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THE WEEK OF OCTOBER 10 - 16, 2022 | 1056

GETTING AHEAD WITH

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Traditionally a residential developer, GuocoLand is pivoting towards investment properties. CEO Cheng Hsing Yao explains why

Read our cover story on Pages 8 & 9

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COVER STORY

Guoco Tower has been able to command attractive rents, says Cheng

GUOCOLAND

Gaining an investment foothold

GuocoLand, traditionally a developer of residences, has progressively pivoted towards investment properties. CEO Cheng Hsing Yao explains the group's strategy behind the move

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GuocoLand, under CEO Cheng Hsing Yao, is undergoing a steady and clear transformation from being a residential developer into a property company that is now earning a growing proportion of its income from investment.

GuocoLand owns 80% of Guoco Tower, which is located above Tanjong Pagar MRT Station; 20 Collyer Quay, located at the heart of Raffles Place; and Guoco Midtown, which is still under development and should get its temporary occupation permit at the end of this year.

"We won the site here [at Tanjong Pagar]," Cheng says. GuocoLand's winning bid was 11%–12% higher than the second bid. In hindsight, the land cost of $1,006 psf was reasonable. "That began our journey into investment assets. This is our first mixed-use and now premium Grade-A property," Cheng adds.

"In the strategy, we wanted to create an investment property arm. This [pivot] is at least a decade long in the making. Historically, we had been a residential developer," Cheng says.

The company started as First Capital and used to focus on the mass market with projects such as Aquarius by the Bay.

"We moved to the higher-end market such as Paterson Residence, Goodwood Residence and Leedon Residence," Cheng says. These developments are in prime Districts 9 and 10.

In 2018, GuocoLand partnered Hong Leong Holdings and Hong Realty (Private) to acquire Pacific Mansion in District 9 for $980 million in a collective sale. The acquisition price worked out to $1,700 psf–$1800 psf for the land and units priced at around $3,200 psf.

However, property development tends to be "lumpy" and "there is no continuity", Cheng says. Therefore, GuocoLand decided to create an investment property arm.

Design and transforming the neighbourhood are important issues for him. The property has to be positioned to attract credit-worthy tenants which can pay Grade-A rents, which is important to the valuation of the building.

ALBERT CHUA/THE EDGE SINGAPORE

Cheng: GuocoLand has transformed the branding and the positioning of Tanjong Pagar into a prime office district

"We opened the building in 2016–2017. There was a downsizing of the financial institutions which were the main occupants and a lot of shadow space from the Marina Bay and M+S projects. There were four million sq ft of space [coming onstream] or four years of absorption rate. That was challenging. But eventually, the traction caught on," Cheng says. He points out that tenants enjoy the amenities and the park in the open space.

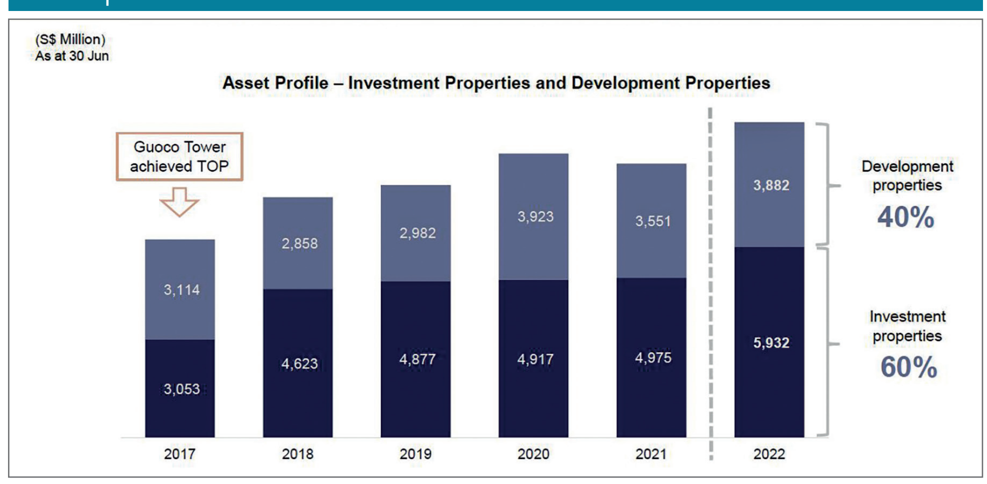
According to Cheng, in the earlier days "the more adventurous tenants" were prepared to explore alternatives to Raffles Place and Marina Bay by renting at Guoco Tower. These included TMT (technology, media and telecommunications) tenants who came in when being located in Marina Bay was not critical. Guoco Tower's rent roll includes companies in the trading, resources, banking and hospitality sectors. A Sofitel-branded hotel occupies one of the towers.

