MITA No. 013/06/2008

27 March 2009

IReinitiate coverage

HOLD

S$5.29

Fair Value: S$5.43

Stock Code:	
Reuters:	CTDM.SI
ISIN Code	C09
Bloomberg:	CIT SP
Event:	Reinitiate Coverage

General Data	
Issued Capital (m)	909
Mkt Cap (Sm/USm)	4,810/ 3,190
Major Shareholder	
Hong Leong	(48.6%)
Aberdeen Asset Mgmt	(13.0%)
Free Float (%)	51.2
NAV per share (S$)	5.97
Daily Vol 3-mth ('000)	3,450
52Wk High (S$)	12.670
52Wk Low (S$)	4.050

Foo Sze Ming
(65) 6531 9810
e-mail: FooSzeMing@ocbc-research.com

City Developments Ltd

Still a gem among peers

Strong balance sheet to withstand turmoil. At the end of 4Q08, City Developments (CDL) has a cash holding of S$775.9m and total borrowings of S$4,146.7m, which translates to a net gearing ratio of 0.48x. If fair value accounting is used, the adjusted net gearing ratio of CDL would ease to 0.32x and this is comparable to the net gearing of CapitaLand after its rights issue and subscription of CapitaMall Trust's rights issue.

Potential beneficiary from the upgraders' market. In comparison with other property developers, CDL is better-positioned to benefit from the demand from HDB upgraders as it has exposure of ~52.5% of its attributable GFA of its landbank to the mass market segment. Some of these sites had been acquired at low prices and the low breakeven cost would give CDL the much-needed flexibility in pricing its new launches under current weak market condition.

Default risk under control. Only about 30% of their units sold by CDL were under the Deferred Payment Scheme (DPS) and CDL has a policy of collecting 20% as down payment from buyers under this scheme; DPS is not extended to sub-sales. We also think that it is unlikely for buyers to just walk away from their purchases as buyers would face legal action for breach of breach of their contractual obligations.

M&C remains financially self-sufficient. Subsidiary M&C's financial position remains strong, with net gearing ratio of 0.16x. With undrawn committed bank facilities of £188.6m and cash-generative operations, we believe that M&C can remain self-sufficient on its own without tapping on its parent, CDL, for additional resources.

Building up war-chest for acquisition. CDL had been active in building up its acquisition war-chest recently, having increased the limit of its Medium Term Note (MTN) Programme from S$700m to S$1,500m in December 08 and raised S$100m from its S$1,000m Islamic Trust Certificate (ITC) Programme in January. CDL is currently in the process of issuing the second tranche of the ITC and expects to raise another S$300m-400m from the programme.

Reinitiate coverage on CDL with HOLD. We ascribe a 30% discount to our valuation of CDL's development profits and investment properties. For its investments in M&C and City e-Solutions, we peg their valuations to their current market capitalizations without any discount. As such, our fair value of CDL is pegged at S$5.43. We believe that CDL is well-positioned to ride through this downturn but for now, upside to share price looks limited and we reinitiate coverage on CDL with a **HOLD** rating.

Year to 31 Dec	Turnover (S$m)	Gross Profit (S$m)	Net Profit (S$m)	EPS (cents)	PER (x)	P/Book (x)	Div Yield (%)
FY 07	3,106.1	1,628.0	725.0	78.3	6.8	0.9	5.7
FY 08	2,945.2	1,673.8	580.9	63.9	8.3	0.9	1.4
FY 09F	2,538.7	1,540.1	444.5	48.9	10.8	0.8	1.4
FY 10F	2,658.2	1,531.5	420.2	46.2	11.4	0.8	1.4

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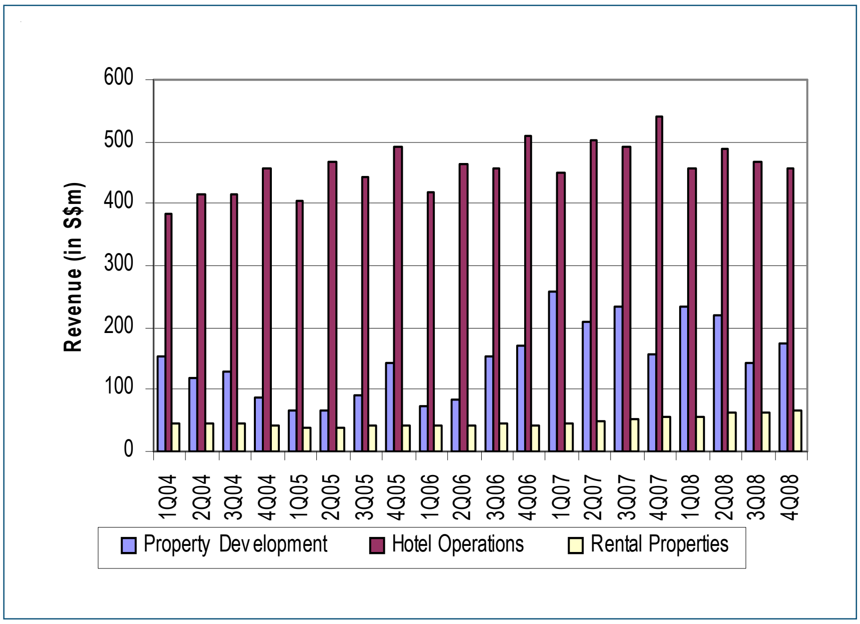
Section A: Financials Review

