

Chip Eng Seng Corporation Ltd

Challenges in operating environment to persist

SINGAPORE | REAL ESTATE | UPDATE (CHANGE OF ANALYST)

14 March 2016

- Encouraging performance at Alexandra Park Hotel despite headwinds in the hospitality sector.
- Challenging environment ahead for properties construction sector and excess supply of local unsold properties could continue lead to weak properties sales.
- A key catalyst to watch for is the unwinding of property cooling measures in Singapore which CES is likely to be a major beneficiary.
- Maintain **accumulate** but revised our target price down to \$0.72 (previous S\$1.04).

What's the news?

- **Buoyant sales of units in local development, High Park Residences and Williamson Estate in Australia.** Both developments are almost completely sold as at Dec-15, booking in healthy development margins according to our projections. In addition, Land bank with marketing materials and planning permit in Melbourne is to be sold for double its purchase price back in 2013.
- **Legal held-ups at Tower Melbourne still ongoing.** The Victorian Civil and Administrative Tribunal has struck out the cancellation application of the development's planning permit in Mar-15. We will monitor closely and provide updates as they become available.
- **Reversed plans to spin off construction segment for the time being.** Plans for the restructuring of its construction arm through a spin-off was called off in Feb-16, quoting challenging market conditions are among factors that prompted for the reversal.
- **Visibility of sustaining current dividends to 2020.** Including only the progressive recognition of revenue and development profits from High Park Residences until its TOP (~\$32m/year), translating to an EPS of \$0.04 which matches the DPS of \$0.04 (excluding special dividends) for the past 6 years.

FY15 results summary

- **FY15 earnings declined 77.6% to \$63m** mainly as a result of lower contribution from property development segment, as the bulk of revenue from previously launched projects has already been recognised in the previous year.
- **The construction segment booked in 8.5% lower revenue of \$305.8m** due to lesser active projects in the year.
- **New hotel segment contribution.** The drop in revenue performance was partially offset by maiden contribution from the hospitality segment from Alexandra Park Hotel which began operations in May-15.
- **Rental income from property investments were up 54.6% to \$9.1m** driven by rental contribution from CES Centre which was incepted in 1Q15.

Investment Action

Taking into account of the challenging operating environment in the key business segments which CES is principally engaged, namely construction, property development and the hospitality sectors, we have assigned a higher discount of 50% to our RNAV estimates.

However, earnings from previously sold developments provide some degree of dividend sustainability (dividend yield of 5.7% based on a closing price of \$0.69) for investors and any weakness in price presents opportunities for investors to accumulate. Along with a change of analyst, we maintain a rating of **accumulate** and have revised our target price down to **\$0.72** (previous S\$1.04).

ACCUMULATE (Maintained)

LAST DONE PRICE	SGD 0.685
FORECAST DIV	SGD 0.040
TARGET PRICE	SGD 0.720
TOTAL RETURN	10.9%

COMPANY DATA

O/S SHARES (MN) :	621
MARKET CAP (USD mn / SGD mn) :	310 / 425
52 - WK HI/LO (SGD) :	0.96 / 0.57
3M Average Daily T/O (mn) :	0.39

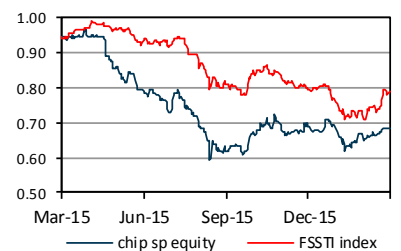
MAJOR SHAREHOLDERS (%)

LIM TIAM SENG	12.5%
LIM CHUAN TIANG	7.1%
CHIA LEE MENG	4.1%
KENYON PTE LTD	4.0%

PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	2.2	(2.1)	(24.2)
STIRETURN	8.9	(10)	(14.4)

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Mar	FY 14	FY 15	FY 16 E
Gross Rev. (SGD mn)	1,105.7	676.5	542.6
Gross Profit (SGD mn)	332.5	161.5	97.7
Net Income (SGD mn)	272.2	57.2	26.5
P/B (x)	0.72	0.59	0.60
DPS (Cents)	4.00	6.00	4.00
Dividend Yield, %	4.7	5.6	5.6

Source: Company Data, PSR est.

