COMPANY UPDATE – Sta. Lucia Land Inc. (SLI):

1Q21 performance shows recovery following FY20 resiliency

EXECUTIVE SUMMARY

FY20 net income declines 1.6% in 2020 despite 12.3% drop in revenues. SLI's net income amounted to Php1.71bn in 2020, slightly lower (-1.6%) year-on-year. The firm's bottom line decline was much more tempered than the decline in its revenues, which slipped 12.3% YoY to Php6.85bn, as attributable to over-all margin improvement. The firm attributed the decline in topline to the impact of the pandemic as it weighed on operations. Reservation sales in the residential development segment slipped, resulting in an 8.3% decline in real estate sales. Meanwhile, the firm's leasing segment experienced the biggest adverse impact with segment revenues declining 40.5% YoY on the back of retail tenant store closures and the provision of rental concessions.

1Q21 bottomline surges 90.6% to Php923.9mn. The firm's profitability recovered in the first quarter of 2021 as driven by a 24.7% surge in revenues, continuing margin strength, and lower tax expenses due to the passage of the CREATE law. The firm's residential business buoyed the firm's topline growth with segment revenues climbing 35.3% amid continuing sluggishness in the leasing business wherein segment revenues declined 28.3% YoY. Nevertheless, the SLI's leasing segment posted some signs of improvement as the segment's gross and core operating margins improved by 14.7pp and 14.5pp, to 53% and 43.3%, respectively. This improvement was driven by better margins from its office leasing asset – the newly-completed six-storey Sta. Lucia Business Center (*SLBC*) – which started contributing to rental revenues late last year.

Despite prevailing sluggishness in commercial leasing, recurring income is set to get a boost over medium-term. SLI remains committed to further expand its leasing business through the development of its second mall – Sta. Lucia Davao Mall – which is slated for completion in 2023. Together with the firm's existing leasing assets, the Sta. Lucia East Grand Mall and SLBC the firm's management team is looking to improve the revenue contribution of leasing income to 8-12% of revenues within the next three years (vs. 7.8% in 2020).

Future growth to be underpinned by strategic expansion and residential development. According to management, SLI expansion's thrust over the coming years will be focused on: (1) continuing pursuit of joint-venture opportunities; (2) expanding into strategic high-growth areas, especially those near key infra projects, and; (3) maximizing selling efforts through its in-house and third-party marketing arms.

Firm files for up to Php9.9bn share offering to help finance growth plans. SLI has filed a registration statement with the Securities and Exchange Commission (*SEC*) in early July for a follow-on offering of up to 3bn primary shares at a price range of between Php2.38 to Php3.29 per share. Proceeds from the offer will be primarily used to fund new and ongoing projects, strategic landbanking, and debt refinancing. Management had indicated that forward development plans will be centered on underserved provincial areas vis-à-vis the saturated Metro Manila market.

RATING SUMMARY	
Stock Symbol	SLI
Recommendation	UNRATED
Target Prices (Php / share)	*NA*
Upside Potential	*NA*

RELATIVE PERFORMANCE	Price	%YTD
SLI	2.90	***46.5%***
Property Index	3,200.36	*-12.7%*
PSEi	6,693.83	*-6.25%*

KEY MARKET DATA	
Market Cap (Php Bn)	*23.80*
Free Float Level (%)	*18.2%*
3mo Avg Value T/O (Php Mn)	*2.5*
6mo Avg Value T/O (Php Mn)	*2.7*

SLI's Stock Price Movement (One-Year)

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PERFORMANCE SUMMARY

in Millions Php	2016a	2017a	2018a	2019a	2020a	Historical CAGR[1]	1Q20a	1Q21a	YoY Growth
Revenues	3,293	3,689	4,032	7,810	6,853	*20.1%*	1,836	2,290	*24.7%*
% growth		*12.0%*	*9.3%*	*93.7%*	*(12.3)%*			*24.7%*	
Gross Profit	1,749	2,243	2,519	4,579	4,460	*26.4%*	1,179	1,470	*24.7%*
% margin	*53.1%*	*60.8%*	*62.5%*	*58.6%*	*65.1%*		*64.2%*	*64.2%*	
Operating Income	1,122	1,619	1,849	3,317	3,392	*31.9%*	916	1,127	*22.9%*
% margin	*34.1%*	*43.9%*	*45.9%*	*42.5%*	*49.5%*		*49.9%*	*49.2%*	
Net Income	730	818	1,065	1,736	1,708	*23.7%*	485	924	*90.6%*
% margin	*22.2%*	*22.2%*	*26.4%*	*22.2%*	*24.9%*		*26.4%*	*40.4%*	
Key Valuation Metrics									
Diluted EPS	0.08	0.09	0.13	0.21	0.21	*26.4%*	0.06	0.11	*90.6%*
Actual P/E (x)[2]	*13.4x*	*11.1x*	*9.6x*	*11.7x*	*9.5x*				
ROE (%)[3]		*5.9%*	*7.4%*	*11.4%*	*10.1%*				

