceed 1x upon the acquisition of ASB. That said, we note that CAPL continues to benefit from recurring income from its investment properties.

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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

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 ("IPR") into a 7 point Issuer Profile Score ("IPS") 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 financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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