

China / Hong Kong Company Update

Swire Pacific

Bloomberg: 19 HK EQUITY | Reuters: 0019.HK

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DBS Group Research . Equity

4 Nov 2022

BUY

Last Traded Price (3 Nov 2022): HK\$53.15 (HSI : 15,339)
Price Target 12-mth: HK\$70.90 (33% upside) (Prev HK\$69.00)

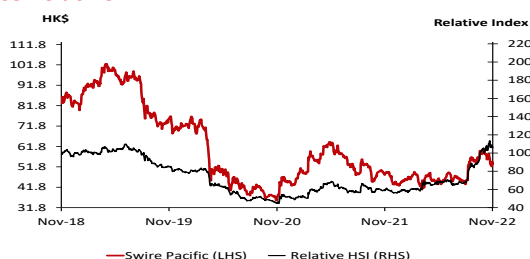
Analyst

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What's New

- Cathay Pacific benefitting from international travel re-opening
- Share buyback to support share prices
- Planned property expansion to brighten long-term prospects
- BUY with HK\$70.90 TP

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2020A	2021A	2022F	2023F
Turnover	80,032	92,403	90,890	100,054
EBITDA	15,266	17,364	17,885	18,395
Pre-tax Profit	771	9,871	10,788	14,523
Underlying Profit	(3,969)	5,300	6,661	10,245
Underlying Profit Gth (%)	N/A	N/A	25.7	53.8
EPS (HK\$)	(2.64)	3.53	4.50	6.93
EPS Gth (%)	N/A	N/A	27.6	53.8
PE (X)	nm	15.1	11.8	7.7
P/Cash Flow (X)	5.3	5.2	6.9	4.8
EV/EBITDA (X)	11.8	10.4	10.1	9.8
DPS (HK\$)	1.70	2.60	2.90	3.05
Div Yield (%)	3.2	4.9	5.5	5.7
Net Gearing (%)	15	14	16	14
ROE (%)	(1.5)	2.0	2.5	3.8
Est. NAV (HK\$):			83.0	118.2
Disc. to NAV (%)			(36)	(55)

Earnings Rev (%): (20) New
Consensus EPS (HK\$): 3.89 6.63
Other Broker Recs: B:6 S:0 H:1

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

Riding on international border re-opening

Investment Thesis

BUY with HK\$70.90 TP. Despite the recent price rally, the stock is still trading at a 36% discount to our current assessed NAV. Swire Pacific is well poised to benefit from international border re-opening through its exposure in Cathay Pacific. Property expansion should underpin the company's long-term growth. Ongoing share repurchase should continue to lend support to its share price.

Property to drive long-term growth. Its property arm, Swire Properties, intends to invest over HK\$100bn in China, Hong Kong and Southeast Asia in the next decade. After securing a retail-led mixed use development site in Xi'an in Mar-22, it acquired a residential/retail site in Wan Chai in Jul-22 and a site for retail-led development in Sanya in partnership with China Tourism Group Duty Free Corporation in Oct-22. Contributions from these new investments should boost long-term property earnings growth.

Cathay Pacific is turning around. With the Hong Kong government removing the compulsory quarantine requirement for all inbound travellers, pent-up demand for travel is set to unfold. This should underpin Cathay Pacific's post-COVID earnings turnaround which in turn adds to Swire Pacific's profit growth.

Valuation:

Our TP is based on a 40% discount to our Dec-23 SOTP valuation.

Where we differ:

We are more positive on the long-term growth of property division led by its ambitious investment plan.

Key Risks to Our View:

Any deterioration in leasing demand for commercial properties in Hong Kong/China could drag Swire Properties' earnings and share price performance.

Any faster-than-expected interest rate hike would lead to capitalisation rate expansion and in turn adversely affect Swire Properties' valuation.

Should Cathay Pacific's Post-COVID recovery be derailed, the company's earnings growth would be dragged.

At A Glance

Issued Capital (m shrs)	1,502
Mkt Cap (HKm/US\$m)	79,831 / 10,170
Major Shareholders (%)	
John Swire & Sons Ltd.	49.9
Free Float (%)	50.1
3m Avg. Daily Val. (US\$m)	18.84
GICS Industry: Real Estate / Real Estate Management & Development	



Watchlist the stock on Insights Direct to receive prompt updates



Swire Pacific

WHAT'S NEW

Strong embedded value

The recurring underlying profit of property division fell by a marginal 2% to HK\$2.97bn in 1H22. Rental income was broadly stable. Retail revenue from Hong Kong fell 10% as a combined result of COVID resurgence and increased amortised rental concessions. The shortfall more than offset higher income from China malls, due to new contributions from Taikoo Li Qiantian in Shanghai and Taikoo Li Sanlitun West in Beijing, which opened for business in 2H21. Office income from Hong Kong was largely steady. While Pacific Place Office suffered from negative reversionary growth, positive reversion was seen at some of the Taikoo Place properties.

