

China / Hong Kong Company Update

Prosperity REIT

Bloomberg: 808 HK EQUITY | Reuters: 0808.HK

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DBS Group Research . Equity

26 Jul 2022

BUY

Last Traded Price (25 Jul 2022): HK\$2.42 (HSI : 20,563)
Price Target 12-mth: HK\$2.78 (15% upside) (Prev HK\$3.34)

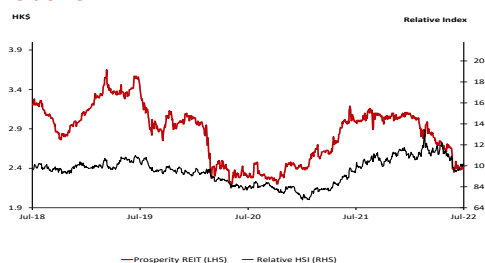
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What's New

- Portfolio occupancy remains high at >95%
- Negative rental reversion narrowed to 4-5%
- >60% of leases expiring in FY22 have been renewed/re-let
- BUY with DDM-based TP of HK\$2.78

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2020A	2021A	2022F	2023F
Gross Revenue	453	445	430	437
Net Property Inc	358	352	339	344
Net Profit	(875)	57	194	172
Distribution Inc	273	268	254	233
DPU (HK\$)	0.18	0.18	0.17	0.15
DPU Gth (%)	(2)	(2)	(5)	(10)
Div Yield (%)	7.4	7.3	6.9	6.3
Gross Gearing (%)	22	23	23	23
Book Value (HK\$)	4.95	4.83	4.66	4.66
P/Book Value (x)	0.5	0.5	0.5	0.5

DPU Rev (%): (3) (10)

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

Safe bet

Investment Thesis

BUY with HK\$2.78 TP. Prosperity REIT is trading at distribution yields of 6.9-6.3% for FY22-23. High portfolio occupancy, coupled with its proactive leasing strategy, should underpin income resilience.

High portfolio occupancy pointing to resilient rental income.

Despite softer occupancy at The Metropolis Tower in Hung Hom, portfolio occupancy stood high at >95%. In FY22, about 40% of leases in terms of gross rental area are up for renewal. Prosperity REIT has renewed >60% of the leases expiring in 2022. This should help mitigate vacancy risk in near term.

Negative rental reversion tapering off. Thanks to positive rental reversions achieved from certain tenants at Prosperity Place and Trendy Centre, overall rental decline upon renewal narrowed to 4-5% from FY21's 7.7%.

Valuation:

Our TP for Prosperity REIT is based on dividend discount model using a discount rate of 6.8%.

Where we differ:

We believe the portfolio occupancy should be well maintained given the REIT's proactive leasing strategy.

Key Risks to Our View:

Market Risk. Any deterioration in leasing demand for decentralised office space could drag its earnings and unit price performance.

Interest rate risk. Any interest rate hike would adversely affect its valuation.

At A Glance

Issued Capital (m shrs)	1,504
Mkt Cap (HKm/US\$m)	3,640 / 464
Major Shareholders (%)	
CK Asset Holdings Limited	18.4
Free Float (%)	81.6
3m Avg. Daily Val. (US\$m)	0.26
GICS Industry: Real Estate / Equity Real Estate Investment	



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Prosperity REIT

WHAT'S NEW**Narrowing rental decline upon renewal**

Amid the economic slowdown, certain investment or trading companies at The Metropolis Tower in Hung Hom did not renew their leases upon expiry in 1H22. This brought the current occupancy at The Metropolis Tower lower at >90% from Dec-21's 98.2%. Despite weaker occupancy at The Metropolis Tower, portfolio occupancy maintained high at 95-96% (Dec-21: 97.7%) as the occupancy of other properties remained largely stable.

Leasing enquiries and on-site inspection activities have recovered on the back of improved pandemic situation since Apr-22. Nonetheless, demand from MNCs remained subdued amid sluggish economy and global travel restrictions. In 2022, c.40% of the leases in terms of gross rental area are scheduled for expiry, with >60% due in 1H22. Prosperity REIT has concluded 60-70% of these expiring leases in 2022. Retention rate is high at c.70%.

Aided by positive rental reversions for certain tenants at Prosperity Place and Trendy Centre, overall rental decline upon renewal further moderated to 4-5% from FY21's 7.7%. Nonetheless, rental reversion at The Metropolis Tower stayed in the negative territory with the lack of new demand from MNCs.

