

China / Hong Kong Company Update

Sunlight REIT

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DBS Group Research . Equity

24 Jul 2023

BUY

Last Traded Price (21 Jul 2023): HK\$2.92 (HSI : 19,075)

Price Target 12-mth: HK\$3.57 (22% upside) (Prev HK\$3.89)

Analyst

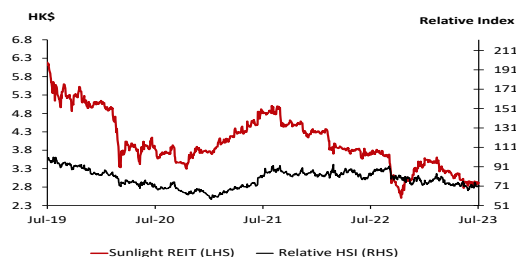
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What's New

- A co-working space operator secures lease at Dah Sing Financial Centre
- High-yielding tenants are returning to Sheung Shui Centre Shopping Arcade
- Portfolio rental reversion is less negative
- Maintain BUY despite lower DDM-based TP of HK\$3.57

Price Relative



Forecasts and Valuation

FY Jun (HK\$ m)	2022A	2023F	2024F	2025F
Gross Revenue	803	786	819	830
Net Property Inc	642	624	652	663
Net Profit	103	344	316	334
Distribution Inc	420	380	354	373
DPU (HK\$)	0.25	0.22	0.21	0.22
DPU Gth (%)	(2)	(10)	(8)	4
Div Yield (%)	8.6	7.7	7.1	7.4
Gross Gearing (%)	23	25	25	24
Book Value (HK\$)	8.36	8.15	8.23	8.41
P/Book Value (x)	0.3	0.4	0.4	0.3

DPU Rev (%): (2) (8) New

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

On a steady recovery path

Investment Thesis

A balanced mix of office and retail assets. With a balanced mix of office and retail assets, Sunlight REIT has demonstrated earnings resilience over economic cycles. Its extensive Grade B office portfolio, housing mainly SMEs and service trade tenants, has made the REIT less vulnerable to the subdued office leasing demand amid global macro uncertainties. Given its proximity to the border, Sheung Shui Centre Shopping Arcade is well poised to tap on the revival of cross border spending upon border reopening with China.

Improving reversionary growth outlook. Occupancy at Dah Sing Financial Centre is set to improve from Mar-23's 87.1%, following the recruitment of a homegrown co-working space operator, theDesk. Aided by positive rental reversions from service trade tenants, the office rental reversion should narrow from 1HFY23's -4.5%. Meanwhile, the retail portfolio should see narrower rental decline upon renewals on the back of healthier occupancy cost ratios. The return of high-margin trades to Sheung Shui Centre Shopping Arcade should further add momentum to its rental earnings recovery.

Cross border spending recovery to dictate unit price performance. Higher mainland tourist arrivals should translate into stronger cross border spending. This should bode well for the rental income of Sheung Shui Centre Shopping Arcade, which accounted for >20% of Sunlight REIT's FY22 NPI. This should provide upside on the stock. However, prolonged interest rate upcycle should remain among the key investment risks.

BUY despite lower TP of HK\$3.57. Sunlight REIT is trading at 7.7-7.1% distribution yields for FY23-24F, translating into yield spreads of 4.0-3.4%. We have revised down our TP to HK\$3.57 mainly reflecting the prolonged interest rate hike. Our TP is based on the Discounted Dividend Model (DDM) using a discount rate of 7.1%.

Key Risks to Our View:

Any derailment of retail market recovery would impact leasing demand for retail space. Macro uncertainties would deteriorate demand for offices.

Any faster-than-expected interest rate hike could drag down its valuation.

At A Glance

Issued Capital (m shrs)	1,682
Mkt Cap (HKm/US\$m)	4,911 / 628
Major Shareholders (%)	
Shau Kee Financial Enterprise Ltd.	22.1
Henderson Sunlight Asset Management Limited	11.5
Silchester International Investors, L.L.P.	10.9
Henderson Land Development Co Ltd	8.5
Free Float (%)	47.0
3m Avg. Daily Val. (US\$m)	0.21
GICS Industry: Real Estate / Equity Real Estate Investment	

Sunlight REIT**WHAT'S NEW****Resilient office portfolio, improving retail scene**

Dah Sing Financial Centre is seeing more leasing enquiries lately, mainly driven by corporates seeking for consolidation or relocation options within the Wan Chai/Causeway Bay precinct. Nonetheless, transactions have been limited and were primarily highlighted by small-sized tenants. In 2Q23, a homegrown co-working space operator, theDesk, has expanded its footprint by leasing one floor at Dah Sing Financial Centre. This should push up the property's occupancy from Mar-23's 87.1%. While negative rental reversion is still working its way through, the property should see stable rental income in the near term as only 5.7% of leases are up for renewal in 2HFY23.