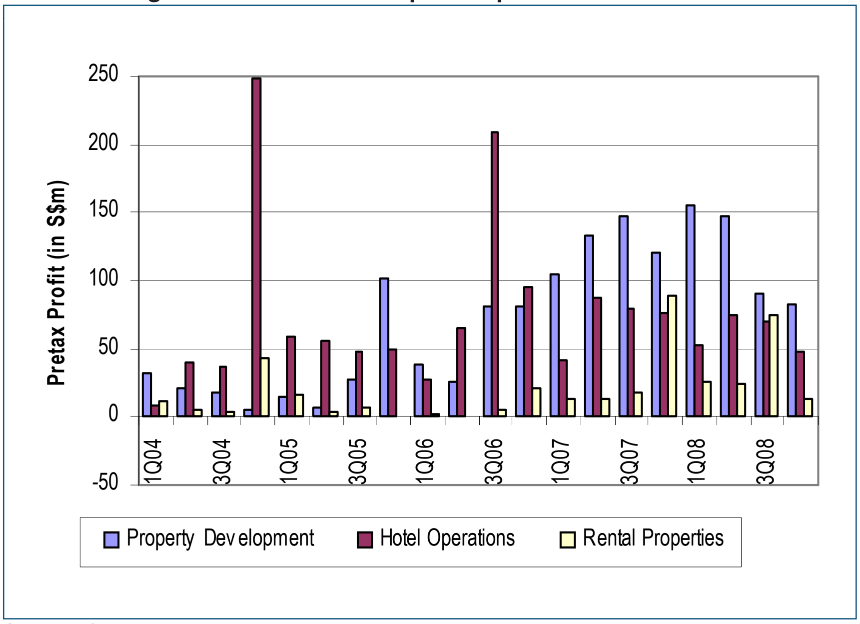
4Q08 earnings hit by impairment losses. City Developments (CDL) reported a weak set of 4Q08 results, which were further marred by impairment losses. 4Q08 revenue fell 6.3% YoY to S$717.5m, dragged down by weak contribution from its hotel segment that was caused by the strength of SGD against Sterling pound. Losses of S$90.8m arising from impairment on Millennium & Copthorne's (M&C) assets, an investment property and loan to a JV in Bangkok were recognized in 4Q08. Excluding the impact of impairment losses and one-off gains, we estimate that its 4Q08 operating profit would have declined by a smaller 7.2% YoY to ~S$165m (reported 4Q08 operating profit fell by 31.6% YoY to S$147.2m).

Exhibit 1: Segmental breakdown of revenue



Source: Company

Exhibit 2: Segmental breakdown of pre-tax profit

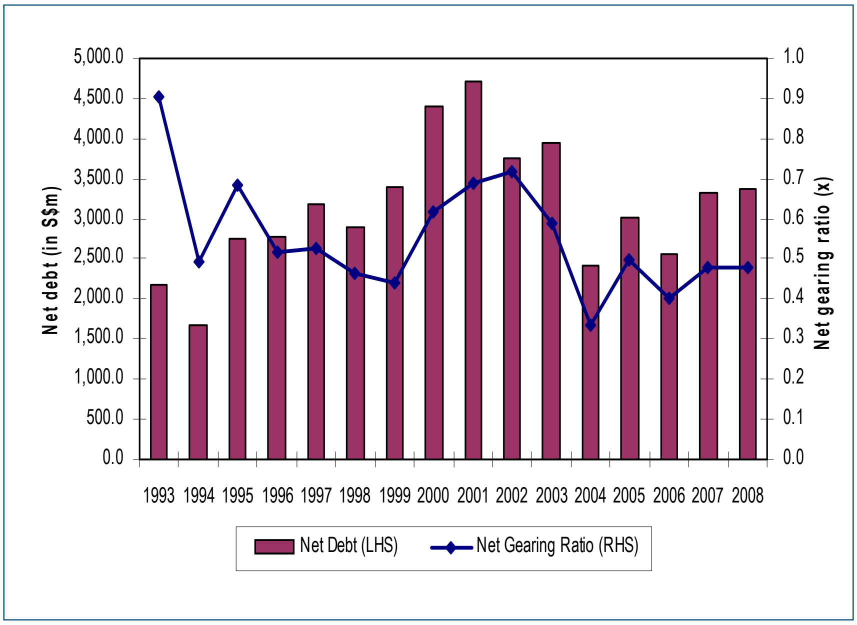


Source: Company

Conservative accounting policy enhances robustness of reported NAV. During the property run-up in 2007, majority of the property developers recognized significant amount of revaluation gains on their properties, which had in turn boosted their reported net asset value. But with the rapid deterioration in the property market, there is lingering uncertainty over the 'true' asset value of developers now. As CDL accounts for its investment properties at cost less depreciation, CDL's book value will not be affected by this uncertainty. Our reappraised valuation of CDL's investment properties is pegged at S$3,690.7m and this is significantly higher than the reported book value of S$2,312.7m for its investment properties at the end of FY08. We believe that this conservative accounting policy will give the market greater confidence as to the robustness of its reported net asset value.