Prosperity REIT has granted rental concessions to semi-retail tenants at Prosperity Place and Trendy Centre, whose businesses were severely impacted by tightening of social distancing measures led by the fifth wave of pandemic. The amount, albeit higher than that of 2020, remains insignificant compared to the overall rental income of the REIT.

Prosperity REIT is in discussions with banks on the refinancing of HK\$1.5bn term loan maturing in Nov-22. Credit margin is expected to be 40-50bps higher than the existing one. In 1H22, Prosperity REIT entered into more interest rate swaps (IRS), raising its current hedging ratio up to >70% (Dec-21: 70%). With a portion of IRS scheduled

to expire in 2H22, Prosperity REIT's hedging ratio is set to decline to 50-55% by the end of 2022. Yet, with >50% of interest cost fixed, concerns on impact on financing costs due to interest rate hikes should not be overplayed.

Prosperity REIT is conducting enhancement works at The Metropolis Tower. Renovation works at the lobby floor has been completed while facelift at office floors is underway. With budgeted capex of HK\$40m, the entire enhancement work is expected to complete by the end of 2023. Other AEI plans include the installation of solar panels at The Metropolis Tower, 9 Chong Yip Street and Trendy Centre.

YTD, Prosperity REIT has bought back 14.9m shares for HK\$42.8m or HK\$2.88 per share on average. This should help offset DPU dilution led by lower rental income.

YTD, unit price of Prosperity REIT retreated by 22%, underperforming its peers by 3-15%. Prosperity REIT is trading at 6.9-6.3% distribution yield for FY22-23. This translates into yield spread of 4.2-3.6%. Despite the global economic downturn, portfolio occupancy remains high which points to income resilience. Negative rental reversion is also tapering off. Maintain BUY at this stage with DDM-based TP of HK\$2.78.

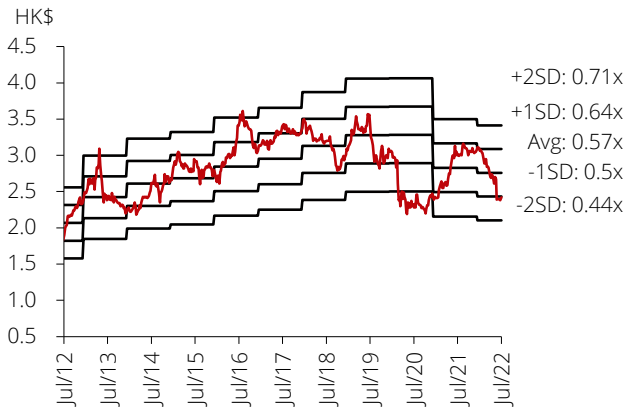
Company Background

Listed in Dec-05, Prosperity REIT was the first private sector REIT listed on the Hong Kong Stock Exchange. In Jan-14, Prosperity REIT made its first major acquisition of 9 Chong Yip Street, a Grade A office building in Kwun Tong. In Mar-17, the REIT sold Harbourfront Landmark in Hong Hum. The REIT currently owns a diverse portfolio of seven office/commercial, industrial/office and industrial properties in decentralised business districts of Hong Kong.

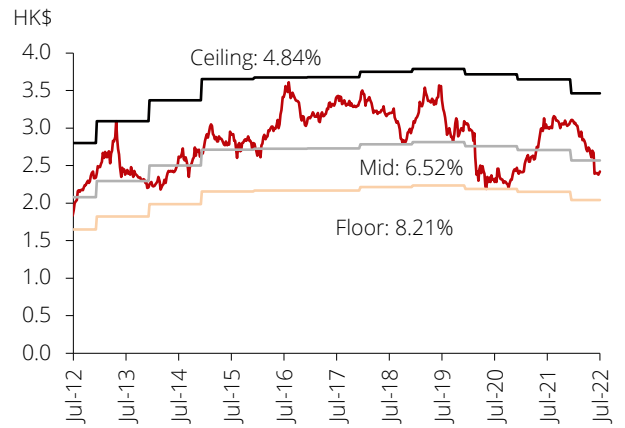
Prosperity REIT

Price to book NAV band and historical yield band

Price to book NAV band



Historical yield band



Source: Bloomberg Finance L.P. DBS HK

Prosperity REIT

Key Assumptions (%)

	2022F	2023F
Office rental - HK	0	(3)

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (HK\$ m)					
Rental income	375	364	351	338	343
Carpark income	30	27	31	30	31
Rental-related income	58	62	63	62	63
Total	462	453	445	430	437