Notes: ***a** :Actual reported;* ***2** :Full-year EPS divided by end-year price* **Data source** *:Company information, China Bank Securities Estimates*
***1** :Four-year CAGR* ***3** :Return on average equity*

SLI posts strong 1Q21 recovery following resiliency in 2020

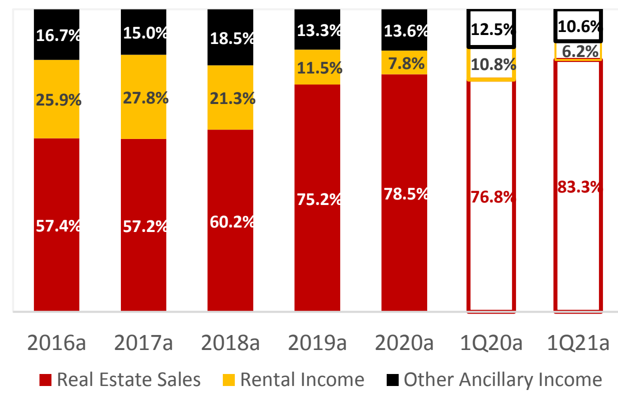
FY20 FINANCIAL PERFORMANCE

Net income declines 1.6% in 2020 despite 12.3% drop in revenues. SLI's net income amounted to Php1.71bn in 2020, slightly lower (-1.6%) year-on-year. The firm's bottom line decline was much more tempered than the decline in its revenues, which slipped 12.3% YoY to Php6.85bn, as attributable to over-all margin improvement.

The firm attributed the decline in topline to the impact of the pandemic as it weighed on operations. Reservation sales in the residential development segment slipped, resulting in an 8.3% decline in real estate sales. Meanwhile, the firm's leasing segment experienced the biggest adverse impact with segment revenues declining 40.5% YoY on the back of retail tenant store closures and the provision of rental concessions.

On the basis revenue contribution, the residential segment remained the key driver of profitability (*Figure 1*). It was also the main driver of SLI's over-all margin improvement, as segment gross margins increased by 8.0pp YoY (*Figure 2*). Meanwhile, margins contracted for the leasing segment (-7.6pp) as associated costs declined at a lower rate than leasing revenues. Improvements in selling and administrative expenses, which declined 15.5% YoY, also helped improve profitability. Over-all, operating and net margins improved by 7.0pp and 2.7pp to 49.5% and 24.9%, respectively (*Figure 3*).

Figure 1: SLI Revenue Mix



Data Source: Company information

1Q21 FINANCIAL PERFORMANCE

SLI bounces back strongly in 1Q21. The firm's profitability recovered in the first quarter of 2021, with net income surging 90.6% YoY to Php923.9mn as driven by a 24.7% surge in revenues, continuing margin strength, and lower tax expenses due to the passage of the CREATE law (*Figure 3*). The firm's residential business buoyed the firm's topline growth with segment revenues climbing 35.3% amid continuing sluggishness in the leasing business wherein segment revenues declined 28.3% YoY (*Figure 2*).

Residential business continues to underpin recovery as leasing segment margins improve despite lower revenues. The firm's residential business remained the key driver of profitability in the first quarter as the firm was able to capitalize on resilient demand, especially in properties outside of Metro Manila. Reservation sales for the quarter stood at Php2.0bn, and compares to Php2.5bn in 1Q20 and Php3.1bn in 4Q20. It is worthy to note that there was a slight decrease in the gross and core operating margins[1] for the segment, which declined 1.6pp and 1.3pp, respectively.

Meanwhile the firm's leasing segment posted some signs of improvement despite the continuing weakness in topline. Segment gross and core operating margins improved by 14.7pp and 14.5pp, to 53% and 43.3%, respectively. Management said that this improvement was driven by better margins from its office leasing asset – the newly-completed six-storey Sta. Lucia Business Center (*SLBC*) – which started contributing to rental revenues late last year. Note that SLBC is currently 100% leased out to a Philippine Offshore Gaming Operator (*POGO*) under a five-year lease contract.

