Asia Credit Research

Lendlease Group ("LLC"): New Credit Review

Wednesday, April 10, 2019

Recommendations Summary

Issuer Profile:	**Bond Recommendation:**	
Neutral (4)	**LLCAU 3.9 '27**	**Neutral**
Fundamental Analysis Considerations • Substantial recurring income from investments segment • Decent credit metrics • Established Australian developer with long pipeline of work	Technical Analysis Considerations • Decent yield with external IG credit rating • Strong recent price rally • Visible retail presence	

Ticker: **LLCAU**

Background

Lendlease Group ("LLC") is a real estate group and has core businesses in property development, property investment and management as well as construction. While listed in ASX and retaining its core in Australia, LLC has expanded and has significant exposure geographically to gateway cities in Europe, Asia and Americas. LLC does not have a controlling shareholder.

Wong Hong Wei, CFA
+65 6722 2533
wonghongwei@ocbc.com

Key credit considerations

- **Leading property company in Australia:** Listed on the ASX with a market cap of AUD7.1bn, LLC is a leading property company in Australia, structuring its business along the lines of Development (FY2014-18 EBITDA contribution: 42.6%), Construction (19.0%) and Investments (38.4%). 67.9% of FY2014-18 EBITDA was generated from Australia, with the rest in Europe (17.5%), Americas (10.9%) and Asia (3.7%). LLC boasts of AUD34.1bn Funds under Management ("FUM") and AUD26.6bn Assets under Management ("AUM").

- **Segregating the Engineering & Services ("E&S") business:** 1HFY2019 net profit plunged to AUD15.7mn (1HFY2018: AUD425.7mn), weighed down by the E&S business, under the Construction segment, which reported negative AUD473.7mn EBITDA from three underperforming projects. We think LLC may eventually exit the E&S business as it is reclassified as non-core. If LLC exits the E&S business, the balance sheet may lighten somewhat as E&S takes up AUD1.56bn in total assets. Building business, which contributed 77% of Construction segment revenue, will become the only major part of the segment going forward. Construction segment is targeted to contribute 10-20% of LLC's EBITDA, down from 20%-30%, without E&S.

- **Very long pipeline ahead:** The development pipeline of AUD74.5bn covers FY2018's development revenue of AUD3.2bn by 23.3x, providing plenty of work ahead. These are held through capital efficient structures, with development properties on the balance sheet at just AUD4.9bn. There is also flexibility on the timing and delivery, allowing LLC to ride the market cycles.

- **Recurring income from investments segment:** Excluding revaluations, we estimate that recurring EBITDA from investments should amount to ~AUD400mn p.a. This covers 1HFY2019 gross interest expense (annualized) by 3.2x. We think that this segment should continue growing with AUD2.9bn of additional secured future FUM in LLC's development projects in delivery. Bigger deliveries include Paya Lebar Quarter (AUD359.6mn), International Quarter London (AUD125.3mn) and The Lifestyle Quarter (AUD361.6mn).

- **Decent credit metrics with ample liquidity:** Net gearing rose to 37% h/h (end-FY2018: 18%) mainly due to net capital of AUD0.8bn allocated to the development segment to support the growth of the development pipeline. According to guidance by LLC, net gearing should range between 24.5% and 48.9%, which is still manageable in our view. Reported interest cover (which LLC adjusts to exclude losses in the E&S projects) stands at 8.1x as of 1HFY2019 (FY2018: 10.7x), which remains healthy. Liquidity is ample with AUD1.09bn of cash and AUD1.02bn of undrawn facilities while there is no short-term debt coming due.

I) Company Overview & Ownership

Founded in 1958, LLC today is a leading property company listed on the Australian Securities Exchange ("ASX") with a market cap of AUD7.1bn. LLC structures its businesses along (1) Development (2) Construction and (3) Investments, which contributed 42.6%, 19.0% and 38.4% of reported operating business EBITDA[1] respectively in FY2014-18[2]. The activities undertaken include designing, constructing, operating and managing property and infrastructure assets.

Figure 1: EBITDA (FY2014-18 avg)* by segment

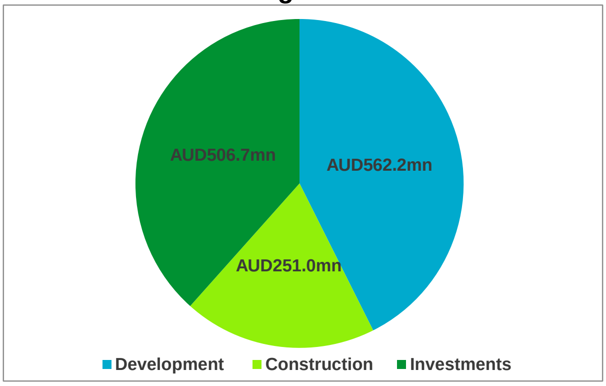
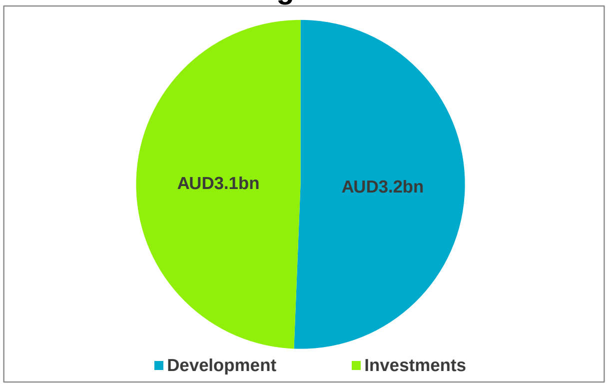


Figure 2: Invested Capital (FY2014-18 avg)* by segment



Source: Company, OCBC
**5 year average is used as the development and construction segments tend to be lumpy*

Headquartered in Australia with 13,000 employees, Australia remains core to LLC which contributed ~68% of reported operating business EBITDA over 2014-18. Outside of Australia, LLC operates in gateway cities in Europe, Asia and America.

Figure 3: EBITDA (FY2014-18 avg) by geography

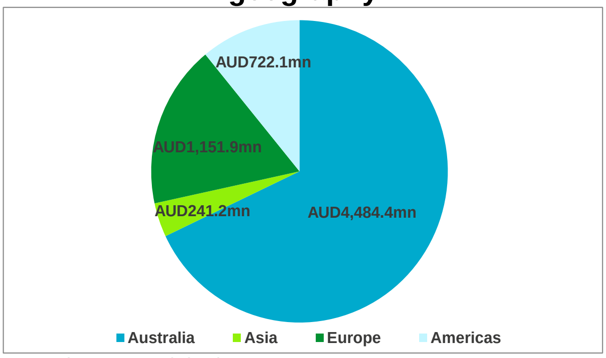
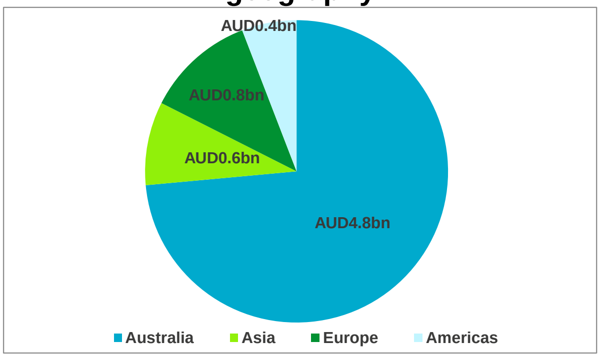


Figure 4: Invested Capital (FY2014-18 avg) by geography



Source: Company, OCBC

Lendlease Corp Ltd and the trustee of Lendlease Trust are guarantors of LLCAU 3.9% '27s. LLC operates as a stapled ownership structure, comprising Lendlease Corp Ltd (a company) and Lendlease Trust (a trust) stapled on a one-for-one basis. This allows the income from the trust to be taxed at the marginal tax rate of individual security holders than being taxed at the company tax rate, which enhances the returns from holding LLC securities.

Figure 5: Major shareholder as at 10 Apr 2019

Investor	Shares	Stake
BlackRock Inc	29.3mn	5.19%
Vanguard Group Inc	29.2mn	5.18%

Source: Bloomberg, Company

There is no controlling shareholder of LLC. The largest shareholders as of 10 Apr 2019 are BlackRock (5.19%) and Vanguard (5.18%), which are investment management companies. Mr Stephen B. McCann has been LLC's CEO and Managing Director (Executive Director) since Dec 2008. Mr McCann has over 25 years of executive experience and prior to LLC, Mr McCann held positions in property, funds management, investment banking and capital markets transactions including senior leadership roles at ABN Amro and as Head of Property at Bankers' Trust.

[1] *Operating Business EBITDA includes the contribution from the main segments but does not include the contribution from Group Services and Group Treasury*
[2] *1HFY2019 figures are not used because of huge one-off losses from the Construction segment (to be discussed in latter sections)*

II) Business Overview & Analysis

LLC classifies its business segments along (1) Development (2) Construction and (3) Investments:

(1) The Development segment include projects in Urbanisation (e.g. development of residential, office, retail, hotel), Communities (e.g. master planned communities which include delivery of streetscape, open spaces, town centres), Infrastructure development and retirement living development.
(2) The Construction segment include project management, design and construction services for residential, offices, retail, healthcare, education, defense, roads, railways, bridges, tunnels and other infrastructure.
(3) The Investments segment owns and manages investments in property and infrastructure co-investments, completed retirement living portfolio and US military housing.

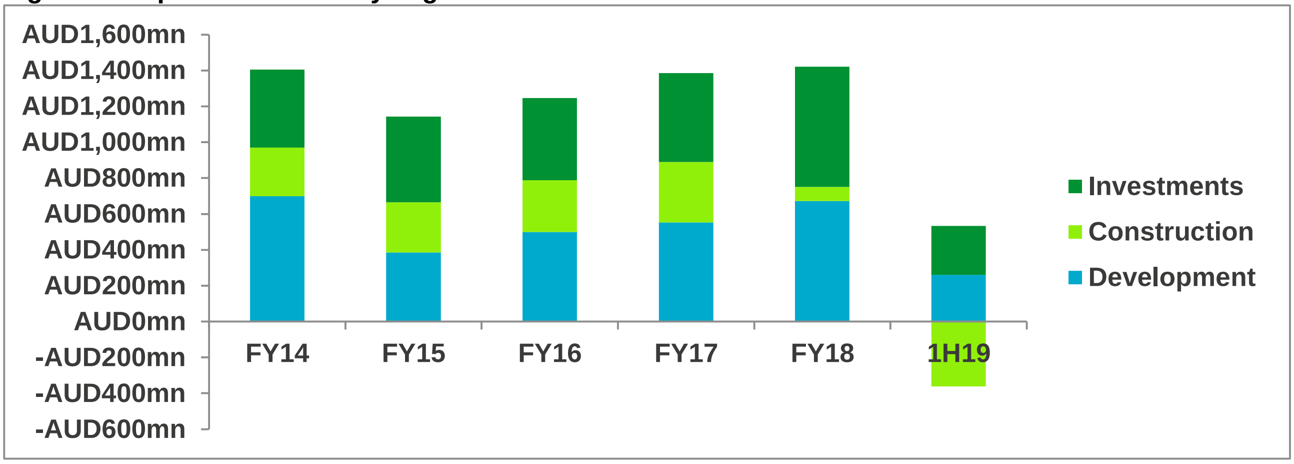
Figure 6: Business segment

Business segment	Development	Construction	Investments
Breakdown of business segment	Urbanisation - Apartments for sale - Commercial development Communities & Retirement Infrastructure	Building Engineering Services	Co-investments Retirement Living Funds under Management Assets under Management - Retail - Military Housing
EBITDA p.a. avg FY2014-18	AUD562.2mn	AUD251.0mn	AUD506.7mn

Source: Company, OCBC

LLC captures synergies by integrating the capabilities of the three business segments. The Development segment provides projects (e.g. the shopping mall Jem) which can be contracted to its Construction segment. Upon completion, the asset can be held under its Investments segment (e.g. Jem is held under Lendlease Asian Retail Investment Fund 3).