Strong balance sheet to withstand turmoil. At the end of 4Q08, CDL has a cash holding of S$775.9m and total borrowings of S$4,146.7m, which translates to a net gearing ratio of 0.48x. Net debt position and net gearing ratio remained stable over the last two years and current financial position is still stronger than that during the 02/03 downturn period and is also comparable to that during the 97/98 Asian financial crisis. If the accounting treatment of its investment properties changes from cost less depreciation to a market valuation approach, the adjusted net gearing ratio of CDL would ease to 0.32x and this is comparable to the net gearing of CapitaLand after its rights issue and subscription of CapitaMall Trust's rights issue, which we estimate it to be between 0.3x and 0.33x.

Exhibit 3: Net debt and Net gearing ratio since 1993



Source: Company, Bloomberg

Building up war-chest for acquisition. In light of the weak property market, asset prices are coming down and the weakness is further compounded by the global de-leveraging process and tight credit market. Such a situation could provide opportunities for asset acquisition. With its conservatively-geared balance sheet and successful track record in Singapore property market, we believe that CDL is well-positioned to take advantage of any opportunity that arises. CDL had also been active in building up its acquisition war-chest in the credit market recently, having increased the limit of its Medium Term Note (MTN) programme from S$700m to S$1,500m in December 08 and raised S$100m from its S$1,000m Islamic Trust Certificate (ITC) programme in January. CDL is currently in the process of issuing its second tranche under ITC and expects to raise another S$300m-400m from the programme.

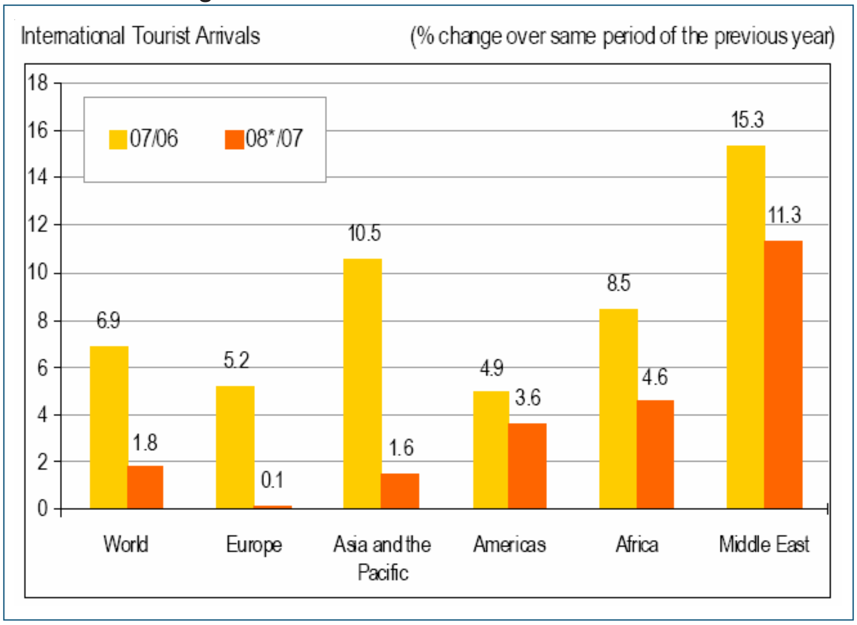
Section B: Hotel Operations

Impairment and revaluation losses weigh on 4Q08 results. Millenium & Corpthorne (M&C), the hotel subsidiary of CDL, reported sharply lower PATMI of £4.5m (decline of 93.5% YoY) for 4Q08 as profitability was dragged by impairment and revaluation losses. Operating performance was also weak as group RevPAR fell 7.6% YoY in constant currency term and headline operating profit fell 12% YoY to £41.8m but in its reporting currency terms (£), operating profit declined by a smaller 0.9% YoY, aided by the weaker £. Impairment charges were made on CDL's 30% and 50% investment in Beijing and Bangkok respectively (~ £19.6m), on Sunnyvale, hotels in the UK and US and land in India (~ £15.5m). A loss of £20.4m was also recognized on the revaluation deficit of investment properties of CDL Hospitality Trust.

M&C remains financially self-sufficient. Despite its weak 4Q08 results, M&C's financial position remains strong, with cash balance of £212.1m, total borrowings of £497.2m and net gearing ratio of 0.16x. Together with unutilized committed bank facilities of £188.6m and cash-generative operations, we believe that M&C can rely on its internal resources and credit lines to tide over the downturn without having to tap on its parent, CDL, for additional resources.