The soon-to-be-completed 1msf Two Taikoo Place in Quarry Bay is > 50% pre-leased. Committed tenants include Julius Baer, BASF, Amundi and Boston Consulting Company. Elsewhere, CITIC Bank is reportedly to be an anchor tenant. Construction works of 46-54 Queen's Road East is well underway with scheduled completion in 2023. Pre-leasing is expected to commence soon. These should add to the company's rental earnings growth.

Listed property arm Swire Properties intends to invest over HK\$100bn in China, Hong Kong and Southeast Asia in the coming decade to power its long-term outlook. While HK\$50bn will be allocated to China with a focus on retail-led mixed-use developments, HK\$30bn will be set aside for expanding the Pacific Place and Taikoo Place portfolios in Hong Kong. The balance will be used for exploring residential trading opportunities in Hong Kong/China and growing its footprint in Vietnam, Indonesia, Singapore, and Thailand.

After securing a retail-led mixed use development site in Xi'an in Mar-22, Swire Properties acquired a residential/retail site in Wan Chai in Jul-22 and a site for retail-led development in Sanya in partnership with China Tourism Group Duty Free Corporation in Oct-22. Contributions from these investments should underpin long-term property earnings growth.

Attributable underlying loss from the aviation division narrowed 31% to HK\$2.23bn (1H21: HK\$3.25bn loss), mainly due to reduced losses at Cathay Pacific. Despite the lingering COVID-19 situation and weaker performance from Air China at the associate level, attributable loss from Cathay Pacific softened to HK\$2.25bn from 1H21's

HK\$3.4bn, mainly due to the increase in capacity and easing COVID-19 restrictions.

With the Hong Kong government lifting the mandatory quarantine requirement for all inbound travelers, strong pent-up demand for travel is set to be unleashed. Against this backdrop, we envisage Cathay Pacific to return to profitability starting from 2H22.

At HAECO, attributable profit fell by 46% to HK\$166m (1H21:HK\$310m), principally due to the absence of financial assistance provided by the US government. Excluding this non-recurring item, HAECO's profit improved, reflecting a recovery in demand for engine overhaul and more airframe base maintenance.

Revenue of beverage division rose slightly by 0.5% in 1H22 despite an 8% sales volume drop, primarily led by price increases in the US. Sales revenue in China and Hong Kong were adversely impacted by pandemic related restrictions. This was partly offset by the strong revenue growth in US (+13%). However, EBITDA margin decreased to 11.1% from 12.4%, reflecting higher raw material costs and operating expenses. Overall, attributable underlying profit softened 22% to HK\$1.15bn. With the gradual easing of the negative impact of COVID-19, the business in Asia is expected to recover in 2H22. Revenue from the US should remain strong. But margin pressure should remain, given rising operating expenses.

In Jul-2022, Swire Coca-Cola agreed to acquire Coca-Cola's bottling businesses in Vietnam and Cambodia from The Coca-Cola Company, representing the company's first foray into the fast-growing non-alcoholic beverage markets in South East Asia. After the acquisition, franchise population will expand by 15% to 876m people, and three bottling facilities in Vietnam and one bottling facility in Cambodia will be added to the company's portfolio. The total consideration amounted to US\$1,015m, payable in cash, reflecting a valuation of c.28.4x PE for the acquired business. The acquisition is expected to be completed in 4Q22.

Hard hit by COVID-19 related lockdowns in Shanghai and Shenzhen in 2Q22, attributable underlying losses of healthcare more than doubled to HK\$103m in 1H22. Swire Pacific has invested HK\$1.7bn in the healthcare sector. Currently, the company has exposure to the healthcare

Swire Pacific

sector in the Yangtze River Delta and the Greater Bay Area through its associate investments in Columbia China Healthcare, Shenzhen New Frontier United Family Hospital and HEAL Medical Group, and DeltaHealth. The company plans to invest at least HK\$20bn in the growing healthcare sector in Mainland China by 2030.