Figure 7: Reported EBITDA by segment



Source: Company, OCBC

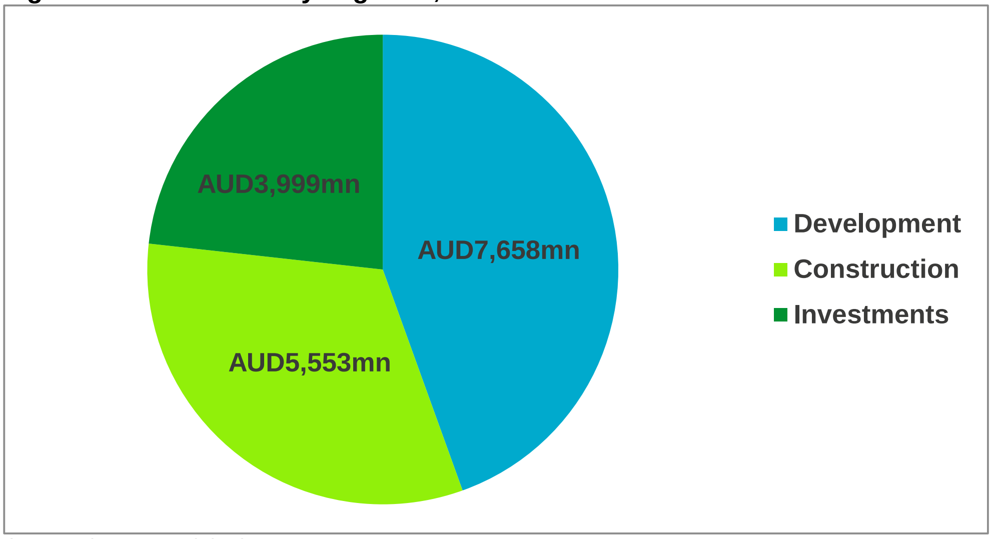
Higher focus on Development and Investments: LLC has an explicit EBITDA mix for Development (40-50%), Construction (10-20%) and Investments (35-45%). This mix is in-line with the EBITDA contribution over FY2014-18 (Development: 42.6%, Construction: 19.0%, Investment: 38.4%). However, contribution from development and construction can be somewhat volatile on a year on year basis given the revenue lumpiness (projects have varying completion dates) and volatile margins. For example, 1HFY2019 recorded negative contribution from construction segment due to significant provisions taken in the Engineering and Services business (within the Construction segment) due to a small number of projects. That said, LLC is restructuring the Engineering and Services segment – we will discuss further details in the latter sections.

Australia as the key contributor: By geography, Australia is the key contributor which accounts for ~75% of FY2015-18 reported EBITDA, followed by Americas (11.4%), Europe (10.8%) and Asia (2.8%). We excluded FY2014 results from this analysis due to the one-off outsized contribution from Europe in FY2014 (AUD592mn) due to the divestment of LLC's stake in Bluewater Shopping Centre in the UK for a profit of AUD485mn and have also excluded 1HFY2019 results due to the significant provisions undertaken in the Engineering and Services business in Australia.

Increasing diversification outside Australia: As a proportion of invested capital, Australia has fallen from 92.5%

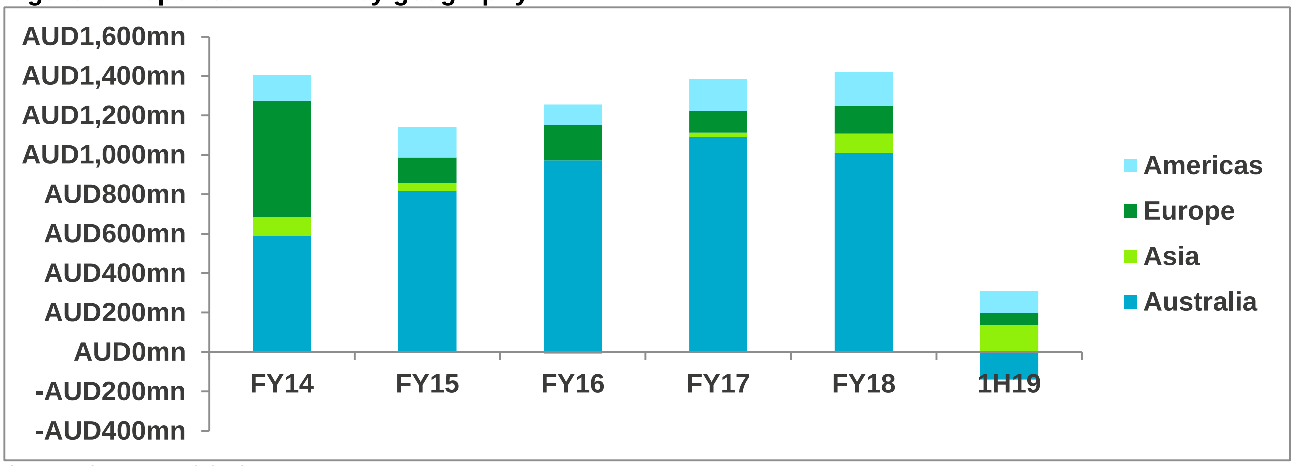
in FY2014 to 54.3% in 1HFY2019. Meanwhile the invested capital mix for Asia, Europe and Americas is 13.6%, 18.5% and 13.6% respectively. This is in-line with LLC's targeted invested capital mix of 50-70% for Australia and 5-20% for each of Asia, Europe and Americas. LLC is targeting 'gateway cities' with high population growth and sites well suited for urban regeneration and infrastructure upgrades. In Australia, these cities include Sydney, Perth, Melbourne and Brisbane and out of Australia, the cities include San Francisco, Los Angeles, Chicago, Boston, New York, London, Milan, Rome, Beijing, Shanghai, Tokyo, Kuala Lumpur and Singapore.

Figure 8: Total assets by segment, 1HFY2019



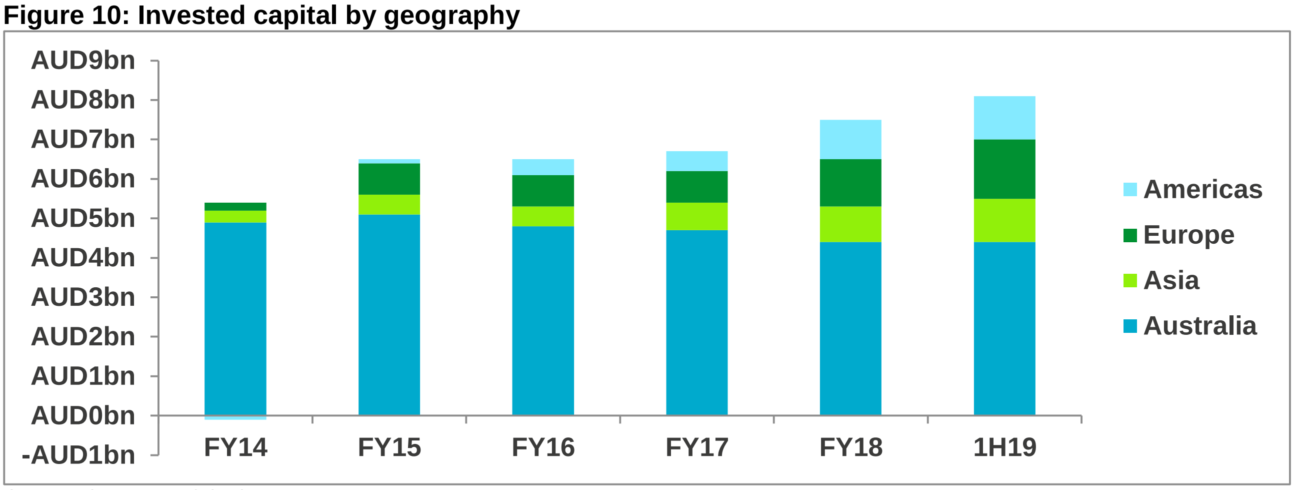
Source: Company, OCBC

Figure 9: Reported EBITDA by geography



Source: Company, OCBC

Figure 10: Invested capital by geography

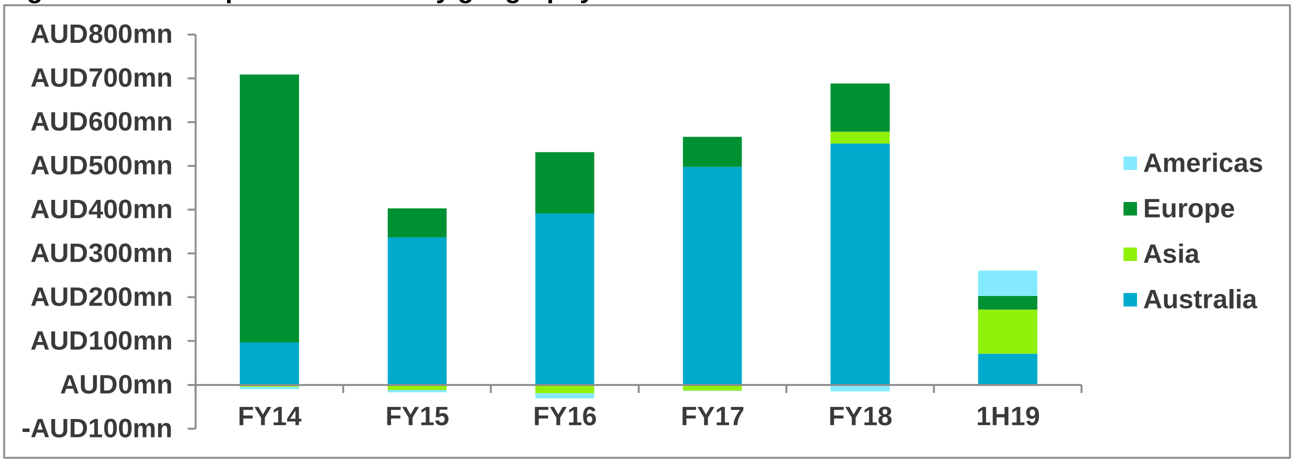


Source: Company, OCBC

Development segment

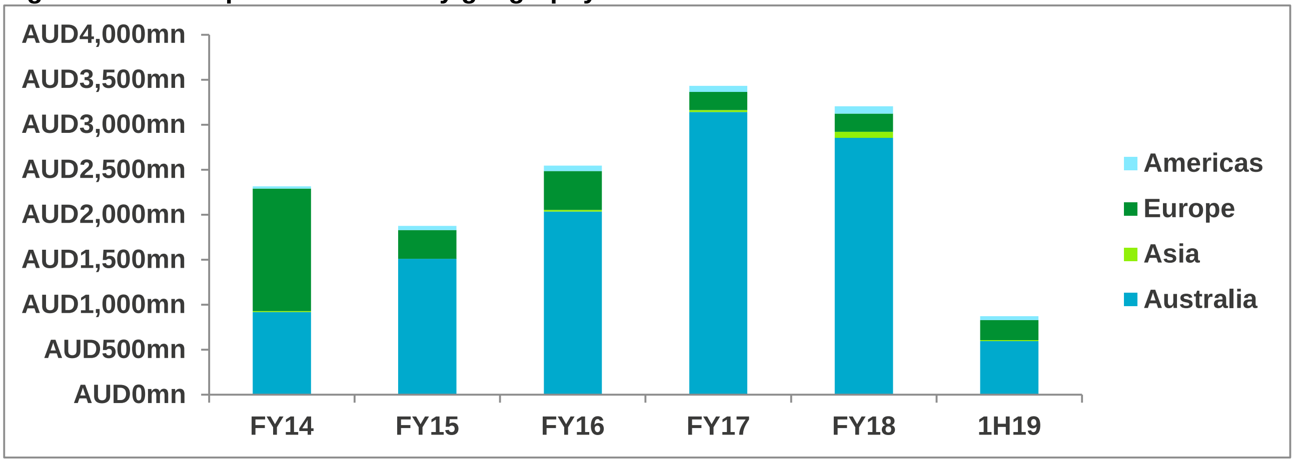
Development is a significant contributor: The development segment is a key segment, contributing AUD673.2mn (47.4%) of FY2018's reported EBITDA and representing AUD7.7bn (44.5%) out of AUD17.2bn in total assets. This segment has performed well, delivering 13.7% and 13.4% Return On Invested Capital ("ROIC") in FY2018 and FY2017 respectively. Australia is the single most important contributor to development EBITDA (FY2018: 81.9%) and revenue (FY2018: 89.1%) though the contribution is smaller in 1HFY2019 at 68.3% and 27.3% respectively.