"We transformed the branding and the positioning of Tanjong Pagar into a prime office district," Cheng says. "We have maintained a 99% to 100% commitment level. There is little space to let out most of the time and we have been able to command attractive rents." According to CBRE, monthly rental rate for prime Grade-A office in 2Q2022 was $11.30 psf, up 3.2% q-o-q and up 7.6% y-o-y.

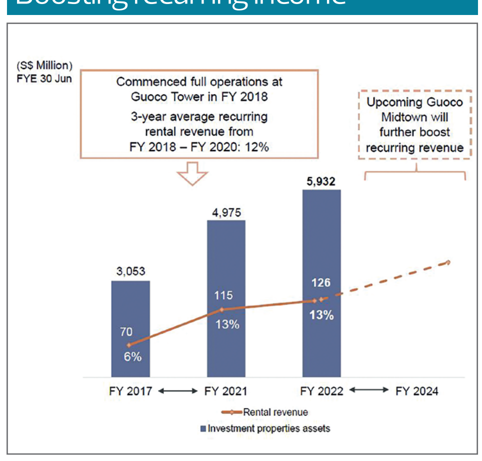
"This model is something we are adopting

ALL CHARTS BY GUOCOLAND

Growing investment properties while maintaining strong base of development business



Boosting recurring income



Boosting capital value

- Strong capital appreciation, mainly from Guoco Tower and Guoco Midtown, with net fair value gain on Singapore's investment properties more than tripling to $253.8 million.

Investment properties assets as at 30 June 2022	
Completed ▪ Guoco Tower ▪ 20 Collyer Quay ▪ DC Mall ▪ Guoco Changfeng City South Tower	S$3.6 Billion
Under Development ▪ Guoco Midtown ▪ Guoco Midtown II (Midtown Modern) ▪ Lentor Modern	S$2.3 Billion
Total	**$5.9 Billion**

for Guoco Midtown. We try to have diversity. We were able to maintain high occupancy through Covid because of a diversified tenant mix. Even if some tenants exited, there isn't a huge, gaping hole," Cheng says.

In recent years, some of the major financial institutions have either reduced the space they take up, or, shifted elsewhere. **UBS**, for one, shifted out of One Raffles Quay to its own building along Penang Road. Others such as **Standard Chartered Bank**, which is at Marina Bay Financial Centre, trimmed the floor space taken. When movements like this happen, property managers had to "backfill" space.

Transforming the neighbourhood

In 2017, GuocoLand clinched a site on Beach Road for $1.6 billion in a government land sale (GLS). "We went to Midtown in 2017 and the timing couldn't have been better. We have then recently completed Guoco Tower and were confident about the office market. We wanted to continue to expand our investment portfolio. In fact, our investment portfolio now is 60% of our total assets," Cheng says.

The site that GuocoLand clinched in 2017 is being developed into Guoco Midtown, an office tower and a residential tower with a small retail component. In 2019, GuocoLand bought a second site, also in a GLS. This is being developed into Midtown Modern. Guoco Midtown and Midtown Modern will be connected directly to Bugis MRT Interchange Station.

"The transformation of the neighbourhood was in our mind. We like this site because earlier mixed-used developments like Duo and South Beach have started the transformation of the area. We saw ourselves as coming in and completing the transformation plan," Cheng says. "We also wanted to give the location and district a branding with the Midtown name."

As he sees it, three elements make a successful development — location, concept and community. "You could be in a prime location. But if you have a poorly conceived project that is poorly managed, you won't get that value. On the flip side, you could be located in what people term as 'fringe'. But because one can deliver a superior product or service and so on, you can attain a better value," Cheng says.

Before the pandemic, Cheng believed that hybrid working was a growing trend and Guoco Midtown has been designed to cater to the core-and-flex (flexible space) trend. "In 2019, we had the core-and-flex leasing concept which we integrated into Guoco Midtown."

