Asia Credit Research

Credit Update: City Developments Ltd ("CDL")

Issuer Profile: Neutral (3)

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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Recommendation

- 1Q2019 results look lackluster with lower revenue (-29.5% y/y to SGD746.2mn) mainly due to absence of contribution from The Criterion EC, which obtained TOP in Feb 2018. While hotel operations continue to post soft results with a small pre-tax loss, this is buffered by growth in the rental segment which resulted in revenues from recurring sources (hotel, rental) remaining flattish y/y.
- Decent sales rate have been achieved for Singapore development properties though we are still somewhat cautious as the pipeline remains significant amidst a weak property market, which may cap prices and hence margins.
- The biggest mover this quarter is the acquisition of 24% effective stake in Sincere Property Group and 70%-stake in a Hongqiao Property, which totals RMB6.7bn (SGD1.35bn). While we remain comfortable with CDL's credit profile, **we are lowering CDL's issuer profile from Positive (2) to Neutral (3)**. We expect credit metrics to soften with net gearing rising to ~42% (1Q2019: 36%) with its credit metrics no longer meeting Positive (2) under our Issuer Profile Score ("IPS") scale.
- As a result, we are no longer Overweight on most of the CITSP curve and have moved the bonds to Neutral. That said, we still prefer the CITSP curve over CAPLSP curve given the wider spreads of the CITSP curve. We similarly hold CapitaLand Ltd's issuer profile at Neutral (3). Alternatively, investors may consider WHEELK 4.5% '21s - we rate Wheelock & Co Ltd at Positive (2) Issuer Profile.

Relative Value:

Bond	Maturity/Call date	Net Gearing	Ask Yield	Spread
CITSP 3% '20s	27/10/2020	36%	2.58%	66bps
CITSP 2.93% '21s	24/03/2021	36%	2.66%	76bps
CITSP 3.78% '24s	21/10/2024	36%	3.04%	108bps
CITSP 3.48% '26s	15/06/2026	36%	3.19%	115bps
CAPLSP 4.3% '20	31/08/2020	58%	2.34%	42bps
CAPLSP 3.8% '24s	28/08/2024	58%	2.88%	93bps
CAPLSP 3.08% '27s	19/10/2027	58%	3.22%	110bps
WHEELK 4.5% '21s	02/09/2021	24%	2.64%	75bps

Indicative prices as at 17 May 2019 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Weaker results with lower contribution from development segment**: Revenue declined 29.5% y/y to SGD746.2mn in 1Q2019, mainly due to decline in the property development segment (-56% y/y to SGD250mn) due to the absence of contribution from The Criterion EC which obtained TOP in Feb 2018. Excluding The Criterion EC's contribution to 1Q2018 results, revenue in 1Q2019 would have rose 6% y/y. We calculate that EBITDA fell 6.2% y/y to SGD277.2mn. Despite weaker EBITDA and revenue, net profit rose 51.9% y/y to SGD211.5mn as (1) CDL recorded SGD144.3mn gain from divestment of Manulife Centre in relation to the second Profit Participation Securities (set up in 2015) and (2) share of after-tax profit of JVs rose to SGD33.5mn (1Q2018: SGD2.8mn) due to contribution from South Beach Residences.

- **Weaker hospitality segment buffered by rental properties**: Overall, revenue from recurring sources (hospitality, rental) remained flattish at SGD463mn in 1Q2019. Rental properties revenue rose to SGD103mn in 1Q2019 (1Q2018: SGD84mn) due to 3 buildings acquired in 2H2018 (Aldgate House, 125 Old Broad Street, Central Mall Office Tower) as well as the re-opening of Le Grove Serviced Residences and Hong Leong City Center. Pre-tax profit surged to SGD181mn (1Q2018: SGD61mn) mainly due to gain from divestment of Manulife Centre. However, Hotel Operations revenue dipped 4.8% y/y to SGD360mn, with a corresponding SGD1.9mn pre-tax loss (1Q2018: pre-tax profit: SGD20.8mn) due to weakening of GBP while Millennium Hotel London Mayfair and Dhevanafushi Maldives luxury Resort and a number of hotels in London and Singapore were closed for refurbishment.

