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HD **Corporate: FCL digests Australand amid market unease**

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Frasers Centrepoint Ltd's acquisition of Australand has widened the scope of its business, but the hefty price it paid could come back to haunt it, especially if strategists calling the top of the Australian **property** market turn out to be right.

Lim Ee Seng, CEO of FCL, told analysts and reporters at the **company**'s recent results briefing that the opportunity to expand regionally by acquiring Australand was too good to pass up. "We had been planning on achieving several key strategic initiatives over the medium term, such as more overseas income and recurring income as well as enhancing our operating platform in Australia, and this acquisition ticked all the boxes," he said. "We had an organic plan to achieve our medium-term objective but this would have taken five to 10 years to reach. This acquisition helps to achieve our target immediately, bringing forward our five-year plan."

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Why the hurry to expand in a mature market like Australia? Lim says the country has "favourable fundamentals" such as transparent regulations and strong corporate governance. And, while growth in a developed market is bound to be slower than in an emerging one, Australand has a scaleable business, he adds. "With scale and depth, we can do much more in Australia. This is what the acquisition is all about."

Chia Khong Shoong, chief financial officer of FCL, adds that Australand has steady cash flows, which could help boost FCL's financial stability. Australand was a stapled security, comprising a **property** trust and a developer. In 1HFY2014, its investment **property** portfolio contributed A$97.8 million ($108.7 million) or 76% to total earnings before interest and tax (Ebit). A further A$38.8 million came from its **residential**, **commercial** and industrial developments.

"When we bought it, one of the reasons was for its recurring income," Chia says. He adds that FCL has been exploring the expansion of its real **estate** investment trust (REIT) platform. However, the **group** wants to ensure that the rest of the **group** is capable of generating recurring income too. "It's a balancing act that we think we can manage quite well."

Yet, the relatively high price that FCL paid for Australand and the sheer size of the acquisition have some market watchers worrying that the **group** might have bitten off more than it can chew. FCL paid A$4.48 per stapled security for Australand, or a total of A$2.6 billion. That was 6% more than Australand's shareholders' funds of A$2.4 billion as at June 30. Most Singapore-listed **property** groups currently trade at discounts of 25% to 40% to their net asset value (NAV). FCL is trading at a 26% discount to its book value of $2.23.

As at Sept 30, FCL's net debt-to-equity ratio stood at 0.95 times, versus 0.57 times a year ago. "Our position reflects the acquisition of Australand and $600 million of perpetual securities issued in September," Chia says. The perpetuals were part of FCL's medium-term note programme that was upsized to $3 billion from $1 billion during an extraordinary general meeting on Nov 12.

Another concern is that FCL funded the acquisition of Australand largely with Singapore dollar debt, resulting in a currency mismatch between its debt and assets. As at Sept 30, some 42% of FCL's assets were in Australia. Yet, Australian dollar debt accounted for only 30% of its total debt. Since the acquisition of Australand was completed in September, the Australian dollar has depreciated 4% against the Singapore dollar. According to Chia, for every 1% change in the value of the Australian dollar against the Singapore dollar, FCL's portfolio sees a $25 million to $30 million change.

Other concerns that have cropped up include the likelihood that the tax benefits Australand enjoyed as a stapled security will no longer apply now that it is completely owned by FCL. **Property** trusts generally have greater tax transparency than companies. FCL's management has also indicated it will revalue Australand's assets only once every two years instead of annually, to keep costs down. As the last revaluation was done in June, the next one will not be due until 2016. Yet, accounting rules require that the goodwill FCL is carrying be tested for impairment annually. As at Sept 30, FCL had intangible assets of $510 million, which analysts attribute mainly to the acquisition of Australand.

Addressing concerns

Chia sought to put these concerns to rest during FCL's recent results briefing. For starters, he denies that the **group** now has too much debt. "Given the capital-intensive nature of our industry, we believe a sensible level of gearing is… about 0.8 to 1 times," he says. Moreover, FCL plans to issue a further $600 million worth of perpetual securities, which would lower its gearing ratio from the current 0.95 times.