Figure 11: Development EBITDA by geography



Source: Company, OCBC

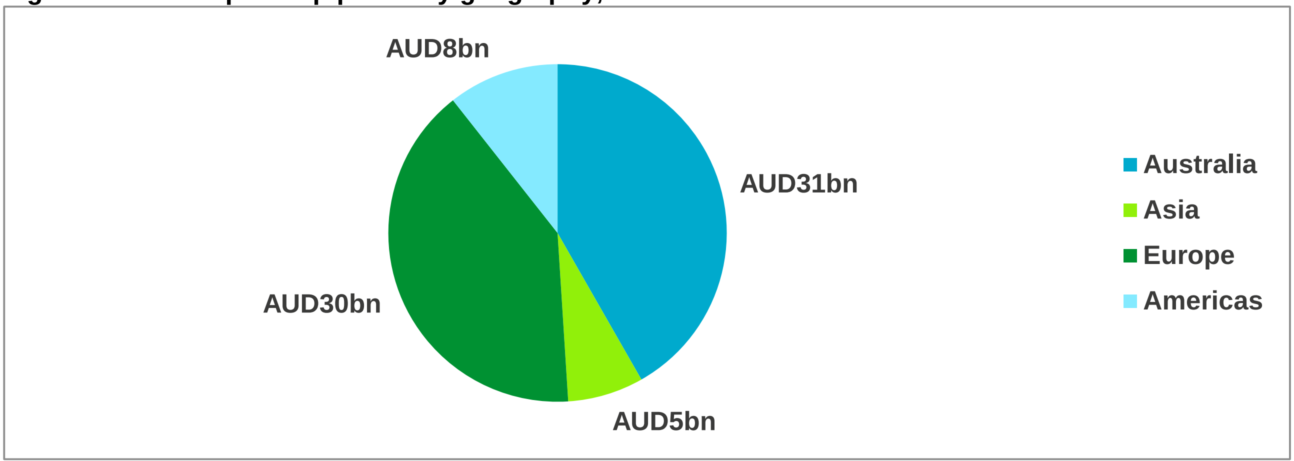
Figure 12: Development revenue by geography



Source: Company, OCBC

Diversification outside Australia with multi-year backlog: The pipeline ahead suggests increasing diversification out of Australia, with Australia accounting for just 41.7% of the pipeline. The backlog as of end-1HFY2019 is large with AUD74.5bn in development pipeline, which represents 23.3x of FY2018's AUD3.2bn development revenue.

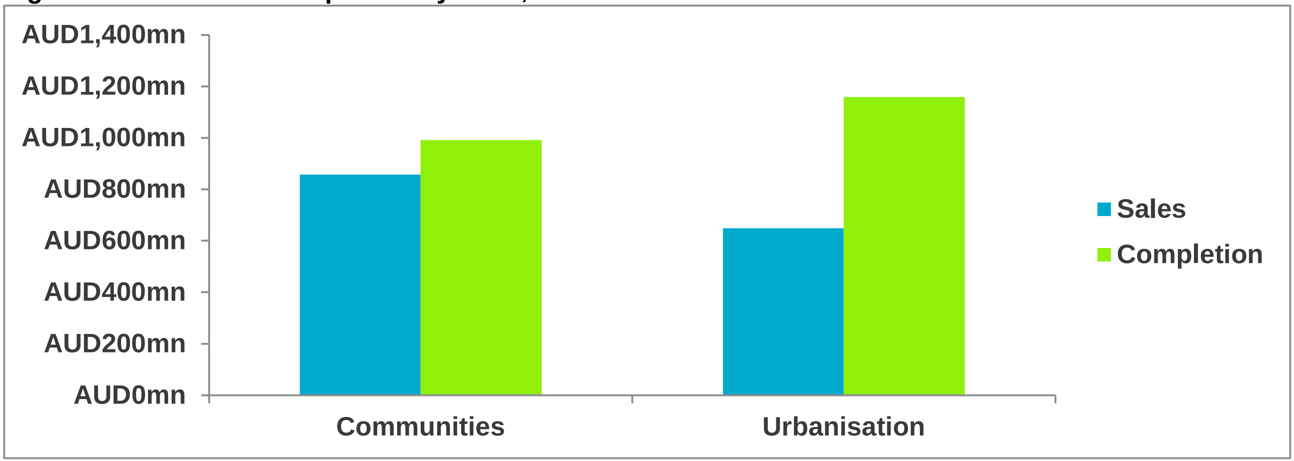
Figure 13: Development pipeline by geography, FY2018



Source: Company, OCBC

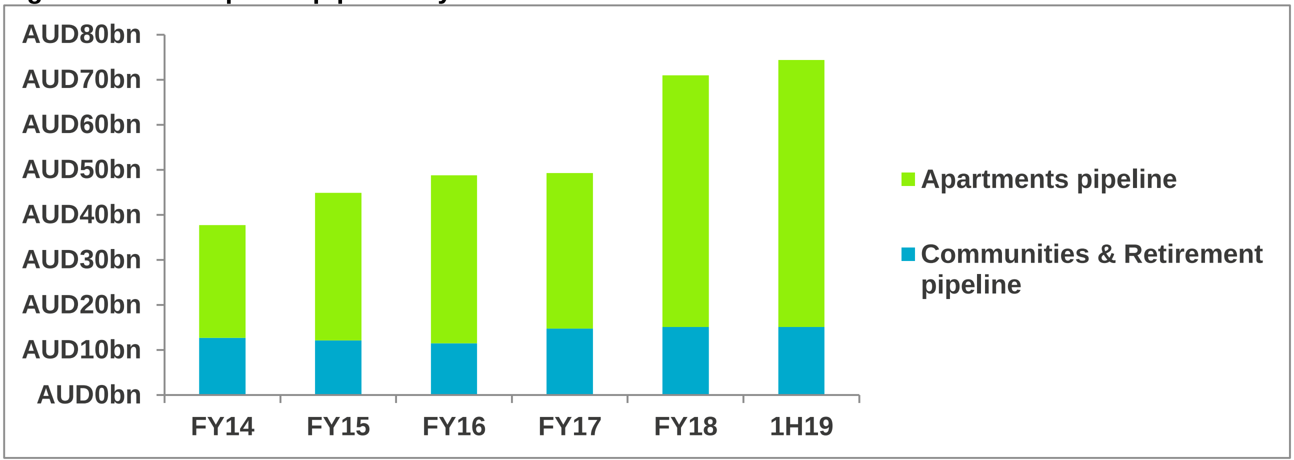
Under the Development segment, the major sub-segments include (1) Urbanisation and (2) Communities and Retirement. Both the Urbanisation (1HFY2019 sales: AUD238.2mn) and Communities (AUD266.0mn) segments are important contributors to the development segment.

Figure 14: Sales and completion by work, FY2018



Source: Company, OCBC

Figure 15: Development pipeline by work



Source: Company, OCBC

Development: Urbanization

Under Urbanisation, primary activities include the development and sale of apartments and commercial buildings.

Decent sales rate on apartment development…: LLC reported AUD648.3mn in sales in FY2018, which is mainly due to Europe Apartments (AUD237.7mn) and Asia Apartments (AUD235.5mn) with the remainder due to sales in Americas (AUD127.1mn) and Australia (AUD48.0mn). Completed apartments in Australia (AUD912mn) and Europe (AUD247mn) in FY2018 totaled AUD1.16bn. This is represented by the completion of 1,314 apartment units in FY2018 (FY2017: 2,533 units), in-line with the target to achieve 1,000-2,000 completions p.a.

… with better results expected in FY2019: While 1HFY2019 saw just AUD238.2mn in apartment sales with settlement of just 145 units, full year FY2019 numbers will likely be stronger as LLC guided that a significant number of residential apartments are due for completion in the second half with a forecasted settlement of 1,500 units, with ~1,000 units due to the Darling Square project in Sydney (with AUD1.3bn of unrealized presales). Thus far, majority of the units put up for sale have been sold. However for FY2019, LLC is guiding for apartment settlements and completions above the 1,000-2,000 target range given the significant amount of apartments due for completion in 2HFY2019.

Revenue visibility ahead due to presales…: In addition, apartment presales in Australia and Europe amounting to AUD2.8bn as of 1HFY2019 represented 2.4x of FY2018 settlement which should provide some revenue visibility over FY2019-FY2020. There is another AUD821.4mn presales from Asia and Americas though FY2018 settlement figures for these regions are not available. 57% of the apartment pre-sales are located in Australia and will be delivered by FY2020.

Settlement risks likely manageable: Despite a slower Australia housing market, we think pre-sales conversion risk looks manageable with LLC disclosing a long-term default rate average of less than 3% – even the weak

Brisbane market saw only ~3% default rate at the Yards project in FY2018. LLC also expects the default rate on the settlements in 2HFY2019 to be low. Settlements in FY2019/2020, in addition to the existing Australian geographies, will include geographies in Singapore, Boston and New York, which should diversify risks away from Australia.

Figure 16: Apartments presales and completion profile

Project	City	Total Units	Units Presold	Presales (AUD bn)	Completion
Darling Square	Sydney	967	967	1.3	FY2019
Victoria Harbour	Melbourne	321	292	0.3	FY2019
Melbourne Quarter	Melbourne	719	552	0.4	FY2020
Paya Lebar Quarter	Singapore	429	412	0.5	FY2020
Wandsworth	London	61	4	-	FY2019
Elephant Park	London	571	483	0.5	FY2019-21
Deptford	London	203	173	0.1	FY2020
Fifth Avenue	New York	130	-	-	FY2019
Clippership Wharf	Boston	80	80	0.1	FY2019

Source: Company, OCBC

Figure 17: Residential for rent apartments completion profile

Project	City	Total Units	Ownership	Completion
Southbank	Chicago	452	50%	FY2019
Clippership Wharf	Boston	284	50%	FY2019
Elephant Park	London	663	20%	FY2021
845 West Madison	Chicago	586	37.5%	FY2021

Source: Company, OCBC

Commercial development is another significant contributor: In FY2018, AUD1.8bn in value from commercial buildings development (1HFY2019: AUD2.5bn) were completed (1 project in Australia and 1 project in Europe)[3]. This was highlighted by LLC as a key contributor to FY2018 result (though EBITDA breakdown between apartment and commercial development was not given). Replenishing the commercial pipeline, 4 developments (3 in Australia, 1 in Europe)[4] worth AUD1.5bn commenced in 2018 (1HFY2019: nil), of which the newly commenced Australian projects have been forward sold[5] to capital partners – we note similarly most of the other Australia projects in the midst of being delivered have been forward sold. We expect commercial development to remain a significant contributor with an unrealized AUD7.2bn of commercial developments in delivery, of which a number will be expected to complete over FY2019-2022. The bigger deliveries include Paya Lebar Quarter (net book value: AUD359.6mn), International Quarter London (AUD125.3mn), Melbourne Quarter (AUD49.4mn) and The Lifestyle Quarter (AUD361.6mn).

