FitchRatings

08 Jun 2020 | Downgrade

Fitch Affirms Ciputra Development at 'BB-', Downgrades Ciputra Residence to 'A(idn)'

Fitch Ratings-Singapore/Jakarta-08 June 2020:

Fitch Ratings has affirmed the Long-Term Issuer Default Rating (IDR) of Indonesia-based property developer PT Ciputra Development Tbk (CTRA) at 'BB-'. The Outlook remains Negative. At the same time, Fitch Ratings Indonesia has downgraded wholly owned subsidiary PT Ciputra Residence's (CTRR) National Long-Term Rating to 'A(idn)' from 'A+(idn)' with a Negative Outlook. A full list of rating actions is at the end of this commentary.

The Negative Outlook reflects our view of the significant challenges CTRA will face and its very limited rating headroom in the near term. CTRA's attributable pre-sales have been below IDR5 trillion, the level at which Fitch would consider negative rating action, and the pandemic has amplified the risks property developers face amid weak property demand over the next 12-18 months.

CTRA had strong take-up rates across its various projects earlier in 2020 before the government imposed social distancing measures. However, the coronavirus pandemic has stalled CTRA's progress of recording IDR5 trillion in attributable pre-sales. This underpins the affirmation of the ratings. We believe CTRA needs to be able to book a minimum of IDR4 trillion of pre-sales in 2020 for the company to show an adequate trajectory to reach the IDR5 trillion threshold in the medium term.

CTRR's rating is based on the consolidated profile of its parent, CTRA. The downgrade of CTRR's National Long-Term Rating follows our assessment of the company's weakening credit profile relative to its nationally rated peers.

'A' National Ratings denote expectations of a low level of default risk relative to other issuers or obligations in the same country or monetary union

Key Rating Drivers

Limited Rating Headroom: We expect attributable pre-sales to return to the IDR5 trillion level only by 2022, although CTRA would need to be moving towards this level by 2020. We expect at least 50% yoy decline in pre-sales in 2Q20, with some easing in subsequent quarters although we believe there are considerable risks in our recovery expectations, particularly the pandemic's duration, the economic conditions after the pandemic — including unemployment and household income trends — and the effect of the crisis on consumer behaviour.

Weaker commodity prices, in particular thermal coal and crude palm oil, will negatively affect exports while the Indonesian rupiah is increasingly volatile. This, coupled with generally tightening financial conditions, will add another challenge to Indonesian GDP growth and depress demand for home purchases for most of the year.

Diversified Portfolio, Established Record: Fitch believes CTRA's rating is supported by its strong market position as one of Indonesia's largest and most diversified property developers by product, geography and segmentation, which allow the company to market its products to a wider range of consumers and should lead to a steep recovery trajectory once the pandemic subsides. The company had over 75 residential and commercial projects across 33 Indonesian cities at end-2019, the most across all Fitch-rated developers.

CTRA's significant exposure to the mid and low-to-mid-end market, which is driven by first-time home buyers, will improve its pre-sales in the medium term, as demand in the segment is less sensitive through cycles. Products in this segment, defined as homes priced below IDR2 billion/unit, accounted for 73% of CTRA's consolidated pre-sales in 2019, up from 64% in 2018. We believe this strategy helped the company outperform its peers as 1Q20 attributable pre-sales rose 5% yoy, compared with the 22% average decline across all Fitch-tracked developers. We believe CTRA can restore its operating performance in a timely manner once the operating environment stabilises.

Sizeable Land Bank: CTRA had around 2,341 hectares of land bank at end-2019 across the country, with a sizeable presence in the main urban areas of Greater Jakarta and Greater Surabaya. The large land bank ensures project longevity, especially when land prices are rising. The Ciputra group also jointly develops projects with land owners on a profit- or revenue-sharing basis, helping it expand its operational scale while limiting the balance-sheet burden. We expect CTRA to provide support to joint ventures to the extent of its shareholdings due to the reputational risk and we have proportionately consolidated the key financials of major subsidiaries when computing CTRA's financial metrics.

Rating Based on Consolidated Profile: CTRA and its subsidiaries have moderate overall intra-group operational and legal linkages that stem from comfortable access to cash within the group, common shareholders and board members among the group companies, and a negative pledge provision in the documents for CTRA's Singapore dollar bond that covers all its principal subsidiaries. There are also risks to the overall reputation of the group from the use of the 'Ciputra' brand. Fitch believes these linkages give CTRA strong operational control over its subsidiaries and therefore they operate as a single entity.

Derivation Summary

CTRA's rating on the international scale may be compared with that of PT Pakuwon Jati Tbk (BB/Stable), PT Bumi Serpong Damai Tbk (BSD; BB-/Stable), PT Modernland Realty Tbk (B/Rating Watch Negative (RWN)), PT Kawasan Industri Jababeka Tbk (B/Negative) and PT Alam Sutera Realty Tbk (B-/RWN).

Pakuwon is one of Indonesia's leading mixed-use property developers with the majority of its operating cash flows from its large investment-property portfolio. Pakuwon is rated higher than CTRA because of its superior non-development income base and more conservative capital structure, which lead to significantly stronger non-development interest cover. Pakuwon's higher rating is also supported by wider profit margins and stronger free cash flow (FCF).