The disposal of a 100% stake in Swire Pacific Offshore (excluding the stake in Cadeler) was completed in Apr-22. The consideration for the transaction was settled partly in cash and partly in the form of warrants issued by the buyer, Tidewater. Coupled with the sale of HUD in 2021, Swire Pacific has completed its divestment of its marine services business. After the disposal of a 6.7% equity interest in Cadeler in Feb 2022, the company's shareholding in Cadeler was reduced to 18.13%.

Trading & industrial division slid into red with an attributable underlying loss of HK\$311m (1H21: profit of HK\$71m). This was mainly dragged down by the impairment of long-term assets and write-off of goodwill for Qinyuan Bakery which totaled HK\$424m. Excluding the non-recurring losses, the division record a profit of HK\$113m in 1H22.

Swire Pacific's net debt surged 14% to HK\$43.9bn from Dec-21's HK\$38.7bn, mainly due to its active land replenishment and construction expenses for investment properties. This translates into 13.6% of total equity (Dec-21: 11.9%). Even allowing for the share buyback program, the ratio would have risen to 15.1% which remains comfortable. There is room for the company to gear up for new investments on the property, beverage and health care fronts.

Interest cost for 72% (Dec-21: 84%) of total debt has been hedged into fixed rates in Jun-22. This should help mitigate the impact of interest rate hikes.

In Aug-22, Swire Pacific announced its intention to spend up to HK\$4bn for share repurchase. This marks its first

share buyback program. Since then, Swire Pacific has bought back 32.2m "A" shares and 31.4m "B" shares for HK\$1.8bn (or HK\$56.3/sh on average) and HK\$285m (or HK\$9.08/sh on average) respectively. This large-scale share repurchase program not only signals the stock's strong embedded value but has also boosted its share price.

In 1H22, first DPS rose 15% to HK\$1.15 for 'A' share (or HK\$0.23 for 'B' share). Swire Pacific revised its dividend policy in FY21 to better achieve its goal in delivering sustainable growth in dividends. It targets to pay out not less than half of its recurring underlying profit regardless of its associate Cathay Pacific's result, but including all dividends received from Cathay Pacific.

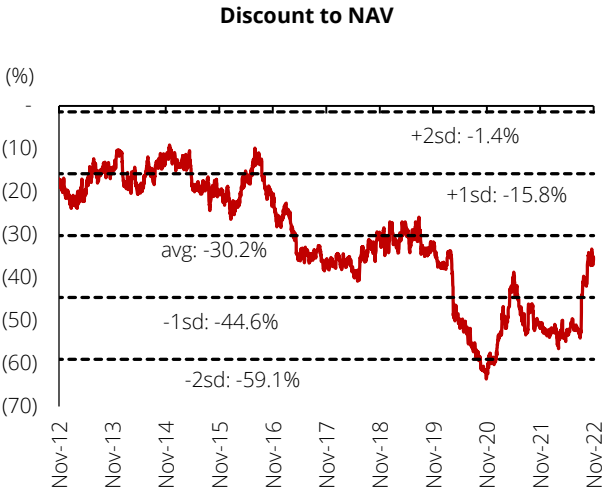
Share price of Swire Pacific has appreciated 23% over the past three months led by share repurchase and international border re-opening. Yet, the stock is now trading at 36% to our current estimated NAV, with dividend yield of 5.5%. Swire Pacific is well poised to benefit from international border re-opening through its exposure in Cathay Pacific. Property expansion should underpin the company's long-term growth. Ongoing share repurchase should continue to lend support to its share price. BUY with HK\$70.90, based on 40% discount to our Dec-2023 NAV.

Company Background

Swire Pacific is a conglomerate with two classes of shares listed in Hong Kong, 'A' Shares (19.HK) and 'B' Shares (87.HK). Swire Pacific owns a c.82% stake in Swire Properties (1972.HK) a major commercial landlord in Hong Kong with key hubs in Admiralty and Island East. Swire Pacific also owns a c.45% stake in Cathay Pacific (293.HK) a major Hong Kong-based airline. The company operates, beverages, healthcare, and trading & industrial division.

