

# China / Hong Kong Company Update

## Champion REIT

Bloomberg: 2778 HK EQUITY | Reuters: 2778.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

22 Feb 2022

### HOLD

Last Traded Price (21 Feb 2022): HK\$3.87 (HSI : 24,170)  
Price Target 12-mth: HK\$4.15 (7% upside) (Prev HK\$4.28)

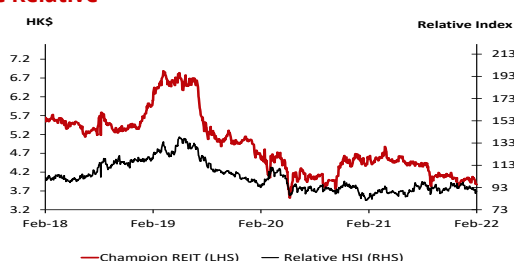
#### Analyst

Jeff Yau +852 36684180 jeff\_yau@dbs.com  
Percy Leung percyleung@dbs.com

#### What's New

- FY21 distributable income fell 3.3% primarily due to lower rental earnings, in line with our estimate
- Payout ratio lowered to 90% in FY21 from FY20's 95%
- Negative reversionary growth is working its way through the portfolio
- Maintain HOLD, DDM-based TP lowered to HK\$4.15 amid uncertain outlook

#### Price Relative



#### Forecasts and Valuation

FY Dec (HK\$ m)	2020A	2021A	2022F	2023F
Gross Revenue	2,920	2,769	2,672	2,685
Net Property Inc	2,347	2,197	2,091	2,086
Net Profit	(12,497)	(831)	1,303	1,277
Distribution Inc	1,477	1,353	1,285	1,262
DPU (HK\$)	0.25	0.23	0.22	0.21
DPU Gth (%)	(6)	(9)	(6)	(2)
Div Yield (%)	6.5	5.9	5.6	5.4
Gross Gearing (%)	23	23	22	22
Book Value (HK\$)	8.61	8.25	8.22	8.42
P/Book Value (x)	0.4	0.5	0.5	0.5

DPU Rev (%): (6) New  
Consensus DPU (HK\$): 0.23 0.21  
Other Broker Recs: B:2 S:5 H:6

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

### Challenging times

#### Investment Thesis

**HOLD with HK\$4.15 TP.** Champion REIT is trading at a distribution yield of 5.6% for FY22 and 5.4% for FY23. The resurgence of COVID cases has delayed income recovery of Langham Place Mall while subdued office demand should continue to weigh on the performance of Three Garden Road.

**Rental reversion at Three Garden Road set to turn more negative.** In 2022, 11.4% of leases at Three Garden Road are scheduled for renewal with another 9.5% up for rent review. Rental decline upon renewal is expected to widen in 2022 with expiring rents exceeding HK\$120psf and current spot rents staying at c.HK\$90psf. The upcoming supply in Central office market could pose a threat to the property's occupancy.

#### Spread of Omicron variant to drag the recovery of Langham Place.

The resurgence of COVID cases has disrupted retail market recovery. This, coupled with delayed reopening of the border with China, should cloud the business outlook of self-operated Langham Beauty which opened for business in Nov-21. Retightening of social distancing measures has forced mandatory closures for many of lifestyle tenants which accounted for 70% of total rental area at Langham Place Office Tower. New round of rental concessions should be inevitable and would drag the rental income at Langham Place Office Tower and Langham Place Mall.

#### Valuation:

Our target price for Champion REIT is based on the Dividend Discount Model using 7.2% discount rate with terminal growth rate of 1%.

#### Where we differ:

We are cautious on the prospects of medium-term leasing demand for Three Garden Road due to new supply in Central

#### Key Risks to Our View:

Any faster-than-expected resolution of the COVID-19 outbreak could help the retail sector recover faster. Easing of social distancing regulations could help revive demand for beauty tenants at Langham Place Office Tower.