Figure 18: Commercial Buildings Completion Profile

Project	City	Area (sqm)	Expected completion
Victoria Harbour	Melbourne	39,000	FY2019
Melbourne Quarter	Melbourne	50,000	FY2021
Barangaroo South	Sydney	11,000	FY2020
University of Melbourne Innovation Precinct	Melbourne	27,000	FY2021
Circular Quay Tower	Sydney	55,000	FY2022
Paya Lebar Quarter	Singapore	29,000	FY2020
The Lifestyle Quarter	Kuala Lumpur	122,000	FY2021
International Quarter London	London	26,000	FY2020

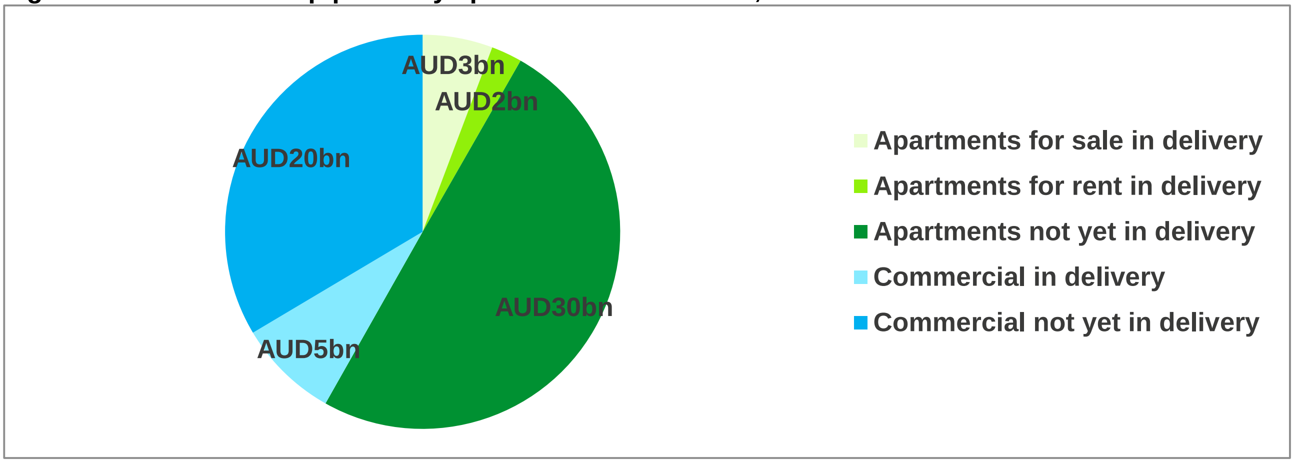
Source: Company, OCBC

Significant pipeline ahead: Overall the Urbanisation pipeline totals AUD59.3bn[6] in 1HFY2019, which is mostly represented by developments in Europe (AUD30.0bn) and Australia (AUD16.8bn), followed by Asia (AUD5.0bn) and Americas (AUD7.5bn). A bigger portion of the pipeline is in apartments (AUD34.5bn) though the commercial pipeline is also significant (AUD24.8bn). Most of the pipeline is secured though not yet in delivery, which comprise 26,191 residential units worth AUD29.6bn and c.1.6m sqm of commercial space[7] worth AUD19.9bn. We note that

[3] *Completed developments include Darling Square office and hotel and International Quarter London*
[4] *These Australian commercial developments comprise (1) Two Melbourne Quarter – 50,000 sqm, (2) The University of Melbourne Innovation Project – 27,000 sqm, (3) Daramu House at Barangaroo – 11,000 sqm).*
[5] *LLC will receive staged payments prior to building completion from forward sale.*
[6] *Made up of 31,180 apartment units and 2.0mn sqm of commercial space.*
[7] *The secured commercial pipeline includes SIlvertown Quays, London (440k sqm), Euston Station, London (400k sqm) and Milano Santa GIula, Milan (253k sqm).*

the Urbanisation pipeline grew strongly in FY2018-1HFY2019 (FY2017: AUD34.6bn) with an enlarged exposure to Europe as 4 projects (High Road West, Euston Station, Silvertown Quays, Milano Santa Giulia project) worth AUD21.9bn were secured in FY2018. ~AUD4.9bn of apartments and ~AUD4.9bn of commercial projects are in delivery, which leaves a still ample AUD49.5bn of work remaining in the pipeline as of 1HFY2019.

Figure 19: Urbanisation pipeline by apartments/commercial, FY2018



Source: Company, OCBC

Development: Communities

Communities as an equally significant contributor: The Communities segment contributed AUD857mn in sales, which forms 56.9% of Development segment's FY2018 sales (1HFY2019: AUD266mn, comprising 52.8% of 1HFY2019 sales). FY2018 saw 3,912 lots completed worth AUD991.4mn (1HFY2019: 908 lots worth AUD197.4mn) in Jordan Springs (7km from Penrith, which is 50km west of Sydney CBD) and Springfield Lakes (32.7km southwest of Brisbane CBD), which is at the upper-end of the target to complete 3,000-4,000 lots p.a. However, LLC has guided that settlements in FY2019 will be below target range given lower settlements in 1HFY2019.

Earnings visibility on top of a long track record: Presales of AUD881.4mn provides earnings visibility into 2HFY2019-FY2020. We expect this segment to continue generating earnings as the pipeline is significant at AUD15.1bn as of 1HFY2019, which should provide more than a decade of supply. Meanwhile, 3,266 lots have been presold, which provides some visibility into FY2020. Communities segment is concentrated in Australia, representing AUD14.3bn out of AUD15.1bn of the Communities pipeline. That said, LLC has a meaningful track record, delivering more than 50 residential communities in the last 50 years and boasts many Australians living in a LLC community. The Communities segment has also developed retirement communities within its Retirement Living portfolio.

Figure 20: Communities projects backlog

Project	Residential (units)	Commercial (sqm)	Expected completion
Yarrabilba	14,190	2,005	FY2047
Elliot Springs	10,675	1,050	FY2061
Springfield Lakes	3,340	22	FY2026
Shoreline	2,890	95	FY2034
Calderwood Valley	3,640	152	FY2036
Gilead	1,590	96	FY2032
Bingara Gorge	1,160	79	FY2026
St Marys – Jordan Springs	835	296	FY2022
The New Rouse Hill	450	-	FY2021
Atherstone	3,420	86	FY2025
Harpley	2,630	358	FY2027
Aurora	2,100	145	FY2026
Blakes Crossing	200	17	FY2020
Alkimos	1,225	28	FY2026
Alkimos Vista	560	-	FY2024
Horizon Uptown	1,617	-	FY2033
Retirement Asia and Others	1	-	Various
Total	**50,483**	**4,429**	

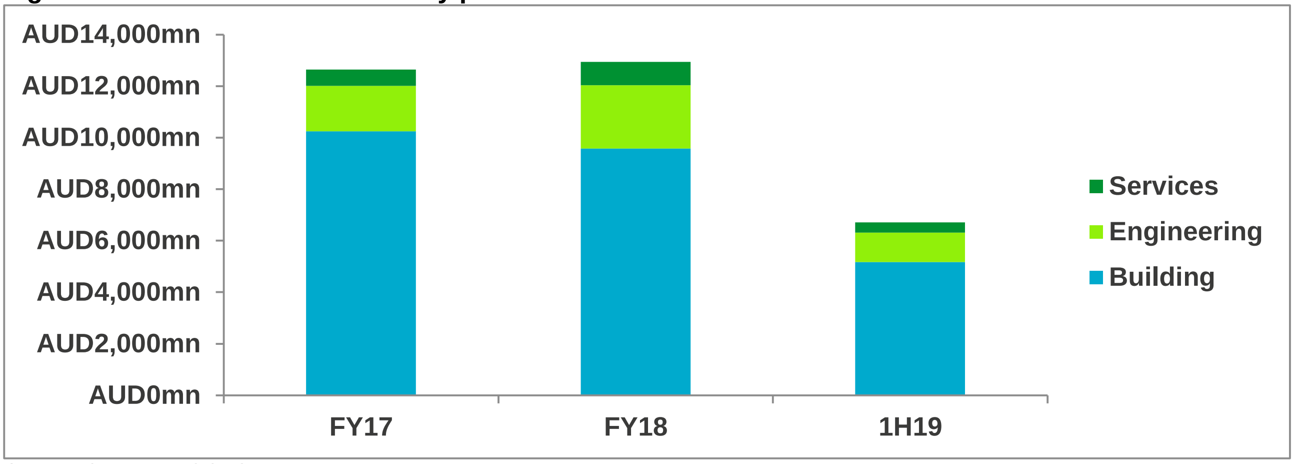
Source: Company, OCBC

Expanding beyond sales through partnerships focusing on build-to-rent and telecommunications: In addition to developing apartments, commercial buildings and communities for sale, in Jan 2018 LLC established an investment partnership with Canada Pension Plan Investment Board ("CPPIB") targeting an investment of AUD2.7bn for the purpose of Build-to-Rent in the UK. The first project at Elephant Park in London (ownership: 20-80, with LLC owning 20%) will deliver 663 units worth AUD800mn in development end value. Separately, LLC has also entered into a 50-50 partnership with First State Super, which is one of Australia's largest superannuation funds, to develop and hold multifamily assets in US gateway cities with USD1bn in equity commitment (USD500mn from each partner).This partnership has acquired 736 units for ~AUD0.5bn which are in delivery. Unusually, LLC has also entered into a 50-50 joint venture with SoftBank with USD400mn equity (USD200mn from each partner) to develop and own telecommunications towers in the United States. The JV is targeting USD5bn of assets over the medium term.

Construction segment

Construction as a significant detractor to results, mainly due to underperformance in Engineering and Services ("E&S") business: The construction segment reported a negative AUD409.0mn EBITDA contribution in 1HFY2019. This is mainly due to AUD500mn pre-tax impact from expected losses on underperforming projects[8] from the E&S business. These projects face issues including lower productivity, excessive wet weather, access issues and remedial work from defective design. As a result, the E&S business performance deteriorated significantly y/y to negative AUD473.7mn EBITDA (1HFY2018: negative AUD173.5mn).

Figure 21: Construction revenue by product



Source: Company, OCBC

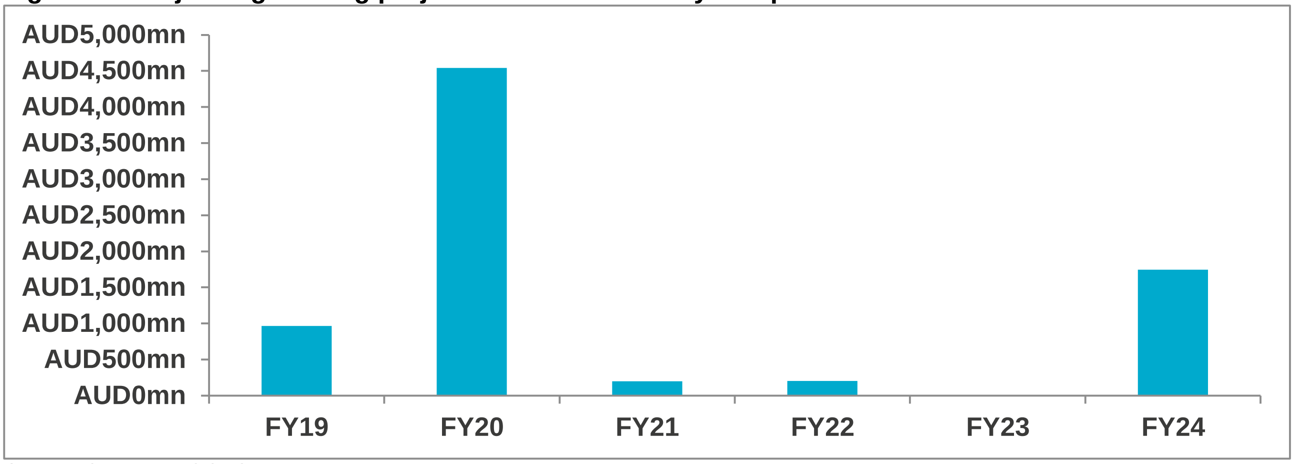
Segregating the Engineering and Services business from Construction, leaving just the Building business: Together with the announcement of the 1HFY2019 results, LLC concluded its review of the E&S business and determined that E&S business is non-core and is no longer a required part of LLC's strategy. We think this could signal an eventual exit from the E&S business, with LLC indicating that it is in the "best interests of clients, employees and securityholders to consider alternatives". Previously in FY2011, LLC had built its engineering capability through the AUD960mn acquisition of Valemus, which is the parent company of Baulderstone, Abigroup and Conneq, which were leading providers of services in engineering in Australia. We think that exiting the E&S business may lighten the balance sheet somewhat as the E&S business takes up AUD1.56bn in total assets. Excluding the E&S business, the construction segment is made up of Building business which delivered AUD111.4mn EBITDA in 1HFY2019, representing 17.3% of LLC's total operating EBITDA (excluding E&S).