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Company Background

Chip Eng Seng (CES) is one of Singapore's leading main contractors and property developers, and listed on the SGX Mainboard since 1999. It started as a subcontractor firm for conventional landed properties in the 1960s, and has since built up a good reputation for quality and reliability. In 1982, CES won its first HDB project as a main contractor, which eventually paved the way to it being awarded the contract for the iconic Pinnacle @ Duxton, which has since been completed. CES is principally engaged in the following business segments, namely real estate development, construction, hospitality and property investment.

Property Development

Singapore

Buoyant sales in High Park Residences. High Park Residences which was launched in 2Q15, clocked in strong sales despite the weak property market where the condominium has already been more than 94% sold till date. Based on our estimates, we expect development margin to come in the ~24% territory, potentially allowing the group to book in a development profit of around \$160.9m over the next few years till TOP is obtained.

Sales expected to be weak in Fulcrum. First launched in 2012, Fulcrum registered weak sales amid the enlarging supply of private properties in Singapore. We are expecting re-launch prices to be significantly below the average selling prices of the previous units sold (~\$2000 psf), as there are still plenty of unsold units (3Q15: 6,058, 4Q15: 5,786) in the market. Furthermore, developers that are due for qualifying certificate (QC) this year may adjust prices downwards in order to move units faster.

Fulcrum has obtained TOP last month and the management intends to re-launch the development in 2Q16, entailing that the group has 18 months post-launch, to clear the remaining 87% of unsold units before QC is due.

In contrast to High Park Residences, Fulcrum is a freehold condominium located at Fort Road (district 15) and consist mainly of larger units (>76 sqm). The required purchase quantum is significantly higher compared to smaller units, thereby increasing the difficulty to obtain loan approvals amid the total debt servicing ratio (TDSR) and mortgage servicing ratio (MSR) requirements.

Successful land tender at Tanah Merah area. The group has successfully tendered for a land parcel at New Upper Changi Road/ Bedok South Avenue 3 (Parcel B) at a price of \$419.4m, translating into a unit land cost of \$761 psf. We estimate that average selling price per square feet is likely to be in the \$1300 psf territory and margins in the range of 15-18% based on the most recent transaction prices of a nearby development, Eco which has been 97% sold since launch.

Although the company has not disclosed information pertaining to the potential development in the site area, however, we are expecting the development to house relatively smaller units like High Park Residences (average 807 sqft), which increases the affordability of these units. The lower quantum requirement should help loosen homebuyers on financing arrangements bounded by the TDSR and MSR requirements.

Australia

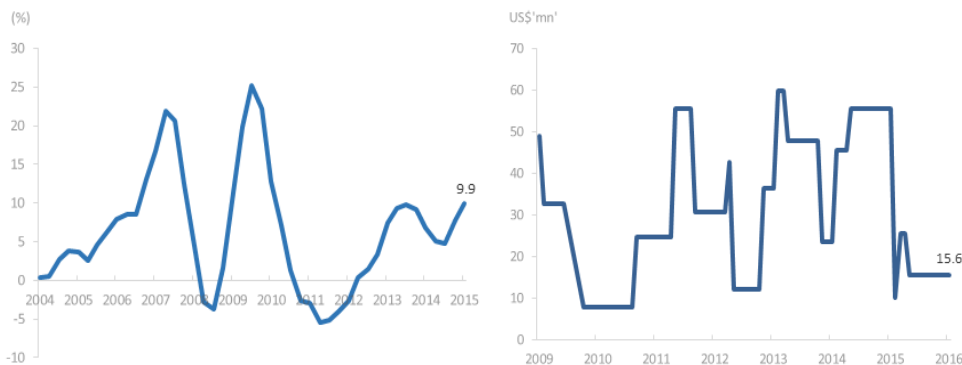
Almost all units are sold in Williamson Estate. Since its launch in Jan-15, Williamson Estate which is a development consisting of townhouses has locked in more than 98% of sales by 4Q15. Our estimates suggest that development margin should be in the region of ~25%, despite the cheaper land prices compared to Singapore but is however offset by higher construction costs.

