China / Hong Kong Company Update

Link REIT

Bloomberg: 823 HK EQUITY | Reuters: 0823.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

11 Feb 2022

BUY

Last Traded Price (10 Feb 2022): HK$68.00 (HSI : 24,924)
Price Target 12-mth: HK$83.30 (23% upside) (Prev HK$82.80)

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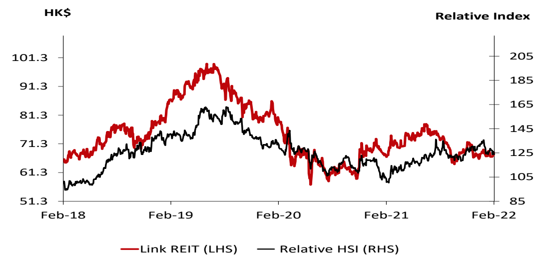
What's New

- Acquiring a 49.9% stake in a joint venture which owns stakes in five prime office assets in Sydney and Melbourne
- Initial NPI yield stands at 4.4% with built-in annual rental escalations of c.4%
- Remains financially sound to pursue yield accretive acquisitions
- Maintain BUY with DDM-based TP of HK$83.3

Price Relative



Forecasts and Valuation

FY Mar (HK$ m)	2020A	2021A	2022F	2023F
Gross Revenue	10,718	10,744	11,840	12,679
Net Property Inc	8,220	8,238	9,048	9,718
Net Profit	(17,122)	1,185	6,436	6,847
Distribution Inc	5,965	6,010	6,806	6,927
DPU (HK$)	2.87	2.90	3.27	3.33
DPU Gth (%)	6	1	13	2
Div Yield (%)	4.2	4.3	4.8	4.9
Gross Gearing (%)	17	18	24	25
Book Value (HK$)	77.61	76.64	79.12	82.24
P/Book Value (x)	0.9	0.9	0.9	0.8
DPU Rev (%):			Nil	1
Consensus DPU (HK$):			3.09	3.25
Other Broker Recs:		B:19	S:0	H:0

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

Deepens office presence in Australia

Investment Thesis

BUY with HK$83.3 TP. Link REIT offers distribution yields of 4.8-4.9% for FY22-23. This translates into a yield spread of 3%, which compares favourably to its 10-year average of 2.6%. While the recent COVID resurgence is causing short-term disruption on Hong Kong's retail market recovery, continued acquisitions would augment its DPU growth.

In acquisition mode. Following a string of acquisitions in China, Australia and Hong Kong in late 2021, Link REIT acquired a 49.9% stake in a joint venture with Oxford Properties Group which holds interests in five prime office assets in Sydney and Melbourne in Feb-22. This not only enhances the distribution yield but also diversifies the earnings base. With current portion of China and overseas assets falling short of management's guidance, we believe there are more acquisitions to come in the years ahead.

Concerns over the retail market disruption in Hong Kong should not be overplayed. In view of recent resurgence of COVID cases, the Hong Kong government has tightened social distancing measures since early Jan-22. Though temporary rental relief for retail tenants may be required, concerns on Link REIT's mall operations should not be overdone. The government has proposed to introduce a vaccine pass to restrict non-vaccinated persons from visiting certain premises including shopping malls. With the first dose vaccination rate high at >80% and people adapt to pandemic restrictions, impact on shopper traffic should be not overplayed.

Valuation:

Link REIT provides unit holders with a relatively visible and steady distribution income stream. Thus, the Dividend Discount Model (DDM) would be the most appropriate valuation method. Under the DDM approach, the target price of Link REIT is equal to the discounted value of all future distributions paid with assumed discount rates of 6.6% and terminal growth of 2%.

Where we differ:

The recent spread of the Omicron variant has delayed the border re-opening but should not derail the retail market recovery. The REIT's community malls should be less vulnerable to the accelerating online shopping trend.

Key Risks to Our View:

Should post-COVID recovery of domestic consumption be derailed, retail rental income would be affected. Any faster-than-expected interest rate hike would adversely affect its distribution and valuation.