#### At A Glance

Issued Capital (m shrs)	5,937
Mkt Cap (HK\$m/US\$m)	22,976 / 2,945
Major Shareholders (%)	
Great Eagle Holdings Ltd	59.3
Eagle Asset Management (CP) Ltd.	8.4
Free Float (%)	32.2
3m Avg. Daily Val. (US\$m)	0.72
GICS Industry: Real Estate / Equity Real Estate Investment	



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## WHAT'S NEW

### FY21 payout ratio reduced to 90%

Champion REIT's FY21 distributable income fell 3.3% to HK\$1.5bn, dragged by reduced rental earnings, partly offset by lower cash finance cost. The results were broadly in line with our estimates. In view of the uncertain business outlook, Champion REIT has lowered the payout ratio to 90% from FY20's 95% to increase its capital reserve for planned renovation at Three Garden Road and prepare for challenges ahead. This resulted in distribution income falling by a larger 8.4% to HK\$1.35bn. Full-year DPU was HK\$0.2279, representing 8.7% decline y-o-y.

Total rental income decreased 5.2% to HK\$2.5bn mainly dragged by weaker performance at Langham Place Mall and Three Garden Road.

Rental income from Three Garden Road shrank 3.8% to HK\$1.46bn led by the impact of negative reversionary growth and lower average occupancy. Negative rental reversion has worked its way through this Grade A office property. Average passing rent fell 2.5% h-o-h to HK\$108.3psf in Dec-21. Meanwhile, thanks to in-house expansion from existing tenants and new lettings from legal firms, occupancy at Three Garden Road rebounded to 89% in Dec-21 from Jun-21's 85%. As of Dec-21, banking is the largest among the property's tenant profile, accounting for 33% of the property's rental area. This was followed by asset management firms, corporates, and legal firms. Flexible workspace took up 5% of the property's total rental area.

In 2022, 11.4% of leases are scheduled for renewal with an additional 9.5% up for rent review. With expiring rents for 2022 standing at >HK\$120psf and the current spot rent of c.\$90psf, rental reversion is expected to turn more negative in 2022. Upcoming office supply in Central may also pose a threat to the property's occupancy. Against this backdrop, Champion REIT has turned more flexible on leasing strategy for Three Garden Road to retain tenants.

Rental receipts from Langham Place Office declined 3.4% to HK\$365m due to negative rental reversions. Passing rents dropped 1% h-o-h to HK\$47.1psf in Dec-21. While the property saw downsizing and departures of certain traditional office tenants, expansion and new letting demand from beauty and healthcare tenants drove its occupancy up to 96.3% in Dec-21 from Jun-21's 91%. This

brought the portion of lifestyle tenants to c.70% of the property's total rental area, up from Jun-21's c.65%.

In FY21, turnover rent at Langham Place Mall doubled to HK\$38m along with the revival of consumer sentiment. However, due to the departure of Beauty Avenue and absence of tourist spending, tenant sales recovery at the mall fell short of the Hong Kong retail market which exhibited 8.1% retail sales growth in 2021. Meanwhile, base rent portion decreased 14.3% to HK\$575m, mainly due to negative rental reversions and short-term rent void led by the departure of Beauty Avenue. Overall, total rental income of the mall was 9.1% lower at HK\$670m. With stabilizing retail scene, more tenants are willing to commit to the base rent in 2H21. The proportion of tenants paying turnover rent only fell to 12% in Dec-21 from Jun-21's 14.3%. The mall was fully occupied as of Dec-21.

Property operating expense was largely flat at HK\$572m. Higher rental commissions and maintenance fees were partly offset by lower government rent and rates and promotion expenses. With net expense ratio higher at 11.9% (FY20: 10.9%), net property income fell by a larger 6.4% to HK\$2.2bn.

Cash finance cost reduced 10% to HK\$401m thanks to lower average HIBOR and a decrease in the fixed rate debt portion. Total debt stood at HK\$15.4bn as of Dec-21 (Jun-21: HK\$16bn). This represented 22.9% of the REIT's total gross asset value (Jun-21: 23.2%). Around 64.6% of interest costs for total debt are on fixed rate basis (Jun-21: 62.1%). All the REIT's borrowings were unsecured in nature as of Dec-21. The REIT has no major refinancing needs in FY22.

