

China / Hong Kong Company Update

Wharf REIC

Bloomberg: 1997 HK Equity | Reuters: 1997.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

4 Mar 2022

BUY

Last Traded Price (3 Mar 2022): HK\$35.05 (HSI : 22,467)
Price Target 12-mth: HK\$40.70 (16% upside) (Prev HK\$43.60)

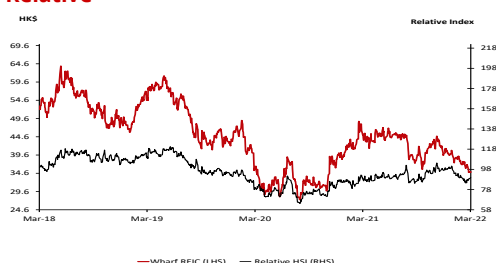
Analyst

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What's New

- Underlying earnings fell 13% led by lower rental earnings, in line with our expectation
- Weaker rental income continued to drag earnings
- Negative reversionary growth working its way through the office and retail portfolio
- Maintain BUY with TP of HK\$40.70 as negatives are mostly priced in

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2020A	2021A	2022F	2023F
Turnover	15,515	16,043	11,833	12,693
EBITDA	10,243	9,349	8,732	9,855
Pre-tax Profit	8,917	8,328	7,551	8,495
Underlying Profit	7,477	6,518	6,271	7,048
Underlying Profit Gth (%)	(23.6)	(12.8)	(3.8)	12.4
EPS (HK\$)	2.46	2.15	2.07	2.32
EPS Gth (%)	(23.6)	(12.8)	(3.8)	12.4
PE (X)	14.2	16.3	17.0	15.1
P/Cash Flow (X)	12.5	12.5	13.5	12.1
EV/EBITDA (X)	15.5	17.0	18.2	16.1
DPS (HK\$)	1.47	1.31	1.34	1.52
Div Yield (%)	4.2	3.7	3.8	4.3
Net Gearing (%)	25	23	20	18
ROE (%)	3.6	3.2	2.9	3.1
Est. NAV (HK\$):			62.5	62.6
Disc. to NAV (%)			(44)	(44)
Earnings Rev (%)			(13)	(9)
Consensus EPS (HK\$):			2.51	2.75
Other Broker Recs:		B:4	S:5	H:7

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

Darkest before the dawn

Investment Thesis

BUY with HK\$40.70 TP. The stock is trading at a 44% discount to our assessed current NAV. Negatives regarding the fifth wave of pandemic should be largely discounted following the recent share correction. Maintain BUY.

While the COVID resurgence delivered severe blow to mall operations... The Omicron outbreak has severely dampened Wharf REIC's retail mall operations. New rental concessions are granted to tenants. These, coupled with evaporating turnover rents and negative reversionary growth, should weigh on retail income. The proposed rental enforcement moratorium adds further uncertainties on the company's rental cash flow.

... this should improve once pandemic situation eases. Holding a portfolio of luxury brands and discretionary trades, malls at Harbour City and Times Square are well positioned to tap on the strong retail market recovery driven by pent-up local demand for consumption and distribution of electronic consumption vouchers once the pandemic subsides. Any easing of border restrictions should add momentum to its earnings recovery with the two shopping landmarks positioned among the must-go destinations among Mainland tourists.

Valuation:

Our target price (TP) for Wharf REIC is based on target discount of 35% discount to our Dec-2022 NAV estimate.

Where we differ:

We are more positive on revival of tourist spending once border with Mainland China re-opens.

Key Risks to Our View:

Any prolonged border closure could drag the income recovery of Wharf REIC's mall business.

At A Glance

Issued Capital (m shrs)	3,036
Mkt Cap (HK\$m/US\$m)	106,412 / 13,615
Major Shareholders (%)	
Wheelock and Co Ltd	43.4
Free Float (%)	56.6
3m Avg. Daily Val. (US\$m)	13.07
GICS Industry: Real Estate / Real Estate Management & Development	



Watchlist the stock on Insights Direct to receive prompt updates



Wharf REIC

WHAT'S NEW

FY21 results in line

Wharf REIC's FY21 underlying earnings dropped 13% to HK\$6.5bn, in line with our estimate. The decline was mainly led by lower rental earnings from investment properties, partly offset by higher development earnings from Suzhou IFS undertaken by Harbour Centre Development Limited, and increased dividend income from its equity portfolio. A final DPS of HK\$0.64 was declared (FY20: HK\$0.69). This brought the full year DPS down 11% to HK\$1.31, representing 65% of its underlying net profit from investment properties and hotels in Hong Kong.

