

Fortune REIT

Bloomberg: 778 HK Equity | Reuters: 0778.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

2 Mar 2022

BUY

Last Traded Price (1 Mar 2022): HK\$7.40 (HSI : 22,762)
Price Target 12-mth: HK\$8.88 (20% upside) (Prev HK\$9.34)

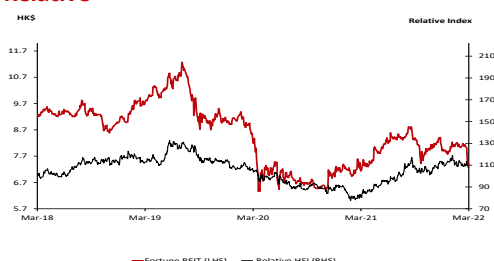
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What's New

- FY21 distributable income rose 1%, slightly ahead of our estimate due to lower-than-expected rental decline
- Lowered payout ratio to 90% to preserve more cash
- Completed refinancing for FY22
- Maintain BUY with DDM-based TP lowered to HK\$8.88

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2020A	2021A	2022F	2023F
Gross Revenue	1,844	1,806	1,749	1,811
Net Property Inc	1,376	1,340	1,277	1,332
Net Profit	(3,193)	1,318	744	772
Distribution Inc	922	883	854	931
DPU (HK\$)	0.47	0.45	0.43	0.46
DPU Gth (%)	(8)	(5)	(4)	8
Div Yield (%)	6.4	6.1	5.8	6.3
Gross Gearing (%)	22	22	22	22
Book Value (HK\$)	14.62	14.78	15.06	15.37
P/Book Value (x)	0.5	0.5	0.5	0.5

DPU Rev (%):		(8)	(4)
Consensus DPU (HK\$):		0.46	0.47
Other Broker Recs:	B:5	S:2	H:1

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

Riding through tough times

Investment Thesis

BUY with HK\$8.88 TP. Fortune REIT is trading at distribution yields of 5.8-6.3% for FY22-23. Despite disruptions led by Omicron, Fortune REIT's business performance should continue to be underpinned by strong domestic consumption recovery once the pandemic subsides.

Preparing for a rainy day. To preserve more cash amidst uncertainty in rental cash flow led by the proposed enactment of temporary rental moratorium, Fortune REIT had prudently lowered the payout to 90% in FY21 from FY20's 95%. The REIT had previously lowered its payout ratio to 90% for 1H20 from the usual 100% in view of challenges led by the COVID-19 outbreak. However, once the pandemic stabilizes, we believe Fortune REIT will pay out its distributable income in full as it did for 2H20.

Don't underestimate the recovery momentum once the pandemic subsides. With >60% of tenants coming from non-discretionary trades, Fortune REIT is well positioned to tap on strong domestic consumption recovery when the pandemic situation stabilizes. Distribution of a new round of electronic consumption vouchers should give an additional boost. Rental uplift upon the completion of asset enhancement works at +Woo and Fortune Metropolis should add further momentum to the REIT's earnings recovery.

Valuation:

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

Where we differ:

We are more positive on the post-COVID recovery of domestic non-discretionary consumption which should benefit Fortune REIT once the pandemic situation stabilizes.

Key Risks to Our View:

Domestic consumption would be seriously affected if tight social distancing measures last for a long period, which would impact retail rental income. Any faster-than-expected interest rate hikes would adversely affect its valuation.

