China / Hong Kong Company Update

Sunlight REIT

Bloomberg: 435 HK Equity | Reuters: 0435.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

4 Feb 2022

BUY

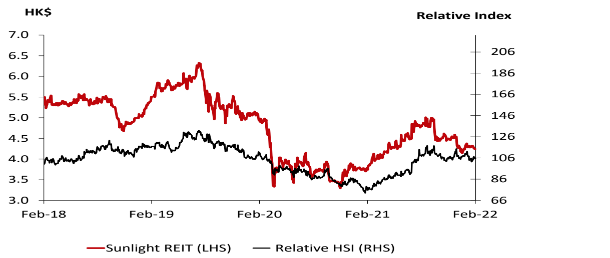
Last Traded Price (31 Jan 2022): HK$4.24 (HSI : 23,802)
Price Target 12-mth: HK$5.01 (18% upside) (Prev HK$5.30)

Analyst
Jeff YAU CFA, +852 36684180 jeff_yau@dbs.com
Percy LEUNG percyleung@dbs.com

What's New

- Office occupancy moderated slightly, led by the departure of a core tenant at The Harvest in Dec 21
- Metro City Ph 1 property staged rebounding footfall and tenants' sales
- Retail reversionary growth turned less negative in 1QFY22
- Maintain BUY with DDM-based TP of HK$5.01

Price Relative



Forecasts and Valuation

FY Jun (HK$ m)	2020A	2021A	2022F	2023F
Gross Revenue	855	799	791	814
Net Property Inc	685	640	628	647
Net Profit	(751)	(234)	372	379
Distribution Inc	445	427	407	416
DPU (HK$)	0.27	0.26	0.24	0.25
DPU Gth (%)	(2)	(5)	(5)	1
Div Yield (%)	6.3	6.0	5.7	5.8
Gross Gearing (%)	22	23	23	22
Book Value (HK$)	8.89	8.44	8.47	8.63
P/Book Value (x)	0.5	0.5	0.5	0.5
DPU Rev (%):			(1)	(2)

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

Embracing challenges

Investment Thesis

BUY with HK$5.01 TP. Sunlight REIT offers distribution yield of 5.7-5.8% for FY22-23. Office rents show initial signs of bottoming, while retail reversionary growth is turning less negative. Even taking into account short-term disruptions caused by the spread of the Omicron variant, we remain positive about the REIT's investment value following the unit price correction.

Retail reversionary growth turning less negative. Tenant sales and footfall at Metro City Phase I have recovered to >80% of pre-COVID levels. The Sheung Shui Centre Shopping Arcade witnesses a slower recovery, reflecting the absence of cross-border spending due to the border control measures in place. Rental decline upon renewal narrowed to 5.4% in 1QFY22 from FY21's 8.4%.

Office occupancy retreated slightly. Office portfolio occupancy moderated after the departure of Chong Hing Bank, a core tenant at The Harvest, in Dec-21. But the impact should be mild, as the surrendered space accounts for just 1.4% of the office portfolio. Despite stabilising spot rents, Dah Sing Financial Centre should continue to see negative reversionary growth in FY22 due to the high expiring rent.

Valuation:

Our target price is based on the Discounted Dividend Model (DDM) using a discount rate of 6.6%.

Where we differ:

We are more positive about Sunlight REIT's earnings resilience, given its balanced asset portfolio and proactive asset and capital management strategy.

Key Risks to Our View:

Market risk. The prolonged COVID-19 pandemic would impact leasing demand for retail space. Macro uncertainties would deteriorate office demand. These could drag its earnings and unit price performance.

Interest rate risk. Any faster-than-expected interest rate hike could drag down its valuation.

At A Glance

Issued Capital (m shrs)	1,672
Mkt Cap (HK$m/US$m)	7,089 / 910
Major Shareholders (%)	
Shau Kee Financial Enterprise Ltd.	22.3
Silchester International Investors, L.L.P.	12.0
Henderson Sunlight Asset Management Limited	10.2
Henderson Land Development Co Ltd	8.6
Free Float (%)	47.0
3m Avg. Daily Val. (US$m)	0.38
GICS Industry: Real Estate / Equity Real Estate Investment	

WHAT'S NEW

Retail reversionary growth turning less negative

Office portfolio occupancy, which stood at 93.1% in Sep 21, has retreated due to increased vacancies at The Harvest in Mong Kok. Chong Hing Bank did not renew the lease for the retail portion from the basement to the fourth floor, with GRA of 11,627sf, upon lease expiry in Dec 21. Sunlight REIT is actively in search of replacement tenants. The short-term rent void, however, is inevitable. Although the property is popular among service trade tenants, given its convenient location, lower rent is expected upon re-letting the space on the ground and first floors. Nonetheless, the overall income impacts should not be overly concerned as the vacated space accounts for only 1.4% of the office portfolio.