For instance, Guoco Midtown tenants get to enjoy event spaces such as meeting and training rooms as well as townhall spaces, and also amenities including a swimming pool.

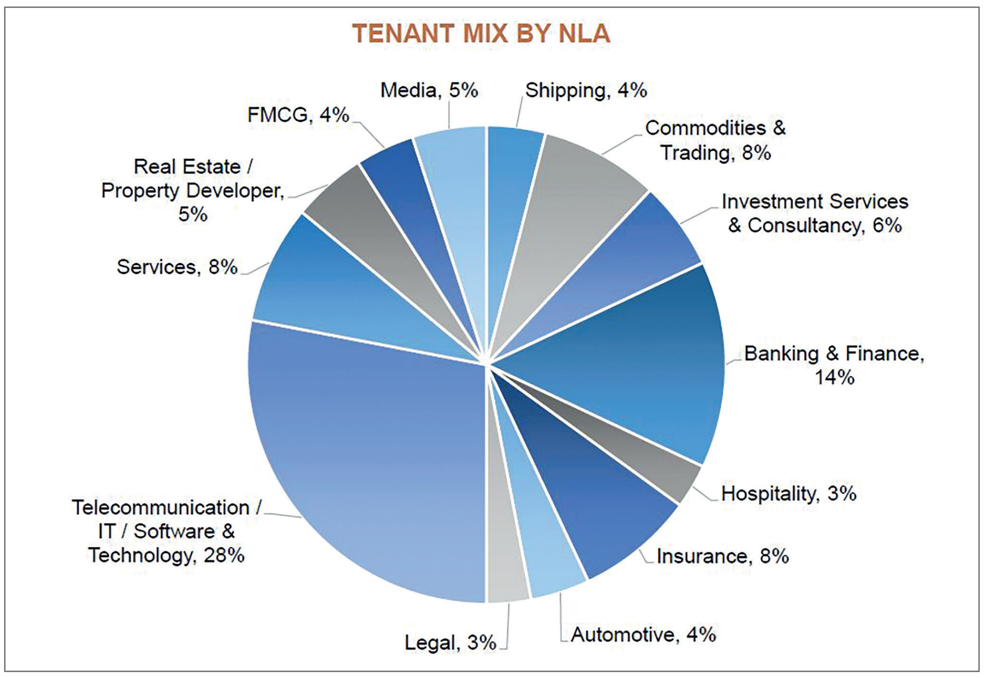
DBS Group Research believes that GuocoLand is increasingly a proxy for the office market. "We believe that the flight-to-quality trend will lead the office market recovery in Singapore. GuocoLand is well positioned to capitalise on this trend, given that Guoco Midtown is the only source of new supply of CBD Grade-A office space in Singapore in 2022–2023 and it will begin its maiden contribution in FY2023. This is on top of positive rental reversionary trends expected for Guoco Tower in a tight supply market," says the DBS report dated Sept 2.

Capital management

When it comes to capital management, all Cheng would say is: "Property development is highly capital-intensive, and we take debt and leveraging as part of the business and part and parcel of managing treasury and capital. We manage interest rates through hedging and making plans. Developments require shorter-term debt while investment properties require longer-term debt."

GuocoLand's gearing ratio (based on net debt to equity) is 1x, which is a lot higher than those of mid-sized developers such as **UOL Group** and **Frasers Property**, and large developers such as **Hongkong Land**, **City Developments**, **CapitaLand Investment** and the unlisted Mapletree Investments.

Diversified tenant mix at Guoco Tower



Based on interest expense of $54 million in 2HFY2022 ended June 30, GuocoLand's cost of debt works out at around 1.9%. This is likely to rise as the US Federal Reserve had raised its Federal Funds Rate by 50 basis points (bps) in March, 75 bps in June, 75 bps in July and 75 bps in September. Hence, the bulk of the increase will only be noticeable in 1HFY2023 ended Dec 31.

Rising interest rates are also likely to affect capital values because they impact discount rates in discounted cash flow computations. However, GuocoLand's valuation methods are based on income capitalisation, direct comparison and residual land method for Guoco Midtown, according to its FY2022 annual report issued on Sept 29. For direct comparison, the sales prices used are $2,850 psf to $3,151 psf, while the capitalisation rates used for the income capitalisation method are 3.3% to 4.5%.

