

Yuexiu REIT

Bloomberg: 405 HK EQUITY | Reuters: 0405.HK

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DBS Group Research . Equity

11 Jul 2023

BUY

Last Traded Price (10 Jul 2023): HK\$1.58 (HSI : 18,480)

Price Target 12-mth: HK\$2.02 (28% upside) (Prev HK\$2.59)

Analyst

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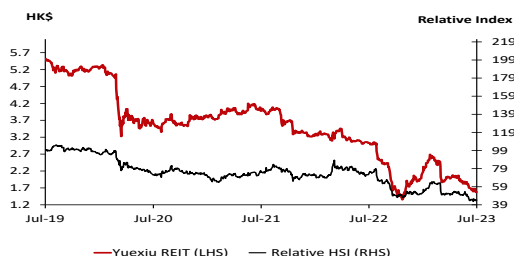
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What's New

- Recovery in hospitality and wholesale segments largely on track with our forecasts from our recent site visit
- Ability to manage its cost of debt is a key factor to watch
- Cutting FY23/24F DPU by 8-17% to reflect higher funding cost assumptions
- Maintain BUY with HK\$2.02/sh TP; potential acceleration of REIT Connect would be a catalyst

Price Relative



Forecasts and Valuation

FY Dec (RMB m)	2021A	2022A	2023F	2024F
Gross Revenue	1,797	1,873	2,126	2,230
Net Property Inc	1,298	1,356	1,566	1,632
Net Profit	645	(529)	(105)	(127)
Distribution Inc	798	533	525	497
DPU (HK\$)	0.22	0.12	0.12	0.11
DPU Gth (%)	1	(44)	(3)	(5)
Div Yield (%)	13.8	7.8	7.5	7.1
Gross Gearing (%)	40	45	45	44
Book Value (HK\$)	4.67	3.65	3.66	3.57
P/Book Value (x)	0.3	0.4	0.4	0.4
DPU Rev (%)			(8)	(17)
Consensus DPU			0.14	0.17
Other Broker Recs:		B:2	S:0	H:2

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

Navigating the headwinds

Investment Thesis

The largest offshore listed China REIT in HK/SG with a solid acquisition pipeline from parent. Yuexiu REIT has the largest PRC portfolio among the listed REITs in Hong Kong and Singapore and is well-diversified across office (68%), retail (10%), wholesale (11%) and hotel (11%) assets. Serving as the offshore REIT platform of Yuexiu Group, Yuexiu REIT is poised to benefit from the robust development pipeline both from Yuexiu Property (123 HK) and the Group.

Hospitality and office recovery could be offset by higher financing costs.

We have cut our FY23/24 DPU by 8/17% as we revised up our average funding cost assumptions. While recovery in the hospitality and office sectors are on track, any increase in DPU from this front will likely be offset by an increase in average funding cost amid a slew of US interest rate hikes (62% of Yuexiu REIT's offshore debt is on floating-rate basis as at Dec-22). Operating performance of White Horse Building (c.5% of FY22 revenue or c.16% historically) – a key drag on its financial performance in the past – has been improving as per our recent site visit but it will likely take time for rental income to see a meaningful pickup.

Eye on debt management capability. Our analysis shows that a 100-bp rise in 1M Hong Kong Interbank Offered Rate (HIBOR) on top of our assumed average HIBOR rate (4.5% and 5.5% for FY23F and FY24F, vs YTD avg of 3.6%) would impact our estimated FY23/24F DPU by c.10-11%. Yuexiu REIT's ability to replace offshore debts with onshore financing in the current interest rate environment would therefore be a key factor to watch. Further asset depreciation risk should be manageable given the continually favourable onshore liquidity profile, potential liquidity and value enhancement from Private Equity Real Estate (PERE) and further relaxation over C-REIT asset classes.

BUY with TP of HK\$2.02/sh. We derive our 12-mth DCF-based target price of HK\$2.02 based on an unchanged discount rate of 7% and terminal growth of 3%. The stock is now trading at an 7.5% FY23F yield, slightly above the historical mean of 7.1%. The potential acceleration of REIT Connect development ([see link for details](#)) could be a unit price catalyst.

Key Risks to Our View:

Faster-than-expected US rate hikes; weaker-than-expected economic recovery in China; stronger than expected RMB depreciation

At A Glance

Issued Capital (m shrs)	4,784
Mkt Cap (HKm/US\$m)	7,559 / 966
Major Shareholders (%)	
Yuexiu Property Co Ltd	36.8
Yue Xiu Enterprises (Holdings) Limited	5.3
Free Float (%)	57.8
3m Avg. Daily Val. (US\$m)	0.93
GICS Industry: Real Estate / Equity Real Estate Investment	

WHAT'S NEW

Takeaways from Guangzhou Investor Day – performance of key properties on track

Yuexiu Financial Tower (23% of FY22 revenue)– decent retention rate and rental reversion. Located in the prime CBD of Zhujiang New Town in Guangzhou, the property's tenants are comprised mainly of sector-leading companies that have more stable rental demand with occupancy maintained at >90% (FY22: 92%) despite the moderating office market in the city. The asset recorded c.90% retention rate so far out of c.30% of GFA that is up for expiry this year with an upbeat rental reversion of c.6%. Existing leases were able to secure c.5-6% built-in rental escalation.