Champion REIT is trading at distribution yield of 5.6-5.4% for FY22-23. The spread of Omicron variant has delayed border re-opening with China and thus the earnings recovery of Langham Place Mall. Businesses for lifestyle tenants at Langham Place Office has been disrupted by retightening of social distancing measures since Jan-22. New round of rental concessions should be inevitable. Three Garden Road should continue to suffer from negative rental reversions and face challenges over upcoming office supply in Central. Hence, we maintain HOLD with a lower DDM-based TP of HK\$4.15.

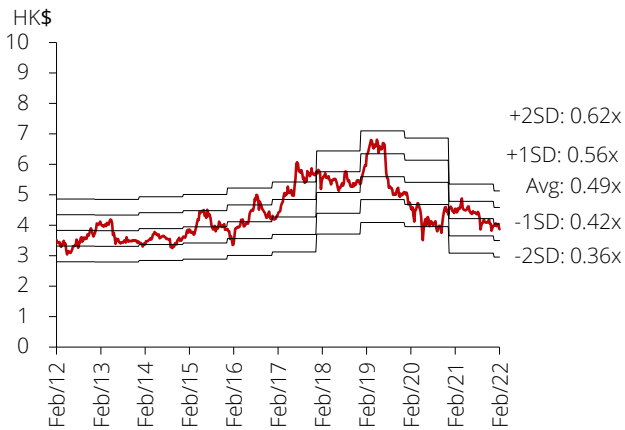
## Champion REIT

### Company Background

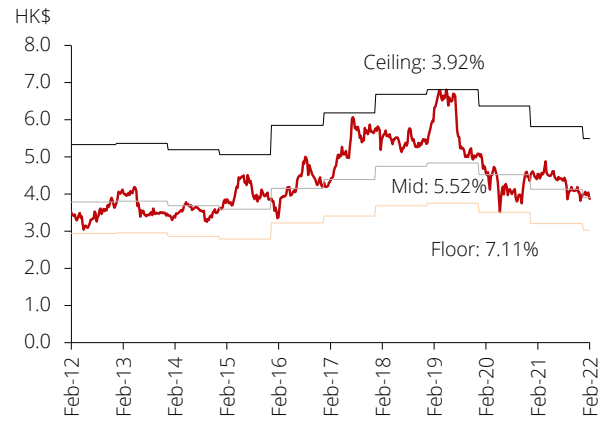
Champion REIT has exposure to both office and retail sectors. Listed in May-2006, the REIT owns Three Garden Road in Central and Langham Place's office and retail portions in Mong Kok with total GRA of 2.93m sf. Champion REIT also owns 27% stake in 66 Shoe Lane, an office property in London.

### Price to book NAV band and historical yield band

Price to book NAV band



Historical yield band



Source: Bloomberg Finance L.P. DBS HK

## Champion REIT

### Result Summary

FY Dec (HK\$m)	2020	2021	Chg (%)	Comments
Rental income	2,558	2,417	(6)	FY21: Income from Three Garden Road and Langham Place Mall fell 3.8% and 9.1% respectively.
Carpark income	41	47	15	
Building management fee	287	274	(4)	
Rental related income	34	31	(10)	
<b>Total revenue</b>	<b>2,920</b>	<b>2,769</b>	<b>(5)</b>	
Property operating expenses	(573)	(572)	(0)	
<b>Net property income</b>	<b>2,347</b>	<b>2,197</b>	<b>(6)</b>	FY21: Net expense ratio rose slightly to 11.9% from FY20's 10.9%
Interest income	54	82	51	
Change in fair value of investment properties	(13,847)	(2,079)	(85)	FY21: Due to lower rental rate assumptions. Cap rate for Three Garden Road, Langham Place Office and Langham Place Mall remained unchanged at 3.7%, 4.1% and 4% respectively
Manager's fee	(282)	(266)	(6)	
Trust and other expenses	(26)	(24)	(8)	
Finance costs	(473)	(431)	(9)	FY21: Cash finance cost fell to HK\$401m from FY20's HK\$445m due to lower average HIBOR and decrease in fixed rate debt portion
Allowance for credit losses on note receivables/interest receivables	0	(76)	<i>n.a.</i>	
Share of results of a joint venture	0	22	<i>n.a.</i>	
<b>Profit before tax</b>	<b>(12,226)</b>	<b>(575)</b>	<b>(95)</b>	
Income taxes	(271)	(256)	(6)	
<b>Net profit</b>	<b>(12,497)</b>	<b>(831)</b>	<b>(93)</b>	
<b>Distributable income</b>	<b>1,554</b>	<b>1,503</b>	<b>(3)</b>	
<b>Distribution amount</b>	<b>1,476</b>	<b>1,353</b>	<b>(8)</b>	FY21: Payout ratio edged down to 90.0% (FY20: 95.0%) to set aside capital for planned renovation and to prepare for challenging market ahead
<b>DPU (HK\$)</b>	<b>0.2496</b>	<b>0.2279</b>	<b>(9)</b>	