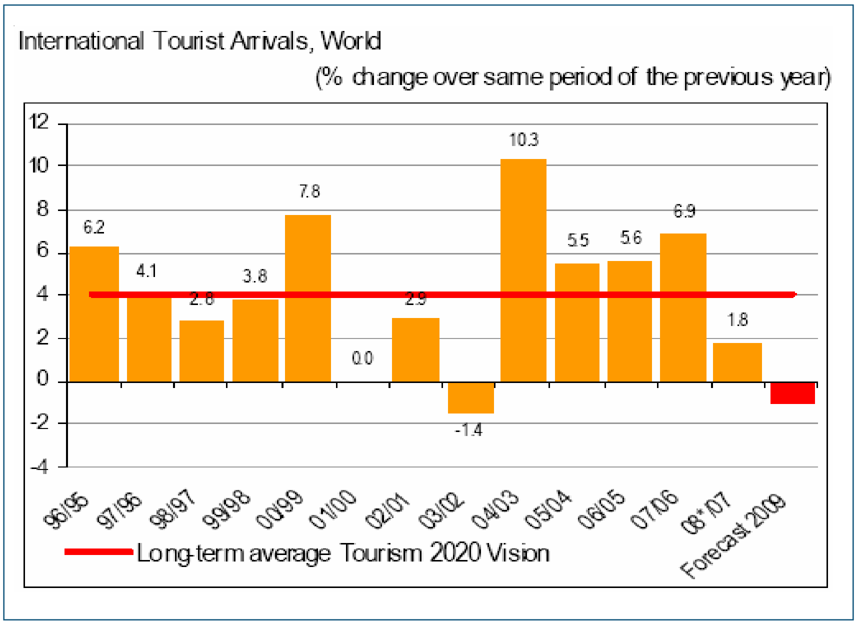
Rapid deterioration of global tourism industry amid global crisis. According to a recent data released by United Nations World Tourism Organization (UNWTO), global international tourist arrivals grew 2% YoY to reach 924m in 2008 but a further analysis of the growth trend in 2008 highlighted the rapid deterioration in the global tourism industry. Strong tourist arrival growth of 5% YoY in 1H08 contributed to much of the growth for the year but the tourism sector took a rapid turn for the worse in 2H08, registering a 1% YoY decline in tourist arrival. For 2009, UNWTO is forecasting an even more modest performance and expects international tourism growth to be in the range of 0% to a 2% decline. The Americas and Europe are expected to be the most affected region while Asia Pacific is still expected to achieve growth in 2009.

Exhibit 4: % change in international tourist arrivals



Source: World Tourism Organization (UNWTO)

Exhibit 5: Negative growth forecast for international tourist arrivals in 2009



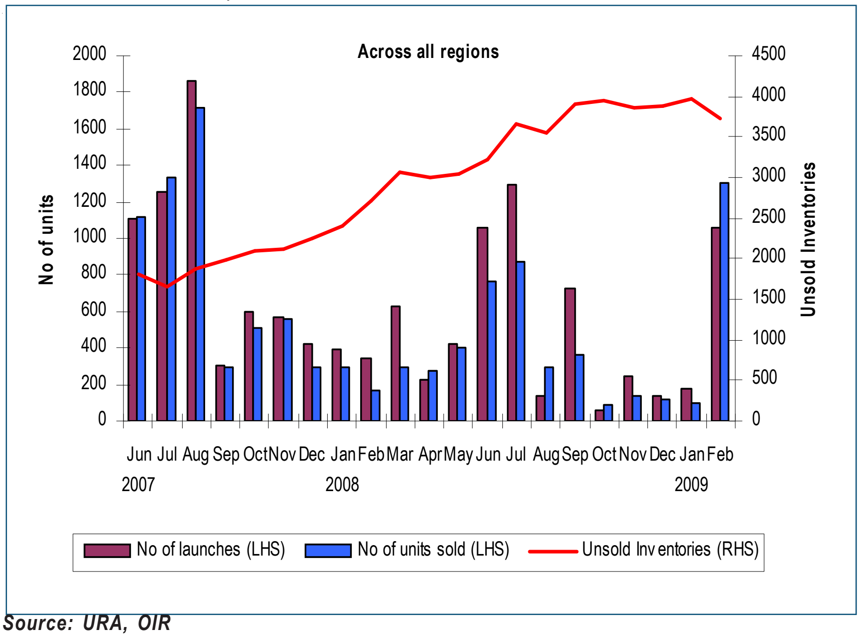
Source: World Tourism Organization (UNWTO)

Weak tourism outlook to weigh down on M&C operations. We believe that the weakness in the tourism sector in the Americas and Europe could negatively affect M&C's operations in FY09 as approximately 60% of M&C's revenue and 50% of its hotel operating profit are derived from its US and Europe hotels. However, the remaining of M&C's revenue and operating profit come from Asia and Australasia regions, which are still expected to experience growth in FY09 and thus should be able to partially cushion the impact of slowdown in the other regions.