Fitch believes BSD and CTRA have similar business risk profiles, with comparable property pre-sales scale as the two largest developers in Indonesia. Both companies have a strong record in the domestic property market and benefit from added financial flexibility from their non-development property cash flows. BSD is more geographically concentrated than CTRA, with the majority of its pre-sales from its mature BSD City township. However, we believe BSD has higher sales flexibility stemming from its larger land bank, which allows BSD to sell large land parcels to co-developers and investors, providing cash flow support during slow demand periods. We believe this, combined with BSD's stronger non-development interest cover, gives it a more resilient profile and results in its Stable Outlook relative to CTRA's Negative Outlook.

Fitch believes CTRA's higher rating relative to Modernland, Jababeka and Alam Sutera is underpinned by CTRA's significantly larger operating pre-sales, supplemented by its healthy non-development interest cover, better geographical diversification in its land bank and projects, lower leverage and exposure to cyclical industrial land sales, and a stronger liquidity position.

CTRR, which is rated based on the consolidated profile of CTRA, may be compared on the national scale with Jababeka (BBB+(idn)/Stable), PT PP Properti Tbk (PPRO; BBB-(idn)/Negative) and PT Sri Rejeki Isman Tbk (Sritex; A+(idn)/Stable). Fitch believes Jababeka's business profile is weaker because CTRR has a significantly larger operating pre-sales scale, more geographically diversified projects and lower business cyclicality due to exposure to residential property sales as opposed to Jababeka's industrial land sales. CTRR also has lower leverage than Jababeka.

Fitch believes CTRR's higher operating pre-sales, wider profit margin, lower leverage and stronger non-development interest cover relative to PPRO, combined with CTRR's better geographical diversification and more established record in residential and commercial property development, warrant a multiple-notch difference between the ratings of the two companies.

Sritex and CTRR both have a strong market position as the leading players in their respective industries. Nevertheless, we believe Sritex's larger operating EBITDA scale, combined with CTRA's relatively more cyclical business given its exposure to property sales, warrant a one-notch rating difference between their rating on the national scale.

Key Assumptions

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

- Attributable pre-sales of IDR3 trillion-4 trillion in 2020

- Discretionary land acquisition spending of around IDR400 billion-500 billion in 2020 and IDR500 billion-600 billion in 2021

- Total construction capex of around IDR3 trillion in 2020

RATING SENSITIVITIES

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

- Presales improvement in line with Fitch's expectations, leading to annual attributable presales of more than IDR5 trillion by 2022, may lead to a revision of the Outlook to Stable

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

- Inability to improve attributable pre-sales to more than IDR5 trillion by 2022, with minimum of IDR4 trillion achieved in 2020.

- Weakening in overall legal and operational ties between the parent and the operating subsidiaries

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

Sufficient Liquidity: CTRA had around IDR4.2 trillion of consolidated cash and around IDR1.1 trillion of undrawn debt facilities as of 31 March 2020, compared with around IDR1.1 trillion of short-term debt maturities, of which around IDR635 billion comprised short-term working-capital facilities that would be typically rolled over in the normal course of business in light of CTRA's established record and strong market position as a leading property developer in Indonesia.

CTRA's liquidity is supported by its relatively large cash balance, diversified funding access to domestic and international bond markets and strong access to the domestic banking market. CTRA's large pool of unpledged assets also provides the company with additional financing avenues if required; we estimate CTRA's unencumbered asset/unsecured debt ratio was around 2x as of 31 March 2020.

Furthermore, CTRA's property-development model allows for financing flexibility, including timing construction costs with sales, and the discretionary nature of acquiring land bank. CTRA's long land-reserve life also means that the company has the flexibility to conserve cash when pre-sales are low. All these factors may allow the company to accumulate cash and shore up its liquidity profile if required.

Summary of Financial Adjustments

- CTRA reports land purchase costs under investment cash flows (capex). We have removed these costs from cash flow from investments and included them under cash flow from operations as working capital.

- The company reports land bank as a long-term asset on its balance sheet. We have classified land bank as part of current inventory due to the nature of CTRA's business of land development and sales. We have also classified advances from customers as part of working capital.

- We have moved 'final tax' to after the 'profit before income tax' line in the income statement.

- We have proportionately consolidated the key financials of CTRA's major subsidiaries to reflect significant minority interests

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

PT Ciputra Development Tbk; Long Term Issuer Default Rating; Affirmed; BB-; RO:Neg
----senior unsecured; Long Term Rating; Affirmed; BB-
PT Ciputra Residence; National Long Term Rating; Downgrade; A(idn); RO:Neg
----senior unsecured; National Long Term Rating; Downgrade; A+(idn)
----senior unsecured; National Long Term Rating; Downgrade; A(idn)

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Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)
Country-Specific Treatment of Recovery Ratings Rating Criteria (pub. 27 Feb 2020)
Exposure Draft: National Scale Rating Criteria (pub. 02 Mar 2020)
National Scale Ratings Criteria (pub. 18 Jul 2018)
Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)
Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 01 May 2020)
Third-Party Partial Credit Guarantees Rating Criteria (pub. 11 Jun 2019)

Applicable Model

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
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Endorsement Status
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