Source: Champion REIT

## Champion REIT

### Key Assumptions (%)

	2022F	2023F
Office rental - HK	0	0
Retail rental (Shopping centre) - HK	5	5

Source: Company, DBS HK

### Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
<b>Revenues (HK\$ m)</b>					
Rental income	2,697	2,558	2,417	2,315	2,302
Carpark income	45	41	47	48	49
Building management fee	303	287	274	278	301
Rental related income	36	34	31	32	33
<b>Total</b>	<b>3,081</b>	<b>2,920</b>	<b>2,769</b>	<b>2,672</b>	<b>2,685</b>

Source: Company, DBS HK

### Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Gross revenue	3,081	2,920	2,769	2,672	2,685
Property expenses	(600)	(573)	(572)	(581)	(599)
<b>Net Property Income</b>	<b>2,481</b>	<b>2,347</b>	<b>2,197</b>	<b>2,091</b>	<b>2,086</b>
Other expenses	(322)	(308)	(290)	(276)	(276)
Joint ventures	0	0	22	19	19
Interest (Exp)/Inc	(444)	(418)	(349)	(305)	(329)
Exceptionals	(1,994)	(13,847)	(2,156)	0	0
<b>Pre-Tax Profit</b>	<b>(280)</b>	<b>(12,226)</b>	<b>(575)</b>	<b>1,529</b>	<b>1,499</b>
Tax	(291)	(271)	(256)	(227)	(222)
<b>Net Profit</b>	<b>(570)</b>	<b>(12,497)</b>	<b>(831)</b>	<b>1,303</b>	<b>1,277</b>
<b>Distribution income</b>	<b>1,565</b>	<b>1,477</b>	<b>1,353</b>	<b>1,285</b>	<b>1,262</b>
Revenue Gth (%)	4	(5)	(5)	(3)	0
NPI Gth (%)	3	(5)	(6)	(5)	0
Dist. Inc Growth (%)	2	(6)	(8)	(5)	(2)
DPU Growth (%)	2	(6)	(9)	(6)	(2)

Source: Company, DBS HK

## Champion REIT

### Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Fixed Assets	81,178	67,318	65,296	65,311	66,631
Long-term Investments	215	320	301	301	301
Other LT Assets	61	0	16	16	16
Associates/JVs	0	0	313	313	313
Bank Balance/Cash & Liquid Debtors	1,962	1,834	1,629	1,763	1,878
Other Non Cash Current	4	1,904	33	33	33
<b>Total Assets</b>	<b>83,679</b>	<b>71,693</b>	<b>67,873</b>	<b>68,023</b>	<b>69,458</b>
ST Debt	1,043	3,442	2,026	3,903	5,364
Creditors	1,394	2,115	1,505	1,505	1,505
Other Current Liab	1,862	1,564	1,387	1,394	1,382
LT Debt	13,924	12,956	13,262	11,386	9,925
Deferred Tax Liabilities	0	0	0	0	0
Other LT Liabilities	621	759	730	730	730
Unitholders' funds	64,834	50,858	48,963	49,105	50,552
<b>Total Capital</b>	<b>83,679</b>	<b>71,693</b>	<b>67,873</b>	<b>68,023</b>	<b>69,458</b>
Share Capital (m)	5,873	5,906	5,937	5,970	6,003
Gross Debt	(14,967)	(16,397)	(15,289)	(15,289)	(15,289)
Working Capital	(2,074)	(3,066)	(2,971)	(4,720)	(6,055)
Book NAV (HK\$)	11.04	8.61	8.25	8.22	8.42
Gross Gearing (%)	18	23	23	22	22