- **Decent residential sales achieved:** Decent sales rate was achieved at Boulevard 88 (40%-stake by CDL), which was launched in 1Q2019 and sold 47 units out of 60 units released (154 total units) for over SGD400mn (SGD3,700 psf). Amber Park (80%-stake) sold 115 units out of 150 released units (592 total units) earlier this month for SGD313mn (SGD2,425 psf). Such sales figures look decent though it remains to be seen if sales rate can be sustained if pricing for the unsold units can be moved higher to support margins. Encouragingly, New Futura (121 units sold out of 124 units total) and The Tapestry (619 units sold out of 861 units total) are largely sold. Over the quarter, CDL also moved more units at Whistler Grand (100%-owned, 60 more units sold q/q), South Beach Residences (50.1%-owned, 22 units more units sold q/q). Going forward, CDL will also be launching the 680-unit Sengkang Central and 820-unit Sumang Walk – we are less concerned about these as these should be more easily moved with lower potential price points. However, we remain somewhat cautious as The Jovell (33%-stake) is still largely unsold (353 units out of 428 total units remaining) while Haus on Handy (100%-stake, 188 units) has yet to launch.

- **Sincerely interested in China, looking to scale bigger**: CDL announced that it will be acquiring ~24% effective stake in Sincere Property Group ("Sincere") via new money (ie: existing shareholders of Sincere gets diluted). Sincere's other shareholders are Greenland Holdings (stake to be below 20%, pending discussion) and Sincere Holdings (~56%). The total consideration is RMB5.5bn (SGD1.1bn), which comprises share subscription and loan to Sincere. Sincere is one of China's top 100 developers with RMB21.3bn contracted sales in 2018, 7 retail malls in operation (GFA: 400k sqm) and 7 under development (GFA: 300k sqm). In total, RMB24bn (SGD4.85bn) pre-sold revenue will be booked from 2019-21 upon handover. Sincere holds 12.6mn sqm in land bank, of which 85% by area is in Tier 2 cities. In addition to the 24%-stake in Sincere, CDL will also acquire a 70%-stake in Shanghai Hongqiao Sincere Centre (Phase 2), a prime commercial asset, from Sincere for RMB1.2bn (SGD247mn). Collectively, the investment outlay for Sincere-related transactions amount to RMB6.7bn (SGD1.35bn). In total, the transactions will increase CDL's exposure in China to ~RMB3bn by asset, which forms 15% of CDL's total assets (from 9%).

- **Weaker credit metrics, further deterioration may be expected with ambition to grow**: Net gearing rose to 36.2% q/q (4Q2018: 32.9%) as CDL granted SGD657.9mn advances to Sincere (another SGD0.4bn in investment outlay to go). We expect net gearing to rise to ~42% when the acquisitions of Sincere, Shanghai Hongqiao Sincere Centre (Phase 2) and residential site at Sims Drive (SGD383.5mn) complete. Even if fair value gains are taken into account (noting that CDL has yet to revalue certain properties), we estimate that net gearing will still increase beyond 30% (1Q2019: 27%). We also note that net debt/EBITDA (Net debt based on 1Q2019, EBITDA based on full year 2018) has deteriorated q/q to 2.8x (4Q2018: 2.5x), which we estimate to further deteriorate to over 3x when the transactions complete while the Singapore property market continue to look lacklustre. We will also not rule out the possibility that CDL will undertake further significant acquisitions (noting that CDL has been on an acquisition path since 2018), given that (1) ROE has fallen to 5.6% in 2018 (2017: 5.6%, 2016: 7.0%), (2) CDL has made explicit ambitions to grow its full year recurring income to SGD900mn by 2028 (2018 recurring EBITDA: SGD530mn) and (3) we think CDL still has further debt headroom to continue acquiring. In view of the weakened credit metrics, we lower **CDL's Issuer Profile from Positive (2) to Neutral (3)**.

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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
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