On the other hand, certain Grade B office buildings in Central, Sheung Wan, and North Point benefit from recovering demand

Occupancy at Dah Sing Financial Centre stood at 88.5% as of Sep 21, with spot rents showing signs of stabilising. However, with expiring rent high at HK$43.6psf, reversionary growth should stay in the negative territory in FY22 when 14.2% of its area is scheduled for roll over. Rental reversion for the overall office portfolio should remain negative at 5%-8% in FY22.

On the backdrop of an easing pandemic situation in Hong Kong, no further rental concessions were granted to retail tenants in 1HFY22. Footfall at the Metro City Phase I property, which serves the daily needs of residents nearby, has returned to >80% of pre-COVID levels. Sheung Shui Centre Shopping Arcade stages a slower recovery, with the absence of cross border shopping due to border closure. Mainland shoppers used to account for one-third of footfall prior to the COVID-19 outbreak.

Leasing sentiment has improved, particularly with F&B and grocery tenants. Against this backdrop, retail tenants are more willing to commit to long-term leases. Rental decline upon renewal has narrowed to 5.4% in 1QFY22 from FY21's 8.4%.

Overall, we estimate Sunlight REIT's total revenue to fall 1% in FY22, reflecting primarily negative reversionary growth. With a slightly higher estimated cost-to-income ratio of 20.7% (FY21:20%), NPI is expected to drop by a larger 2%.

Sunlight REIT is in discussions with banks for the refinancing of its HK$2bn term loan maturing in mid-22. The credit margin is expected to be slightly higher than the existing one.

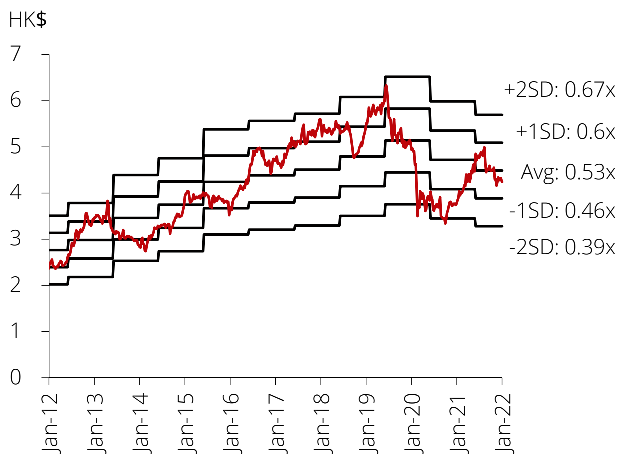
Unit price of Sunlight REIT fell 5.6% in the past four months. Meanwhile, Sunlight REIT is trading at 5.7%-5.8% distribution yields for FY22-23, translating into yield spreads of 4.0%-4.1%. Office rents show initial signs of bottoming, while retail reversionary growth is turning less negative. Even taking into account short-term disruptions caused by the spread of the Omicron variant, we remain positive on the REIT's investment value following the unit price correction. Maintain BUY with DDM-based TP of HK$5.01. Any faster-than-expected interest rate hike remains an overhang.

Company Background

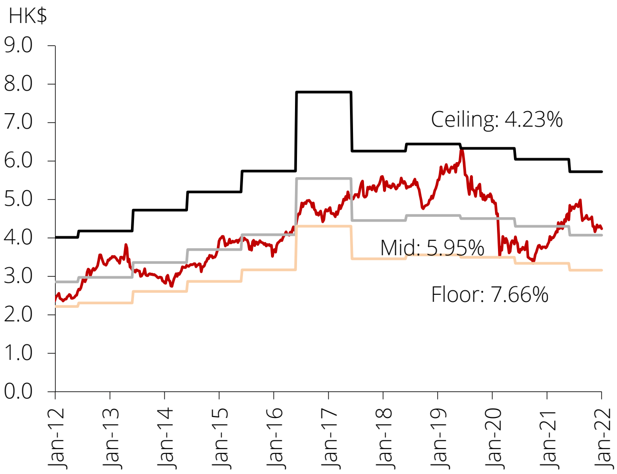
Sunlight REIT is the first Hong Kong REIT with exposure to both office and retail sectors. Listed in December 2006, the REIT now owns a diverse portfolio of 16 office and retail properties. Its three major properties are Sunlight Tower in Wanchai, Sheung Shui Centre Shopping Arcade in Sheung Shui, and the Metro City Ph 1 property in Tseung Kwan O.