Source: DBS HK

### Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Income	(280)	(12,226)	(575)	1,529	1,499
Tax Paid	0	(271)	(256)	(227)	(222)
Joint ventures	0	0	(22)	(19)	(19)
Chg in Wkg.Cap.	133	633	(579)	0	0
Other Non-Cash	2,137	13,934	2,130	43	43
<b>Operational CF</b>	<b>1,991</b>	<b>2,070</b>	<b>697</b>	<b>1,327</b>	<b>1,302</b>
Net Capex	(37)	(15)	(15)	(15)	(14)
Net change in asso/jv	0	0	(382)	0	0
Associates' div	0	0	22	19	19
Assoc, MI, Invsmt	43	(2,155)	2,236	82	82
<b>Investment CF</b>	<b>5</b>	<b>(2,170)</b>	<b>1,861</b>	<b>86</b>	<b>87</b>
Net Chg in Debt	(53)	1,488	(1,109)	0	0
New issues/Unit Buyback	0	0	0	0	0
Distribution Paid	(1,581)	(1,507)	(1,464)	(1,278)	(1,274)
Other Financing CF	0	0	0	0	0
<b>Financing CF</b>	<b>(1,635)</b>	<b>(19)</b>	<b>(2,572)</b>	<b>(1,278)</b>	<b>(1,274)</b>
Chg in Cash	362	(119)	(13)	135	115

Source: Company, DBS HK

**Champion REIT**

**Target Price & Ratings History**



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	1-Mar-21	HK\$4.54	HK\$4.42	Hold
2:	17-Feb-22	HK\$3.95	HK\$4.28	Hold

Source: DBS HK

Analyst: *Jeff Yau*

*Percy Leung*

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**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

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**Champion REIT**

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**DBS Bank (Hong Kong) Limited**

13<sup>th</sup> Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

Tel: (852) 3668-4181, Fax: (852) 2521-1812

**Champion REIT**

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**DBS Regional Research Offices**

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**HONG KONG**

**DBS Bank (Hong Kong) Ltd**

**Contact: Carol Wu**

13th Floor One Island East,

18 Westlands Road, Quarry Bay, Hong Kong

Tel: 852 3668 4181

Fax: 852 2521 1812

e-mail: [dbsvhk@dbs.com](mailto:dbsvhk@dbs.com)

**MALAYSIA**

**AllianceDBS Research Sdn Bhd**

**Contact: Wong Ming Tek (128540 U)**

19th Floor, Menara Multi-Purpose, Capital Square,

8 Jalan Munshi Abdullah 50100, Kuala Lumpur, Malaysia.

Tel.: 603 2604 3333

Fax: 603 2604 3921

e-mail: [general@alliancedbs.com](mailto:general@alliancedbs.com)

Co. Regn No. 198401015984 (128540-U)

**SINGAPORE**

**DBS Bank Ltd**

**Contact: Janice Chua**

12 Marina Boulevard,

Marina Bay Financial Centre Tower 3

Singapore 018982

Tel: 65 6878 8888

e-mail: [groupresearch@dbs.com](mailto:groupresearch@dbs.com)

Company Regn. No. 196800306E

**INDONESIA**

**PT DBS Vickers Sekuritas (Indonesia)**

**Contact: Maynard Priajaya Arif**

DBS Bank Tower

Ciputra World 1, 32/F

Jl. Prof. Dr. Satrio Kav. 3-5

Jakarta 12940, Indonesia

Tel: 62 21 3003 4900

Fax: 6221 3003 4943

e-mail: [indonesiaresearch@dbs.com](mailto:indonesiaresearch@dbs.com)

**THAILAND**

**DBS Vickers Securities (Thailand) Co Ltd**

**Contact: Chanpen Sirithanarattanakul**

989 Siam Piwat Tower Building,

9th, 14th-15th Floor

Rama 1 Road, Pathumwan,

Bangkok Thailand 10330

Tel. 66 2 857 7831

Fax: 66 2 658 1269

e-mail: [research@th.dbs.com](mailto:research@th.dbs.com)

Company Regn. No 0105539127012

Securities and Exchange Commission, Thailand