Indonesia's Property Sector Stable, Slow Recovery Expected

Analyst: Agung Iskandar

PEFINDO is of the view that the outlook of the property industry in Indonesia is stable in the near to medium term, supported by strong demand, particularly for the housing sector due to the country's huge housing backlog of 10-12 million units in 2017, the young demographic age, and the expanding middle class segment. These factors will drive demand for property, particularly for the residential segment. The ability of developers to supply housing every year is only 300,000-400,000 units, far below the housing need of about 800,000 units per year.

However, we also consider the industry challenging due to the economic downturn, new regulations, and macroeconomic issues that prolonged until the first half of 2017 (1H2017), which contributed to a weakening market as buyers delayed property purchases. We expect these factors will slow the presales growth of several property developers, which will eventually lead to lower revenue generation in 2017. The Jakarta governor election also caused an uncertain business environment, which created a wait and see mood by developers, customers, and investors. As a result, several property developers changed their strategies, such as adjusting their property portfolios, product price segmentation, unit size, and rescheduling product launches to the second half of 2017. We maintain a stable outlook for the Indonesian property industry, but expect a slow recovery in the near to medium term. We are positive on the residential segment, particularly landed houses, which should be a main driver for presales in 2017, followed by land plot sales from property developers such as PT Bumi Serpong Damai Tbk (BSDE, $_{id}$AA-/Stable), PT Agung Podomoro Land Tbk (APLN, $_{id}$A-/Negative), and PT Intiland Development Tbk (DILD, $_{id}$A-/Negative).

Slow property market growth is also shown by lower growth of Bank Indonesia's (BI) yearly Residential Property Price Index (RPPI). In 1H2017, the RPPI grew by 1.18% quarter-on-quarter (QoQ), slower than previous quarter growth of 1.23% QoQ. BI showed residential property sales growth in 1H2017 was slower at 3.61% QoQ from 4.16% QoQ in the previous quarter. This was in line with limited residential demand. We expect the slowdown in residential property prices will continue in the remainder of 2017.

Modest tax amnesty impact on pre-sales of property developers in Indonesia

In order to boost property demand and project development, the government launched the tax amnesty program in June 2016, which obtained repatriated funds of IDR144.7 trillion up to March 2017. The program has not had a significant impact in increasing property presales in Indonesia, as most of the repatriated funds are still in bank accounts. We note that most of the assets declared came from private individuals (small and medium sized enterprises), compared to private entities, which should have supported property demand. The impact of the tax amnesty may sustain property demand from the middle to upper segment, but we view the impact as modest and it may not be adequate to increase property sales significantly, given that some developers are still in wait and see mode to launch new projects. Buyers in the middle to upper segment are also worried about changing regulatory issues, such as the progressive tax for vacant land and apartments at the beginning of 2017.

Presales did not see a significant increase up to 1H2017, although some developers were able to book revenue growth on an annual basis. Most developers reported weak presales in 1H2017, which translated to weaker achievements compared to 1H2016. We are of the view that weak presales were mainly caused by delayed product launches in 1H2017 due to political issues, the festive season, and changes in property regulations, which toned down customers' buying appetite for property.

In our portfolio, PT Bumi Serpong Damai Tbk (BSDE) booked presales of IDR2.5 trillion in 1H2017, flat year-on-year (YoY), about 35% of its yearly target of IDR7.2 trillion. This was BSDE's weakest performance in the last five years, from 40-50% in the first half of the year. PT Summarecon Agung Tbk (SMRA) also booked lower presales growth of 19% YoY in 1H2017 due to poor project absorption in both the residential and high rise segments. PT Agung Podomoro Land Tbk (APLN) and PT Intiland Development Tbk (DILD) booked higher presales in 1H2017, but the increase did not majorly come from selling its property projects, but was due to land selling transactions. In 1H2017, APLN sold its landbank in Karawang, West Java, to China Fortune Land Development for IDR1.4 trillion, while DILD sold its industrial land area in Ngoro Industrial Park to PT Toyota Astra Motor for IDR386 billion. We expect relatively weak presales to continue and take a longer time to recover until the next presidential election in 2019, as buyers and investors are delaying purchases due to uncertain political conditions in Indonesia.