Figure 2: FY 2020 and 1Q21 Segment Information

	FULL-YEAR 2020				FIRST QUARTER 2021			
	Residential	*% Chg YoY*	Leasing	*% Chg YoY*	Residential	*% Chg YoY*	Leasing	*% Chg YoY*
Net Revenues	5,383	*(8.3)%*	535	*(40.5)%*	1,906	*35.3%*	142	*(28.3)%*
Gross Profit	3,358	*5.2%*	166	*(52.2)%*	1,153	*31.9%*	75	*(0.7)%*
Operating Profit	2,326	*17.8%*	131	*(56.6)%*	855	*31.5%*	61	*7.6%*
Net Income	1,619	*10.4%*	89	*(67.0)%*	872	*97.7%*	46	*5.8%*
Gross Margin	*62.4%*	*+8.0pp*	*31.1%*	*-7.6pp*	*60.5%*	*-1.6pp*	*53.0%*	*+14.7pp*
Operating Margin	*43.2%*	*+9.6pp*	*24.6%*	*-9.1pp*	*44.9%*	*-1.3pp*	*43.3%*	*+14.5pp*
Net Margin	*30.1%*	*+5.1pp*	*16.6%*	*-13.4pp*	*45.8%*	*+14.4pp*	*32.4%*	*+10.5pp*

Note: *All data in Php Mns except margin data* ***Data Source*** *: Company information, China Bank Securities estimates*

[1] Computed as segment revenues less cost of real estate sales / leasing, and selling and administrative expenses

Figure 3: FY 2020 and 1Q21 Results Summary

	FULL-YEAR 2020			FIRST QUARTER 2021		
In Bn Php	**FY19r**	**FY20r**	***% Chg YoY***	**1Q20r**	**1Q21r**	***% Chg YoY***
Net Revenues	**7.81**	**6.85**	*(12.3)%*	**1.84**	**2.29**	*24.7%*
Gross Profit	**4.58**	**4.46**	*(2.6)%*	**1.18**	**1.47**	*24.7%*
Gross Profit margin (%)	*58.6%*	*65.1%*		*64.2%*	*64.2%*	
Operating Income	**3.32**	**3.39**	*2.3%*	**0.92**	**1.13**	*22.9%*
Operating margin (%)	*42.5%*	*49.5%*		*49.9%*	*49.2%*	
Pretax Profit	**2.43**	**2.40**	*(1.3)%*	**0.69**	**0.87**	*26.7%*
Pretax margin (%)	*31.1%*	*35.0%*		*37.4%*	*38.0%*	
Net Income	**1.74**	**1.71**	*(1.6)%*	**0.48**	**0.92**	*90.6%*
Net margin (%)	*22.2%*	*24.9%*		*26.4%*	*40.4%*	

** r: Reported* ***Data Source*** *: Company filings, China Bank Securities estimates*

BUSINESS UPDATES

Despite prevailing sluggishness in commercial leasing, recurring income is set to get a boost over medium-term. SLI's leasing business continued to encounter challenges after a particularly challenging 2020. Management noted that they had provided rental concessions ranging from 50-100% of monthly rent payments last year, totaling Php166.5mn. Moreover, as of end-March 2021, 49 tenants terminated their existing lease contracts while some tenants continued with their modified leases (percent-of-revenue lease payment scheme vs. the prior fixed monthly rate plus percent-of-revenue scheme), leading to a decline in rental income for the period. Further rent concessions may also be granted this year, which may impact segment profitability.

Despite these short-term challenges, SLI remains committed to further expand its leasing business through the development of its second mall – Sta. Lucia Davao Mall (24,143 sq.m. GLA) – which is slated for completion in 2023. Together with the firm's existing leasing assets, Sta. Lucia East Grand Mall (*SLEGM,* 99,077 sq.m. in retail GLA) and SLBC (26,011 sq.m in office GLA), the firm's management team is looking to improve the revenue contribution of leasing income to 8-12% of revenues[2] within the next three years (vs. 7.8% in 2020). SLI also continues to be on the lookout for other opportunities to boost recurring income, such as developing new office, mall and hotel projects, as well as through strategic partnerships.

SLI has over 192 completed and ongoing residential projects across the country, over 2,500 ha. of raw landbank. Despite construction delays and a dent in demand due to the pandemic, SLI continues to have a strong inventory and pipeline of residential developments. As of March 31, 2021, the firm has over 86 completed projects and 106 projects under development in 11 regions. Most of these projects are in fringe locations, in close proximity to key business hubs and infrastructure. Apart from its saleable inventory, the firm also has 2,531.40 ha. of landbank for development.

Meanwhile, the firm is also continuing to expand its client base through its various marketing arms to mitigate risks associated with its historical dependence on OFW uptake. In particular, the firm is eyeing to increase the share of business process outsourcing (*BPO*) employees, small and medium enterprise (*SME*) owners, and middle class employees to over-all inventory uptake.