At A Glance

Issued Capital (m shrs)	1,959
Mkt Cap (HK\$/US\$m)	14,497 / 1,855
Major Shareholders (%)	
Focus Eagle Investments Ltd.	20.9
Ballston Profits Ltd.	5.7
Free Float (%)	73.4
3m Avg. Daily Val. (US\$m)	2.14
GICS Industry: Real Estate / Equity Real Estate Investment	



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Fortune REIT

WHAT'S NEW

Payout ratio cut to 90% to build up cash reserve

Despite reduced rental earnings, Fortune REIT FY21's distributable income rose by a marginal 1.1% to HK\$981m thanks to lower cash finance cost. The result was 3% above our estimate due to smaller-than-expected rental earnings decline. Fortune REIT has reduced its FY21 payout ratio to 90% from FY20's 95%, bringing distribution income down by a larger 4.2% to HK\$883m. We view this as a prudent move to preserve cash amid uncertainties raised by the enactment of rental moratorium. Final DPU was HK\$0.1987, taking full year DPU to HK\$0.4483, down 4.9% y-o-y.

This is not the first time that Fortune REIT has cut its payout ratio. Back in mid-2020, Fortune REIT had lowered its payout ratio for 1H20 to 90% from its usual 100% in view of the challenges led by the outbreak of COVID-19. Yet, as the pandemic situation gradually stabilised, Fortune REIT resumed its 100% payout in 2H20.

Base rent declined 3.3% to HK\$1.44bn as a result of negative reversionary growth and lower portfolio occupancy. On the back of domestic consumption recovery in 2H21, tenant sales at Fortune REIT's portfolio grew broadly in line with the Hong Kong retail market which exhibited 7.9% tenant sales growth in the same period. Against this backdrop, rental decline upon renewal narrowed to 4-5% in 2H21 from 1H21's 9-10%. No further rental concessions were granted in the period. Carpark income rose 13% to HK\$116m in FY21 led by a better utilization rate in 2H21 amid loosening of social distancing measures. Overall, total revenue fell 2% to HK\$1.81bn.

Portfolio occupancy moderated to 94.3% in Dec-21 from Jun-21's 95.8%, mainly due to commencement of AEs at Fortune Metropolis and +WOO.

Commenced in Jul-21, the HK\$16m facelift of the food court at Fortune Metropolis is close to completion. Over 30% of the 15,000sf space has been pre-committed by tenants. The mall was 83.2% let as of Dec-21 (Jun-21: 87.1%). Meanwhile, AEI at +WOO Ph 2 will be carried out in 3 stages. Stage 1 is scheduled for completion in 1H22. As a result, occupancy at +WOO softened to 86.7% in Dec-21 from Jun-21's 92.1%. Pre-leasing of the renovated area is underway with pre-commitment rate of c.50%.

Thanks to a flexible leasing strategy, Fortune REIT has maintained a healthy retention rate of 74% in FY21, despite the two renovations.

Total property operating expenses was flat at HK\$425m. Increases in utility expenses, leasing commissions and advertising and promotion expenses were offset by savings from credit losses allowance and legal fees. This brought net property income down 2.6% to HK\$1.34bn, implying a cost-to-income ratio of 23.5% (FY20: 23.1%).

Cash finance cost decreased 20% to HK\$173m as a result of lower HIBOR. Effective borrowing cost for the year was 2.18%, down from FY20's 2.8%.

As of Dec-21, total debt stood at HK\$8.9bn (Jun-21: HK\$8.8bn), representing 22.4% of the REIT's total asset value (Jun-21: 22.5%). Fortune REIT has entered into more interest rate swaps, bringing the hedging ratio up to 70% in Dec-21 from Jun-21's 51%. In Jan-22, Fortune REIT secured a 5-year HK\$1.2bn sustainability-linked loan to refinance its debt maturing 2022. This has lengthened the REIT's average debt maturity to 3.9 years. There is no refinancing need till Oct-23.

In 2022, 40.7% of the portfolio's gross rental area is scheduled for roll over. Amid sluggish retail market, Fortune REIT has turned more flexible on its leasing strategy to retain tenants. Reversionary growth could possibly be under pressure in the near term.

We have lowered our distribution income forecast for FY22 by 8% on an assumed payout ratio of 95%.