Rocky ride in the short term…: LLC is undertaking steps to address the E&S business and estimates that it may incur restructuring costs of AUD450mn-AUD550mn on a pre-tax basis. The steps to take may include technology and systems costs, employee costs and advisory costs, and costs to conclude customer contracts due to LLC's decision. This is significant compared to FY2014-18 average EBITDA of AUD1.1bn p.a. In view of the impairments taken and steps taken to de-risk, we think it may be unlikely for E&S projects to contribute significantly to EBITDA.

… though there should be stability in the longer-term (hopefully): While LLC has disappointed markets (yet again) due to the significant costs of restructuring and the surprising losses in the E&S business, we think that further losses are likely to be more contained. According to LLC, most major Engineering projects, including the loss-making E&S projects, are well advanced and are expected to complete by end-2020. Next, the total costs for restructuring and loss taken for the non-performing E&S projects amounts to AUD950mn-AUD1.05bn, which is already large in relation to the Engineering revenue of AUD5.4bn over FY2017-19 and Engineering backlog revenue of AUD5.0bn. Also, LLC is reducing the risk profile for the E&S business by sharing risks more appropriately with project partners. While this should limit the contribution by the E&S business, we think LLC can manage given that the Building business (instead of the E&S business) is the largest contributor to the Construction segment.

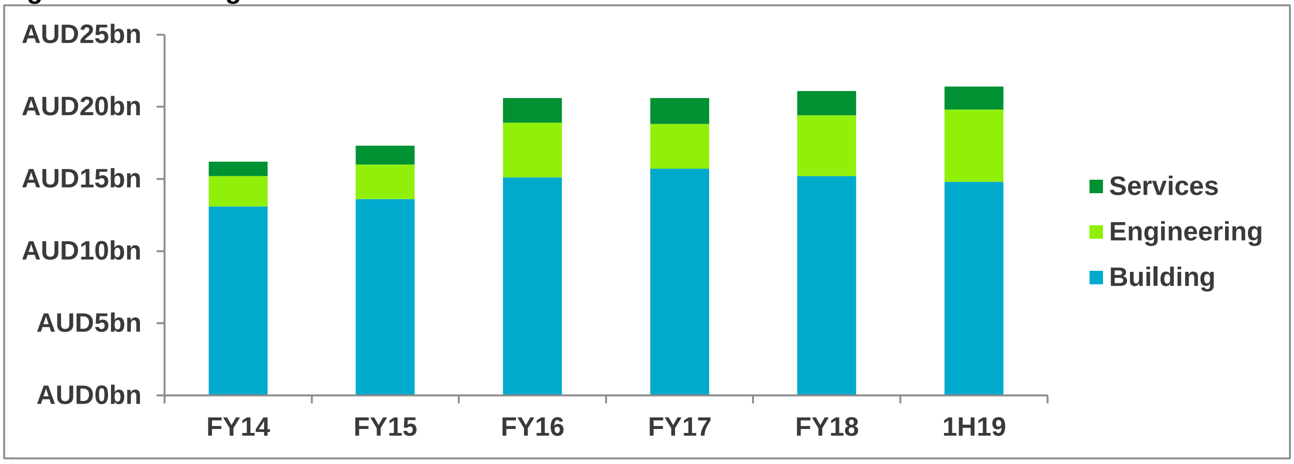
[8] *NorthConnex (Contract value: AUD1.3bn), Gateway Upgrade North (AUD692mn), Kingsford Smith Drive (AUD500mn)*

Figure 22: Major Engineering projects contract value by completion date



Source: Company, OCBC

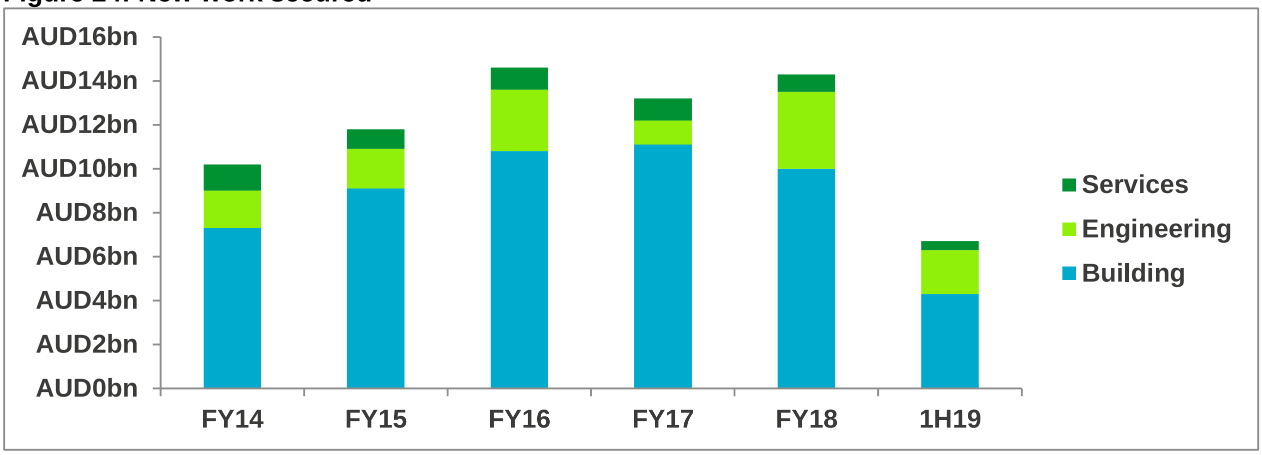
Figure 23: Backlog revenue / Orderbook



Source: Company, OCBC

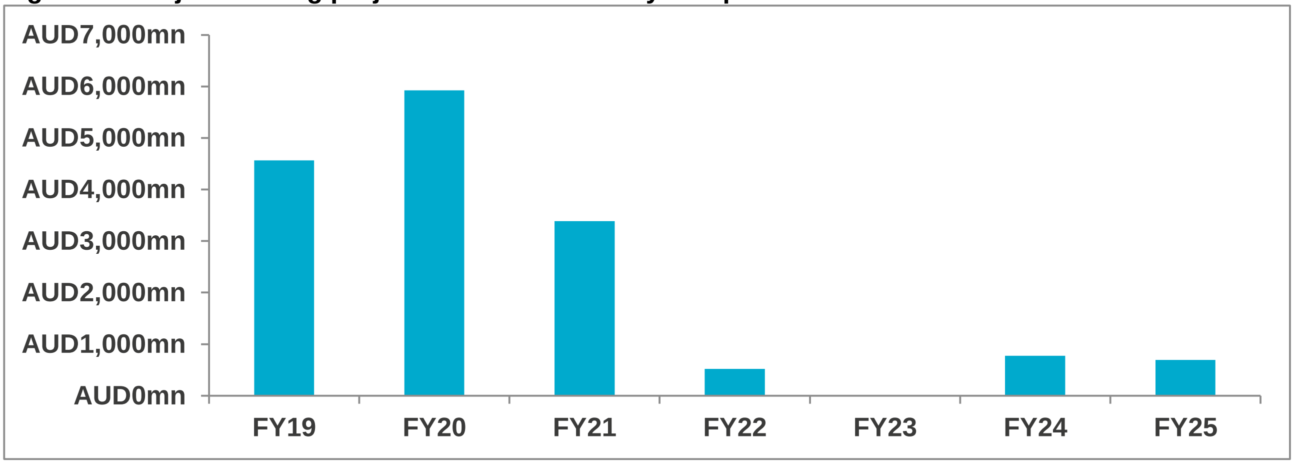
Building business as the major contributor of the construction segment: The Building business delivered ~AUD10bn in revenue p.a. in FY2017-18, representing ~77% of the total revenue delivered by the construction segment. This is ~1.5x the Building backlog of AUD14.8bn. The building business is also the major contributor to the construction segment. Building backlog represents 69% of the backlog of three total construction segment) with bulk of the projects expected to complete in FY2019-21. While the pipeline is not large relative to revenue, we note that the Building segment has been consistent in securing new work. We are not overly worried that customers in the pipeline would back out given that 65% of the backlog relates to government clients and LLC itself. EBITDA margin for construction (less E&S) stands at 2.1% in 1HFY2019 (1HFY2018: 3.0%). This is in-line with the revised target of 2-3% EBITDA margin for the segment (previous target: 3-4%), which has been revised downwards as it excludes the E&S business. In 1HFY2019, the building business contributed AUD75.7mn in profit after tax (1HFY2018: AUD92.3mn), lower y/y due to lower EBITDA margin. To note, the Construction segment will comprise only Building business in future periods (as E&S business has been segregated).