Swire Pacific

Discount to NAV



Source: Bloomberg Finance L.P., DBS HK

Swire Pacific

Key Assumptions (%)

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

Source: DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (HK\$ m)					
Property	14,135	13,262	15,848	13,931	13,951
Aviation	15,901	11,483	11,464	13,295	14,890
Beverages	43,316	45,080	53,925	54,192	61,856
Marine Services	2,451	1,889	1,601	524	0
Trading & Industrial	9,843	8,308	9,553	8,936	9,345
Others	6	10	12	12	13
Total	85,652	80,032	92,403	90,890	100,054

Source: DBS HK

Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Turnover	85,652	80,032	92,403	90,890	100,054
EBITDA	29,065	15,266	17,364	17,885	18,395
Depr / Amort	(4,823)	(4,178)	(4,370)	(4,501)	(4,636)
EBIT	24,242	11,088	12,994	13,384	13,758
Associates Inc	2,401	(8,482)	(1,375)	(996)	2,465
Interest (Exp)/Inc	(2,042)	(1,835)	(1,748)	(1,600)	(1,700)
Exceptionals	0	0	0	0	0
Pre-tax Profit	24,601	771	9,871	10,788	14,523
Tax	(2,018)	(2,185)	(2,439)	(2,505)	(2,653)
Minority Interest	(4,786)	(2,555)	(2,132)	(1,623)	(1,625)
Underlying Profit	17,797	(3,969)	5,300	6,661	10,245
Sales Gth (%)	1	(7)	15	(2)	10
Net Profit Gth (%)	109	N/A	N/A	26	54
EBITDA Margins (%)	34	19	19	20	18
EBIT Margin (%)	28	14	14	15	14
Tax Rate (%)	8	283	25	23	18

Source: DBS HK

Swire Pacific

Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Fixed Assets	308,930	291,718	289,892	289,777	291,994
Other LT Assets	11,852	13,015	11,656	11,656	11,656
Intangibles Assets	12,852	13,096	13,395	13,395	13,395
Deferred Tax Asset	667	562	468	468	468
Associates/JVs	66,643	65,650	72,024	70,328	72,043
Bank Balance/Cash & Liquid	21,345	29,264	22,894	21,947	26,915
ST Investments	0	384	3,577	3,577	3,577
Inventory	9,143	8,650	12,096	18,804	21,389
Debtors	8,618	9,788	9,365	9,425	9,485
Other Non Cash Current	1,347	983	949	949	949
Total Assets	441,397	433,110	436,316	440,325	451,871
ST Debt	11,569	6,929	17,283	19,283	19,283
Creditors	23,230	24,927	27,468	27,568	27,318
Other Current Liab	2,763	2,570	3,525	3,525	3,525
LT Debt	56,464	61,235	44,266	44,266	45,766
Deferred Tax Liabilities	11,014	11,556	12,572	12,572	12,572
Other LT Liabilities	6,863	6,747	7,034	7,034	7,034
Minority Interests	56,142	56,454	57,218	57,971	59,423
Shareholder's Equity	273,352	262,692	266,950	268,106	276,950
Total Cap. & Liab.	441,397	433,110	436,316	440,325	451,871
Share Capital (m)	1,502	1,502	1,502	1,479	1,479
Net Cash/(Debt)	(46,688)	(38,900)	(38,655)	(41,602)	(38,134)
Working Capital	2,891	14,643	605	4,325	12,189
Net Gearing (%)	17	15	14	16	14

Source: DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
EBIT	24,242	11,088	12,994	13,384	13,758
Tax Paid	(1,397)	(2,314)	(2,559)	(2,505)	(2,653)
Depr/Amort	7,700	9,213	4,370	4,501	4,636
Profit or loss on disposal of FAs/subsidiaries/investment	(2,411)	(1,897)	(2,001)	(400)	0
Chg in Wkg.Cap	(2,852)	374	(1,377)	(6,068)	(2,145)
Other Non-Cash	(14,741)	(5,005)	238	(1,500)	(1,700)
Operating CF	10,541	11,459	11,665	7,413	11,896
Net Capex	(5,146)	(2,043)	(2,289)	(2,646)	(1,412)
Investments	0	(26)	1,010	0	0
Associates & JVs	757	(5,151)	(3,946)	0	0
Others	16,758	8,945	(1,119)	0	0
Investing CF	12,369	1,725	(6,344)	(2,646)	(1,412)
Net Chg in Debt	(3,571)	130	(6,946)	2,000	1,500
Minority Interests	(1,246)	(1,354)	(1,421)	(1,111)	(1,153)
New Capital	0	0	0	(2,500)	(1,500)
Dividend	(4,730)	(3,529)	(3,004)	(4,103)	(4,363)
Other Financing CF	(1,005)	(935)	(971)	0	0
Financing CF	(10,552)	(5,688)	(12,342)	(5,714)	(5,516)
Chg in Cash	12,358	7,496	(7,021)	(947)	4,968

Source: DBS HK

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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