FitchRatings

RATING ACTION COMMENTARY

# Fitch Affirms Ciputra Development at 'B+'; Outlook Stable

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Fitch Ratings - Singapore - 24 Nov 2021: Fitch Ratings has affirmed Indonesia-based property developer PT Ciputra Development Tbk's (CTRA) Long-Term Issuer Default Rating (IDR) at 'B+' with Stable Outlook. The agency has also affirmed the long-term rating on CTRA's SGD150 million unsecured notes due 2 February 2026 at 'B+' and its Recovery Rating at RR4'. A full list of the rating actions is at the end of this commentary.

The affirmation with Stable Outlook reflects our expectation that CTRA will maintain steady performance in the next 12-18 months. CTRA's IDR is constrained by its small operating scale compared to higher-rated peers, whereby we do not expect its attributable presales (excluding the share of presales attributable to minority owners) to rise above IDR5 trillion in the next two years.

## KEY RATING DRIVERS

Scale Constrains Rating: We forecast CTRA's attributable presales to rise to IDR4.5 trillion in 2021 and around IDR4.8 trillion in 2022. The company will need to sustain attributable presales of more than IDR5 trillion before Fitch would consider a rating upgrade.

Steady Performance Amid Challenges: CTRA's attributable presales rose 40% yoy to IDR3.5 trillion in 9M21 - a strong result given it was achieved amid tight mobility restrictions over July-August 2021, which limited large-scale project launches. We expect landed homes priced under IDR2 billion to continue to drive presales, supported by end-user demand, domestic interest rates at all-time lows and an improving operating environment.

Sales of homes priced above IDR2 billion also improved in the last few quarters, which we attribute to the wealth effect from strong prices for key export commodities. In addition, CTRA's sales have benefitted significantly from the Value Added Tax (VAT) rebate on completed homes effective from 1 March 2021 to 31 December 2021. The extension of the VAT rebate is uncertain, but we expect a better operating environment, with vaccination rates steadily rising, which will allow CTRA to launch a steady stream of projects, mitigating the risk of lower presales.

Mortgages Boost Cash Collections: We expect CTRA's cash flow from operations (CFFO) to improve in 2021-2022 due to improving presales, as well as a higher mix of mortgage loan-funded sales. Looser rules on mortgage loans, which were enacted in early 2021 and allow banks to disburse up to 90% of loans to developers up front, have been a key driver of stronger cash collections.

CTRA reported consolidated cash collections of IDR6.3 trillion in 9M21, up 40% yoy, with mortgage-funded sales rising to 58% from 50% over the period, displacing instalment-funded sales. Rising interest rates pose a threat to housing demand over the longer term. However, we do not expect domestic interest rates to rise more than 50bp next year, which should not derail housing demand given interest rates have fallen by 150bp since early 2020.

Significant Ratings Headroom: We expect CTRA's homebuilder leverage - defined as net debt/adjusted inventory - to remain at around 15% in the next 12-18 months (end-September 2021: 14%), as we think the company will maintain a cautious approach to land banking and capex until there is more visibility around a sustained economic recovery. Its leverage is well below the 45% level where we would consider negative rating action. Consequently, CTRA has significant headroom for investments, but we expect a measured approach in line with its track record.

Neutral Free Cash Flows: Fitch has assumed that CTRA will pay out all of its profits in the form of dividends such that free cash flows (FCF) remain neutral to marginally negative in 2022-2024, which is much higher than the 10%-15% pay-out ratio seen historically. This is because the company has not announced any specific expansion or acquisition plans, and we believe it is unlikely that CTRA will continue to operate at the current low leverage over the longer term, should strong cash collections continue amid a sustained economic recovery.

Risks to Non-Development Income: Uneven vaccination rates across Indonesia pose a risk to the recovery of CTRA's non-development cash flows, which mainly stem from shopping malls and hotels. CTRA's hospitals have partly offset the weakness in malls and hotels due to high demand for Covid-19 tests and related care, while non-Covid-19 revenue has rebounded. Non-development revenue fell to 18% of total revenue in 9M21, but we think it will return to around 25% from 2023, which was the level prior to 2020, if the pandemic is brought under control.

Large Land Bank; Joint Operations: CTRA owns more than 2,300 hectares of land, with a large presence in the main urban areas of Greater Jakarta and Greater Surabaya. The large land bank ensures project longevity and healthy cash flows, especially amid rising land prices. CTRA develops projects with other land owners on a profit- or revenue-sharing basis. CTRA reports joint operations on a proportionally consolidated basis, while Fitch proportionally consolidates its key joint ventures (JVs) - reported on equity method - when calculating credit metrics. The JVs have very limited debt and cash.

## DERIVATION SUMMARY

CTRA's rating may be compared with PT Pakuwon Jati Tbk (BB/Stable), PT Bumi Serpong Damai Tbk (BSD; BB-/Stable), PT Lippo Karawaci Tbk (B-/Stable), and PT Kawasan Industri Jababeka Tbk (KIJA, B-/ Stable).

Pakuwon is one of Indonesia's leading mixed-use property developers with the majority of its operating cash flows stemming from its large investment-property portfolio of shopping malls, hotels and offices. Pakuwon is rated two notches higher than CTRA because of its large non-development cash flows and more conservative capital structure, which supports strong credit metrics during downturns in property demand. This offsets Pakuwon's smaller property-development business than CTRA, which Pakuwon manages prudently with most of its construction funded by customer presales, rather than debt.