For the operating investment properties, Guoco Tower is valued at $2.68 billion and 20 Collyer Quay at $540.7 million. Guoco Midtown is valued at $2.02 billion based on the residual land value method.

For the 12 months ended June 30, GuocoLand's FY2022, revenue rose 13% to $965.5 million, gross profit rose 36% to $365.7 million and net profit, including revaluation gains of $328.1 million, was 132% higher at $392.7 million. Property development accounted for 71% of gross profit, with property investment at 26%. This is in contrast to the company's portfolio valuation comprising 60% of investment properties versus 40% of development properties.

As property development is typically a lumpy business, GuocoLand's free cash flow (FCF) has been uneven. In FY2022, this was a negative $350 million compared to a positive FCF of $213 million in FY2021.

No plans to restructure yet

A DBS Group Research report published in September suggested that GuocoLand was a potential restructuring play which could crystallise value. "Trading at a P/NAV (price to net asset value) multiple of just 0.44x and with a 3.6% yield, valuations are attractive. With a growing portfolio of commercial assets, the potential securitisation of GuocoLand's income-producing portfolio or conversion into a 'stapled security' could be a significant share price catalyst, with potential upside ranging from 50% to 100%."

Cheng appears satisfied that 26% of gross profit is from property investment. "We see there is potential for investment income to grow because it is a dynamic number."

On the development property front, GuocoLand will only buy a site if it makes sense. "The broad trend is we want to build upon investment property," he says. "To date, we have been quite asset-heavy and adopted a majority-ownership approach. These are some of the most prime assets in town, so we are happy to have majority ownership."

Would GuocoLand be interested in capital partners? "There isn't anything on the horizon in Singapore but if projects come up, and the sites get bigger, we could bring in equity partners," Cheng replies.

Meanwhile, the company has almost finished selling its current projects in the market. For example, Wallich Residence is 93% sold; Meyer Mansion is 95% and Midtown Modern, 82%.

Are there any plans to narrow the discount between the trading price of $1.64 as at Oct 6 versus the NAV of $3.86 as of June 30? "The NAV is very solid, it's backed by really solid assets and we are delivering growing income," Cheng says.

Observers note that GuocoLand is almost like a REIT because of stable income, with a rather consistent dividend payout, albeit without a specific dividend policy as yet, as the board makes decisions on dividend policy and it depends on financial performance. For FY2020 ended June 30, and FY2021, GuocoLand paid 6 cents per share. For FY2022, the payout will be maintained.

There is always the extra profit margin as and when there is development income that can be booked, to give the "delta".

When asked if GuocoLand would be interested in including Guoco Tower in a REIT portfolio and adding Guoco Midtown as a pipeline asset, perhaps not in the current environment but sometime in the future, Cheng says: "We are exploring our options. We could divest also in the private market or to a private fund. We have other options to consider. Anyway, we are just completing Guoco Midtown."

Cheng acknowledges that he has looked at DBS's digital exchange and the concept of tokenisation and fractionalisation of assets. "If you can attract institutional investors, do you need to do fractionalisation?" he ponders.

Overseas projects

While 70% of GuocoLand's assets are located in Singapore, 20% are located in China and 5% in Malaysia via a 68% stake in **GuocoLand Malaysia** which, in turn, holds a 22% stake in **Tower REIT**. Cheng says the group is reviewing overseas projects.

"We are going through a review of our strategy for China and Malaysia because both markets are going through a fundamental adjustment, especially China. It's not just the property market but the adjustments might be more fundamental," Cheng says.

"If there is a strong asset, we may increase our investment in China. If there is something compelling in Singapore, we have no problem increasing our investment in Singapore."

GuocoLand is around 70%-held by Malaysian magnate and billionaire Quek Leng Chan through various companies including Hong Kong Exchange-listed **Guoco Group**, which in 2001 famously divested Dao Heng Bank to **DBS Group Holdings** for $10 billion or 3x book value at the time.

"For us, it is about identifying a balanced approach. We want to manage the risk, balancing upside and downside constantly. We try to maintain stability," says Cheng. **E**

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GuocoLand's flex and core leasing concept will be integrated into Guoco Midtown