Meanwhile, Grade B offices continued to benefit from solid demand from SMEs and service trade tenants. Occupancy at Strand 50 is expected to improve from Mar-23's 89.6%, thanks to in-house expansion of existing tenant which partially filled up the space vacated by theDesk in early 2023. Winsome House in Central should also see higher occupancy due to the recruitment of a new tenant. This should help support a recovery in portfolio occupancy. Aided by positive rental reversions from service trade tenants, reversionary growth for leases expiring in 2HFY23, accounting for 17.1% of the office portfolio's gross rental area, should narrow from 1HFY23's -4.5%.

Scheduled for completion in Jul-23, renovation work at Metro City Phase I (MCPI) has been substantially done. With a capex of <HK\$20m, the enhancement work includes the reconfiguration of shop layout on the upper floor and refurbishment of common facilities. This has inevitably caused disruption on footfall recovery at MCPI. Nevertheless, tenants' sales have seen a meaningful rebound amid the normalisation of social activities, especially for F&B.

Thanks to the return of Mainland tourists following the border re-opening, footfall at Sheung Shui Centre Shopping Arcade (SSC) has seen double-digit growth. The improved retail scene has also prompted the return of high margin trade tenants at SSC, and

hence, bodes well for the property's near to medium term rental outlook. Overall, tenant sales recovered on par with that of Hong Kong retail market.

With occupancy cost ratio edging down to a healthier level, we are seeing positive rental reversions from selected tenants at Sunlight REIT's retail portfolio. On the other hand, property agencies suffered from subdued residential demand and hence rental had declined upon lease renewals. Overall, we forecast retail reversionary growth to improve from 1HFY23's -4.8%.

Sunlight REIT has concluded the refinancing plan for the HK\$300m loan that matured in 2Q23. Despite new IRS entered in 2Q23, Sunlight REIT's hedging ratio should fall slightly from Dec-22's 55.8% after drawing a new loan to finance the acquisition of West 9 Zone Kids in 1H23.

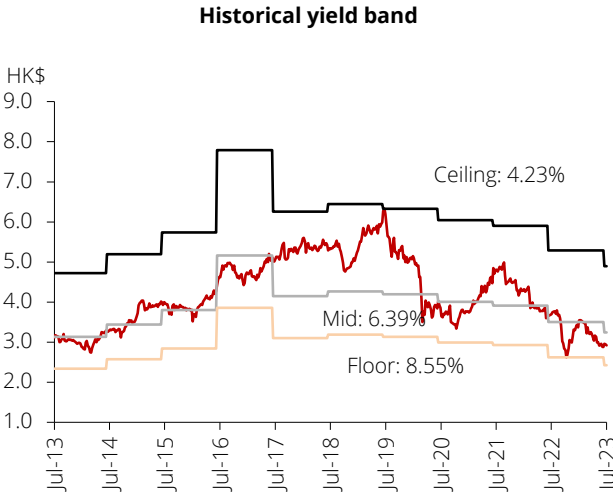
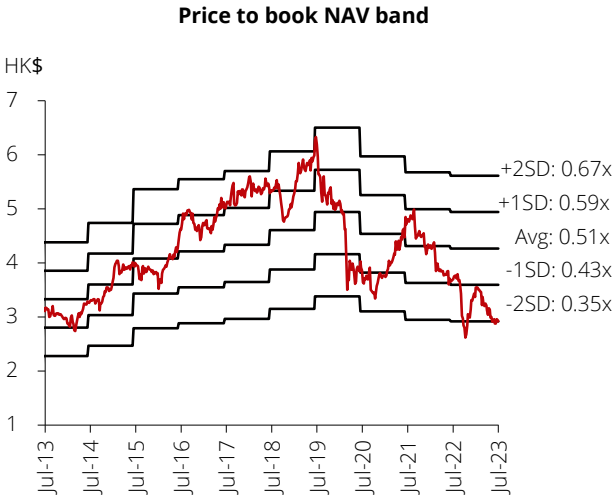
Sunlight REIT offers distribution yields of 7.7-7.1% for FY23-24F, translating into yield spreads of 4.0-3.4%. Despite headwinds over the office market, Sunlight REIT's office portfolio should demonstrate resilience as underpinned by solid demand for Grade B office space. Its retail portfolio is well poised to capture the Hong Kong retail market recovery led by improving economic outlook and inbound tourism. Maintain BUY with DDM-based TP of HK\$3.57.