Revenue from investment properties fell 8% to HK\$10.9bn, primarily due to income drag from retail and office portfolios in Hong Kong. Despite higher turnover rent and occupancies, and reduced impact from amortized rental concessions, retail revenue from Harbour City and Times Square declined 7% and 11% respectively, as a result of negative base rent reversions. Plaza Hollywood also registered 4% decline in rental income.

Hong Kong retail market exhibited 8.1% sales growth in 2021 along with the easing pandemic situation. Thanks to promotional campaigns and strong business recovery from top-tier tenants, both Harbour City and Times Square registered above-market retail sales growth in 2021. As a result, turnover rents more than doubled to HK\$709m in FY21.

During the period, retailers took the advantage of soft market rents to setup new stores and expand their presence in Harbour City/Time Squares. These include quality names such as Dior, Piaget, Miu Miu, Salvatore Ferragamo, Cartier, and Alexander McQueen. Hence, occupancies at Harbour City and Times Square improved to 93% and 95% as of Dec-21 from Jun-21's 91% and 92% respectively.

Negative rental reversions worked its way through the office portfolio in FY21 as office demand remained subdued. This brought the office income at Harbour City and Times Square down 11% and 5% respectively in FY21. In Dec-21, office occupancies at Harbour City and Times Square stood at 85% and 89% respectively, slightly improved from Jun-21's 82% and 88%.

While higher promotional expenses helped stimulate tenants' sales, rental margin contracted to 77.7% in FY21

from FY20's 82.5%. This resulted in rental earnings falling by a larger 13% to HK\$8.4bn.

Supported by domestic staycation and long stay demand, operating losses from the hotel division narrowed to HK\$356m from FY20's HK\$379m. This was despite the initial loss of newly opened Niccolo Suzhou held by HCDL. The renovated Prince Hotel will reopen upon easing travel restrictions.

Consolidated net debt stood at HK\$47.5bn as of Dec-21, down slightly from Jun-21's HK\$50.4bn. This translated into a gearing of 23.1% (Jun-21: c.24%). Financial position remains comfortable in our view. The company also holds a HK\$13.9bn equity portfolio, comprising mainly Hong Kong and China property stocks.

The fifth wave of pandemic has disrupted retail market recovery and further delayed the border reopening with Mainland China. This prompted the company to offer new rental concessions to tenants. But the magnitude could be lower than in 2020 given retail rent correction over the past two years. Turnover rent should also fall substantially. These, coupled with negative reversionary growth, should weigh on the company's retail income. Hotel operations should remain loss-making given new tightening measures.

Moreover, the proposed rental enforcement moratorium should inevitably introduce new uncertainties to its rental cash flow, but the overall impacts should not be overplayed considering its high-quality tenant profile.

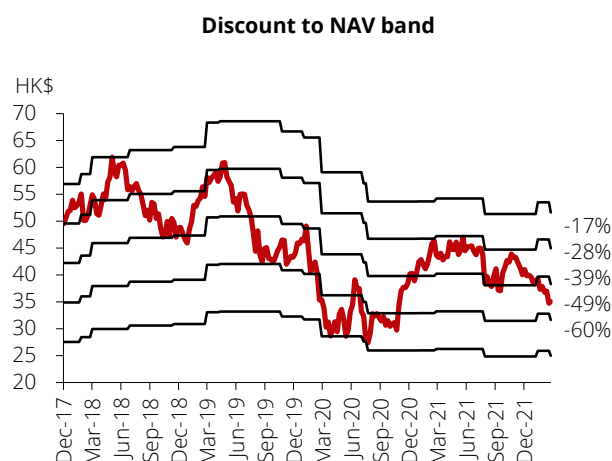
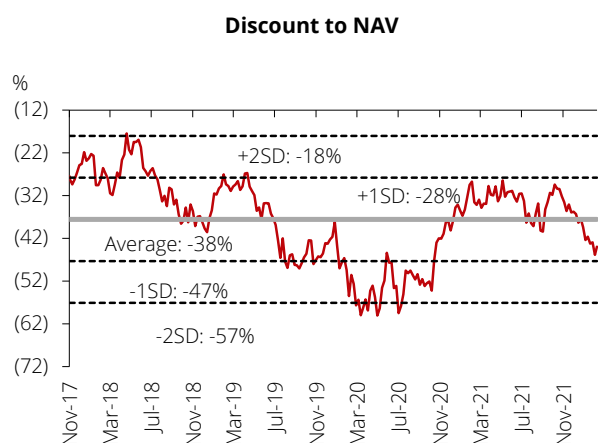
Following the recent price correction led by sluggish retail scene, the stock is trading at 44% discount to our current appraised NAV, below its average of 38% since listing. Undoubtedly, the resurgence of COVID cases clouds the company's core business. But, once the pandemic situation stabilizes, domestic consumption recovery should regain momentum upon strong pent-up demand among local shoppers, with consumption vouchers to give an additional boost. Any positive news on lifting border restrictions should further improve the sentiment towards the counter. With most of negatives discounted following the recent sell-off, we maintain BUY with a TP of HK\$40.70, premised on 35% target discount to our Dec-22 NAV estimate.

