Asia Credit Research

First Sponsor Group Ltd: Credit Update

Thursday, 11 August 2016

In for a penny, in for a pound

- **Healthy 2Q2016 results:** FSG reported a 40.8% increase in revenue y/y to SGD42.2mn but gross profit was down 11.5% y/y to SGD14.0mn. In line with the first quarter, strong revenue contribution from the sale of development properties (242 residential units, 17 commercial units and 49 car park lots in the Millennium Waterfront project) and full-quarter contribution from the Zuiderhof I and Arena Towers investment properties dampened the sharp y/y fall in property financing revenue, which fell by 90.7%. The shift in revenue mix, together with higher sales costs recognized from development properties, contributed to the weaker gross profit performance in 2Q2016. Overall Q22016 gross profit margin declined to 33.3% from 53% in Q22015 due to the lack of high-margin property financing income. Whilst profit was healthy, FSG took a large hit in translation differences from RMB weakness, leading to a wider loss in comprehensive income of SGD24.5mn against a SGD8.6mn loss y/y (no cash flow impact). In 1H2016, EBITDA/Gross interest was 3.3x, declining largely from the lack of income from property financing (LTM2016: 10.4x). However, balance sheet remains steady with FSG's gross debt-to-equity ratio at 0.4x. We focus on the debt-to-equity ratio (vs. net debt-to-equity), given that cash receipts from pre-sales are an implicit form of financing with a corresponding liability item (in line with market practice among property developers in China).

- **Dutch income a plus:** Despite only contributing 18% to total assets as at 30 June 2016, the company generates ~SGD5mn per quarter (2Q2015: SGD5.3mn) in recurrent income from the Netherlands. Such income consist of rental from Zuiderhof I, Arena Towers and a loan extended to FSG's 33% associated company in the Netherlands. Barring any large sales of Dutch investment properties, such income will persist over the term of FSG's bond. Following the non-recognition of interest income from its Chinese property financing portfolio, FSG's profit before tax has declined to ~SGD13mn in 2Q2016. We take comfort that recurrent income from the Netherlands provides ~40% of PBT and 2.5x coverage to interest expense, particularly more so given the inherent cash flow lumpiness in property development. FSG will deepen its developmental activities in the Netherlands through the re-development of Boompjes (Rotterdam), Terminal Noord (The Hague) and in time, may enter into greenfield developments.

- **Dongguan to be next growth engine within China:** To date, FSG has launched three residential plots within the Millennium Waterfront Project, Chengdu, totaling 5,928 residential units, of these ~72% have been sold/pre-sold. The company will start construction and pre-sales of plot D in 2H2016. Plot D is targeted to comprise 1,274 residential units, albeit smaller than earlier launched units. Our base case assumes that FSG is able to generate at least SGD200mn more in top line from plot D and the remaining unsold units. Assuming sales of 90 units a month, inventory will be fully sold within the next 2.5 years. FSG is on track to commence phase 1 construction of the Star of East project in Dongguan this year. The company has been approached by interested parties to collaborate on the Dongguan project and such proposals are currently being evaluated (no firm transaction as of report date). Despite the red-hot housing market in Dongguan (y/y price increase of 35%), we are inclined to view a de-risking of the Dongguan project as a credit positive. This is pertinent in light of uncertainties surrounding policies to curb asset bubbles in China, particularly in cities which have seen strong price growth.

Treasury Advisory
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Interest Rate Derivatives
Tel: 6349-1899
Investments & Structured Products
Tel: 6349-1886

GT Institutional Sales
Tel: 6349-1810

OCBC Credit Research
Ezien Hoo, CFA
+65 6722 2215
EzienHoo@ocbc.com

- **Recoveries from property financing business provides optionality:** As at 30 June 2016, total property financing loan portfolio amounted to SGD148.7mn. 88% of these are problematic loans of which the company is pursuing legal proceedings against the borrowers. The company remains confident that they are able to recoup fully on such loans (including interests in arrears and penalty interest). Per company, these loans are secured against high quality China-based properties and under a typical timeline for recovery, could be made-whole by next year. Financial flexibility at FSG is manageable and we have based our analysis on the company assuming a worst case scenario where there is no resolution of the problem loans by June 2018 (maturity date of the bonds). As such the successful recovery from the property financing portfolio provides upside potential to its credit profile.

- **Recommendation:** The next call date on FSGSP'18s is in June 2017@101. We think that the existence of certain contingent events, including new opportunities in Europe, the recovery of entrusted loans and possible deferments on the Wenjiang government loan means that it is likelier that FSG will opt to conserve cash than to call the bond come June 2017. We think there is upside potential on the bond and hence are Overweight the bonds. The bonds currently have a YTW of 640 bps. We retain our Neutral issuer profile on the company.

