Asia Credit Research

Earnings Review: City Developments Ltd ("CDL")

Recommendation

- We think CDL's poorer 4Q2018 is a blip mainly due to the timing of property sale and impairments at its 65%-owned M&C. Post Jul 2018 property cooling measures, property sales are moving at a moderate pace though we remain cautious still given the subdued property outlook.
- That said, CDL's credit profile remains anchored with 58.7% of its assets producing recurring income and CDL is targeting to scale the reported EBITDA contribution from this segment further to SGD900mn p.a by 2028 (2018: SGD530mn).
- However, given the ambition for growth and to lift ROE (which has fallen to 5.6%), CDL may tap further on its still relatively prudent balance sheet for acquisitions. Already, net gearing rose y/y to 32.9% (2017: 10.7%) on the back of SGD2.5bn acquisitions made in 2018. We continue to hold CDL at Positive (2) Issuer Profile, albeit precariously, as its credit profile remains supported by recurring income. We may review CDL's Issuer Profile if credit metrics continue to soften.
- In general, we still think that the CITSP curve looks more attractive than the CAPLSP curve given the former's credit metrics look healthier, with a stronger Issuer Profile of Positive (2) than CapitaLand Ltd (Issuer Profile: Neutral (3)).

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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Relative Value:

Bond	Maturity/Call date	Net Gearing	Ask Yield	Spread
CITSP 3% '20s	27/10/2020	33%	2.69%	71bps
CITSP 2.93% '21s	24/03/2021	33%	2.77%	79bps
CITSP 3.78% '24s	21/10/2024	33%	3.16%	107bps
CITSP 3.48% '26s	15/06/2026	33%	3.39%	121bps
CAPLSP 4.3% '20	31/08/2020	56%	2.62%	63bps
CAPLSP 3.8% '24s	28/08/2024	56%	3.18%	111bps
CAPLSP 3.08% '27s	19/10/2027	56%	3.50%	126bps

Indicative prices as at 27 Feb 2019 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Lower revenue due to timing of property sale…**: CDL reported 4Q2018 results. Revenue fell 40.6% y/y to SGD788.3mn, mainly from the fall in property development revenue (-74% y/y to SGD197mn) due to the absence of contribution from The Brownstone EC (which contributed to revenue in entirety upon TOP in 4Q2017, as opposed to progressive recognition). Hotel operations revenue was largely stable at SGD452.9mn (4Q2017: SGD450.2mn). Meanwhile, rental properties revenue rose (+19.4% y/y to SGD102.8mn) following the acquisition of Aldgate House (worth SGD328mn) and 125 Old Broad Street (SGD683mn) in the UK, as well as the reopening of Le Grove Serviced Apartments (Jul 2018) and opening of Hong Leong City Centre, Suzhou ("HLCC)'s retail mall (Jun 2018).

- **… with impairments pushing results lower though partly mitigated by strong rental performance**: Overall, profit before tax ("PBT") fell 50.4% y/y to SGD110.6mn, falling more than revenue. The dip in contribution from property development (-41.7% y/y to SGD103.1mn) is mainly due to the fall in revenue. However, hotel operations PBT fell to a negative SGD53.2mn (4Q2017: +SGD1.4mn) mainly due to a larger y/y impairment loss of SGD94.1mn (4Q2017: SGD52.2mn of impairments) made on hotels in the US and poorer UK hotels performance impacted by Brexit, which impacted the number of corporate guests from Europe. We note a significant amount of impairments worth GBP36mn (SGD64.3mn) were done at the ~65%-owned M&C level. Meanwhile, rental properties saw an increase of 45.9% y/y to SGD58.0mn on the back of increased revenue though it rose more relative to revenue growth due to contribution from its First Sponsor Group Ltd associate. Also CDL wrote back a provision where it

earlier provided interest support for Profit Participation Securities 2 platform following the divestment of two office buildings.

- **Property sales moving along at a moderate pace…:** On the Singapore residential development front, sales at Whistler Grand is decent with 260 units sold out of 300 units launched, though there is a further 416 units that remains to be sold. According to CDL, 87% of buyers are Singaporeans, who are mainly first-time home buyers. South Beach Residences also sold decently with 53 units moved out of 75 units released. However, the 33%-owned The Jovell sold only 58 units out of 250 units released.

- **… though we are cautious on the Singapore property still:** As mentioned in our Credit Outlook 2019, the outlook of Singapore residential property is subdued. As such, we are maintaining caution over CDL's planned launches in 2019, especially the high end ones (which may not attract sufficient Singapore buyers). These include 80%-stake in 592 unit Amber Park, 100%-stake in 188-unit Haus on Handy and 40%-stake in 154-unit Boulevard 88. CDL will also be launching the 680-unit Sengkang Central and 820-unit Sumang Walk though we are less concerned as these should be targeted to the mass market. If the Singapore development segment slows, this will have a significant impact. The segment contributed SGD429mn out of SGD1.19bn reported EBITDA in 2018 and represented SGD5.68bn out of SGD20.8bn of total assets. That said, any impact should be cushioned by recurring income. 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.

- **Growing recurring income to provide stability to the portfolio:** Recurring reported EBITDA has fallen to SGD530mn in 2018 (2017: SGD599mn), coming mainly from hotel operations (SGD192mn) and rental properties (SGD303mn). We compute recurring EBITDA to total interest coverage at 3.9x, which looks manageable. That said, CDL continues to reiterate the target to reach SGD900mn in recurring income by 2028 – which CDL has made some progressed through SGD2.5bn of acquisitions and investments in 2018. Assets allocated to recurring income segment represents SGD12.1bn out of SGD20.8bn of total assets.

- **Watch out on credit metrics given plenty of debt headroom with an ambition for growth**: Net gearing rose to 32.9% (3Q2018: 24.4%) in spite of SGD278.9mn cash generated from operating activities due to SGD981.4mn consideration paid for acquisitions, which includes 125 Old Broad Street, Central Mall Office Tower and Hotel Cerretani Florence. CDL also recorded SGD69.1mn in purchase of plant, property and equipment (4Q2017: SGD29.9mn) which we think is likely due to AEI works at Republic Plaza, expected to complete in 2H2019. If fair value gains on investment properties are included, CDL has more debt headroom as net gearing would fall to 23%. This debt headroom could be tempting to tap on, given that (1) ROE has fallen to 5.6% in 2018 (2017: 5.6%, 2016: 7.0%) and (2) CDL has made explicit ambitions to grow its recurring income. We may review CDL's Issuer Profile rating if net gearing continues to rise substantially.

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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.

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