Section C: Residential Development and Commercial Properties

Residential property market outlook remains weak… No signs of sustainable recovery for Singapore residential property market yet. Despite the improvement in the February private property sales figures, outlook of the property market remains murky, bogged down by economic issues such as negative GDP growth, falling wages and rising unemployment rates. Also, with an estimated 10,448 private residential units to be completed in 2009, the large supply of completed units entering the market is another area of concern and the situation could be worsen by the tightening of property financing by banks.

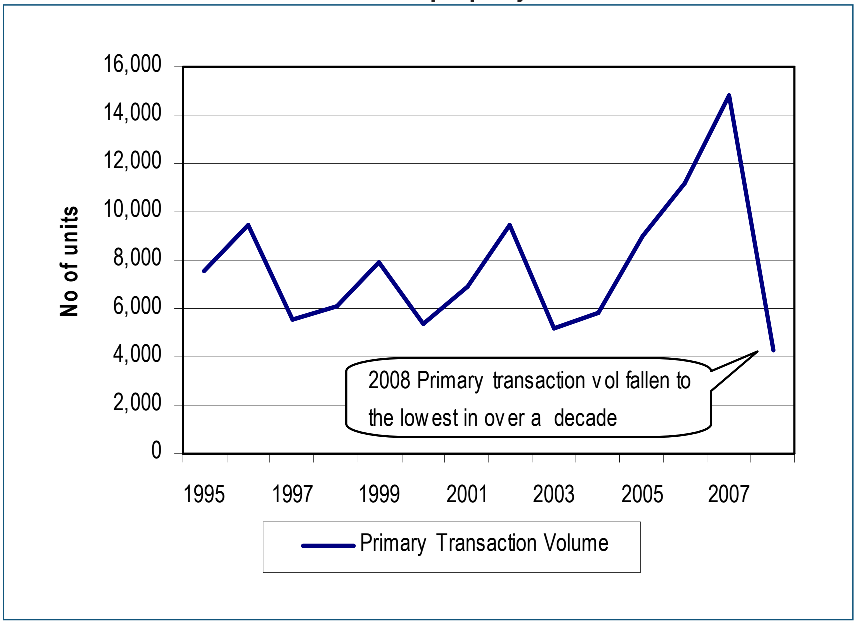
Exhibit 6: Launches, Units sold and Unsold Inventories



Source: URA, OIR

…But pockets of pent-up demand seen in the mass market segment recently. The recent successful launches of projects like Caspian, Alexis and Double Bay Residences show that there is still demand for private properties coming from HDB (public housing) upgraders. We believe that recent demand could have been driven by several factors such as 1) low psf pricing of between S$600 psf to S$650 psf, 2) low absolute pricing as developers offer more smaller size units, 3) pent-up demand from upgraders who had refrained from buying in 2008, as evident by the plunge in primary transaction volume to the lowest in over a decade. The still resilient HDB resale prices have provided another boost to the upgraders' market, thanks to the narrower price gap between a mass market property and HDB flat. However, with developers now rushing in to capture the market of HDB upgraders, we are also concerned that this pent-up demand pool could dry up rapidly.

Exhibit 7: Transaction volume of new property sales



Source: URA, OIR

Healthy take-up for The Arte. With the recent improvement in buying sentiments, The Arte at Thomson held its private preview last weekend. 100 out of the total 336 units were released during the preview and 60 units were sold at an average selling price (ASP) of S$880 psf. Unlike many of the recently-launched projects that come with studio units to improve their affordability, minimum unit size at The Arte is 1,055 sq ft and based on its ASP of S$880, the smallest unit in the project could cost around S$928,000 and an average size unit will cost over S$1m. With its relatively higher absolute pricing in comparison to the other recently launched projects, we believe that a take-up rate of 60% for The Arte during it first week of private preview is a commendable achievement.

CDL could potentially benefit from the upgraders' market. Although the strong property sales in February are unlikely to be sustainable, over the medium term, we still believe that the mass market segment will do relatively better than the mid- and high-end segments due to their affordability. In comparison with other property developers, CDL is likely to be a beneficiary of this demand from HDB upgraders as it has a significant landbank exposure (approx 52.5% of its attributable GFA of its landbank) to the mass market segment. Also, some of these sites (Pasir Ris land parcels and Upper Changi Road site) had been acquired at low costs and breakeven prices for these sites are still significantly lower than the current achievable prices. We believe that low breakeven cost would give CDL the much-needed flexibility in pricing its new launches under current weak market condition.

Exhibit 8: CDL's mass market landbank exposure

	Stake	Attributable Land Area (sq ft)	Attributable GFA (sq ft)
Hong Leong Garden Condominium	100	266,072.8	425,716.6
Pasir Ris Land Parcels	51	857,176.5	1,800,070.6
Tampines Road/Upper Changi Road North	33	295,707.7	413,990.8
		1,418,957.0	2,639,777.9
CDL's landbank		2,635,180.8	5,023,589.9
% of landbank exposure to mass market		53.8	52.5

Source: Company, OIR

Default risk under control. As clarified by CDL, only about 30% of their units sold were under the Deferred Payment Scheme (DPS) and CDL had the policy of collecting 20% as down payment from buyers under the DPS. In addition, CDL did not extend DPS to sub-sales. As such, we believe that the risk of DPS default for CDL is well-controlled. We also think that it is unlikely for buyers to just walk away from their purchases as the sales and purchase agreement is a legally binding agreement and buyers could face legal action from the developer if they breach their contractual obligations.