Fortune REIT is trading at distribution yield of 5.8-6.3% for FY22-23. Despite temporary business disruptions led by Omicron, we remain positive on Fortune REIT's income outlook once the pandemic subsides. With >60% of income coming from tenants in non-discretionary trades, Fortune REIT is well placed to tap on strong domestic consumption recovery that is further bolstered by new round of electronic consumption vouchers following the easing of social distancing measures. While concerns over the temporary rental enforcement moratorium remains a near-term share overhang, we keep BUY rating with lower DDM-based TP of HK\$8.88.

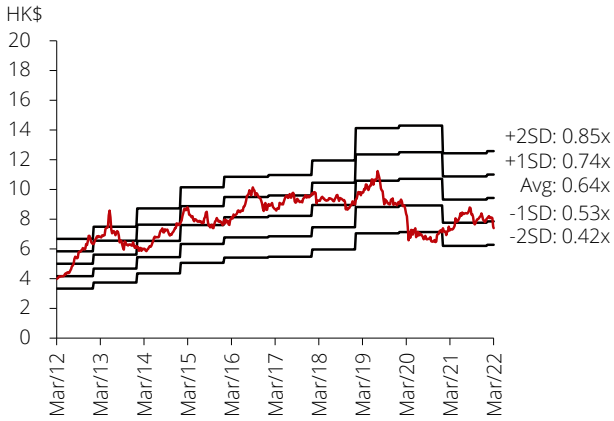
Fortune REIT

Company Background

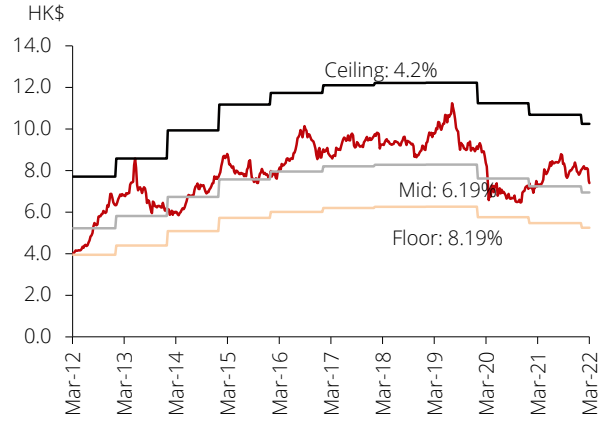
Fortune REIT owns 16 suburban malls in Hong Kong with a gross rental area of c.3m sf. The malls are mostly located near densely populated residential areas which ensure a certain level of foot traffic.

Price to book NAV band and historical yield band

Price to book NAV band



Historical yield band



Source: Bloomberg Finance L.P. DBS HK

Fortune REIT
Result Summary

FY Dec (HK\$m)	FY20	FY21	% Chg	Comments
Total revenue	1,843.8	1,806.4	(2.0)	FY21: Dragged by negative rental reversions and lower portfolio occupancy
Property operating expenses	(425.1)	(424.8)	(0.1)	FY21: Increases in utility expenses, leasing commission and advertising and promotion expenses were offset by saving from lower credit losses and legal fees
Manager's performance fee	(42.6)	(41.5)	(2.6)	
Net property income	1,376.1	1,340.2	(2.6)	
Manager's base fee	(122.2)	(117.2)	(4.1)	
Foreign currency exchange loss	(0.1)	0.0	n.a.	
Interest income	0.2	0.1	(65.4)	
Trust expenses	(14.5)	(14.1)	(2.6)	
Change in fair value of investment properties	(3,799.9)	358.0	n.a.	FY21: Average capitalisation rate remained the same at 4.3%
Finance costs	(426.6)	(45.8)	(89.3)	FY21: Cash finance cost was 20% lower at HK\$173m (FY20: HK\$215m) mainly due to lower HIBOR
Profit before tax	(2,987.0)	1,521.1	n.a.	
Tax	(205.9)	(203.6)	(1.1)	
Net profit	(3,193.0)	1,317.5	n.a.	
Distributable income	970.4	981.1	1.1	
Distribution income	921.9	883.0	(4.2)	FY21: Payout ratio reduced to 90% (FY20: 95%)
DPU (HK\$)	0.4716	0.448	(4.9)	

