

China / Hong Kong Company Update

Wharf REIC

Bloomberg: 1997 HK Equity | Reuters: 1997.HK

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DBS Group Research . Equity

5 Aug 2022

BUY

Last Traded Price (4 Aug 2022): HK\$36.05 (HSI : 20,174)
Price Target 12-mth: HK\$42.00 (17% upside) (Prev HK\$41.10)

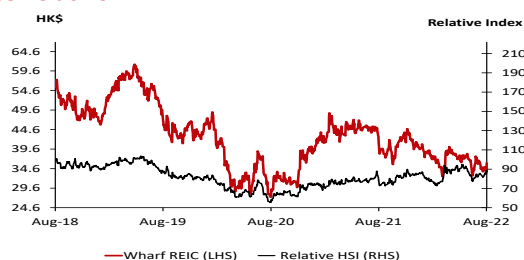
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What's New

- 1H22 underlying earnings rose 3%, a positive surprise
- Higher rental margins underpinned earnings recovery
- Retail reversionary growth turning less negative
- Maintain BUY with higher TP of HK\$42

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2020A	2021A	2022F	2023F
Turnover	15,515	16,043	12,290	12,939
EBITDA	10,243	9,370	8,880	9,955
Pre-tax Profit	8,917	8,328	7,674	8,288
Underlying Profit	7,477	6,518	6,359	6,874
Underlying Profit Gth (%)	(23.6)	(12.8)	(2.4)	8.1
EPS (HK\$)	2.46	2.15	2.09	2.26
EPS Gth (%)	(23.6)	(12.8)	(2.4)	8.1
PE (X)	14.6	16.8	17.2	15.9
P/Cash Flow (X)	12.9	11.7	13.7	12.8
EV/EBITDA (X)	15.7	17.2	18.1	16.2
DPS (HK\$)	1.47	1.31	1.36	1.47
Div Yield (%)	4.1	3.6	3.8	4.1
Net Gearing (%)	25	23	22	20
ROE (%)	3.6	3.2	3.1	3.3
Est. NAV (HK\$):			63.0	64.6
Disc. to NAV (%)			(43)	(44)

Earnings Rev (%)			5	3
Consensus EPS (HK\$):			2.12	2.22
Other Broker Recs:		B:5	S:5	H:4

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

Higher margins a positive surprise

Investment Thesis

BUY with HK\$42 TP. The stock is trading at a 43% discount to our assessed current NAV. Stronger-than-expected margin improvement was a positive surprise to the market. This, coupled with retail market recovery, should boost sentiment towards the counter.

Retail negative rental reversion tapering off. Footfall and tenants' sales at Harbour City and Times Square have improved with the gradual easing of social distancing measures and distribution of consumption vouchers. Meanwhile, following the strong correction over the past few years, retail rents have exhibited signs of stabilization with retail reversionary growth turning less negative. We expect negative rental reversion to continue to taper off on the back of an improving retail scene, and possibly turn positive in 2023.

Margin improvement to propel earnings recovery. While the company continues to offer coupons to stimulate tenant sales, selling and marketing expenses in 1H22 was substantially lower y-o-y, partly reflecting tenants' reduced reliance on supportive measures. This lifted the rental margin to 82.6%, versus 1H21's 78.6%. Sustainable margin improvement should add momentum to its full year earnings recovery.

Valuation:

Our target price (TP) for Wharf REIC is based on a 35% discount to our Jun-2023 NAV estimate.

Where we differ:

We are more positive on revival of tourist spending once the 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 (HKm/US\$m)	109,448 / 13,943
Major Shareholders (%)	
Wheelock And Co Ltd	43.4
Free Float (%)	56.6
3m Avg. Daily Val. (US\$m)	13.74
GICS Industry: Real Estate / Real Estate Management & Development	



Watchlist the stock on Insights Direct to receive prompt updates



Wharf REIC

WHAT'S NEW

Interim results above expectations

Wharf REIC's 1H22 underlying earnings rose 3% to HK\$3.4bn thanks to improved rental earnings. The result was 10% above our estimate mainly due to higher-than-expected rental margin. Interim DPS was 4.5% higher at HK\$0.7, representing 65% of its underlying net profit from investment and hotel properties in Hong Kong.

Gross rental receipts were 2.2% lower at HK\$5.35bn. Faced by fierce competition among the precincts, retail income from Times Square sank 22% partly resulting from negative reversionary growth and rental concessions. Average retail passing fell 28% to HK\$156psf in 1H22. Retail rental income from Harbour City rose 1% despite negative rental reversions. Income from Plaza Hollywood was flat y-o-y. Following the market correction over the past few years, retail rents are stabilising on the back of retail market recovery. Thus, retail reversionary growth has been less negative.

The gradual easing of social distancing measures and distribution of electronic consumption vouchers has underpinned domestic consumption recovery since Apr-22. Footfall and tenants' sales at Harbour City and Times Square have improved. Despite COVID resurgence in early 2022, turnover rent in 1H22 was largely flat at HK\$335m (1H21: HK\$329m).