Office rental rates under pressure. The outlook of Singapore office market still remains worrisome with the looming supply of new office space. An estimated 1.6m sq ft and 2.8m sq ft of office space are expected to be completed in 2009 and 2010 respectively, and these represent increases of approximately 2.2% and 3.9% in the total office space in Singapore (~72m sq ft as at the end of 2008). However, take-up rate of these new office spaces is expected to be slow as companies shelve their expansion plans or even scale back on their operations in light of the weak economic outlook. Financial institutions, which had been a key source of demand for office space in 2007, had been badly hit by the subprime and credit crisis. As they scale back their operations, it is possible that some of their vacant office space may emerge in the leasing market as shadow office spaces and thus worsening the oversupply situation. As such, we are now expecting office rental rates to decline by 25% in 2009, followed by another 20% decline in 2010.

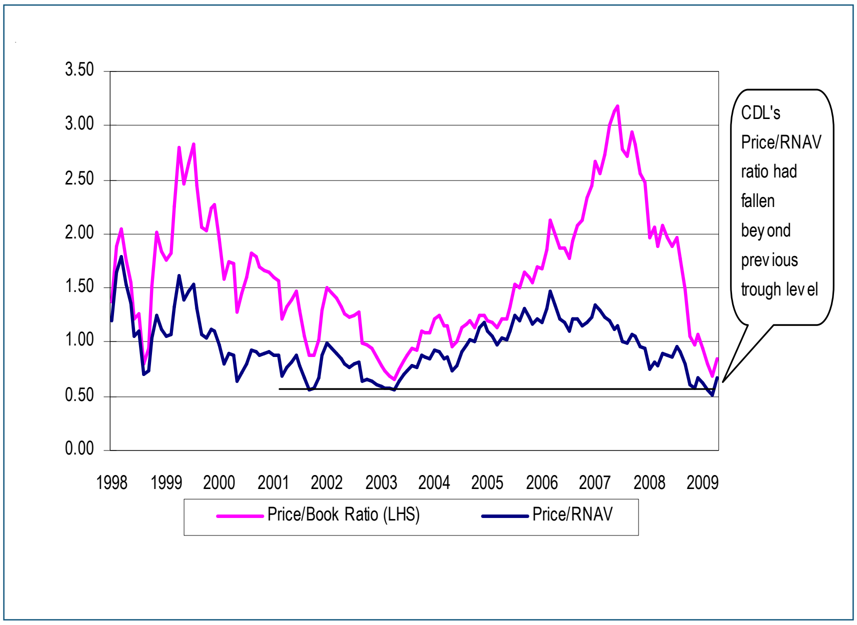
Full impact of falling rental rates to be felt in FY10. Due to its significant exposure to the office sector (~62.2% of attributable NLA of investment properties from office buildings), we expect CDL's rental properties segment to be negatively affected by the expected decline in office rental rates. For FY08, revenue from rental properties increased by 22.3% YoY but we expect growth in rental revenue to slow down to 3.1% YoY increase in FY09. The full impact of the slowing rental rate is expected to be felt in FY10 where we expect 3.7% YoY decline in rental income.

Delay in projects as market softens. The Quayside Collection at Sentosa Cove was originally planned to be launched in 2H08 but its launch was subsequently deferred in light of the weak market demand. Nevertheless, CDL proceeded with the construction for the project as it managed to secure relatively low construction costs for them. Also, in late 2008, CDL announced that the construction of the South Beach development will be deferred. This large-scale project will require significant resources and the delay of the project is a prudent move under the current uncertain market condition and it allows CDL and its partners to conserve their resources in a tight credit market. Also, with the decline in construction material prices and slowing down in construction projects tender, construction cost is expected to decline and the construction of the project could be secured at more attractive terms in future.