Source: Fortune REIT

Fortune REIT

Key Assumptions (%)

	2022F	2023F
Retail Rental (Shopping Center) - HK	5	5

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (HK\$ m)					
Base rent & other income	1,713	1,600	1,567	1,524	1,570
Charge-out collections	247	244	239	225	241
Total	1,960	1,844	1,806	1,749	1,811

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Gross revenue	1,960	1,844	1,806	1,749	1,811
Property expenses	(479)	(468)	(466)	(472)	(480)
Net Property Income	1,481	1,376	1,340	1,277	1,332
Other expenses	(151)	(137)	(131)	(137)	(140)
Interest (Exp)/Inc	(265)	(246)	(193)	(199)	(216)
Exceptionals	631	(3,981)	505	0	0
Pre-Tax Profit	1,696	(2,987)	1,521	942	976
Tax	(219)	(206)	(204)	(197)	(204)
Net Profit	1,477	(3,193)	1,318	744	772
Distribution income	994	922	883	854	931
Revenue Gth (%)	1	(6)	(2)	(3)	4
NPI Gth (%)	1	(7)	(3)	(5)	4
Dist. Inc Growth (%)	1	(7)	(4)	(3)	9
DPU Growth (%)	0	(8)	(5)	(4)	8

Source: Company, DBS HK

Fortune REIT

Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Fixed Assets	42,820	39,075	39,500	40,489	41,496
Other LT Assets	8	0	21	21	21
Bank Balance/Cash & Liquid	136	177	118	93	127
Debtors	85	84	77	78	79
Other Non Cash Current	0	0	9	9	9
Total Assets	43,049	39,336	39,725	40,689	41,732
ST Debt	3,499	3,595	1,600	1,500	0
Creditors	1,239	1,199	1,078	1,087	1,094
Other Current Liab	193	35	0	0	0
LT Debt	4,980	5,165	7,241	7,491	9,142
Deferred Tax Liabilities	501	531	562	562	562
Other LT Liabilities	14	180	61	61	61
Unitholders' funds	32,624	28,632	29,183	29,989	30,874
Total Capital	43,049	39,336	39,725	40,689	41,732
Share Capital (m)	1,941	1,959	1,975	1,991	2,008
Gross Debt	(8,479)	(8,759)	(8,841)	(8,991)	(9,142)
Working Capital	(4,709)	(4,568)	(2,474)	(2,407)	(879)
Book NAV (HK\$)	16.81	14.62	14.78	15.06	15.37
Gross Gearing (%)	20	22	22	22	22

Source: DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Income	1,696	(2,987)	1,521	942	976
Tax Paid	(13)	(340)	(204)	(197)	(204)
Chg in Wkg.Cap.	(59)	(47)	(114)	5	5
Other Non-Cash	(238)	4,355	(48)	321	341
Operational CF	1,385	980	1,156	1,070	1,118
Net Capex	(157)	(55)	(160)	(150)	(150)
Assoc, MI, Invsmt	2	0	0	0	0
Investment CF	(156)	(55)	(160)	(150)	(150)
Net Chg in Debt	(399)	260	81	150	151
Distribution Paid	(987)	(929)	(943)	(897)	(868)
Other Financing CF	(249)	(215)	(193)	(199)	(216)
Financing CF	(1,636)	(884)	(1,055)	(945)	(933)
Chg in Cash	(406)	41	(59)	(25)	35

Source: Company, DBS HK

Fortune REIT

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	3-Aug-21	HK\$8.52	HK\$9.16	Buy
2:	9-Aug-21	HK\$8.57	HK\$9.32	Buy
3:	25-Jan-22	HK\$8.06	HK\$9.34	Buy

Source: DBS HK

Analyst: Jeff Yau

Percy Leung

Fortune REIT

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

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