Upcoming settlement for the sale of land with planning permit at 170 Victoria Street. The sales and purchase agreement to sell the 2,927 sqm land site, with an existing 2-storey heritage building as well as planning permit and marketing materials, was entered in Mar-15 for A\$64.8m. The land site was originally purchased in Apr-13 for A\$32m and the settlement date for the land sale is on 26 Mar-16.

We note that residential land sales has seen robust growth in the past two years where the volume of land sales peaked in Jun-14 while land prices continue to grow, suggesting that the land availability in the market is declining.

Soft demand for Willow Apartments. Housed under the same land site area as Williamson Estate, Willow Apartments is slated to be launched in 1Q16. We are less positive about the Melbourne residential market despite the surging Melbourne property market, as transaction volume has been decelerating in the past few months.

Figure 1 & 2 YOY growth of Melbourne property prices and transaction volume



Source: Bloomberg, Phillip Securities Research (Singapore)

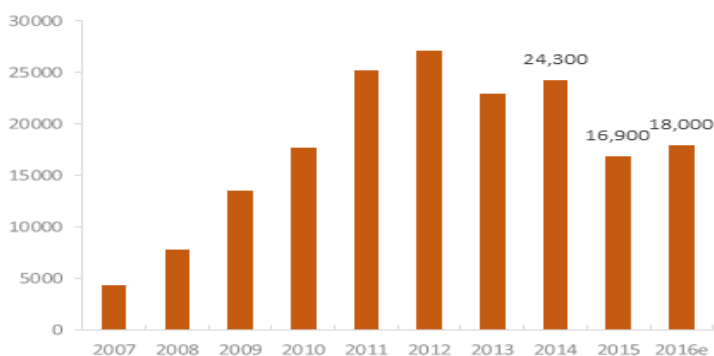
Legal held-ups at Tower Melbourne still ongoing. The latest update on the legal status of Tower Melbourne (TM) development was through now an announcement in Mar-15, stating that the Victorian Civil and Administrative Tribunal has struck out the cancellation application of the development's planning permit.

We acknowledge that there are uncertainties towards whether the development can be completed on time and subsequently affect the group's revenue recognition. As such, our estimates have excluded the potential development profits to be booked from TM until more clarity is in sight. We expect development profits from the development to add \$0.053 in our RNAV/share projection.

Construction

Challenging environment ahead from lesser supply of new HDB projects. Current order book shrank to \$570.1m from \$622.2m in 4Q14 due to lesser number of active projects. The group's solid track record as a main contractor for HDB projects puts it in good stead to tender for new built-to-order (BTO) projects. However, the supply of new BTO projects is expected to maintain or decelerate further amid a large supply of BTO projects released between 2011 and 2014. HDB's projected new BTO launches in 2016 is 18,000 compared to 16,900 in 2015.

Figure 3. Number of new BTO Launches in Singapore

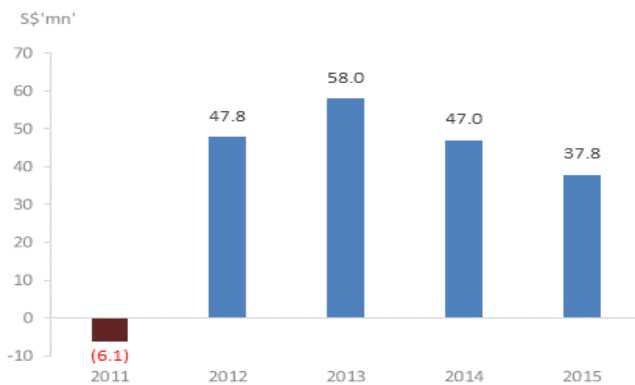


Source: HDB, Phillip Securities Research (Singapore)

Margin compressions expected as residential construction demand wanes. Residential construction activities remain lacklustre as the excess supply of unsold private properties has led developers to adopt a cautious stance towards new property development. Consequently, we anticipate public project tenders to be increasingly competitive amid the challenging landscape.