Section D: Valuation and Recommendation

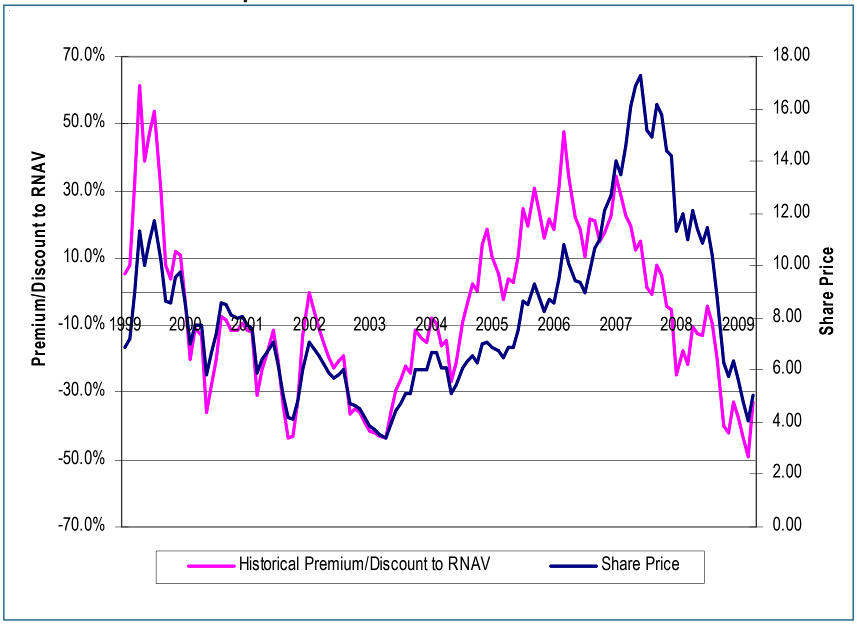
Valuation fell beyond previous trough levels in early March. Our FY09 RNAV estimate of CDL is pegged at S$7.46 per share and this is based on our estimates of CDL's residential development profits (S$1,846.1m), surplus on investment properties (S$1,555.7m), deficit on CDL's stakes in M&C and City e-Solutions (-S$1,813.8m) and its end FY08 net asset value of S$5,198.8m. Sharp decline in CDL's share price in early March had caused its Price/RNAV ratio to decline to 0.51x and this was already lower than the previous trough valuation of CDL in 2001 and 2003 (refer to Exhibit 9). Since then, global equities managed to stage a rebound and based on yesterday's closing price of S$5.29, CDL is now trading at a Price/RNAV of 0.71x.

Exhibit 9: Historical Price/Book and Price/RNAV ratios for CDL



Source: Bloomberg, OIR

Exhibit 10: Historical premium/discount to RNAV



Source: Bloomberg, OIR

Reinitiate coverage with HOLD and S$5.43 fair value. Outlook of the property market remains challenging but taking into account the strength of CDL's financial position, we ascribe a 30% discount to our valuation of CDL's development profits and investment properties and this is in line with the discount rate that we ascribe to its closest peer, CapitaLand. For its investments in listed entities (M&C and City e-Solutions (CES)), we peg their valuations to their current market capitalizations. As M&C and CES are now trading at low valuations now (M&C Price/Book: 0.32, CES Price/ Book: 0.31), we do not ascribe further discount to their market caps in our valuation of CDL. As such our fair value of CDL is pegged at S$5.43 (refer to Exhibit 11).

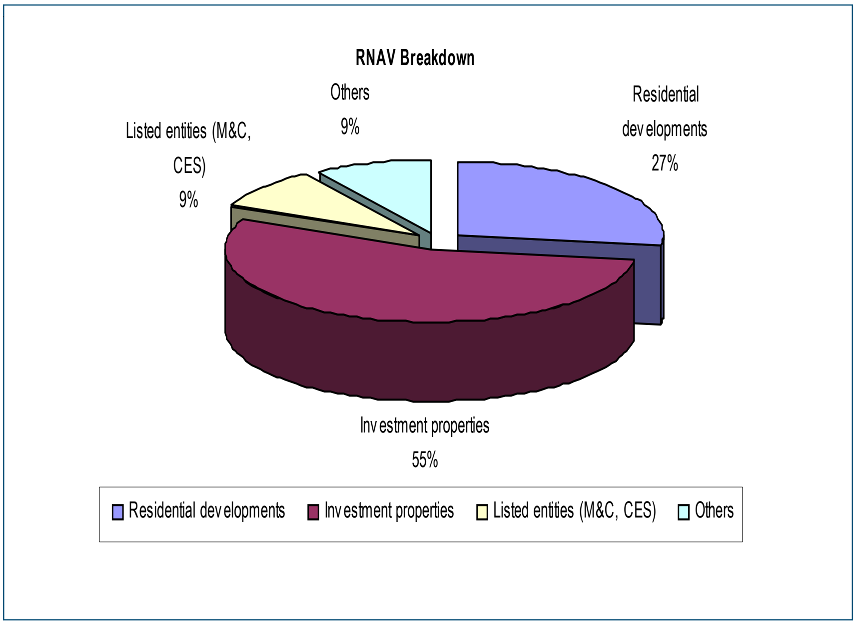
Current share price of S$5.29 implies an upside potential of just 2.6%, suggesting that CDL looks fairly valued now. Nevertheless, we still like the company for its conservative management, strong balance sheet, diversified operations, low cost landbank with significant mass market exposure and proven track record in the Singapore property market. As such, we reinitiate coverage with a **HOLD** rating.

