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Sunland Capital Pty Ltd

1 March 2021

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Issuer Outline

Sunland Group (Sunland, Group) is an ASX listed residential property development group with over 30 years' industry experience. The business operates primarily in South-East Queensland, Sydney and Melbourne and is comprised of two main segments:

- Residential housing and urban development (Housing): The development and sale of land (urban development), medium-density housing products and project services.
- Multistorey residential apartments (MS): The MS segment comprises medium-rise residential projects, generally between five and 15 storeys, and high-rise residential projects above 15 storeys.

The Group is vertically integrated with the delivery of projects completed by specialist in-house teams covering land acquisition, project feasibility analysis, design, project management, construction, and sales and marketing. The Group targets projects which deliver a minimum 20% return on costs.

In October 2020, Sunland announced a strategic initiative that will see the Group sell its undeveloped projects, complete (then sell) current developments, pay all outstanding liabilities (including debt) and return all remaining cash to shareholders.

Security
AUD50m 6.20% Oct 2024

ISIN
AU3CB0268001

Currency
AUD

Type
Senior unsecured

Key Financials (AUDm)

LTM (30 Dec)	2020
Revenue	305.3
EBITDA	17.0
Net Debt	149.9
Total Debt/TTA	28.1%

Source: FIIG Securities, Company reports

Note: TTA = Total Tangible Assets

Key Terms

Coupon Type	Fixed	Minimum Amount	AUD10,000
Rate	6.20%	Denomination	AUD1,000
Frequency	Quarterly	Issuer Credit Rating	Unrated
Domicile	Australia	Issue Credit Rating	Unrated
Amount Issued/Outstanding	AUD50m/AUD50m	AU Withholding Tax Exempt	Yes

Key Dates

Issue Date	31 October 2019	Maturity Date	31 October 2024
Call Dates	From 31 Oct 2022 @102.00	From 31 Oct 2023 @101.00	From 30 April 2024 @ 100.00

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Strengths

- Near term development pipeline: Sunland has a history of maintaining a viable pipeline at various stages of development that provides staggered forward earnings with a relatively good level of predictability.

  After its most recent strategy review, the Company has elected not to replenish its current development pipeline. Over the next three years, Sunland will strategically divest non-core assets whilst completing certain developments with cash proceeds allocated toward addressing the dislocation between its current equity price and net tangible asset value per share (all cash, minus liabilities, returned to shareholders). In effect, a wind-down of current operations.

  Sunland currently has nine key development projects (eight in Queensland and one in New South Wales) comprising 1,443 units / lots split across its Multi-Storey (568 lots), Housing (376 lots) and Urban (499 lots) segments. 911 lots have already been settled, with an additional 532 subject to contracts (conditional and unconditional).

- Successful operations through multiple cycles: Sunland has over 30 years' experience with a successful history of navigating multiple property and economic cycles. The Group has managed to navigate a period of economic stability in Australia in the early 90's, where the cash rate peaked at 17.5%. Furthermore, they managed to navigate the GFC, which, among other factors, resulted from stress in the U.S. real estate market. Despite the COVID-19 pandemic, Sunland has been able to navigate through this uncertain period and has continued to deliver strong presales in all of its three key business segments.

- Stable earnings of key segment: Sunland's Housing segment continues to generate stable earnings. Since 2012, the Group's Housing segment has generated between AUD155m and AUD260m in revenue. Furthermore, it has accounted for approximately 81% of Group revenues, on average.

  Although there is a strong concentration to South-East Queensland, Brisbane has been one of the better performing regions, exhibiting a lower decline in housing prices than Sydney, Melbourne and Perth. Furthermore, according to data from the Australian Bureau of Statistics (ABS), Brisbane had the highest net internal migration of all major capital cities in 2019 (and Queensland had the highest net interstate migration).