Company Background

Sunlight REIT is the first Hong Kong REIT with exposure to both office and retail sectors. Listed in December 2006, the REIT now owns a diverse portfolio of 16 office and retail properties. Its three major properties are Dah Sing Financial Centre in Wanchai, Sheung Shui Centre Shopping Arcade in Sheung Shui, and the Metro City Ph 1 property in Tseung Kwan O.

Sunlight REIT

Price to book NAV band and historical yield band



Source: Bloomberg Finance L.P. DBS HK

Sunlight REIT

Key Assumptions (%)

	2023F	2024F
Office rental - HK	(5)	0
Retail rental (Shopping centre) - HK	5	5

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Jun	2021A	2022A	2023F	2024F	2025F
Revenues (HK\$ m)					
Rental income	645	643	624	657	666
Carpark income	32	34	35	36	37
Rental-related income	121	127	126	126	127
Total	799	803	786	819	830

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Jun	2021A	2022A	2023F	2024F	2025F
Gross revenue	799	803	786	819	830
Property expenses	(160)	(161)	(162)	(167)	(167)
Net Property Income	640	642	624	652	663
Other expenses	(108)	(106)	(107)	(110)	(112)
Interest (Exp)/Inc	(85)	(93)	(116)	(173)	(160)
Exceptionals	(605)	(264)	0	0	0
Pre-Tax Profit	(158)	179	401	369	391
Tax	(76)	(76)	(57)	(53)	(57)
Net Profit	(234)	103	344	316	334
Distribution income	427	420	380	354	373
Revenue Gth (%)	(6)	0	(2)	4	1
NPI Gth (%)	(7)	0	(3)	4	2
Dist. Inc Growth (%)	(4)	(2)	(10)	(7)	5
DPU Growth (%)	(5)	(2)	(10)	(8)	4

Source: Company, DBS HK

Sunlight REIT

Balance Sheet (HK\$ m)

FY Jun	2021A	2022A	2023F	2024F	2025F
Fixed Assets	18,342	18,095	18,654	18,956	19,417
Long-term Investments	141	104	104	104	104
Other LT Assets	38	53	53	53	53
Deferred Tax Asset	0	1	1	1	1
Bank Balance/Cash & Liquid Debtors	623	631	435	406	396
Other Non Cash Current	0	11	11	11	11
Total Assets	19,200	18,960	19,323	19,596	20,047
ST Debt	2,003	1,299	0	500	1,800
Creditors	71	69	69	69	69
Other Current Liab	337	286	286	286	286
LT Debt	2,398	2,990	4,896	4,396	3,096
Deferred Tax Liabilities	205	218	218	218	218
Other LT Liabilities	61	47	47	47	47
Unitholders' funds	14,124	14,051	13,807	14,080	14,531
Total Capital	19,200	18,960	19,323	19,596	20,047
Share Capital (m)	1,672	1,682	1,695	1,711	1,728
Gross Debt	(4,401)	(4,289)	(4,896)	(4,896)	(4,896)
Working Capital	(1,733)	(947)	156	(373)	(1,683)
Book NAV (HK\$)	8.45	8.36	8.15	8.23	8.41
Gross Gearing (%)	23	23	25	25	24

Source: DBS HK

Cash Flow Statement (HK\$ m)

FY Jun	2021A	2022A	2023F	2024F	2025F
Pre-Tax Income	(158)	179	401	369	391
Tax Paid	(16)	(46)	(57)	(53)	(57)
Depr/Amort	0	0	0	0	0
Chg in Wkg.Cap.	(27)	(12)	0	0	0
Other Non-Cash	737	403	162	221	208
Operational CF	536	525	506	537	543
Net Capex	(28)	0	(787)	(30)	(30)
Net Change in Investments	(25)	0	0	0	0
Assoc, MI, Invsmt	(255)	5	20	33	28
Investment CF	(309)	5	(767)	3	(2)
Net Chg in Debt	166	0	607	0	0
New issues/Unit Buyback	(6)	(5)	0	0	0
Distribution Paid	(434)	(424)	(401)	(363)	(363)
Other Financing CF	(93)	(98)	(136)	(206)	(188)
Financing CF	(368)	(527)	70	(569)	(550)
Chg in Cash	(141)	3	(191)	(30)	(10)

Source: Company, DBS HK

Sunlight REIT

Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	7-Sep-22	HK\$3.63	HK\$4.26	Buy
2:	21-Oct-22	HK\$2.80	HK\$3.60	Buy
3:	3-Feb-23	HK\$3.54	HK\$3.97	Buy
4:	16-Feb-23	HK\$3.47	HK\$3.89	Buy

Source: DBS HK

Analyst: Percy Leung

Jeff Yau

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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