Wharf REIC has granted rental concessions to tenants in view of the fifth wave of the pandemic but the amount this round is much lower compared to 2020.

Taking advantage of softer rents after the correction in the past two years, several international brands have made their Hong Kong debut at Harbour City. These include Casa Loewe, AMANTE, deLaCour and Sound United. Dior, Piaget and Van Cleef & Arpels will open their new flagship stores at Harbour City in 2H22. As of Jun-22, retail occupancy at both Harbour City and Times Square stood firm at 93%.

Despite negative reversionary growth amid market rental pressure, office income from Harbour City rose 3% while that of Times Square was flattish, thanks to improved occupancy. Times Square saw in-house expansion from technology tenants in the period. The property remained 90% let as of Jun-22 (Dec-21: 89%). Meanwhile, office occupancy at Harbour City improved to 87% in Jun-22 from Dec-21's 85%.

While Wharf REIC continued to offer coupon redemptions to its customers, selling and marketing expenses was 52% lower at HK\$250m, partly reflecting tenants' reduced reliance on supportive measures. This brought the rental margin higher to 82.6% in 1H22 from 1H21's 78.6%. Hence, despite lower rental income, overall rental earnings rose 2.7% to HK\$4.43bn.

Operating loss from hotel division further narrowed to HK\$172m in 1H22 from 1H21's HK\$208m as the operating performance in 1H21 was partly dragged by opening expense for Niccolo hotel in Suzhou.

Net debt stood at HK\$46.8bn as of Jun-22, down from Dec-21's HK\$47.5bn. Led by lower rental assumptions, Wharf REIC recorded HK\$5.1bn revaluation deficit on investment property in 1H22 with cap rates broadly stable. This brought the gearing slightly higher at 23.5% in Jun-22, (Dec-21: 23.1%). Interest cost of c.100% of its total borrowings are on floating basis as of Jun-22. Therefore, interest expense is expected to rise noticeably in 2H22 with higher interest rates. As of Jun-22, Wharf REIC's equity portfolio was valued at HK\$12.7bn (Dec-21: HK\$13.9bn). It comprises mainly blue-chip property stocks.

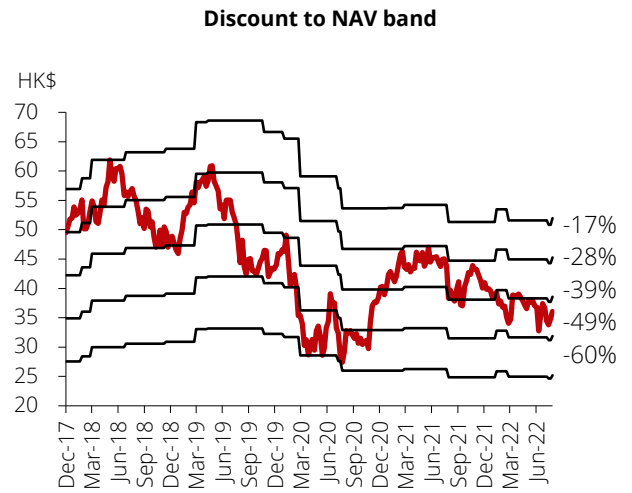
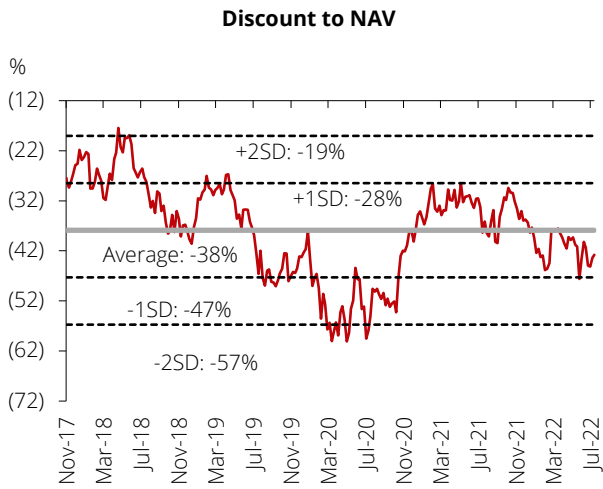
YTD, share price of Wharf REIC has retreated by 9%. The stock is trading at 43% discount to NAV. The Hong Kong retail market is on the road to recovery led by the revival of domestic consumption. Distribution of the remaining phase of consumption vouchers in Aug-22 should give an additional boost and should improve sentiment towards the stock. While negative rental reversion continues to work its way through its portfolio, rental margin improvement should add momentum to its earnings recovery. Hence, we maintain BUY with TP of HK\$42.

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.