At A Glance

Issued Capital (m shrs)	2,082
Mkt Cap (HK$m/US$m)	141,576 / 18,162
Major Shareholders (%)	
APG Asset Management N.V.	5.4
State Street Global Advisors Asia Ltd.	5.3
Free Float (%)	89.3
3m Avg. Daily Val. (US$m)	43.22
GICS Industry: Real Estate / Equity Real Estate Investment	

WHAT'S NEW

Acquires 49.9% stake in a JV that owns interests in five office assets in Australia

Link REIT agreed to form a joint venture with Oxford Properties Group, through which the two companies will jointly hold stakes in five premium office assets in Sydney and Melbourne. Upon completion of the deal (expected in 1H22), Link REIT and Oxford Properties Group will own 49.9% and 50.1% stake in the joint venture respectively. Total contribution for Link REIT amounted to A$596.1m. This marks the REIT's first venture in Melbourne's office market, and the second in Sydney's office market following the acquisition of 100 Market Street in Dec-19.

Oxford Properties Group (Oxford) is a leading global real estate investor and asset manager. It is solely owned by OMERS, one of the largest Canadian defined benefit pension plans. Founded in 1960, Oxford manages a c.C$80bn portfolio across four continents including USA, Canada, Europe and Asia Pacific. Link REIT, jointly with Oxford, will form an Investment Advisory Committee to govern and decide on major matters of the joint venture, including business plans and budgets. Meanwhile, Investa will act as the property manager, responsible for the daily operations of the portfolio. Investa, with AUM over A$11.7bn, is one of the largest and integrated real estate investment management and development companies in Australia.

Spanning a total net lettable area of 0.19msm, the portfolio comprises four and one premium office buildings strategically located at the heart of Sydney and Melbourne CBD respectively. All the properties have achieved or plan to achieve at least NABERS Star Rating of 5 for Energy and 4.5 for Water. This, coupled with its prime location and high transportation connectivity, make the portfolio well positioned to benefit from the emerging "flight to quality" trend in a post-COVID era. Specifications of each property are listed in the chart on page 4.

As of Dec-21, the portfolio was 92.6% let. It has a weighted average lease expiry of 5.8 years with <7% of floor area scheduled for roll over in 2022-23. This points to low vacancy risk in the near term.

The office leasing market in Australia is showing signs of picking up as occupiers start to return to office. The demand should continue to be underpinned by economic recovery with expected GDP growth of 4.25% in 2022 and low unemployment rate. Supply risk should be limited as softened pre-committed rate and inflation expectations have delayed new project launches. These should benefit its office portfolio.

Among trades, financial services is by far the largest tenant group, contributing 41.8% of the portfolio's total gross rent. This is followed by professional services and healthcare and life science tenants, with 32.5% and 6.2% respectively. Despite economic slowdown amid the COVID outbreak, the portfolio has a healthy rental collection rate of c.100%, thanks to a diversified income base backed by tenants with strong covenants. Since all properties are either recently completed or have undergone major refurbishments, no material capital expenditure is expected in the near term.

Based on the agreed property value of A$1.13bn and net passing income of A$49.6m for 49.9% stake of the portfolio, initial rental yield stands at 4.4%. There will also be a built-in annual rental escalation of c.4% to mitigate impact of inflation over lease tenor. Overall, we estimate the acquisition would enhance the REIT's FY23 DPU by c.1.2%.

Upon deal completion, Link REIT's pro-forma adjusted gearing is expected to rise 1ppt to 24.6%. Link REIT remains financially sound to gear up for yield accretive acquisitions when opportunity knocks.

Following the acquisition, overseas assets will account for 6.4% of Link REIT's total portfolio valuation. Meanwhile, proportion for Hong Kong and China assets stand at 76.9% and 16.7% respectively. With management guidance for China and overseas assets to be 20-25% and 10-15% respectively, we believe Link REIT will continue to explore acquisition opportunities in China and overseas to drive portfolio growth and meet its Vision 2025 target.