Reversed plans to spin off construction segment for the time being. Plans for the restructuring of its construction arm through a spin-off was called off in Feb-16, quoting challenging market conditions are among factors that prompted for the reversal. We are of the view that even if a spin-off was to proceed, valuations of the construction arm is unlikely to be attractive as net asset value (NAV) of the segment has been dropping for the past years.

Figure 4. Historical NAV of construction segment



Source: Company data, Phillip Securities Research (Singapore)

Hospitality

Encouraging performance at Alexandra Park Hotel despite headwinds in the hospitality sector. Alexandra Park Hotel began operations in May-15 and has delivered a revenue of \$14.1m for the seven-month period which was slightly below our expectations, due to weaker operating statistics amid headwinds in the hospitality sector.

We opine that booking in a RevPAR of >\$125 (average occupancy rate: 85%, average daily room rate: \$150) moving forward is achievable despite the soft corporate demand, translating to a break even occupancy rate of ~65%. This is attributed to the scarcity of hotel facilities within the locality which is in close proximity to business parks such as Alexandra Business Park, Biopolis and Fusionpolis etc.

Visitors returning but oversupply of rooms persists. While the growth in international visitor arrivals turned the corner and saw a marginal yoy growth of 0.9% in 2015 (2014: -3% yoy), however, average daily room rates will likely carry on to be pressured by new rooms entering the market. As a result, we have revised our forecast downwards on the hotel's operating performance.

The hotel room supply in Singapore is estimated to grow at a CAGR of between 3.9% over the next three years. It will still take some time before the growth in visitor arrivals could catch up with the upcoming new rooms.

Investment Properties

Maiden contribution from CES Centre. The leasing of CES Centre, a 12-storey commercial office building located in the fringe of the CBD with a total gross floor area of 131.9K sqft, began in 1Q15 after obtaining TOP in Dec-14. The investment property contributed \$3.2 million in gross rental, working out to be ~\$3.2 psf/month after excluding rental contribution from two floors which the group currently occupies.

Comparing the psf rental to nearby commercial buildings such as My Manhattan and Thong Cai Building, despite being older establishments, are commanding rental of at least \$4 psf/month and upwards, suggests that there is some room for higher rental reversions going forward.

May turn overseas for acquisitions amid softening commercial rental space market in Singapore. The growing supply of office units where 4.6m new office units are expected to be completed in 2016, coupled with uncertainties in the economic environment, are factors likely to weaken rental going further.

In view of the softening local commercial rental market, we expect the group to look abroad into other markets in particular, the Australian market where the commercial rental market is still witnessing strong growth.

Potential Catalysts

Settlement of legal issue for TM before the exercise of sunset clause. The construction for TM is projected to last for 48 months. The sunset clause for TM states that the latest date of hand over of units is in end 2020. This means that as long as the legal issue reaches a conclusion by this year, the completion of construction and subsequently handing over of TM would allow full recognition of the revenue and development profits (adding \$0.053 in our RNAV/share projection) generated from the sale of TM. TM has already been fully sold.

Unwinding of property cooling measures in Singapore. CES is likely to be a major beneficiary on the unwinding of property cooling measures in Singapore. 1) ASP of new property development project in Tanah Merah as well as sales momentum of Fulcrum are likely to be bolstered, potentially expanding development profit margin. 2) The rejuvenation of demand for property investments is likely to fuel property development and consequently construction activities. Given the group's established track record and reputation as a main contractor, allows it to be well-positioned to clinch new construction contracts. 3) As a result, a recovery in the construction sector could lift valuations of its construction arm, rekindling the probability of a spin off.