Figure 24: New work secured



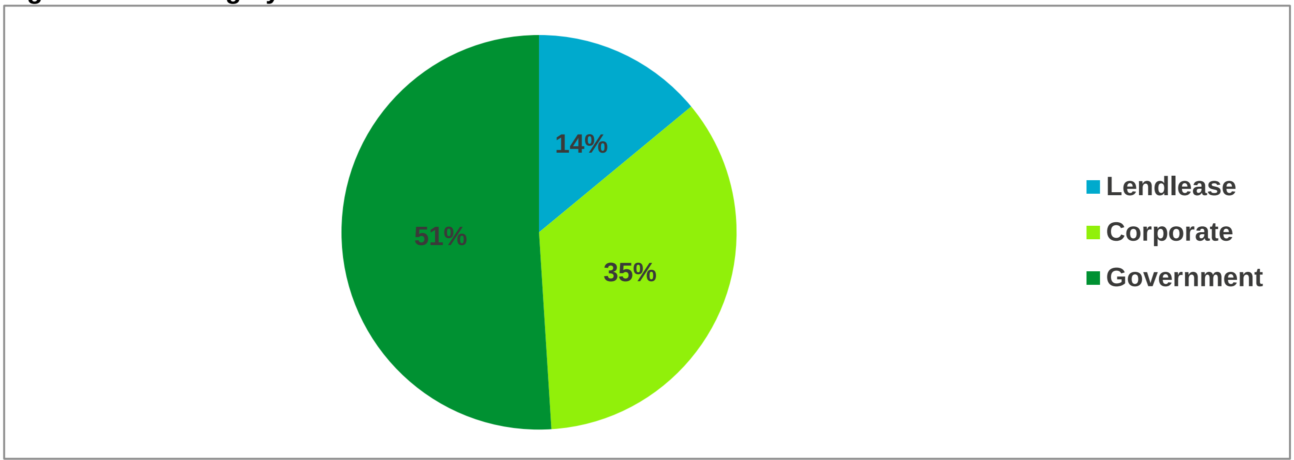
Source: Company, OCBC

Figure 25: Major Building projects contract value by completion date



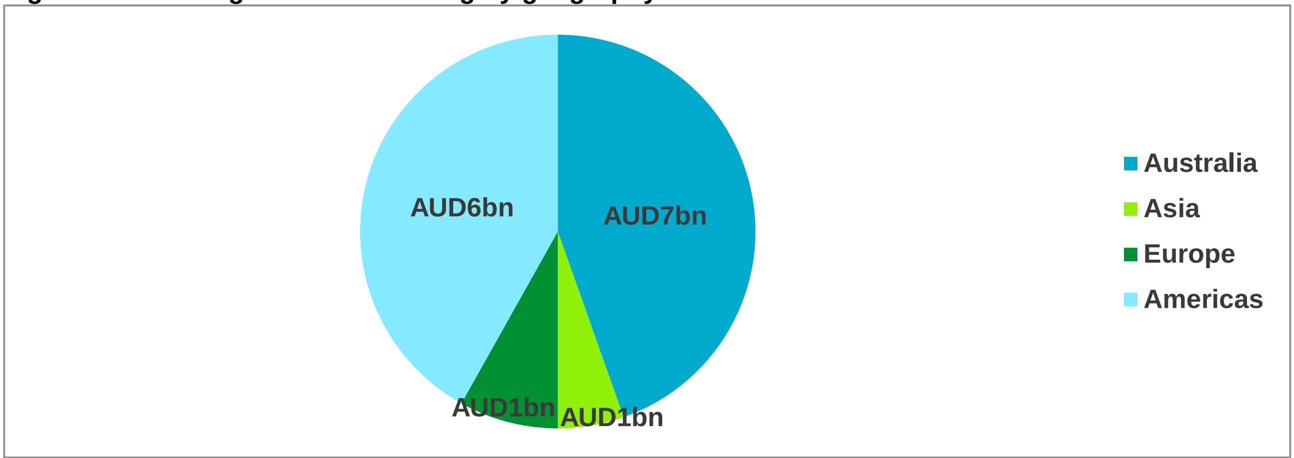
Source: Company, OCBC

Figure 26: Backlog by Client



Source: Company, OCBC

Figure 27: Building business backlog by geography

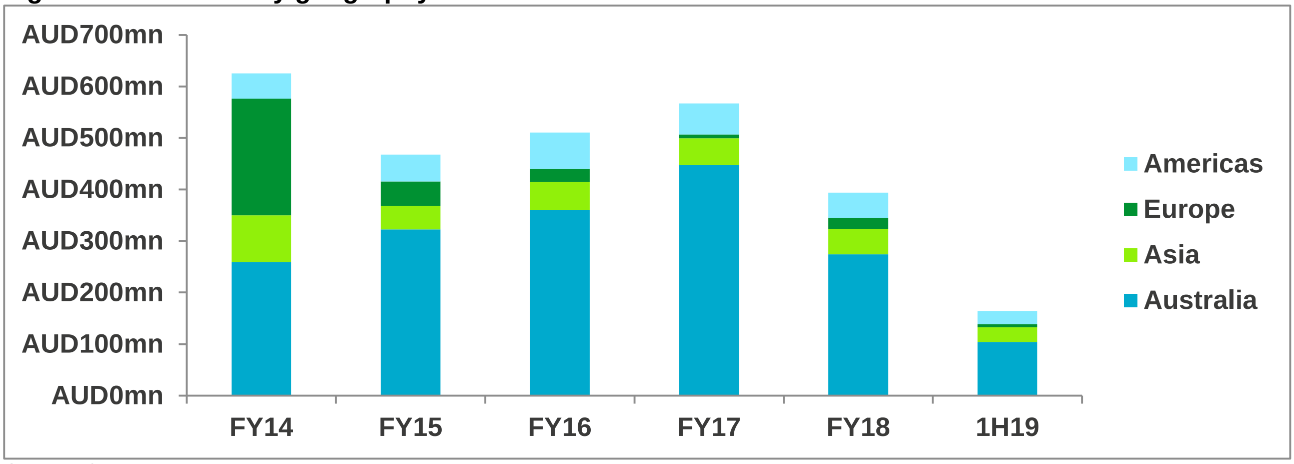


Source: Company, OCBC

Investments segment

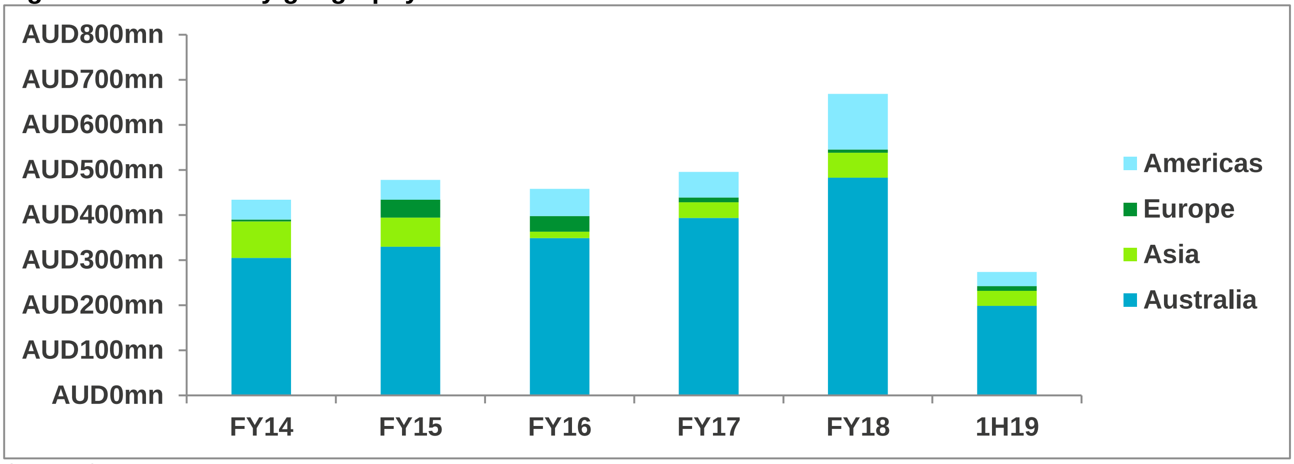
Investments segment is the second largest contributor: The investments segment is the second largest contributor, contributing AUD668.9mn (47.1%) of FY2018's reported EBITDA and representing AUD4.0bn (23.2%) out of AUD172.bn in total assets. The investments segment has delivered 13.6% ROIC in 1HFY2019 (1HFY2018: 16.5%), exceeding the target of 8-11%. Bulk of the EBITDA is generated from Australia given that we estimate LLC holds ~AUD2.67bn of investments (accounted for LLC's share) in Australia. In addition, AUD24.1bn out of AUD34.1bn of Funds under Management ("FUM") and AUD7.6bn out of AUD13.3bn Assets under Management ("AUM") are located in Australia.

Figure 28: Revenue by geography



Source: Company

Figure 29: EBITDA by geography



Source: Company

Reported EBITDA contribution from both ownership interests and operating earnings: LLC generated AUD203mn EBITDA as of 1HFY2019 (1HFY2018: AUD319mn) – through the ownership of AUD3.56bn in investments in geographies including Australia (AUD2.67bn), Asia (AUD399.1mn) and Americas (AUD372.1mn). The investments include co-investments in funds (~AUD1.7bn), 75%-stake in Retirement Living portfolio (~AUD1.4bn), US military housing (AUD209mn) and ownership in infrastructure assets (AUD163mn). EBITDA from ownership interests is lower y/y partly due to lower revaluations in 1HFY2019 at AUD76.5mn (1HFY2018: AUD92.4mn) and sale of 25%-stake in the Retirement Living portfolio, which was booked as 100%-ownership in the first 5 months in 1HFY2018. LLC also generates operating earnings of AUD69.6mn (1HFY2018: AUD64mn), from management fees via its investment management platform (FUM: AUD34.1bn), retail asset management platform (AUM: AUD13.3bn) and management of Military Housing (AUM: AUD13.3bn).

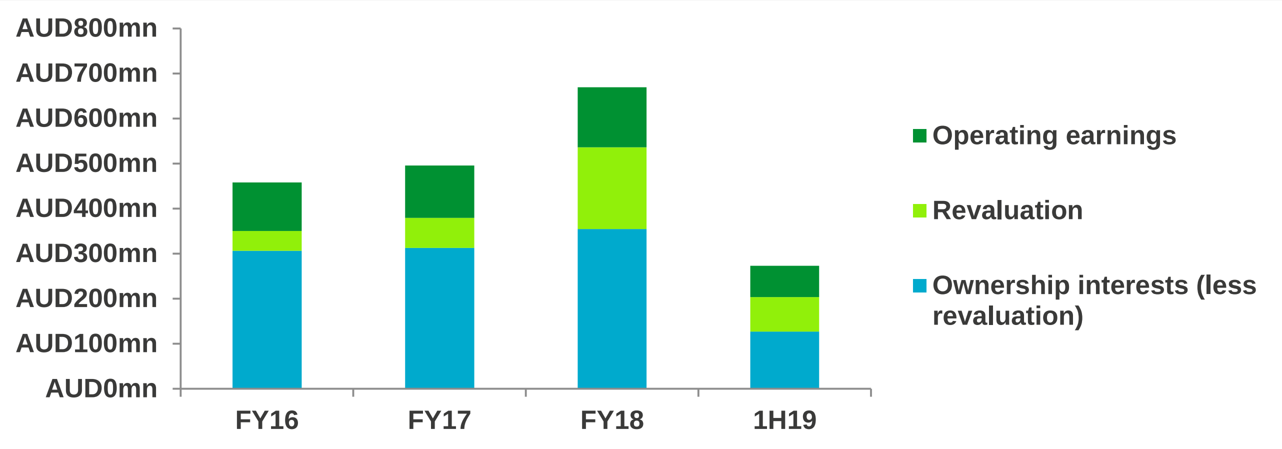
Figure 30: Investments

Investments	Geography	LLC interest (%)	AUD mn
Lendlease International Towers Sydney Trust*	Australia	15	555.9
Australian Prime Property Fund Commercial*	Australia	8	362.0
Australian Prime Property Fund Industrial*	Australia	10.8	94.1
Craigieburn Central	Australia	25	80.9
Australian Prime Property Fund Retail*	Australia	1.7	77.3
Lendlease One International Towers Sydney Trust*	Australia	2.5	52.1
Lendlease Public Infrastructure Investment Co	Australia	10	39.6
Lendlease Sub Regional Retail Fund	Australia	9.9	37.2
Lendlease Real Estate Partners New Zealand	Australia	5.3	10.2
Lendlease Communities Fund 1	Australia	20.8	1.1
Retirement Living	Australia	75%	1,359.1
Total Australia			**2,669.4**
ARIF 1 (313@somerset)*	Asia	14.4	42.1
ARIF 2 (Setia City Mall)	Asia	37.5	27.8

ARIF 3 (Jem)*	Asia	20.1	191.1
313@somerset	Asia	25.0	96.0
Parkway Parade Partnership Ltd*	Asia	6.1	42.1
Total Asia			**399.1**
US Military Housing, invested equity	America	-	209.1
Telecommunications infrastructure, invested equity	America	-	163.0
Telecommunication towers	America	-	N/A
Total Americas			**372.1**
Retail at Barangaroo & others	Various	Various	**115.1**
Total			**3,555.7**

Source: Company, OCBC estimates
**These are also under LLC's funds management platform*

Figure 31: EBITDA by activity



Source: Company

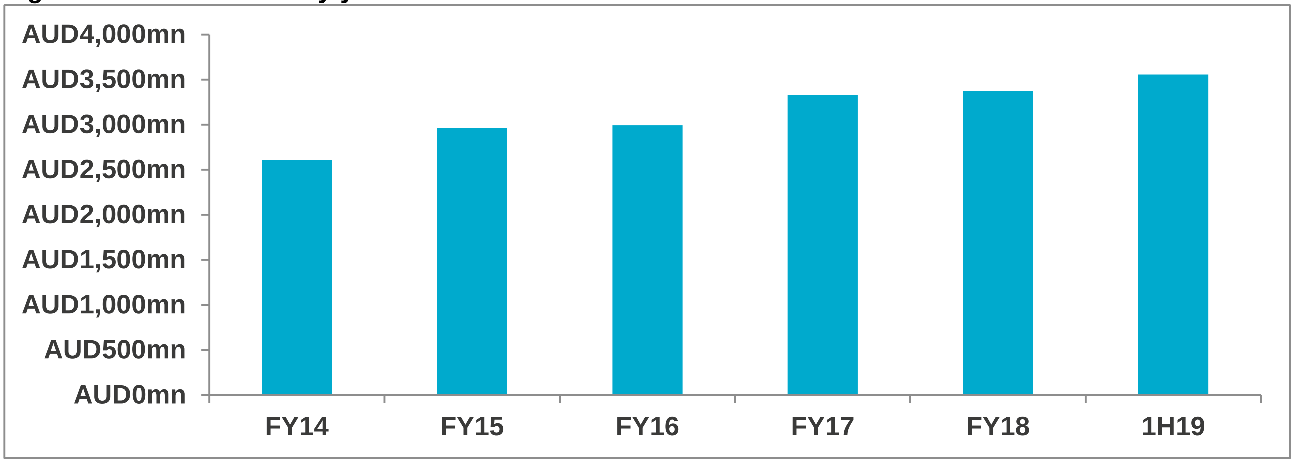
Figure 32: Funds under management ("FUM")