Wharf REIC

Company Background

Listed in Nov-17 by way of introduction, Wharf REIC is a leading commercial property landlord in Hong Kong which boasts a sizeable completed investment property portfolio. Major rental properties include Harbour City and Times Square. Wharf REIC also owns a 72% stake in Harbour Centre Development.

Discount to NAV



Source: Bloomberg Finance L.P., DBS HK

Wharf REIC

Result Summary

HK\$m	FY20	FY21	% Chg	Comments
Turnover	15,515	16,043	3	FY21: mainly led by higher income from property development, partly offset by shortfall from rental income
Segment results				
Investment Property	9,733	8,441	(13)	FY21: as a result of negative reversionary growth for office and retail portfolio, and increased promotion and marketing expense
Development Property	444	543	22	FY21: primarily stemmed from Suzhou IFS by HCDL
Hotels	(379)	(356)	(6)	FY21: improvement in occupancy driven by domestic demand
Investment and others	342	502	47	
Corporate expenses	(167)	(66)	(60)	
Operating profit before fair value change on investment properties	9,973	9,064	(9)	
Fair value change on investment properties	(13,965)	(2,203)	(84)	
Other net income (charge)	(1,459)	62	<i>n.a.</i>	FY21: include impairment losses provision of HK\$67m (FY20: HK\$1.05bn) made for hotels and net foreign exchange gain of HK\$40m (FY20: HK\$284m loss)
Finance costs	(1,407)	(760)	(46)	FY21: interest capitalisation of HK\$4m (FY20: HK\$16m) for development property projects and effective borrowing rate fell to 1.4% from FY20's 1.9%
Share of results after tax of associates & JV	(75)	(125)	67	
Profit before taxation	(6,933)	6,038	<i>n.a.</i>	
Taxation	(1,205)	(1,599)	33	FY20: Includes one-off LAT write-back of HK\$504m for China property development
Minority interests	284	(48)	<i>n.a.</i>	
Net profit	(7,854)	4,391	<i>n.a.</i>	
Underlying profit	7,477	6,518	(13)	
First Interim DPS (HK\$/sh)	0.78	0.67	(14)	
Second Interim DPS (HK\$/sh)	0.69	0.64	(7)	
Total DPS (HK\$/sh)	1.47	1.31	(11)	

Source: Wharf REIC

Wharf REIC

Key Assumptions (%)

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

Source: DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (HK\$ m)					
Investment Property	14,230	11,795	10,859	10,416	10,715
Development Property	38	2,621	3,722	0	0
Hotels	1,507	630	838	794	1,353
Others	268	469	624	624	624
Total	16,043	15,515	16,043	11,833	12,693

Source: DBS HK

Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Turnover	16,043	15,515	16,043	11,833	12,693
EBITDA	12,977	10,243	9,349	8,732	9,855
Depr / Amort	(290)	(294)	(309)	(321)	(334)
EBIT	12,687	9,949	9,040	8,411	9,521
Associates Inc	76	(75)	0	0	0
Interest (Exp)/Inc	(974)	(957)	(712)	(860)	(1,026)
Exceptionals	0	0	0	0	0
Pre-tax Profit	11,789	8,917	8,328	7,551	8,495
Tax	(1,961)	(1,205)	(1,599)	(1,246)	(1,402)
Non-controlling Interest	(37)	(235)	(211)	(34)	(45)
Underlying Profit	9,791	7,477	6,518	6,271	7,048
Sales Gth (%)	(3)	(3)	3	(26)	7
Net Profit Gth (%)	(3)	(24)	(13)	(4)	12
EBITDA Margins (%)	81	66	58	74	78
EBIT Margin (%)	79	64	56	71	75
Tax Rate (%)	17	14	19	17	17