Peer Comparison

BB Ticker	Name	Mkt Cap (SGD)	Last Px (SGD)	P/E	ROE	ROA	Dividend Yield	P/B	Gearing
CHIP SP Equity	CHIP ENG SENG CORP LTD	425.4	0.69	7	8.5	3.2	5.7	0.6	45.0
			Peers' average		21.2	8.8	6.5	0.9	26.7
SOIL SP Equity	SOILBUILD CONSTRUCTION GROUP	156.6	0.24	8.5	25.7	12.6	8.5	1.8	N.A.
HLSH SP Equity	HOCK LIAN SENG HOLDINGS LTD	198.9	0.39	2.2	51.8	23.2	10.3	0.9	4.6
BOCJ SP Equity	BOUSTEAD PROJECTS LTD	214.4	0.67	8.4	-	-	-	0.8	30.6
LBG SP Equity	LIAN BENG GROUP LTD	222.9	0.45	1.8	28.5	10.5	6.7	0.4	28.4
KSHH SP Equity	KSH HOLDINGS LTD	226.3	0.51	3.7	23.5	11.7	5.5	0.7	23.0
WHUR SP Equity	WEE HUR HOLDINGS LTD	243.6	0.27	4.0	15.6	6.8	10.4	0.8	15.9
KOH SP Equity	KOH BROTHERS GROUP LTD	116.2	0.28	4.2	11.3	4.2	2.9	0.5	33.2
LKH SP Equity	LOW KENG HUAT SINGAPORE LTD	435.9	0.59	5.1	14.9	5.7	8.5	0.7	27.8
UEM SP Equity	UNITED ENGINEERS LTD	1,331.8	2.09	13.4	5.6	2.2	2.4	0.7	32.2
TEE SP Equity	TEE INTERNATIONAL LTD	115.6	0.23	8.5	13.9	2.5	3.0	1.2	44.6

Source: Bloomberg, Phillip Securities Research (Singapore)

Figure 5. RNAV Table

RNAV Valuation (S\$ m)	Valuation (S\$ m)
NAV as at 31 Dec 2015	743.0
Development surplus (Singapore)	116.2
Development surplus (Australia)	38.3
RNAV	897.5
Shares outstanding (m)	621.0
RNAV per share (S\$)	1.445
Discount (%)	50%
Target Price(S\$)	0.723
Current price (S\$)	0.680
Upside/(downside), (%)	6.3%

Source: PSR

Financials

Income Statement

Y/E Dec, SGD mn	FY13	FY14	FY15	FY16E	FY17E
Revenue	502	1,106	676	543	552
Cost of Sales	-413	-773	-515	-445	-453
Other Items of Income					
Int & Div Income	2	40	5	10	9
Other Income	15	40	5	10	9
Other Items of Expense					
Marketing & Distribution	-21	-6	-28	-8	-8
Administrative Expenses	-28	-57	-57	-57	-58
Finance Costs	-2	-4	-16	-12	-13
Share of Results of Associates	30	17	1	0.4	0.2
Profit Before Tax	85	324	68	33	32
Income Tax Expense	-12	-43	-10	-7	-6
Net Income	73	281	63	21	20