Wharf REIC

Discount to NAV



Source: Bloomberg Finance L.P., DBS HK

Wharf REIC

Result Summary

HK\$m	1H21	1H22	% Chg	Comments
Turnover	7,485	6,210	(17)	1H22: led by lower income from property development undertaken by its listed subsidiary, Harbour Centre Development
Segment results				
Investment Property	4,310	4,425	3	1H22: rental margins improved to 82.6% from 1H21's 78.6%
Development Property	146	(27)	<i>n.a.</i>	
Hotels	(208)	(172)	(17)	
Investment and others	208	250	20	
Corporate expenses	(28)	(30)	7	
Operating profit before fair value change on investment properties	4,428	4,446	0	
Fair value change on investment properties	(284)	(5,053)	1,679	
Other net income (charge)	(62)	365	<i>n.a.</i>	1H22: included impairment provision of HK\$80m (1H21: HK\$67m) made for a Mainland development property project and FX gain of HK\$389m (1H21: loss of HK\$41m)
Finance costs	(359)	(609)	70	1H22: included unrealised MTM loss of HK\$243m (1H21: gains of HK\$10m) on cross currency and interest rate swaps and no interest expense capitalised (1H21: HK\$4m)
Associates	(60)	0	(100)	
Profit before taxation	3,663	(851)	<i>n.a.</i>	
Taxation	(709)	(679)	(4)	1H22: included LAT of HK\$5m (1H21: HK\$12m)
Minority interests	16	62	288	
Net profit	2,970	(1,468)	<i>n.a.</i>	
Underlying net profit	3,272	3,373	3	
Interim DPS	0.67	0.70	4	Representing 65% of underlying net profit from investment properties and hotels in HK

Source: Wharf REIC

Wharf REIC

Key Assumptions (%)

	2022F	2023F
Office rental - HK	0	(3)
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	10,626	10,880
Development Property	38	2,621	3,722	135	0
Hotels	1,507	630	838	905	1,434
Others	268	469	624	624	624
Total	16,043	15,515	16,043	12,290	12,939

Source: DBS HK

Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Turnover	16,043	15,515	16,043	12,290	12,939
EBITDA	12,977	10,243	9,370	8,880	9,955
Depr / Amort	(290)	(294)	(330)	(280)	(291)
EBIT	12,687	9,949	9,040	8,600	9,664
Associates Inc	76	(75)	0	0	0
Interest (Exp)/Inc	(974)	(957)	(712)	(926)	(1,376)
Exceptionals	0	0	0	0	0
Pre-tax Profit	11,789	8,917	8,328	7,674	8,288
Tax	(1,961)	(1,205)	(1,599)	(1,275)	(1,368)
Minority Interest	(37)	(235)	(211)	(41)	(47)
Underlying Profit	9,791	7,477	6,518	6,359	6,874
Sales Gth (%)	(3)	(3)	3	(23)	5
Net Profit Gth (%)	(3)	(24)	(13)	(2)	8
EBITDA Margins (%)	81	66	58	72	77
EBIT Margin (%)	79	64	56	70	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	248,629	253,410
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	2,654	3,810
Inventory	5,139	5,226	2,325	2,325	2,325
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	270,589	276,531
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
Minority Interests	5,250	4,858	4,770	4,714	4,664
Shareholder's Equity	216,164	204,551	206,106	205,963	213,469
Total Cap. & Liab.	284,341	277,914	272,268	270,589	276,531
Share Capital (m)	3,036	3,036	3,036	3,036	3,036
Net Cash/(Debt)	(42,629)	(52,018)	(47,534)	(45,180)	(42,524)
Working Capital	(17,982)	(7,818)	(7,590)	(8,276)	(11,200)
Net Gearing (%)	20	25	23	22	20

Source: DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
EBIT	12,687	9,949	9,040	8,600	9,664
Tax Paid	(1,002)	(3,692)	(1,380)	(1,275)	(1,368)
Depr/Amort	290	294	330	280	291
Chg in Wkg.Cap	1,072	(844)	812	40	(20)
Other Non-Cash	(1,024)	(883)	(834)	(926)	(1,376)
Operating CF	12,023	4,824	7,968	6,720	7,192
Net Capex	(6,505)	(362)	(393)	(200)	(250)
Investments	(1,659)	(7,948)	592	0	0
Associates & JVs	99	178	(1)	0	0
Investing CF	(8,065)	(8,132)	199	(200)	(250)
Net Chg in Debt	3,152	7,824	(4,318)	(1,500)	(1,500)
New Capital	0	0	0	0	0
Dividend	(6,829)	(5,236)	(4,339)	(4,166)	(4,286)
Other Financing CF	0	0	0	0	0
Financing CF	(3,677)	2,588	(8,657)	(5,666)	(5,786)
Chg in Cash	281	(720)	(490)	854	1,156

Source: DBS HK

Wharf REIC

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	6-Aug-21	HK\$38.80	HK\$37.60	Hold
2:	17-Jan-22	HK\$38.80	HK\$43.60	Buy
3:	4-Mar-22	HK\$35.05	HK\$40.70	Buy
4:	20-Jul-22	HK\$34.45	HK\$41.10	Buy

Source: DBS HK

Analyst: Jeff Yau, CFA
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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