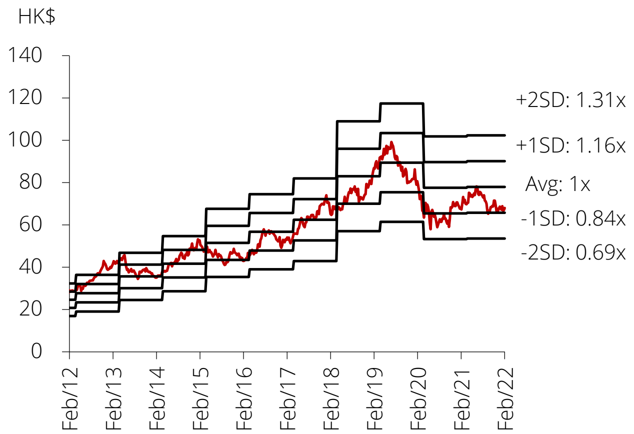
Link REIT is trading at distribution yields of 4.8-4.9% for FY22-23. This translates into yield spread of 3% which compares favourably to its 10-year average of 2.6%. The recent COVID resurgence has delayed the border re-opening, and is causing short-term disruption to the retail sector. While temporary rental relief may be required, concerns on Link REIT's mall operations should not be overdone. The government has proposed to implement a vaccine pass in late Feb-22 which restricts non-vaccinated persons from visiting certain premises including shopping malls. Impact on shopper traffic should not be overplayed as >80% of the total population has received the first vaccine dose. On the other hand, continued acquisitions should augment the REIT's distribution growth and diversify its income base. We maintain BUY with DDM-based TP increased slightly to HK$83.3. Any faster-than-expected interest rate hike remains the key investment risk, among others.

Company Background

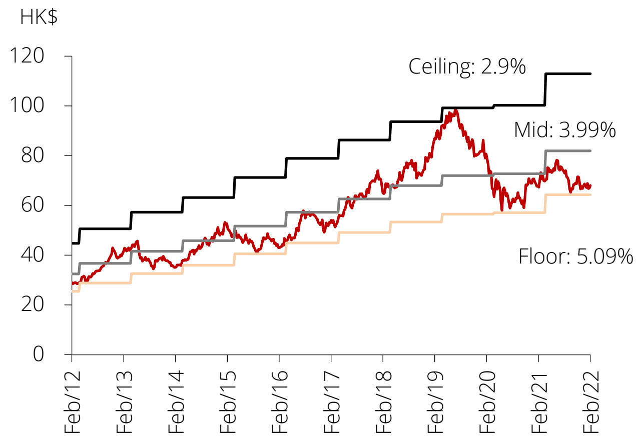
Link REIT is the largest listed REIT in Hong Kong. Its portfolio comprises mainly retail properties located adjacent to public housing estates and has a 60% stake in The Quayside in Kwun Tong. In China, Link REIT holds a portfolio of neighborhood malls in first-tier cities mainly Beijing, Guangzhou, Shanghai and Shenzhen and an office property in Shanghai. In 2020, Link REIT expanded its presence in overseas office market by acquiring 100 Market Street in Sydney and The Cabot in London. In Oct-21, Link REIT made its maiden foray into the China logistics property market by acquiring 75% stake of two modern warehouses in Dongguan and Foshan. In Nov-21, Link REIT acquired 50% interests in three retail properties in Sydney, marking its first venture in the Australian retail market. In the same month, Link REIT purchased a godown in Chai Wan and a mixed-use car parking building in Hung Hom. In Feb-22, Link REIT further expanded its office presence in Australia.