Chia also points out that FCL itself has $2.1 billion of unrecognised revenues from presales, and there is a further $1 billion of unrecognised revenues at Australand. As these are booked as revenue and earnings, it would lower the **group**'s gearing ratio. "Most of this will come in the next 24 to 30 months," Chia says. On top of that, FCL might raise additional cash by offloading some of its assets into its REITs. "We talked about Alexandra Point as a potential divestment," Chia says. Frasers **Commercial** Trust has a right of first refusal to Alexandra Point, which is valued at $289 million.

As for the currency mismatch between its debt and assets, Chia indicates that the FCL **group** is looking at the matter. "We will, over time, look at making adjustments to this position," he says. "What we do hedge is the income and cash flows." He promises that there will be disclosure on this matter in FCL's next annual report.

Chia also says FCL will not necessarily suffer significantly higher taxes after acquiring Australand, despite the loss of some tax benefits at the Australian unit. "We are going to achieve fairly similar tax outcomes as to what it was before. It may not be as proficient, but we could get most of the way there," he says.

Stable in Singapore

Meanwhile, FCL is not doing too badly in Singapore. This year, it managed to sell some 480 **residential** units from various developments. "Sales continue to move. All our current projects are over 95% **sold**," says CEO Lim. "We are one of the most efficient developers and are able to launch a project within six to eight months of acquiring a plot of land."

That quick turnaround means FCL's projects tend to have a high level of presales before construction even starts. "A high level of presales means we can fund construction costs with progress payments," Lim says. However, FCL has less room to do this with projects in overseas markets such as **China** and Australia, where the development has to be completed before the **company** can book any revenue and earnings.

At any one point, FCL aims to hold sufficient land for 1½ years of supply, or around 1,500 units. Last year, FCL paid $1.43 billion, or $1,077 psf per plot ratio (ppr) for a **site** in Yishun that has been named Northpoint City. Construction starts next year, and when completed, it will have 900 **residential** units atop a shopping mall that will be integrated with Northpoint 1 and Northpoint 2. "The mall at Northpoint City will be integrated with the two malls Northpoint 1 and 2 to form a new mall with half a million sq ft of leasable area," Lim says proudly.

Separately, FCL is developing an 800,000 sq ft Grade-A office block on Cecil Street, which could be completed as early as 2017. FCL acquired this **site** in August last year for $924 million, of $1,112 psf ppr.

At the moment, FCL has limited exposure to **China**. It is developing a logistics hub in Chengdu, and a **residential** project in Suzhou. It is also developing a township in Songjiang, outside Shanghai, now called Gemdale Megacity. Previously, FCL held a 100% stake, but divested 55% to Gemdale, after which it was able to move sales.

Lim says FCL is approaching **China** cautiously amid the turmoil in its **property** sector, but emphasises that the **company** cannot avoid trying to become a player in that market. "**China** is one country in Asia that we cannot ignore, because of the trends of rapid urbanisation and rising wealth," he says, adding that the volatility could last for the next two to three years. “Building a base in **China** from bottom up takes a long time and is not easy, and one of the best ways is to find partners you can work with.”

Analysts cautious

Many analysts are expecting a placement of FCL shares soon. Thai billionaire Charoen Sirivadhanabhakdi now controls around 88% of the **company** and needs to loosen his grip to boost the shareholding spread. Some market watchers expect to see some heavy trading of the stock and a rise in its market price ahead of the exercise.

Yet, few analysts are making strong calls on FCL. In fact, although its results briefing on Nov 13 was very well attended, only two reports have been issued so far. One is from DBS Vickers and the other is from CIMB. Both research houses are recommending “buys” on the stock.

For its financial year to Sept 30, FCL reported a 30.7% decline in earnings to $500.7 million on a 33.2% rise in revenues to $2.7 billion. The **company** declared total dividends of 8.6 cents per share for the year, which translates into a yield of 5.2%. The dividends for FY2014 represented a payout ratio of 50% The **company**’s policy is to pay out as much as 75% of earnings. “We have calibrated the payout, so we hope not to disappoint,” Chia says.

CIMB forecasts a 14% rise in earnings to $571.7 million for FY2015. Shares in FCL are up 10.7% since they listed by way of introduction in February. At current levels, they are trading at 8.25 times forward earnings, and about 0.73 times FY2014 NAV of $2.23 per share. CIMB has a price target of $2.11, representing a 30% discount to FCL’s estimated RNAV $3.02.

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