Price to book NAV band and historical yield band

Price to book NAV band



Historical yield band



Source: Bloomberg Finance L.P. DBS HK

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 Jun	2019A	2020A	2021A	2022F	2023F
Revenues (HK$ m)					
Rental income	684	689	645	633	651
Carpark income	35	34	32	33	35
Rental-related income	131	132	121	125	128
Total	851	855	799	791	814

Source: Company, DBS HK

Income Statement (HK$ m)

FY Jun	2019A	2020A	2021A	2022F	2023F
Gross revenue	851	855	799	791	814
Property expenses	(168)	(170)	(160)	(164)	(166)
Net Property Income	683	685	640	628	647
Other expenses	(119)	(110)	(108)	(108)	(110)
Interest (Exp)/Inc	(85)	(103)	(85)	(87)	(96)
Exceptionals	1,194	(1,143)	(605)	0	0
Pre-Tax Profit	1,672	(671)	(158)	432	441
Tax	(81)	(80)	(76)	(60)	(62)
Net Profit	1,591	(751)	(234)	372	379
Distribution income	450	445	427	407	416
Revenue Gth (%)	4	0	(6)	(1)	3
NPI Gth (%)	6	0	(7)	(2)	3
Dist. Inc Growth (%)	3	(1)	(4)	(5)	2
DPU Growth (%)	3	(2)	(5)	(5)	1

Source: Company, DBS HK

Balance Sheet (HK$ m)

FY Jun	2019A	2020A	2021A	2022F	2023F
Fixed Assets	20,003	18,918	18,342	18,508	18,889
Long-term Investments	136	116	141	141	141
Other LT Assets	43	38	38	38	38
Deferred Tax Asset	0	0	0	0	0
Bank Balance/Cash & Liquid	550	499	623	598	583
Debtors	25	49	55	55	55
Other Non Cash Current	49	54	0	0	0
Total Assets	20,806	19,674	19,200	19,340	19,707
ST Debt	599	1,643	2,003	600	0
Creditors	70	60	71	71	71
Other Current Liab	305	348	337	337	337
LT Debt	3,638	2,597	2,398	3,801	4,401
Deferred Tax Liabilities	179	192	205	205	205
Other LT Liabilities	23	63	61	61	61
Unitholders' funds	15,992	14,771	14,124	14,265	14,631
Total Capital	20,806	19,674	19,200	19,340	19,707
Share Capital (m)	1,652	1,662	1,673	1,684	1,695
Gross Debt	(4,237)	(4,239)	(4,401)	(4,401)	(4,401)
Working Capital	(350)	(1,449)	(1,733)	(356)	230
Book NAV (HK$)	9.68	8.89	8.44	8.47	8.63
Gross Gearing (%)	20	22	23	23	22

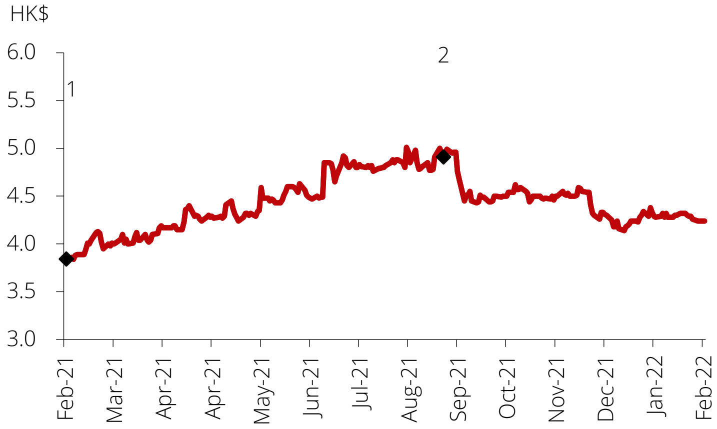
Source: DBS HK

Cash Flow Statement (HK$ m)

FY Jun	2019A	2020A	2021A	2022F	2023F
Pre-Tax Income	1,672	(671)	(158)	432	441
Tax Paid	(76)	(77)	(16)	(60)	(62)
Depr/Amort	0	0	0	0	0
Chg in Wkg.Cap.	13	(14)	(27)	0	0
Other Non-Cash	(1,057)	1,297	737	134	144
Operational CF	552	534	536	505	523
Net Capex	(61)	(53)	(28)	(30)	(30)
Net Change in Investments	(29)	20	(25)	0	0
Assoc, MI, Invsmt	(117)	83	(255)	9	9
Investment CF	(206)	50	(309)	(21)	(21)
Net Chg in Debt	(20)	0	166	0	0
New issues/Unit Buyback	(13)	(4)	(6)	0	0
Distribution Paid	(446)	(452)	(434)	(413)	(412)
Other Financing CF	(93)	(113)	(93)	(96)	(105)
Financing CF	(571)	(569)	(368)	(510)	(517)
Chg in Cash	(226)	15	(141)	(25)	(15)

Source: Company, DBS HK

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	5-Feb-21	HK$3.82	HK$4.42	Buy
2:	8-Sep-21	HK$4.94	HK$5.30	Buy

Source: DBS HK

Analyst: Jeff YAU CFA,
Percy LEUNG

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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*

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DBS Bank (Hong Kong) Limited

13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

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

DBS Regional Research Offices

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

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
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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
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

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
Company Regn. No 0105539127012
Securities and Exchange Commission, Thailand