Cash Flow

Y/E Dec, SGD mn	FY13	FY14	FY15	FY16E	FY17E
Profit Before Tax	85	324	68	33	32
Depreciation & Amortization	3	4	6	6	6
Other Non-cash items	-75	-35	-10	30	30
OCF Before Changes in WC	14	293	64	69	68
Trade & Other Receivables	23	-128	-27	48	-4
Trade & Other Payables	-7	-193	16	-5	2
Inventories	-107	-38	288	97	177
Net interest expense	-0.4	0.5	-13.9	-9.9	-10.4
Income Taxes Paid	-2	-3	-16	-12	-13
Other Items Combined	-47	-297	-74	-106	-110
Cashflow from Operations	-114	-74	300	150	177
PPE & Investment Properties	-18	-56	-21	2	-11
Other Items Combined	12	-2	3	0	0
Cashflow from Investing	-6	-59	-18	2	-11
Loans & Borrowings	307	172	-82	-50	64
Dividends Paid	-26	-26	-37	-25	-25
Other Items Combined	-119	-13	-5	0	0
Cashflow from Financing	162	133	-124	-75	39
Increase in Cash & Equivalents	42	1	157	77	205
Cash & Equivalents (Beginning)	242	284	285	442	520
Cash & Equivalents (Ending)	284	285	442	520	725

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

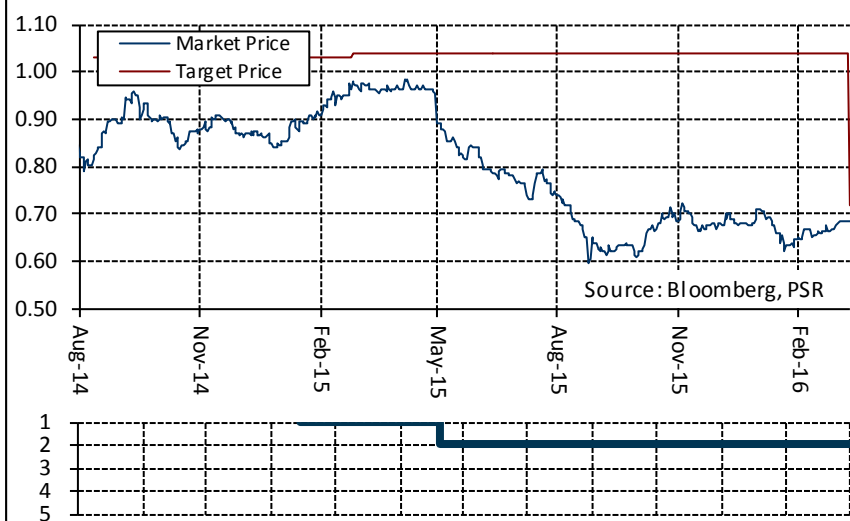
Balance Sheet

Y/E Dec, SGD mn	FY13	FY14	FY15	FY16E	FY17E
Property, Plant & Equipment	162	214	225	217	222
Investment Properties	186	294	287	279	284
Other Non-current Assets	31	22	23	16	14
Non-Current Assets	380	529	536	512	520
Development Properties	651	924	625	529	352
Completed ppty held-for-sale	0	40	39	39	39
Trade & Other Receivables	129	216	249	201	204
Cash & Short-Term Deposits	284	285	442	520	725
Other Current Assets	20	14	15	15	15
Current Assets	1,085	1,480	1,371	1,303	1,335
Total Assets	1,465	2,008	1,907	1,815	1,855
Loans & Borrowings	281	2	120	103	99
Trade & Other Payables	108	111	117	111	113
Other Liabilities	76	131	80	86	93
Current Liabilities	464	244	317	301	305
Loans & Borrowings	488	938	738	705	773
Deferred Tax Liabilities	15	8	16	16	16
Non-Current Liabilities	502	946	754	721	789
Total Liabilities	966	1,272	1,164	1,069	1,118
Non-Controlling Interests	0	0	-5	0	6
Shareholder Equity	499	736	743	747	738

Ratios

Y/E Dec	FY14	FY15	FY16E	FY17E
Valuations, Growth & Margins (%)				
Valuations				
P/B	0.9	0.6	0.6	0.6
Dividend Yield	4.7	5.7	5.7	5.7
Growth				
Revenue	120%	-39%	-20%	2%
Net Income	283%	-78%	-67%	-5%
Shareholder Equity	48%	1%	1%	-1%
Margins				
Gross Profit Margin	18%	30%	24%	18%
Net Profit Margin	9%	24%	9%	4%

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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