In response to the changing demand dynamics in the market, Yuexiu REIT opted to conduct an AEI on the property last year to offer some smaller-sized units with interior fittings to cater to SMEs, a segment that is seeing more robust business growth. This decision has started to pay off as the REIT is able to charge above-average market rent of c.Rmb260-270/sm/mth for new tenants. This has in part helped the REIT manager to maintain an overall stable rent and occupancy performance in the midst of rising new supply in the area and moderating leasing demand in the market.

Yuexiu Financial Tower



Source: DBS HK

Four Seasons Hotel (13% of FY22 revenue) – encouraging performance. Hospitality saw the most encouraging sign of recovery amongst the properties we visited. Occupancy has recovered to 90% YTD alongside a robust performance in average daily room rate that has returned to 2019's level (Rmb2,074), 30% y-o-y higher. This is mainly led by the normalization of business travel and resumption of exhibition events in the city. Having said that, the pickup in outbound international travel since 2Q23 may lead to some demand leakage. The sustainability of recovery in the hotel segment, which may potentially be a source of DPU upside (based on consensus estimate) for the REIT should be closely monitored.

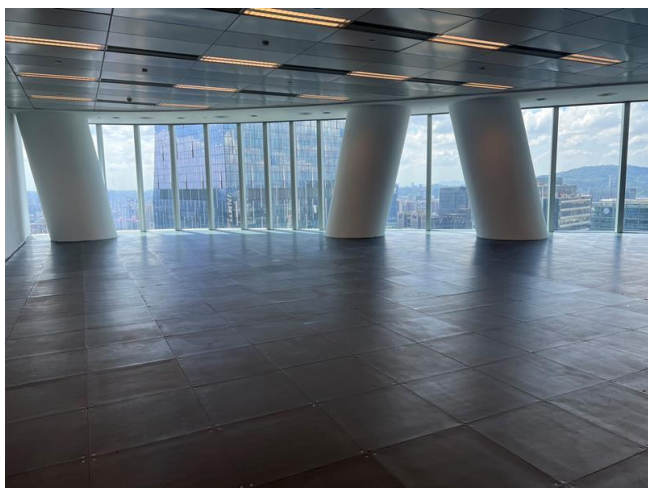
Four Seasons Hotel



Source: DBS HK

Guangzhou IFC (25% of FY22 revenue) – progressing steadily. Also located in Guangzhou's CBD and in a more premium location than Yuexiu Financial Tower, Guangzhou IFC's tenants are mainly comprised of Fortune 500 companies, including banks, trusts and law firms. Yuexiu REIT has managed to secure 100% renewal rate for contracts up for expiry this year, with some even opting to expand their office space. Industries like digital finance, securities, fund management and energy have seen stable leasing demand. There is likely a mild pick-up in vacancy in 1H23 from FY22 (88%) for the property due to its adjustments in tenant mix to secure more larger-size tenants, but this should be short-lived and filled in 2H23.

Guangzhou IFC



Source: DBS HK

GZIFC mall and Victory Plaza (7% of FY22 revenue) – recovery on track. Recovery in IFC mall was relatively mild. Retail sales from Guangzhou Friendship Store (c.59% of total GFA) was largely flat YTD, whereas the other tenants saw relatively stronger growth with catering posting c.15-20% y-o-y growth in 1H23 (catering makes up c.30% of total GFA).

As for Victory Plaza, most leases up for expiry (45% of total GFA) this year come from its anchor tenant “Uniqlo”. The mall has successfully renewed the contract with the fast fashion company in 1H23 to comprise of 100% turnover base rent. With the tenant delivering retail sales growth of 20% y-o-y YTD, rental income is expected to return to c.80% of pre-Covid levels (or +20% vs 2022). Though the landlord saw recovery momentum moderating in 2Q23 vs 1Q23, retail sales for Victory Plaza has remained in the positive territory during the quarter.

Tenant profile of Victory Plaza



Source: DBS HK

White Horse Building (5% of FY22 revenue) – occupancy back to normal while rental reversion under pressure. The White Horse Building has been one of the major drags to Yuexiu REIT's business performance since the outbreak of the pandemic, mainly due to the on-and-off COVID lockdowns and store closures. The REIT manager has taken the opportunity to conduct AEI during the period to cater to the changing wholesale model and they have opted to increase the portion of catering and retail to boost foot traffic. Occupancy of the building has improved to >90% in Apr and they anticipate to see further improvement in 2H23 backed by its robust client waiting list (c.800-1000 potential tenants in negotiation). Having said that, rental reversion was largely flat in 1H23. Overall retail sales in the property have recovered to FY20's level (where rental income was Rmb288m), or c.70-80% of 2019's level.