Fund under management	Geography	Asset class	AUD bn
Australian Prime Property Fund Retail	Australia	Retail	5.8
Australian Prime Property Fund Commercial	Australia	Office	5.0
Lendlease International Towers Sydney Trust	Australia	Office	4.4
Managed Investment Mandates	Australia	Various	4.0
Lendlease One International Towers Sydney Trust	Australia	Office	2.6
Australian Prime Property Fund Industrial	Australia	Industrial	1.0
Lendlease Sub Regional Retail Fund	Australia	Retail	0.6
Lendlease Public Infrastructure Investment Co	Australia	Social Infrastructure	0.4
Lendlease Real Estate Partners New Zealand	Australia	Retail	0.3
Total Australia			**24.1**
Managed Investment Mandate	Asia	Retail & Office	3.4
Lendlease Asian Retail Investment Fund	Asia	Retail	2.6
Parkway Parade Partnership Ltd	Asia	Retail	1.5
Lendlease Jem Partners Fund Ltd	Asia	Retail	0.5
Total Asia			**8.0**
Lendlease Retail LP	Europe	Retail	1.3
Lendlease Residential Investment Partnership	Europe	Residential	0.3
Total Europe			**1.6**
Lendlease Americas Residential Partnership	Americas	Residential	**0.4**
Total			**34.1**

Source: Company, OCBC

Continued growth in investments segment: Ownership interests (before revaluations) has grown steadily from AUD306mn in FY2016 to AUD355mn in FY2018 on the back of growth in total investments (FY2016: AUD3.0bn, FY2018: AUD3.4bn), which further grew to AUD3.56bn as of 1HFY2019. Moving forward, we expect further growth in total segments as the part of the development pipeline, especially the commercial projects, may join the investments segment (ie: LLC keeping stakes in the completed properties for investment purposes). In addition, operating earnings may follow the growth in FUM and AUM (less Military Housing), which has grown at 12.8% CAGR from FY2014 to 1HFY2019. According to LLC, there is AUD2.9bn of additional secured future FUM across LLC's development projects in delivery. Over FY2019-22, the bigger deliveries include Paya Lebar Quarter (net book value: AUD359.6mn), International Quarter London (AUD125.3mn), Melbourne Quarter (AUD49.4mn) and The Lifestyle Quarter (AUD361.6mn). In general, we think that the investments segment should generate growing and recurring cashflows though there may be short term blips. For example, LLC is looking to sell half the stake in Westfield Marion, which is Adelaide's biggest mall, following AUD2bn in redemption requests. We understand that LLC may, at specific dates, offer fund investors options to exit or reduce their positions in the fund.

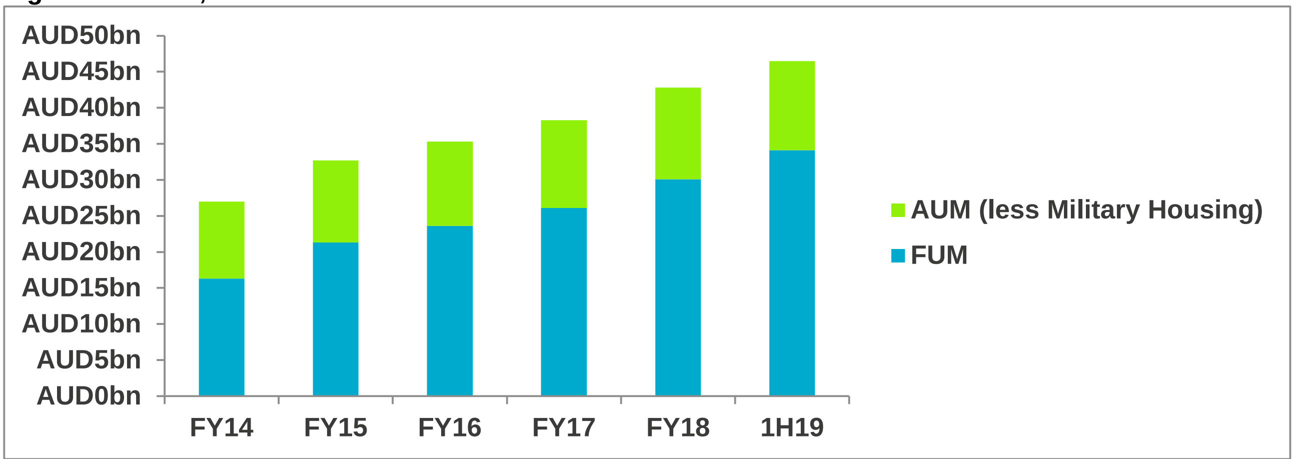
Figure 33: Investments by year



Source: Company

Monetization via REITs and partners: Thus far, LLC has a limited publicly listed platform to monetize assets held by itself and third party investors in its managed funds. That said, this may change as reported IFR Asia, LLC is looking to list its retail assets via a REIT listed on the SGX, which may raise USD500mn (~AUD700mn). In Singapore, LLC's completed retail projects include 313@somerset, Jem and Parkway Parade. We also would not preclude injecting non-Singapore assets into a potential REIT listed on the SGX. Equity partners offer another way for LLC to monetize its stakes – as demonstrated by LLC's sale of ~10%-stake in Lendlease One International Towers Sydney Trust.

Figure 34: AUM, FUM



Source: Company

Figure 35: Assets under management ("AUM")

AUM	**AUD bn**
Retail – Australia	7.6
Retail – Asia	4.9
Retail - Europe	0.8
Military Housing	13.3
Total	**26.6**

Source: Company

III) Financial Analysis

Dip in 1HFY2019 performance due to E&S, expect a better 2HFY2019: We calculate that LLC's EBITDA fell to negative AUD322.8mn in 1HFY2019 (FY2018: +AUD622.5mn), mainly due to the E&S business delivering a negative AUD473.7mn reported EBITDA due to underperforming projects. The decline was also due to the core segment (excluding E&S) with reported operating EBITDA (excluding E&S) falling 34% y/y to AUD645.4mn with dips in all 3 segments of Development (-41% y/y to AUD260.8mn), Construction (-24% y/y to AUD111.4mn) and Investments (-29% y/y to AUD273.2mn) though we are not worried and think 2HFY2019 should be stronger. For Development, this is mainly due to timing issue with LLC guiding for higher completions in 2HFY2019. For Construction, the results were down from a strong 1HFY2018 as 1HFY2019's results were in-line with the revised segment EBITDA margin target of 2-3%. Investments underperformed mainly from lower revaluations and sale of 25%-stake in the Retirement Living portfolio.

Good earnings visibility from investments segment to buffer earnings volatility in other segments: Excluding revaluations, we estimate that the recurring EBITDA portion of investments segment should amount to ~AUD400mn p.a. which covers 1HFY2019 gross interest expense (annualized) by 3.2x. Investments segment is targeted to contribute 35-45% of the total reported EBITDA, though the contribution in FY2018 is higher at 47.1% due to the underperformance in the E&S business which weighed down performance of the Construction segment. Overall, we think contribution from the Investments segment should provide some stability in earnings and buffer against volatility in other segments, for example due to timing issues.

Very long pipeline to provide sustainability of work: The pipeline is significant, with work that can last LLC through the next decade. The Development segment pipeline of AUD74.5bn covers FY2018's development revenue by 23.3x, which includes AUD34.5bn apartments pipeline, AUD24.8bn commercial pipeline and AUD15.1bn communities pipeline. While the Building business pipeline (under the Construction segment) of AUD14.8bn merely covers ~AUD10bn revenue p.a. by ~1.5x, we note that the Building segment has been consistent in securing new work.

Decent diversification by business segments with further diversification outside Australia: Looking at EBITDA over FY2014-18 (if we assume 1HFY2019's lackluster results to be one-off), LLC is diversified along the businesses of Development (segment EBITDA contribution as a total: 42.6%), Construction (19.0%) and Investments (38.4%). This is in-line with the revised target to achieve EBITDA mix of 40-50% (for Development), 10-20% (for Construction) and 35-45% (for Investments) respectively. While majority of EBITDA thus far has been concentrated in Australia (67.9%, over FY2014-18), we should see increasing proportion of contribution outside of Australia given that invested capital as a proportion in Australia has fallen to 54.3% in 1HFY2019. The pipeline of development work also suggests a swing outside of Australia, with Europe, Americas and Asia forming 58.3% of the total pipeline. We think this should partly mitigate against any potential slowdown in the Australian market (for example, Australia House Price Index Established Homes have fallen by 5.5% since its peak in Dec 2017).

Balance sheet lightened by capital efficient structures: Despite a large AUD74.5bn development pipeline, LLC's reported net gearing (defined as net debt to total tangible assets, less cash) is a mere 15.2% (our calculation of net gearing: 37%). Development properties inventories on the balance sheet is just AUD4.9bn; the pipeline is held in capital efficient structures (e.g. staged payments where LLC may not pay for full land price upfront, capital provided by partners), which frees up capital and reduces the drag on returns on capital. There is also flexibility on the timing and delivery, which allows LLC to ride the market cycles.

Significant amount of assets held under associates/JVs: We think entering into associates/JVs (worth AUD3.2bn on the balance sheet) is also another way for LLC to lighten the balance sheet while diversifying across projects. Furthermore, LLC holds only minority stakes in most of its AUD3.56bn in investments, with the significant exception being the 75%-stake in Retirement Living worth AUD1.36bn. We think divestments of these stakes may not be readily accessible to LLC as it does not necessarily hold sufficient control of these entities. In addition, we understand that most of the associates/JVs may hold substantial amount of debt. For example, as of 31 Dec 2018, Paya Lebar Quarter (which LLC has a 30%-stake worth AUD359.6mn) has a net gearing of 1.25x. The funds which LLC holds stakes in and count towards its FUM usually also hold debt. For example, Lendlease International Towers Sydney Trust (LLC: 15%-stake worth AUD555.8mn) has a reported gearing of 13.7%. That said, LLC does not disclose the quantum of contingent liabilities at the LLC group level, we think that it is unlikely for the LLC group to provide significant corporate guarantees. For example, LLC did not guarantee the SGD300mn bond issue (LLCAU 3.28% '21s) from Lend Lease Retail Investments 3 Pte Ltd (the entity which holds Jem).

Decent credit metrics: Reported net gearing rose to 15.2% h/h (end-FY2018: 8.2%) mainly due to increase in capital allocated to the Development segment with invested capital climbing to AUD5.1bn (FY2018: AUD4.3bn) to support the growth of the development pipeline, which grew to AUD74.5bn (end-FY2018: AUD71.1bn). In addition, AUD174.1mn worth of securities was purchased, which relates to the share buyback of LLC shares. We think it is unlikely for LLC to resume share buyback as reported net gearing has reached its target range. LLC guided that reported net gearing should continue to range between 10%-20%. On our calculated net gearing basis, the guidance should imply net gearing between 24.5% and 48.9%, which is still manageable in our view. With LLC guiding that results will be skewed towards 2HFY2019, we should expect cash inflows in 2HFY2019 with an expected AUD2.0bn of revenue from apartment settlements from ~2,200 units. Using FY2018's EBITDA (assuming 1HFY2019's poor results are one-off), EBITDA/Total Interest is healthy at 5.0x, with a manageable net debt/EBITDA at 1.9x. Reported interest cover (which LLC adjusts to exclude AUD500mn losses from the underperforming E&S projects) stands at 8.1x as of 1HFY2019 (FY2018: 10.7x), which remains healthy.