Capex spending continued to favor land development in 1Q21. According to management, the firm's capital expenditures (capex) amounted to Php996mn as of 1Q21, amounting to 19.1% of total 2020 capex. In terms of capex mix, 77.5% of 1Q21 capex went to development, construction and operational needs while the balance was for strategic landbanking. This mix is in line with the trend that we've been seeing over the past three years where development capex as a percent of total capex has picked up (*Figure 4*).

Firm files for up to Php9.9bn share offering to help finance growth plans. SLI has filed a registration statement with the Securities and Exchange Commission (*SEC*) in early July for a follow-on offering of up to 3bn primary shares at a price range of between Php2.38 to Php3.29 per share. Proceeds from the offer will be primarily used to fund new and ongoing projects, strategic landbanking, and debt refinancing. Management had indicated that forward development plans will be centered on underserved provincial areas vis-à-vis the saturated Metro Manila market.

Figure 4 : Capital and Project Expenditures

	2016a		2017a		2018a		2019a		2020a		1Q21a	
	Php Mns	% total	Php Mns	% total	Php Mns	% total	Php Mns	% total	Php Mns	% total	Php Mns	% total
Dev't and Construction	2,474	*62.8%*	3,129	*52.1%*	6,187	*95.1%*	6,422	*66.2%*	3,834	*73.6%*	772	*77.5%*
Land Banking	1,464	*37.2%*	2,877	*47.9%*	319	*4.9%*	3,282	*33.8%*	1,377	*26.4%*	224	*22.5%*
Total	**3,938**	*100.0%*	**6,006**	*100.0%*	**6,506**	*100.0%*	**9,704**	*100.0%*	**5,211**	*100.0%*	**996**	*100.0%*

Data Source *: Company information*

[2] Assuming at least a 90% occupancy rate across its leasing assets

OUTLOOK

Future growth to be underpinned by strategic expansion and residential development. According to management, SLI expansion's thrust over the coming years will be focused on the following:

- ***Continuing the asset-light joint venture model:*** SLI also intends to continue capitalizing on its experience in the 'asset-light' joint-venture (*JV*) model wherein it will partner with landowners to develop their land holdings in exchange for a share of the developed property. This limits the need for landbanking capex, allowing the firm to more swiftly realize cash flows from its JV projects. SLI's interests in these JVs range between 40-85%, and comprises ~46% of the firm's total land bank. These JV projects also contributed 13.7% of firm revenues in 1Q21.
- ***Expanding in strategic growth areas:*** The firm plans to double down in its geographic footprint through the strategic acquisition of ~2,015 ha. of land in high-growth areas, including fringe areas close to key business hubs (Metro Manila, Davao and Iloilo), and locations close to key infrastructure projects. The firm's intent is to ensure a development portfolio spanning several years, capitalizing on rising demand against a backdrop of improving economic conditions.
- ***Maximizing marketing efforts, especially in developments near infrastructure projects***: SLI's third-party marketing channels will continue to augment the company's in-house efforts in generating real estate sales. Apart from having on-the-ground sales teams in close proximity to their projects across the country, the firm also has a presence in key global hubs. As of end-March 2021, the firm's third-party marketing sales force amounted to 200 agents in the Americas, 3,300 in Europe, 350 in the Middle East and over 8,767 in Asia (including the Philippines).

Opportunities in other business segments may provide windfall down the line. Apart from its residential development business, the firm's other segments also stand to enhance the firm's long-term prospects, specifically through:

- ***Expanding its commercial property portfolio***: As provided in a preceding section of this report, SLI is in the process of boosting its recurring revenues through its current and pipeline leasing assets – SLEGM, SLBC, and its upcoming Sta. Lucia Davao mall. Moreover, the company is also actively on the lookout for other opportunistic developments in the commercial leasing and hotel space.
- ***Homebuilding services through Sta. Lucia Homes:*** The firm is also looking at opportunities to capitalize on the growing demand for home developments within their projects through its subsidiary, Sta. Lucia Homes, Inc. (*SLHI*). This is a potentially lucrative driver of growth, in our view, with historical margins comparable to its leasing business (note that the firm's home construction business in 2016-2017 averaged a 38.7% gross profit margin). Moreover, the provision of such services is a good complement to its existing residential development business.

Prospects buoyed by demand uptick for areas outside central business districts. More than the recovery in demand from pandemic lows, the firm also stands to benefit from secular demand growth for properties located in fringe areas as developers have slowly expanded their development pipelines to include projects outside major central business districts. According to a February 2021 survey conducted by Colliers[3], over 70% of respondents planned to develop properties in the fringe areas of Mandaluyong, Alabang and Las Pinas considering that these locations comprised 21% of take-up for mid-income to luxury projects in 2020.