White Horse Building



Source: DBS HK

Proactively managing its floating rate exposure. To-date, the REIT has successfully secured two loans with amounts of Rmb1.5bn/4bn at fixed rates of 4.15%/3.2% respectively. The loans would be used to replace two HKD-denominated debt maturities this year and should help to reduce the REIT's floating rate ratio from c.69% as at Dec-22 to c.56% per our estimates and partially reduce the impact of rising finance expenses from elevating HIBOR. Management intends to replicate the arrangement to the remainder of its offshore debts as they fall due. As for gearing, it may rise to slightly above 46% given the weakness in RMB.

Company Background

Yuexiu REIT was established through the acquisition of four commercial properties (White Horse Building, Fortune Plaza, City Development Plaza, and Victory Plaza) from Yuexiu Property (“YXP”, 123 HK). Yuexiu REIT was listed on the Main Board of the HKSE in 2005, where its IPO raised more than HK\$2bn. It is the first listed REIT with assets in the PRC. Following its listing, Yuexiu REIT acquired Neo Metropolis in 2009, GZIFC in 2012, Shanghai Yuexiu Tower in 2015, and Wuhan Yuexiu Fortune Centre in late 2017.

Income Statement (RMB m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Gross revenue	1,759	1,797	1,873	2,126	2,230
Property expenses	(436)	(498)	(517)	(560)	(598)
Net Property Income	1,323	1,298	1,356	1,566	1,632
Other expenses	(359)	(350)	(435)	(451)	(455)
Joint ventures	0	0	0	0	0
Interest (Exp)/Inc	355	(23)	(1,496)	(888)	(955)
Exceptionals	(703)	13	302	0	0
Pre-Tax Profit	616	938	(273)	228	222
Tax	(204)	(264)	(238)	(299)	(314)
Non-Controlling Interests	(22)	(30)	(18)	(34)	(36)
Net Profit	391	645	(529)	(105)	(127)
Distribution income	649	798	533	525	497
Revenue Gth (%)	(15)	2	4	14	5
NPI Gth (%)	(12)	(2)	4	16	4
Dist. Inc Growth (%)	(15)	23	(33)	(2)	(5)
DPU Growth (%)	(17)	1	(44)	(3)	(5)

Source: Company, DBS HK

Balance Sheet (RMB m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Fixed Assets	29,700	37,657	37,702	37,702	37,702
Long-term Investments	3,458	3,400	3,399	3,259	3,113
Other LT Assets	0	0	30	0	0
Intangibles Assets	860	860	860	861	860
Deferred Tax Asset	262	260	235	235	235
Associates/JVs	0	0	0	0	0
Bank Balance/Cash & Liquid	1,802	1,453	1,334	1,470	914
ST Investments	0	0	0	0	0
Inventory	4	3	3	3	3
Debtors	23	24	20	20	20
Other Non Cash Current	150	206	283	253	259
Total Assets	36,260	43,862	43,866	43,803	43,107
ST Debt	3,307	2,894	4,364	4,364	4,364
Creditors	559	4,202	621	1,135	1,151
Other Current Liab	539	627	382	363	376
LT Debt	10,693	14,728	15,541	15,141	14,741
Deferred Tax Liabilities	4,997	5,202	5,381	5,381	5,381
Other LT Liabilities	392	286	256	239	225
Preferred Shares	0	0	0	0	0
Non-Controlling Interests	1,188	1,206	1,217	1,251	1,286
Unitholders' funds	14,585	14,718	16,104	15,929	15,582
Total Capital	36,260	43,862	43,866	43,803	43,107
Share Capital (m)	3,303	3,417	4,784	4,784	4,784
Gross Debt	14,001	17,622	19,905	19,505	19,105
Working Capital	(920)	(4,596)	(697)	(1,223)	(1,245)
Book NAV (HK\$)	5.17	5.05	3.92	3.89	3.82
Gross Gearing (%)	39	40	45	45	44

Source: DBS HK

Yuexiu REIT
Cash Flow Statement (RMB m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Pre-Tax Income	791	938	(273)	228	222
Tax Paid	(102)	(87)	49	(197)	(211)
Depr/Amort	83	85	88	141	145
Chg in Wkg.Cap.	118	87	(3,420)	674	199
Other Non-Cash	(195)	(249)	3,911	(26)	(26)
Operational CF	695	775	354	820	329
Net Capex	(29)	(18)	0	0	0
Net change in asso/jv	0	0	0	0	0
Net Change in Investments	0	0	0	0	0
Assoc, MI, Invsmt	16	(4,144)	(3,711)	26	26
Investment CF	(13)	(4,162)	(3,711)	26	26
Net Chg in Debt	506	3,729	2,283	(400)	(400)
New issues/Unit Buyback	0	0	3,359	0	0
Distribution Paid	(694)	(682)	(893)	(310)	(511)
Other Financing CF	(10)	(11)	(1,474)	0	0
Financing CF	(199)	3,036	3,274	(710)	(911)
Chg in Cash	483	(352)	(83)	136	(556)

Source: Company, DBS HK

Yuexiu REIT

Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	5-Sep-22	HK\$2.42	HK\$3.26	Buy
2:	13-Mar-23	HK\$2.02	HK\$2.59	Buy

Source: DBS HK

Analyst: Ben Wong
 Jason Lam
 Dexter Chun

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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