Exhibit 11: FY09 RNAV Table

	in S$m
NPV of development profits	1,846.1
Investment properties	3,690.7
Less:	
- Book value of investment properties	-2,135.0
	1,555.7
Stakes in listed entities	630.0
Less:	
- Book value of listed entities	-2,443.7
Surplus on listed entities	-1,813.8
Net Asset (end FY08)	5,198.8
RNAV	6,786.8
Outstanding share base (m)	909.3
RNAV per share	**$7.46**
Fair value (Discount for development profits and investment properties pegged at 30% and listed investments kept at market value)	**$5.43**

Source: OIR estimates

Exhibit 12: RNAV Breakdown



Source: OIR estimates

CDL's Key Financial Data

EARNINGS FORECAST Year Ended 31 Dec (S$ m)	FY07	FY08	FY09F	FY10F
Revenue	3,106.1	2,945.2	2,538.7	2,658.2
Cost of sales	-1,478.2	-1,271.4	-998.5	-1,126.6
Gross profit	1,628.0	1,673.8	1,540.1	1,531.5
Other operating income	29.2	138.1	94.9	99.7
Administrative expenses	-522.8	-504.6	-479.3	-488.9
Other operating expenses	-396.2	-527.5	-501.1	-526.2
Profit from operations	738.2	779.8	654.6	616.1
Net finance costs	-70.3	-84.5	-93.3	-74.5
Share of after-tax profit of associates	16.3	19.0	13.0	13.0
Share of after-tax profit of jointly-controlled entities	270.5	119.5	48.3	28.8
Profit before income tax	954.6	833.8	622.5	583.4
Income tax expense	-65.4	-152.1	-124.5	-116.7
Profit for the period	889.2	681.7	498.0	466.7
Minority interests	-164.2	-100.7	-53.5	-46.5
Shareholders' profit	725.0	580.9	444.5	420.2

BALANCE SHEET As at 31 Dec (S$ m)	FY07	FY08	FY09F	FY10F
Property, plant and equipment	4,038.3	4,161.5	4,217.8	4,272.8
Investment properties	2,468.3	2,312.7	2,287.7	2,263.0
Other non-current assets	1,263.0	1,223.8	1,277.8	1,334.5
Development properties	2,578.0	2,920.1	2,774.1	2,635.4
Trade and other receivables	1,076.9	1,098.6	947.0	805.5
Cash and cash equivalents	711.6	775.9	741.0	782.1
Other current assets	82.4	30.9	32.5	34.1
Total assets	12,218.6	12,523.5	12,277.8	12,127.4
Interest-bearing borrowings (Non-current)	3,235.4	3,286.6	2,724.8	2,210.8
Other non-current liabilities	542.0	524.7	550.9	578.4
Trade and other payables	585.0	641.2	665.7	751.1
Interest-bearing borrowings (Current)	796.3	860.1	713.0	578.5
Other current liabilities	143.5	188.7	198.1	208.0
Total liabilities	5,302.2	5,501.2	4,852.5	4,326.8
Share capital	1,991.4	1,991.4	1,991.4	1,991.4
Reserves	3,207.4	3,438.3	3,814.6	4,166.6
	5,198.8	5,429.7	5,806.0	6,158.0
Minority interests	1,717.6	1,592.6	1,619.4	1,642.6
Total equity	6,916.4	7,022.3	7,425.4	7,800.6
Total equity and liabilities	12,218.6	12,523.5	12,277.8	12,127.4

CASH FLOW Year Ended 31 Dec (S$ m)	FY07	FY08	FY09F	FY10F
Profit before income tax	954.6	833.8	622.5	583.4
Adjustments	-143.2	58.7	181.8	184.8
Operating profit before working capital changes	811.4	892.5	804.3	768.1
Changes in working capital	-97.9	-365.6	321.6	365.0
Income tax paid	-98.2	-78.8	-62.3	-58.3
Cashflow from operating activities	615.3	448.1	1,063.6	1,074.8
Cashflow from investing activities	-596.4	-236.9	-158.2	-154.0
Cashflow from financing activities	-74.3	-119.4	-934.2	-879.8
Net change in cash	-55.4	91.8	-28.8	41.1
Cash at beginning of the year	774.6	710.6	769.9	741.0
Forex	-8.7	-32.5	0.0	0.0
Cash at end of the year	710.6	769.9	741.0	782.1
Other adjustments (Overdraft, reclassification)	1.0	6.0	0.0	0.0
Reported cash on balance sheet	711.6	775.9	741.0	782.1
Key Ratios				
PER (x)	6.8	8.3	10.8	11.4
P/NAV (x)	0.9	0.9	0.8	0.8
Gross profit margin (%)	52.4	56.8	60.7	57.6
Net profit margin (%)	28.6	23.1	19.6	17.6
Net gearing (x)	0.5	0.5	0.4	0.3
Dividend yield (%)	5.7	1.4	1.4	1.4
ROE (%)	13.9	10.7	7.7	6.8
ROA (%)	7.3	5.4	4.1	3.8

Source: Company data, OIR estimates

SHAREHOLDING DECLARATION:
The analyst/analysts who wrote this report holds NIL shares in the above security.

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- For companies with less than S$150m market capitalization, OIR's Buy = More than 30% upside from the current price; Hold = Trade within +/- 30% from the current price; Sell = More than 30% downside from the current price.

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Carmen Lee
Head of Research

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