- Experienced management: The Board of Directors and management team have a long track record, and are supported by specialist in-house teams who cover all aspects of project acquisition and delivery. Dr Soheil Abedian remains a material shareholder and holds the position of Chairman. However, the day-to-day business is run by the executive management team, with oversight by the Board.

- Solid balance sheet: Since the GFC, Sunland has been seeking to maintain a conservative approach to its balance sheet. As at 31 December 2020, the Group has cash on hand of AUD40.2m and AUD171m in undrawn working capital facilities (on a pro forma basis, accounting for the restructuring of Sunland's working capital and corporate facilities).

  As a result of its strategy review, Sunland will be gradually paying down all its debt as developments are completed, as evidenced by about AUD60m being repaid in the six month period ended 31 December 2020.

- Good profitability: The Group is vertically integrated with the delivery of projects completed by specialist in-house teams covering land acquisition, project feasibility analysis, design, project management, construction, and sales and marketing. The Group targets projects which deliver a minimum 20% return on costs. In FY19, the Group achieved a return on cost of 28% on its housing segment, exceeding its targeted development margin of 20%.

Risks

- Property and development risks: Sunland is exposed to the inherent risks associated with economic and property cycles. The Group is exposed to risks from the Queensland, NSW and Victorian property markets (noting that current remaining developments are currently located in Queensland and New South Wales). Each project is also subject to idiosyncratic development risks such as increased costs, insurance costs and extreme weather. This has been the case recently in Sunland's Housing & Urban segment, which has experienced low development margins as a result of completion delays.

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- Settlement risk: The Group maintains contact with buyers from pre-sale to settlement, and states it is typically aware of any pending issues before the completion date. Tighter lending criteria has seen an increase in the number of forfeited deposits. Management indicated that contracts unable to be fulfilled had deposits forfeited, and resales achieved at the prior contract value or above.

  Furthermore, Sunland's multi-storey developments typically target the high-end of the owner-occupier market. This is distinctly different from generic investor stock and has not shown in recent times the same signs of oversupply, particularly in the market where these are located. We also note that Sunland is well-diversified, supported by its core earnings from the Housing division.

  A key cash flow support to Sunland delivering on its strategic review will be the settlement of contracted lots, currently expected to generate in the region of AUD350m of revenue (or AUD70m of profit, based on Sunland's target development margin of 20%). A failure to settle a material portion of these contracted sales would reduce cash inflows and delay the likely repayment of the Notes.
- Regulatory and political risk: The property sector has come under scrutiny from regulators and politicians. In recent years, APRA has forced banks to implement policies aimed at reducing capital available for investment and owner-occupied loans. Additionally, the banking regulator has attempted to reduce interest only borrowing. Similarly, politicians have threatened to implement policies aimed at curtailing the property market. For example, the Australian Labor Party (ALP) threaten to abolish negative gearing for new home purchases, which would have had a significant impact for investors. For the time being, the regulatory environment remains stable. The Liberal Party has provided clear guidance in relation to current guidelines related to laws, whilst the prudential regulator, APRA, has implemented accommodative policies toward the property sector. While this risk is mitigated by the relatively short time frame to deliver the Strategic Review, this is nonetheless one that could impact property prices and therefore Sunland's ability to fully monetise its assets.
- Profit and cash flow are typically volatile: Due to the nature of property development, income can be volatile, recognised only in the year development has finished and properties are settled. It is also not uncommon for future development plans to change as market conditions change and therefore impact forecasts.
- Increasing gearing: Sunland is increasing gearing to replenish and deliver its development portfolio. Although the Group continues to focus on its Housing segment, it is still completing projects in its Multi-storey segment. The Group will generally look to leverage multi-storey projects to a greater level in order to manage equity more efficiently as they have a longer delivery program. Typically Sunland gears to 35% against house/land developments and 70-80% on high-rise projects (debt to inventory value). However this is coming from a low base and is controlled by gearing and leverage covenants under the Notes and bank lending facilities. It should be further noted that, since the start of the COVID-19 pandemic, the Group has implemented a number of measures to support liquidity and near term leverage. Unless Sunland were to start new large developments (which we would view as unlikely given the current strategic review), we consider the risk of a material increase in gearing as relatively low.
- Distributions to shareholders: Sunland has had historically shareholder friendly capital management policies, primarily through substantial share buyback programmes (FY19: 11.1m shares for AUD17.6m, FY18: 3.7m shares for AUD6.7m, FY17: 7.9m shares for AUD13.3m). The Group had intended to execute a new share buyback programme for up to 25% of outstanding shares for a maximum value of AUD60m. This latest programme was subsequently cancelled in mid-March 2020, as COVID-19 uncertainty was growing. While the recent announcement that Sunland would pay a dividend of 30 cents per share (including a special dividend of 22 cents), Noteholders have the benefit of covenants that need to be met prior to a distribution being paid. In particular, the terms of the Notes require that Sunland maintain minimum Net Tangible Assets of AUD300m, which will likely act as a constraint while the Company unwinds its activities.