Price to book NAV band and historical yield band

Price to book NAV band



Historical yield band



Source: Bloomberg Finance L.P. DBS HK

Specifications of each property

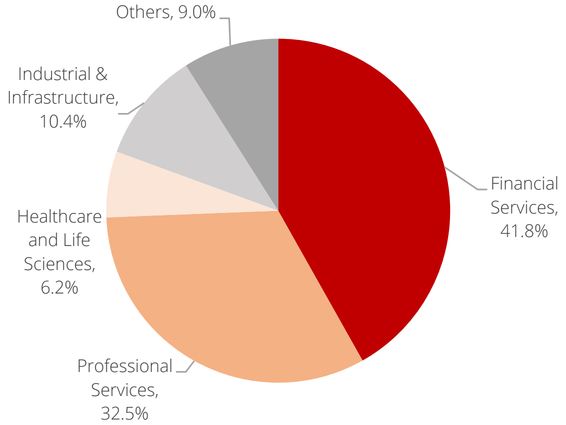
Property	151 Clarence St	126 Phillip St	388 George St	347 Kent St	567 Collins St
Location	Sydney	Sydney	Sydney	Sydney	Melbourne
Grade	A	Premium	A	A	Premium
Completion / Recent Major Refurbishment	2018	2005	2020	2020	2015
Net Lettable Area (sqm)	21,891	42,131	41,255	26,819	55,052
Parking Spaces	41	84	73	74	156
Stake held by target portfolio (%)	100	25	50	100	50
Major tenants	Arup, Mills Oakley	Deutsche Bank, Allens	QBE, Aware Super	IOOF, Zurich	Jemena, Corrs Chambers Westgarth
NABERS / Green Star	- 5.5 Star Energy - 4.5 Star Water - 6 Star Green Star	- 5 Star Energy - 4.5 Star Water	- 5 Star Energy* - 4 Star Water* - 5 Star Green Star*	- 5 Star Energy - 4.5 Star Water	- 5.5 Star Energy - 5.5 Star Water

Source: Link REIT

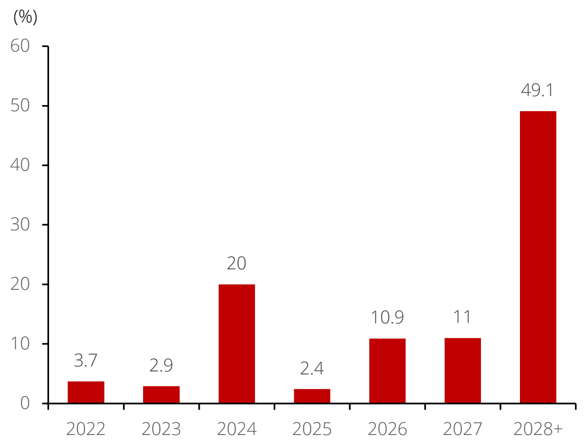
**Target*

Tenant mix and lease expiry profile of office portfolio

Tenant mix



Lease expiry profile



Source: Link REIT

Key Assumptions (%)

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

Source: Company, DBS HK

Segmental Breakdown (HK$ m)

FY Mar	2019A	2020A	2021A	2022F	2023F
Revenues (HK$ m)					
Retail and commercial	7,648	7,626	7,787	8,397	9,084
Car parks	1,979	1,912	1,883	2,097	2,194
Other revenues	410	1,180	1,074	1,347	1,401
Total	10,037	10,718	10,744	11,840	12,679

Source: Company, DBS HK

Income Statement (HK$ m)

FY Mar	2019A	2020A	2021A	2022F	2023F
Gross revenue	10,037	10,718	10,744	11,840	12,679
Property expenses	(2,348)	(2,498)	(2,506)	(2,792)	(2,961)
Net Property Income	7,689	8,220	8,238	9,048	9,718
Other expenses	(405)	(416)	(428)	(462)	(492)
Joint ventures	0	0	0	125	465
Interest (Exp)/Inc	(513)	(447)	(644)	(1,002)	(1,413)
Exceptionals	15,030	(23,948)	(5,322)	0	0
Pre-Tax Profit	21,801	(16,591)	1,844	7,708	8,278
Tax	(1,359)	(712)	(1,092)	(1,233)	(1,349)
Non-Controlling Interests	(113)	181	433	(39)	(82)
Net Profit	20,329	(17,122)	1,185	6,436	6,847
Distribution income	5,723	5,965	6,010	6,806	6,927
Revenue Gth (%)	0	7	0	10	7
NPI Gth (%)	0	7	0	10	7
Dist. Inc Growth (%)	5	4	1	13	2
DPU Growth (%)	9	6	1	13	2