Source: DBS HK

Wharf REIC

Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Fixed Assets	267,801	253,173	251,142	263,188	273,333
Long-term Investments	4,065	13,041	13,870	13,870	13,870
Deferred Tax Asset	669	1,334	884	884	884
Associates/JVs	2,853	1,082	983	983	983
Bank Balance/Cash & Liquid	2,907	2,260	1,800	2,767	3,925
Inventory	5,139	5,226	2,325	2,341	2,341
Debtors	885	1,675	1,161	1,141	1,146
Other Non Cash Current	22	123	103	103	103
Total Assets	284,341	277,914	272,268	285,277	296,585
ST Debt	12,300	6,107	4,500	6,000	10,100
Creditors	8,384	8,185	7,717	7,737	7,722
Other Current Liab	6,251	2,810	762	762	762
LT Debt	33,236	48,171	44,834	41,834	36,234
Deferred Tax Liabilities	2,403	2,534	2,599	2,599	2,599
Other LT Liabilities	353	698	980	980	980
Non-controlling Interests	5,250	4,858	4,770	4,707	4,657
Shareholder's Equity	216,164	204,551	206,106	220,658	233,532
Total Cap. & Liab.	284,341	277,914	272,268	285,277	296,585
Share Capital (m)	3,036	3,036	3,036	3,036	3,036
Net Cash/(Debt)	(42,629)	(52,018)	(47,534)	(45,067)	(42,409)
Working Capital	(17,982)	(7,818)	(7,590)	(8,147)	(11,069)
Net Gearing (%)	20	25	23	20	18

Source: DBS HK

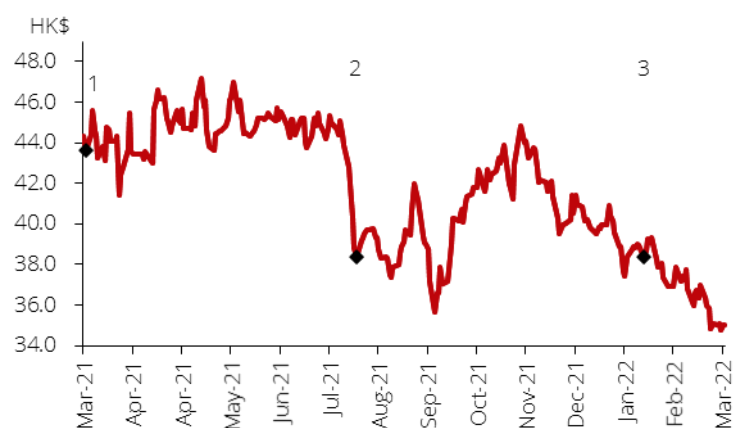
Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
EBIT	12,687	9,949	9,040	8,411	9,521
Tax Paid	(1,002)	(3,692)	(1,599)	(1,246)	(1,402)
Depr/Amort	290	294	309	321	334
Chg in Wkg.Cap	1,072	(844)	(100)	40	(20)
Other Non-Cash	(1,024)	(883)	(716)	(876)	(1,026)
Operating CF	12,023	4,824	6,934	6,650	7,407
Net Capex	(6,505)	(362)	(500)	(200)	(250)
Investments	(1,659)	(7,948)	(1,167)	0	0
Associates & JVs	99	178	0	0	0
Investing CF	(8,065)	(8,132)	(1,667)	(200)	(250)
Net Chg in Debt	3,152	7,824	(1,500)	(1,500)	(1,500)
New Capital	0	0	0	0	0
Dividend	(6,829)	(5,236)	(4,227)	(3,983)	(4,499)
Other Financing CF	0	0	0	0	0
Financing CF	(3,677)	2,588	(5,727)	(5,483)	(5,999)
Chg in Cash	281	(720)	(460)	967	1,159

Source: DBS HK

Wharf REIC

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	5-Mar-21	HK\$44.30	HK\$42.90	Hold
2:	6-Aug-21	HK\$38.80	HK\$37.60	Hold
3:	17-Jan-22	HK\$38.80	HK\$43.60	Buy

Source: DBS HK

Analyst: Jeff Yau

Percy Leung

Wharf REIC

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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