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Gross revenue	462	453	445	430	437
Property expenses	(96)	(95)	(93)	(91)	(93)
Net Property Income	366	358	352	339	344
Other expenses	(64)	(61)	(58)	(59)	(60)
Interest (Exp)/Inc	(60)	(54)	(53)	(46)	(76)
Exceptionals	133	(1,077)	(142)	0	0
Pre-Tax Profit	375	(835)	98	234	208
Tax	(42)	(40)	(41)	(40)	(36)
Net Profit	333	(875)	57	194	172
Distribution income	275	273	268	254	233
Revenue Gth (%)	3	(2)	(2)	(3)	2
NPI Gth (%)	4	(2)	(2)	(4)	1
Dist. Inc Growth (%)	2	(1)	(2)	(5)	(8)
DPU Growth (%)	1	(2)	(2)	(5)	(10)

Source: Company, DBS HK

Prosperity REIT

Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Fixed Assets	11,126	10,147	9,967	9,866	9,991
Other LT Assets	27	0	0	0	0
Bank Balance/Cash & Liquid	387	352	206	153	134
Debtors	12	13	13	13	13
Total Assets	11,552	10,512	10,186	10,032	10,138
ST Debt	0	798	1,535	0	0
Creditors	191	188	191	193	195
Other Current Liab	194	188	173	170	160
LT Debt	2,320	1,530	788	2,323	2,323
Other LT Liabilities	210	266	236	247	258
Unitholders' funds	8,637	7,543	7,263	7,098	7,201
Total Capital	11,552	10,512	10,186	10,032	10,138
Share Capital (m)	1,503	1,524	1,502	1,523	1,544
Gross Debt	(2,340)	(2,340)	(2,340)	(2,340)	(2,340)
Working Capital	13	(809)	(1,680)	(198)	(208)
Book NAV (HK\$)	5.75	4.95	4.83	4.66	4.66
Gross Gearing (%)	20	22	23	23	23

Source: DBS HK

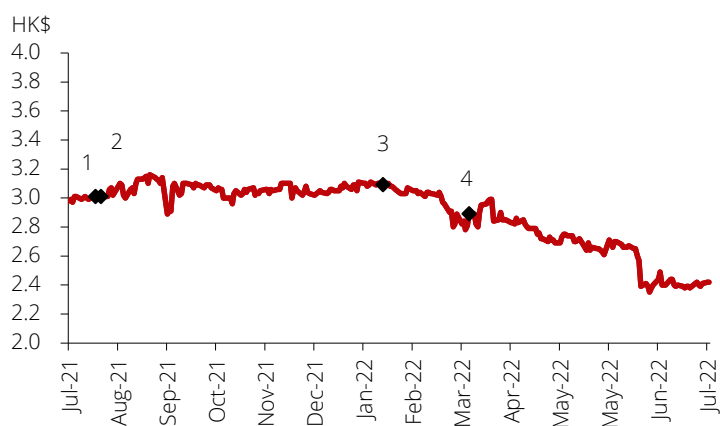
Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Income	375	(835)	98	234	208
Tax Paid	1	(52)	(36)	(29)	(25)
Chg in Wkg.Cap.	4	(12)	5	2	2
Other Non-Cash	(19)	1,185	245	95	126
Operational CF	361	286	312	302	311
Net Capex	(8)	(4)	(7)	(10)	(10)
Net Change in Investments	0	0	0	0	0
Assoc, MI, Invsmt	5	5	1	1	1
Investment CF	(3)	1	(6)	(9)	(9)
Net Chg in Debt	0	0	0	0	0
New issues/Unit Buyback	0	0	(119)	(43)	0
Distribution Paid	(272)	(271)	(275)	(257)	(243)
Other Financing CF	(58)	(51)	(46)	(47)	(77)
Financing CF	(330)	(322)	(440)	(346)	(320)
Chg in Cash	28	(35)	(133)	(53)	(19)

Source: Company, DBS HK

Prosperity REIT

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	10-Aug-21	HK\$3.01	HK\$3.26	Buy
2:	13-Aug-21	HK\$2.99	HK\$3.34	Buy
3:	21-Jan-22	HK\$3.08	HK\$3.34	Buy
4:	11-Mar-22	HK\$2.81	HK\$3.34	Buy

Source: DBS HK

Analyst: *Percy Leung*
Jeff Yau

Prosperity 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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