Source: Company, DBS HK

Balance Sheet (HK$ m)

FY Mar	2019A	2020A	2021A	2022F	2023F
Fixed Assets	218,634	194,613	200,375	218,200	225,259
Other LT Assets	36	231	218	218	218
Intangibles Assets	433	424	392	392	392
Associates/JVs	0	0	0	10,108	10,573
Bank Balance/Cash & Liquid	6,789	7,877	2,530	2,097	4,643
ST Investments	0	2,746	2,742	2,742	2,742
Inventory	0	0	0	0	0
Debtors	933	1,231	1,195	1,205	1,215
Other Non Cash Current	112	497	2,433	128	128
Total Assets	226,937	207,619	209,885	235,091	245,170
ST Debt	3,367	937	3,248	5,682	15,482
Creditors	2,585	2,640	2,504	2,494	2,484
Other Current Liab	2,174	2,278	2,893	2,923	2,953
LT Debt	20,850	33,661	35,388	51,682	45,382
Deferred Tax Liabilities	3,191	2,871	3,029	3,029	3,029
Other LT Liabilities	5,444	5,115	4,130	4,130	4,130
Non-Controlling Interests	587	406	(27)	421	503
Unitholders' funds	188,739	159,711	158,720	164,729	171,207
Total Capital	226,937	207,619	209,885	235,091	245,170
Share Capital (m)	2,109	2,057	2,071	2,082	2,082
Gross Debt	(24,217)	(34,598)	(38,636)	(57,364)	(60,864)
Working Capital	(292)	6,496	255	(4,928)	(12,192)
Book NAV (HK$)	89.48	77.64	76.64	79.12	82.24
Gross Gearing (%)	11	17	18	24	25

Source: DBS HK

Cash Flow Statement (HK$ m)

FY Mar	2019A	2020A	2021A	2022F	2023F
Pre-Tax Income	21,801	(16,591)	1,844	7,708	8,278
Tax Paid	(1,102)	(933)	(737)	(1,233)	(1,349)
Depr/Amort	22	75	75	75	75
Disposal of FAs/Subsidaries	(2,761)	15	0	0	0
Chg in Wkg.Cap.	(204)	(282)	(70)	10	10
Other Non-Cash	(11,766)	24,305	5,966	1,002	1,413
Operational CF	5,990	6,589	7,078	7,562	8,427
Net Capex	2,253	(1,673)	(8,375)	(11,928)	(625)
Net change in asso/jv	0	0	0	(9,984)	0
Net Change in Investments	0	(2,777)	0	0	0
Assoc, MI, Invsmt	4,522	3,918	(2,167)	2,395	90
Investment CF	6,775	(532)	(10,542)	(19,517)	(535)
Net Chg in Debt	(4,320)	10,129	3,169	18,728	3,500
New issues/Unit Buyback	(3,216)	(4,240)	(379)	0	0
Distribution Paid	(5,517)	(5,930)	(3,966)	(6,399)	(6,878)
Other Financing CF	(89)	(725)	(884)	(683)	(1,503)
Financing CF	(13,142)	(766)	(2,060)	11,646	(4,881)
Chg in Cash	(377)	5,291	(5,524)	(308)	3,011

Source: Company, DBS HK

Target Price & Ratings History

S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	25-Feb-21	HK$72.50	HK$78.00	Buy
2:	14-Apr-21	HK$71.90	HK$79.35	Buy
3:	7-Jun-21	HK$74.10	HK$80.40	Buy
4:	18-Jun-21	HK$75.55	HK$80.65	Buy
5:	8-Oct-21	HK$65.90	HK$80.65	Buy
6:	8-Nov-21	HK$68.70	HK$81.45	Buy
7:	11-Nov-21	HK$70.40	HK$82.80	Buy

Source: DBS HK

Analyst: Jeff YAU CFA,
Percy LEUNG

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
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

Completed Date: 11 Feb 2022 13:02:45 (HKT)
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Sources for all charts and tables are DBS HK unless otherwise specified.

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