BSD is rated one notch above CTRA to reflect its larger property-development scale, with attributable presales expected to be sustained at more than IDR 5.5 trillion in the medium term. This is despite CTRA's property-development business being more geographically diversified than BSD's business, which draws most of its presales from the Tangerang region in Greater Jakarta. Both issuers have a track record of maintaining low leverage and strong liquidity.

CTRA is rated two notches higher than Lippo and KIJA to reflect its larger operating scale with attributable presales forecast to remain above IDR4.5 trillion in the next two years versus Lippo at around IDR3 trillion and KIJA at under IDR1 trillion. CTRA's larger scale manifests in greater geographic and price-point diversity than these peers.

Both Lippo and KIJA also have higher leverage than CTRA, with Lippo's free cash flows under pressure due to a high interest-cost burden. KIJA's rating is supported by its non-development EBITDA that covers the entirety of its interest costs, despite its small property-development business.

## KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Attributable presales (excluding minority interests' share of presales) of IDR4.5 trillion in 2021, and IDR4.7 trillion in 2022

- Attributable cash collections of IDR5.7 trillion in 2021 and IDR5.9 trillion in 2022

- Attributable construction costs of IDR2.5 trillion in 2021 and IDR2.6 trillion in 2022

- Attributable land acquisition spending of IDR400 billion-500 billion in 2021-2022

- Dividends rising to IDR1.6 trillion in 2022 and IDR1.8 trillion in 2023 such that FCF is neutral to marginally negative. Alternatively, FCF may be channelled towards growth if the operating environment remains conducive, in Fitch's view.

KEY RECOVERY RATING ASSUMPTIONS

- The recovery analysis assumes CTRA will be liquidated in a bankruptcy rather than continue as a going concern because it is an asset-trading company

- To estimate liquidation value, we assume a 75% advance rate against the value of accounts receivable and a 50% advance rate against aggregate value of inventory, investment in associates, advances paid for land, net of contract liabilities, unearned revenues and tenant deposits.

- We assume a 100% advance rate against land for development, given the reported book value is around IDR339,000/sqm, which is conservative compared with the reported average selling price of land bank of around IDR7.1 million/sqm as of 30 September 2021.

- We have assumed 100% advance rate against the net book value of investment properties, because our estimate of the market value of CTRA's shopping malls and offices, which is based on what we believe are stressed capitalisation rates of 10%-11% in the current environment is well above net book value.

- We assume that CTRA's approximately IDR7.98 trillion in secured bank loans outstanding as of 30 September 2021 will rank prior to its SGD150 million senior unsecured notes in a liquidation

- We have deducted 10% of the resulting liquidation value for administrative claims

- The above estimates result in a recovery rate corresponding to an 'RR1' Recovery Rating for CTRA's senior unsecured notes. Nevertheless, we have rated the senior notes 'B+' with a Recovery Rating of 'RR4' because, under Fitch's Country-Specific Treatment of Recovery Ratings Rating Criteria, Indonesia falls into 'Group D' of creditor friendliness. Instrument ratings of issuers with assets in this group are subject to a soft cap at the issuer's IDR and Recovery Rating of 'RR4'.

## RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Attributable presales sustained above IDR5 trillion

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Attributable presales sustained below IDR3.5 trillion

Net debt / adjusted inventory sustained above 45%, so long as non-development gross profits before depreciation and amortisation / net interest cost is sustained at or above 1.0x

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

## LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity, Diversified Funding: As of 30 September 2021, CTRA reported IDR6.5 trillion in cash and cash equivalents and large committed undrawn bank facilities, compared to IDR789 billion of current debt maturities due in the next 12 months. The near-term maturities include short-term working capital funding of IDR290 billion, which we expect will be rolled over by lenders over the normal course of business. We forecast CTRA's operating cash flows to remain strong, but FCF to remain neutral based on our assumption that the company will either expand its investments prudently to capitalise on expected economic growth and maintain an efficient capital structure, or pay higher shareholder dividends, rather than let cash accumulate.

CTRA has the most diversified funding sources among rated Indonesian developers in terms of access to domestic banks with its cross-border unsecured medium-term notes accounting for just 17% of total debt. The company issued a new SGD150 million 6% unsecured medium-term note due in February 2026 to prepay an existing note, which was due in September 2021.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

## RATING ACTIONS

| ENTITY / DEBT | RATING | | | RECOVERY | PRIOR |
|---|---|---|---|---|---|
| PT Ciputra Development Tbk | LT IDR | B+ Rating Outlook Stable | Affirmed | | B+ Rating Outlook Stable |

| | | | | | |
|---|---|---|---|---|---|
| senior unsecured | LT | B+ | Affirmed | RR4 | B+ |

VIEW ADDITIONAL RATING DETAILS

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## APPLICABLE CRITERIA

Parent and Subsidiary Linkage Rating Criteria (pub. 26 Aug 2020)

Country-Specific Treatment of Recovery Ratings Criteria (pub. 06 Jan 2021)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 16 Oct 2021) (including rating assumption sensitivity)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 16 Oct 2021)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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| | |
|---|---|
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