Increasing financial leverage in PEFINDO's property portfolio

The financial leverage of several property players in PEFINDO's portfolio has shown a higher trend for the past five years up to 1H2017, as reflected by lower EBITDA margins amid weak sales growth and higher debt levels. Several property developers, such as APLN, SMRA, and DILD, are focusing more on developing the residential segment, particularly apartment projects which require higher working capital needs amid slower take-up rates. The developers have a track record of missing their property sales targets over the past couple of years, which further pressured their financial leverage, in our view. We placed a negative outlook for the three companies, reflecting our expectation of higher debt appetite and weaker cash flow protection measures in the near term.

In our portfolio, BSDE has the strongest capital structure among its peers due to strong revenue growth and EBITDA margin in 1H2017, helped by land sales from a joint venture (JV) with Mitsubishi Corporation that generated revenue of IDR840 billion. We expect BSDE will maintain its strong capital structure in the near term as its revenue will still majorly come from selling property in the Serpong area, particularly landed houses and land plots, which, in our view, should generate better cash flow compared to the high-rise residential segment. MDLN's revenue in 1H2017 improved due to selling industrial land in Modern Cikande, while its residential segment slightly improved due to higher revenue recognition from delayed projects in 2016. We expect MDLN's financial leverage to remain high in the near term, due to higher debt amid weak presales and project launch delays.

We will closely monitor the financial profiles of our rated companies, particularly those who have a negative outlook. Most highly depend on the high-rise segment, which needs higher debt compared to peers engaging more in the landed residential segment. We also anticipate the possibility of more aggressive financial leverage and weakening cash flow protection measures following continuous weakening demand. We will monitor the achievement of presales targets in 2017, which may translate into future company performances.

Table 1. Rating comparison among peers (IDR billion)

For the period ended	**PT Bumi Serpong Damai Tbk** *30-Jun-17*	**PT Summarecon Agung Tbk** *30-Jun-17*	**PT Modernland Realty Tbk** *30-Jun-17*	**PT Agung Podomoro Land Tbk** *30-Jun-17*	**PT Intiland Development Tbk** *30-Jun-17*
Adjusted assets	42,110.0	21,204.9	13,418.3	29,548.1	12,546.6
Inventory	7,942.3	5,580.2	1,068.3	4,008.7	2,211.4
Real estate assets	10,473.3	6,288.8	5,793.5	5,426.7	4,154.5
Adjusted debt	8,603.5	7,807.8	4,803.1	9,824.6	4,172.8
Adjusted equity	26,309.2	8,214.0	5,603.8	11,120.0	5,937.5
Sales	4,213.4	2,684.6	1,433.6	3,934.5	1,339.6
EBITDA	2,282.2	692.1	537.1	1,626.8	393.6
Net Income	2,010.1	48.8	246.0	696.0	187.6
GPM [%]	73.4	43.0	55.0	51.9	43.4
EBITDA Margin [%]	54.2	25.8	37.5	41.3	29.4
Debt/EBITDA [x]	*1.9	*5.6	*4.5	*3.0	*5.3
DER [x]	0.3	1.0	0.9	0.9	0.7
FFO/debt [%]	*44.9	*5.4	*7.9	*24.5	*6.9
EBITDA/IFCCI [x]	7.6	1.8	1.9	4.5	1.8
Rating	$_{id}$AA-/Stable	$_{id}$A+/Negative	$_{id}$A/Negative	$_{id}$A-/Negative	$_{id}$A-/Negative

Source: PEFINDO database, 2017
FFO = EBITDA – IFCCI + Interest Income – Current Tax Expense
EBITDA = Operating Profit + Depreciation Expense + Amortization Expense
IFCCI = Gross Interest Expense + Other Financial Charges + Capitalized Interest; (FX Loss not included)
MI= Minority Interest **Annualized*