Ample liquidity: While LLC cancelled a AUD500mn bond issuance in Nov 2018 due to the announcement of the significant provisions in the E&S business, we think LLC retains access to sufficient liquidity. AUD1.09bn of cash should be sufficient for LLC to manage its operating cashflow needs, given that there is no short-term debt coming due. In addition, LLC has AUD1.02bn of undrawn facilities (AUD895.5mn in bank credit facilities, AUD124.1mn in bank overdrafts). Average cost of debt has fallen to 4.2% in 1HFY2019 (FY2018: 4.8%), though this is likely due to LLC removing hedges, with fixed debt proportion lower, accounting for just 59% of the total debt (FY2018: 86%). Meanwhile, debt maturity is termed out with an average debt maturity of 4.0 years.

IV) Technical Considerations

Positives

- External credit rating though the rating is borderline IG
- Limited new SGD issuances
- Recognisable name in Singapore with visible retail presence

Negatives

- Negative headlines from loss-making E&S business
- Strong recent price rally

Figure 36: Relative Value

Issue	Maturity	Ask Price	Ask YTW	I-Spread	Net debt/equity
LLCAU 3.9 '27	27/04/2027	99.95	3.91%	186bps	37%
CAPLSP 3.08 '27	19/10/2027	98.9	3.23%	115bps	56%
CITSP 3.48 '26	15/06/2026	102.1	3.15%	114bps	33%
WINGTA 4.7 '24	28/02/2024	103.85	3.83%	194bps	Net cash
SLHSP 4.5% '25	12/11/2025	105.3	3.59%	159bps	61%

**Indicative spreads based on offer prices from Bloomberg on 10/04/19*

In the SGD space, we do not find close comparables. That said, **we think LLCAU '27s is trading fair** around 3.9% against peers we rate at Neutral (4) Issuer Profile, which should trade just below 4% handle (e.g. SLHSP 4.5% '25s, WINGTA 4.7% '24s).

That said, for investors in the IG space looking for yield pickup, we think that LLCAU '27s look somewhat interesting when we compare against CAPLSP '27s and CITSP '26s as it yields higher despite having a similar or better net gearing ratio which we think compensates for the difference in credit profile. In addition, we think CapitaLand Ltd [Issuer Profile: Neutral (3)] and City Developments Ltd [Issuer Profile: Positive (2)] may continue push gearing higher. LLCAU '27s also has a Bloomberg Composite credit rating of "BBB-" while CAPLSP '27s and CITSP '26s are unrated.

V) Conclusion & Recommendation

LLC is a leading property company listed in Australia. While it is facing short-term headwinds from losses in the E&S business, we think that this should not prove to be a long-term drag as LLC is looking to reduce its risk from this segment. We like that LLC has a very long pipeline of development work ahead, which it has flexibility on the timing and delivery to ride market cycles. LLC also has significant earnings visibility coming also from its investments segment which is targeted to contribute 35%-45% of the total EBITDA. We estimate that the recurring EBITDA from the investments segment can cover interest expense by 3.2x. Meanwhile, credit metrics is decent with net gearing of 37%. **We initiate LLC with an Issuer Profile of Neutral (4).**

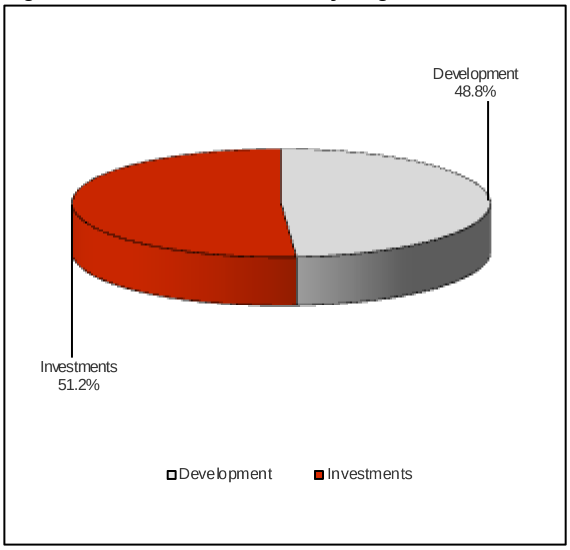
Lendlease Group

Table 1: Summary Financials

Year Ended 30th Jun	FY2017	FY2018	1H2019
Income Statement (AUD'mn)			
Revenue	16,659.0	16,556.1	7,761.7
EBITDA	860.1	622.5	-322.8
EBIT	761.9	515.9	-384.2
Gross interest expense	133.9	124.2	61.9
Profit Before Tax	1,007.0	1,066.2	-31.0
Net profit	758.7	793.6	15.7
Balance Sheet (AUD'mn)			
Cash and bank deposits	1,249.2	1,177.1	1,088.1
Total assets	20,854.2	16,963.6	17,457.6
Short term debt	291.9	474.8	0.0
Gross debt	2,152.4	2,358.5	3,364.1
Net debt	903.2	1,181.4	2,276.0
Shareholders' equity	6,166.5	6,414.2	6,106.8
Cash Flow (AUD'mn)			
CFO	256.5	181.8	-744.8
Capex	136.4	110.3	46.9
Acquisitions	501.7	561.3	219.5
Disposals	726.4	515.9	467.7
Dividend	337.9	372.0	190.2
Interest paid	-120.4	-122.1	-85.2
Free Cash Flow (FCF)	120.1	71.5	-791.7
Key Ratios			
EBITDA margin (%)	5.16	3.76	-4.16
Net margin (%)	4.55	4.79	0.20
Gross debt to EBITDA (x)	2.50	3.79	-5.21
Net debt to EBITDA (x)	1.05	1.90	-3.53
Gross Debt to Equity (x)	0.35	0.37	0.55
Net Debt to Equity (x)	0.15	0.18	0.37
Gross debt/total assets (x)	0.10	0.14	0.19
Net debt/total assets (x)	0.04	0.07	0.13
Cash/current borrowings (x)	4.28	2.48	NM
EBITDA/Total Interest (x)	6.42	5.01	-5.21

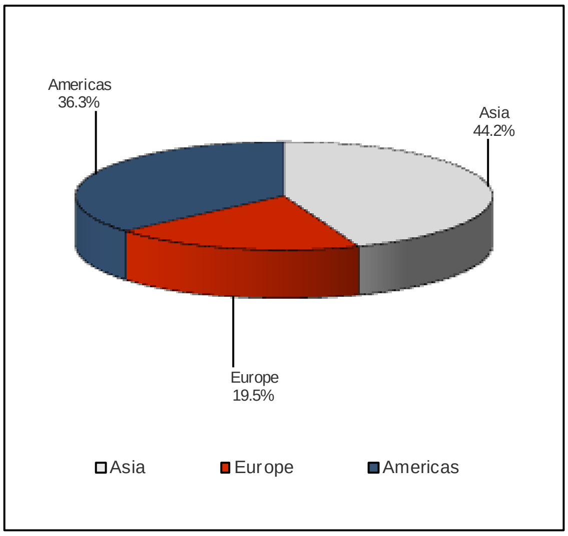
Source: Company, OCBC estimates

Figure 1: EBITDA breakdown by Segment - 1H2019



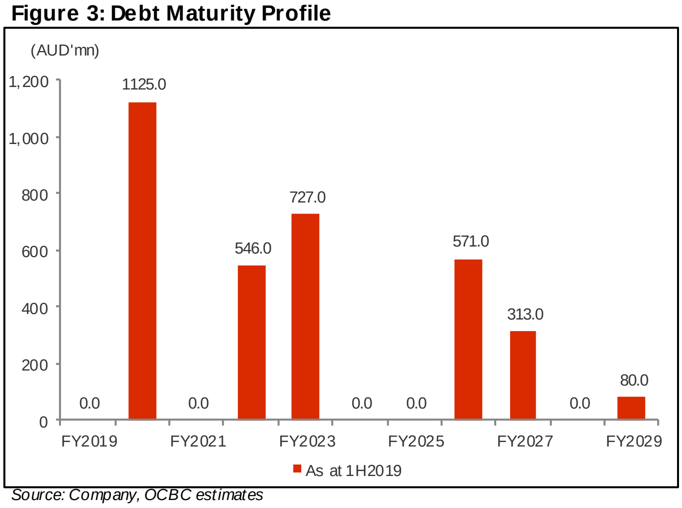
Source: Company | Excludes Corporate Activities, Construction was loss-making

Figure 2: EBITDA breakdown by Geography - 1H2019



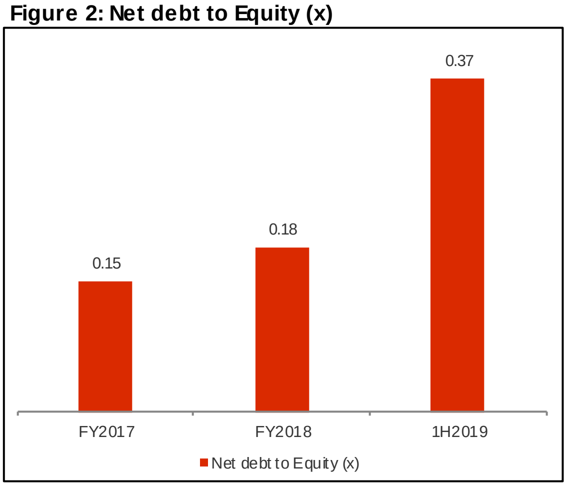
Source: Company | Excludes Corporate Activities, Australia was loss-making

Figure 3: Debt Maturity Profile



Source: Company, OCBC estimates

Figure 2: Net debt to Equity (x)



Source: Company

OCBC Global Treasury	
Treasury Advisory **Corporate FX & Structured Products** Tel: 6349-1888 / 1881 **Interest Rate Derivatives** Tel: 6349-1899 **Investments & Structured Products** Tel: 6349-1886 **GT Institutional Sales** Tel: 6349-1810	**Credit Research** **Andrew Wong** +65 6530 4736 WongVKAM@ocbc.com **Ezien Hoo, CFA** +65 6722 2215 EzienHoo@ocbc.com **Wong Hong Wei, CFA** +65 6722 2533 wonghongwei@ocbc.com **Seow Zhi Qi** +65 6530 7348 ZhiQiSeow@ocbc.com

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.

The credit research team would like to acknowledge and give due credit to the contributions of Ferlicia Leow Soh Koon

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.

Disclaimer for research report
This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

This report is intended for your sole use and information. By accepting this report, you agree that you shall not share, communicate, distribute, deliver a copy of or otherwise disclose in any way all or any part of this report or any information contained herein (such report, part thereof and information, “**Relevant Materials**”) to any person or entity (including, without limitation, any overseas office, affiliate, parent entity, subsidiary entity or related entity) (any such person or entity, a “**Relevant Entity**”) in breach of any law, rule, regulation, guidance or similar. In particular, you agree not to share, communicate, distribute, deliver or otherwise disclose any Relevant Materials to any Relevant Entity that is subject to the Markets in Financial Instruments Directive (2014/65/EU) (“**MiFID**”) and the EU’s Markets in Financial Instruments Regulation (600/2014) (“**MiFIR**”) (together referred to as “**MiFID II**”), or any part thereof, as implemented in any jurisdiction. No member of the OCBC Group shall be liable or responsible for the compliance by you or any Relevant Entity with any law, rule, regulation, guidance or similar (including, without limitation, MiFID II, as implemented in any jurisdiction).

Co.Reg.no.:193200032W