First Sponsor Group Ltd

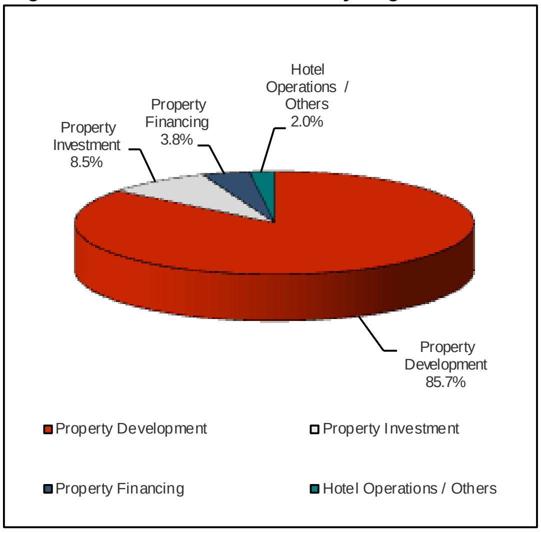
Table 1: Summary Financials

Year Ended 31st Dec	FY2014	FY2015	1H2016
Income Statement (SGD'mn)			
Revenue	153.2	215.0	87.8
EBITDA	35.8	71.5	12.8
EBIT	34.4	69.8	12.1
Gross interest expense	2.1	4.6	3.9
Profit Before Tax	40.5	91.0	29.0
Net profit	21.7	67.4	20.8
Balance Sheet (SGD'mn)			
Cash and bank deposits	131.8	112.0	132.2
Total assets	1,293.0	1,800.8	1,618.2
Gross debt	83.0	477.1	388.9
Net debt	-48.8	365.1	256.8
Shareholders' equity	894.5	978.1	923.1
Total capitalization	977.5	1,455.2	1,312.0
Net capitalization	845.7	1,343.2	1,179.9
Cash Flow (SGD'mn)			
Funds from operations (FFO)	23.1	69.0	21.6
CFO	-252.3	-67.1	-9.4
Capex	33.0	33.7	28.3
Acquisitions	0.2	172.8	0.0
Disposals	14.9	4.9	0.4
Dividends	0.0	11.5	5.9
Free Cash Flow (FCF)	-285.3	-100.8	-37.7
* FCF Adjusted	-270.6	-280.2	-43.2
Key Ratios			
EBITDA margin (%)	23.4	33.2	14.6
Net margin (%)	14.2	31.3	23.7
Gross debt to EBITDA (x)	2.3	6.7	15.2
Net debt to EBITDA (x)	-1.4	5.1	10.0
Gross Debt to Equity (x)	0.1	0.5	0.4
Net Debt to Equity (x)	-0.1	0.4	0.3
Gross debt/total capitalisation (%)	8.5	32.8	29.6
Net debt/net capitalisation (%)	-5.8	27.2	21.8
Cash/current borrowings (x)	NM	0.5	1.5
EBITDA/Total Interest (x)	17.0	15.4	3.3

Source: Company, OCBC estimates

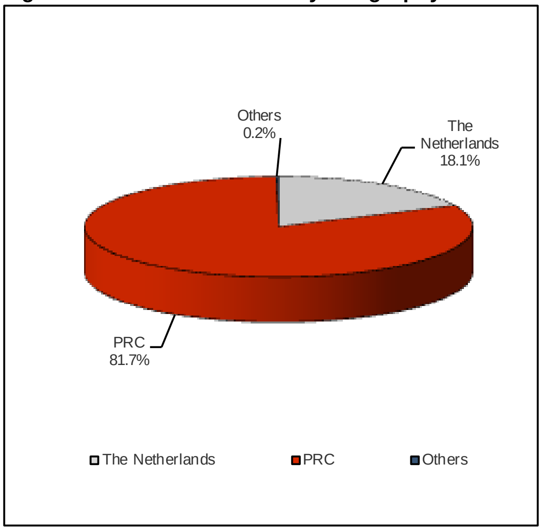
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals*

Figure 1: Revenue breakdown by Segment - 1H2016



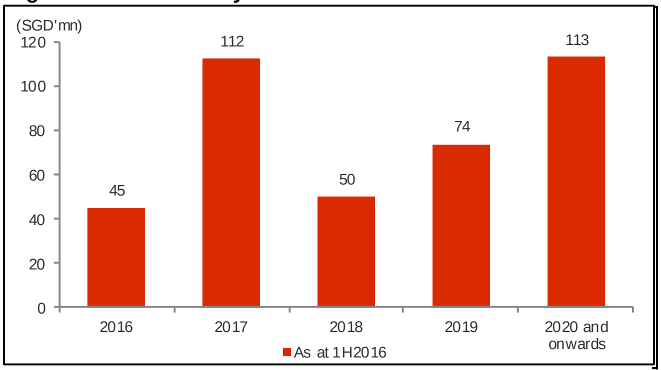
Source: Company

Figure 2: Asset breakdown by Geography - 1H2016



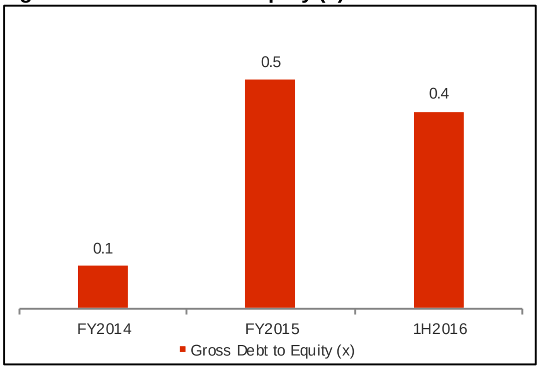
Source: Company

Figure 3: Debt Maturity Profile



Source: Company

Figure 4: Gross Debt to Equity (x)



Source: Company, OCBC estimates