Other risks

- Call risk: A decision to call the bonds ahead of the maturity date depends on a number of factors, including the relative cost of entering new debt financing, the company's liquidity position, and the availability and attractiveness of new funding opportunities at the call date. Given the strategic review underway, we believe that it is highly likely that the Notes will be redeem on or about their first call date in October 2022.

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- Duration risk: n/a
- Interest deferral/cancellation: n/a
- Non-viability trigger: n/a

Summary

Sunland's 6.20% 31 October 2024 senior unsecured bond offers exposure to a high yielding fixed rate note from an ASX-listed developer with a long history of successfully navigating multiple property and economic cycles but with an uncertain near-term outlook given the current COVID-19 pandemic.

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Financials

Profit and Loss (AUDm) - FYE 30 June	FY17	FY18	FY19	FY20
Revenue	405.7	330.0	282.7	167.2
Gross Profit	87.1	75.2	54.7	24.7
EBITDA	65.4	61.7	39.0	9.5
Depreciation and Amortisation	(1.6)	(1.6)	(1.9)	(2.3)
EBIT	63.8	60.1	37.1	7.2
Interest Expense	(13.8)	(12.0)	(11.7)	(6.2)
Operating Profit Before Tax	50.0	48.2	25.4	1.0
NPBT	50.0	48.2	25.4	1.0
Tax	(14.7)	(13.5)	(7.7)	1.4
NPAT	35.3	34.7	17.7	2.4
Balance Sheet (AUDm)	FY17	FY18	FY19	FY20
Cash	14.6	10.6	19.8	13.1
Current Receivables	79.1	7.6	5.0	10.2
Inventory and Investment Property	548.1	569.2	488.6	537.8
Plant and Equipment	8.9	8.5	10.4	9.7
Other	0.5	1.7	3.7	3.3
Total Assets	651.2	597.6	527.5	574.0
Accounts Payable	25.8	8.0	11.8	18.4
Secured Debt	169.2	127.4	77.5	138.3
Unsecured Debt	50.0	50.0	50.0	50.0
Other	42.3	45.6	36.7	25.6
Total Liabilities	287.3	230.9	175.9	232.2
Total Equity	363.8	366.7	351.6	341.8
Cash Flows (AUDm)	FY17	FY18	FY19	FY20
Net Operating Cash Flow	(6.7)	63.9	94.1	(77.5)
Capital Expenditures	(2.0)	(3.0)	(4.5)	(2.5)
Land Acquisition	(3.2)	-	-	-
Other	2.0	0.0	-	-
Net Investing Cash Flow	(3.2)	(3.0)	(1.6)	20.2
Total Dividends	(14.6)	(17.0)	(15.1)	(5.6)
Equity Raised	(13.3)	-	-	-
Net Borrowings	32.4	(41.2)	(50.5)	62.8
Net Financing Cash Flow	4.6	(64.9)	(83.3)	50.6
Net Cash Flow	(5.3)	(4.0)	9.2	(6.7)

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