We expect this trend of higher demand for 'fringe area' properties to continue as consumers' purchasing power grows alongside the regional economies. Moreover, we also see consumers increasingly becoming more open to locations that are a little further than central business district (CBD) fringe areas, such as Rizal, Batangas, and Laguna, as more infrastructure projects come online.

Upcoming capital-raising to provide additional runway for development goals. While the firm's balance sheet and debt service capacity continue to be strong (debt-to-equity ratio of 0.94x, interest coverage ratio of 4.37x, and current ratio of 2.12x as of 1Q21), its upcoming development plans will likely require additional funding. As such, we believe that the firm's plans of raising additional equity through a follow-on offering will provide the firm additional runway to reach its medium-term goals. Moreover, a higher equity position will also help the firm maximize its ability to borrow which may prove advantageous considering the prevailing low interest rate environment.

[3] Based on Colliers Quarterly Report (Residential), published in April 30, 2021

FINANCIAL SUMMARY

Amounts in Millions Php	2016a	2017a	2018a	2019a	2020a
INCOME STATEMENT					
Revenues	3,293	3,689	4,032	7,810	6,853
Growth		*12.0%*	*9.3%*	*93.7%*	*(12.3)%*
Gross Profit	1,749	2,243	2,519	4,579	4,460
Growth		*28.3%*	*12.3%*	*81.8%*	*(2.6)%*
Operating profit	1,122	1,619	1,849	3,317	3,392
Growth		*44.3%*	*14.2%*	*79.4%*	*2.3%*
Pre-tax profit	832	1,131	1,142	2,431	2,399
Growth		*36.0%*	*1.0%*	*112.8%*	*(1.3)%*
Net Income	730	818	1,065	1,736	1,708
Growth		*11.9%*	*30.3%*	*63.0%*	*(1.6)%*
BALANCE SHEET					
Current Assets					
Cash and cash equivalents	140	626	1,065	903	943
Receivables	2,520	2,687	1,874	2,369	3,495
Contract assets	-	-	701	1,619	1,880
Real estate inventories	11,953	16,028	18,304	21,870	24,931
Other current assets	2,493	2,754	5,204	4,716	5,401
Non-Current Assets					
Installment contract receivables	934	1,500	495	547	1,014
Contract assets (non-current)	-	-	673	1,242	967
Investment properties	5,153	5,158	5,154	5,597	5,712
Other non-current assets	932	1,055	1,246	1,489	1,442
Total Assets	24,125	29,807	34,716	40,352	45,786
Current Liabilities					
Accounts payable other other liabilities	2,800	2,992	3,991	4,784	5,408
Short-term debt	2,396	5,475	3,608	3,521	6,149
Contract liabilities	-	-	2,018	3,039	3,592
Customer deposits	909	1,223	-	-	-
Current portion of long-term debt	-	-	-	467	3,028
Other current liabilities	79	46	20	50	87
Non-Current Liabilities					
Long-term loans (net)	3,935	5,040	9,999	10,998	8,002
Other non-current liabilities	541	721	627	1,379	1,822
Total Liabilities	10,659	15,497	20,262	24,238	28,088
Equity					
Share capital	11,126	11,126	11,126	11,126	11,126
Retained Earnings	2,644	3,462	4,402	6,139	7,847
Treasury shares	(740)	(740)	(1,640)	(1,640)	(1,640)
Other equity	435	462	565	489	365
Total Equity	13,466	14,310	14,454	16,114	17,698
Total Liabilities and Equity	24,125	29,807	34,716	40,352	45,786
CASH FLOW STATEMENT					
Operating Cash Flow	(1,800)	(2,970)	(1,638)	(26)	(608)
Investing Cash Flow	(614)	(271)	(207)	(463)	(451)
Financing Cash Flow	340	3,727	2,283	327	1,099
Effects of FX rates	-	-	-	-	-
Net change in cash	(2,075)	486	438	(161)	39

Data Source *: Company information*

IMPORTANT DISCLOSURES

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- **HOLD:** A HOLD recommendation on a stock reflects our neutral view on either the underlying company’s fundamentals, or the stock’s valuation, if not both. We expect the stock price to move within a range of +/-15% over a 6-12 month period.
- **SELL:** A SELL recommendation on a stock reflects our negative view on the underlying company’s fundamentals and valuation. We expect the stock to decrease in price by more than 15% over a 6-12 month period.
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