

China / Hong Kong Company Update

Fortune REIT

Bloomberg: 778 HK Equity | Reuters: 0778.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

11 Jan 2024

BUY

Last Traded Price (10 Jan 2024): HK\$4.79 (HSI : 16,097)
Price Target 12-mth: HK\$6.50 (36% upside) (Prev HK\$7.36)

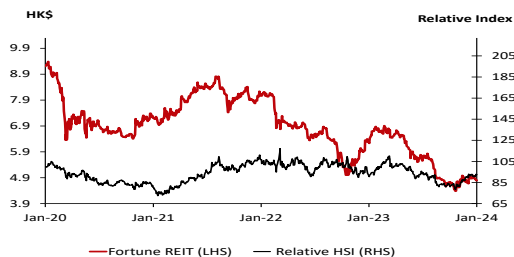
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What's New

- Portfolio occupancy to pick up slightly to c.95%, thanks to improvement in Fortune Metropolis
- Reversionary growth expected to stay broadly neutral in FY24
- Commitment rate for stage 3 AEI at +WOO Ph 2 has reached >50%
- Attractively valued amid peaking interest rate, Maintain BUY with TP of HK\$6.50.

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2022A	2023F	2024F	2025F
Gross Revenue	1,764	1,798	1,818	1,848
Net Property Inc	1,290	1,309	1,326	1,348
Net Profit	503	665	621	686
Distribution Inc	877	818	777	845
DPU (HK\$)	0.44	0.41	0.38	0.41
DPU Gth (%)	(2)	(8)	(6)	7
Div Yield (%)	9.2	8.5	8.0	8.6
Gross Gearing (%)	24	24	24	24
Book Value (HK\$)	14.52	14.41	14.58	14.75
P/Book Value (x)	0.3	0.3	0.3	0.3
DPU Rev (%)		(4)	(10)	New
Consensus DPU (HK\$):		0.42	0.43	0.46
Other Broker Recs:		B:2	S:1	H:3

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

Too much value to ignore

Investment Thesis

A pure suburban mall play. Fortune REIT owns 16 neighbourhood malls in Hong Kong in densely populated private residential areas with a total GRA of c.3msf. With c.70% of tenants from non-discretionary trades, Fortune REIT's rental earnings has demonstrated resilience across economic cycles. In Oct-22, Fortune REIT acquired the Stars of Kovan property in Singapore, marking its first overseas acquisition since its listing.

Gradual completion of AEI at +WOO to fuel revenue growth.

Commitment rate for stage 1& 2 AEI at +WOO Ph2 has exceeded 85%. Started in 3Q23, stage 3 of the renovation work is well underway with >50% of the space being committed. The entire asset enhancement works is scheduled for completion in 2Q24, and should underpin the REIT's rental income growth in the years ahead. However, higher cash financing cost should remain near-term earnings drag.

Interest rate pivot to drive unit price growth. Interest rates are gradually peaking out. Any potential rate cut should improve sentiment towards the counter.

Maintain BUY with DDM-based TP of HK\$6.50. Fortune REIT is trading at 8.0-8.6% distribution yields for FY24-25. This translates into yield spreads of 4.0-4.6%, above its 10-year average of 3.7%. Current valuation is attractive, especially taking into account that interest rate is gradually peaking out. Our target price is based on a Discounted Dividend Model (DDM) with a discount rate of 7.1%

Key Risks to Our View:

Any derailment in local retail market recovery would impact leasing demand for retail space and hence weigh on the company's earnings recovery. Stronger-than-expected interest rate hikes would adversely impact its valuation.

At A Glance

Issued Capital (m shrs)	2,014.7
Mkt Cap (HKm/US\$m)	9,650 / 1,234
Major Shareholders (%)	
Focus Eagle Investments Ltd.	20.5
Ballston Profits Ltd.	5.6
Free Float (%)	73.9
3m Avg. Daily Val. (US\$m)	1.0
GICS Industry: Real Estate / Equity Real Estate Investment	

Fortune REIT**WHAT'S NEW****Enhancement works bearing fruit**

Fortune REIT's portfolio continued to record positive tenant sales growth in 2H23 supported by post-pandemic economic recovery. This was primarily led by the upward momentum from restaurants sales. Selected eateries have seen their sales exceeding pre-COVID levels. On the other hand, supermarket sales fell mildly due to weaker groceries demand from locals.

+WOO in Tin Shui Wai saw the strongest pickup in footfall with the gradual completion of asset enhancement work. Overall footfall recovered to c.95% of pre-COVID level.

Portfolio occupancy should improve slightly to c.95% from Jun-23's 94.1% mainly led by higher occupancy from Fortune Metropolis in Hung Hom. In Dec-23, Fortune REIT welcomed their first new energy vehicle tenant, MG, into its portfolio by opening an open-concept showroom at Fortune Metropolis. Coupled with new interior design and F&B tenants, occupancy at Fortune Metropolis should rise to c.88% from Jun-23's 82.9%. Meanwhile, with the recruitment of a new elderly home, the occupancy of Smartland in Tsuen Wan improved to c.95% from Jun-23's 90.5%. Occupancy at +WOO should remain stable at c.90%.

Occupancy cost ratio of the portfolio has edged down to a healthier level than that prior to the COVID outbreak. Restaurant operators, household product retailers and gym tenants recorded positive rental growth on renewals. However, this should be more than offset by negative rental reversions from real estate agencies, supermarket and kindergarten tenants. Hence, overall reversionary growth for the overall portfolio should remain mildly negative for FY23. We expect reversionary growth to be broadly flattish in FY24 as dragged by property agency tenants given the prevailing sluggish residential market.

Commitment rate for stage 1 & 2 renovation works at +WOO Ph2 has exceeded 85%, mainly featuring F&B and fashion tenants.

Stage 3 of the AEI has commenced in 3Q23 and is expected to complete by 2Q24. Fortune REIT has secured tenants for >50% of the space under renovation, including general retail trade, F&B and cinema. ROI for the entire AEI is targeted c.10%. Elsewhere, Fortune REIT is scheduling an asset enhancement work at Fortune Metropolis in 2H24. With a total capex of c.HK\$200m, this should enhance the layout and improve the retail offerings of the mall.

Gearing should remain stable at c.24%. Refinancing for the HK\$1.5bn loan that expired in Oct-23 has been completed with credit margin slightly higher than the previous one. Fortune REIT should see a decline in hedging ratio (Jun-23: c.63%) along the natural expiry of IRS in 2024. Higher cash financing costs would be a near-term earnings drag to the REIT.

Fortune REIT is trading at distribution yields of 8.0-8.6% for FY24-25. This translates into yield spread of 4.0-4.6%, above its 10-year average of 3.7%. Current valuation is attractive, especially taking into account that interest rate is gradually peaking out. Gradual completion of enhancement works should enhance rental value of +WOO Ph 2, which in turn underpins Fortune REIT's revenue growth in the years ahead. Moreover, interest rate upcycle is near an end. This should bode well for sentiment towards the counter. Maintain BUY with a DDM-based TP of HK\$6.50.

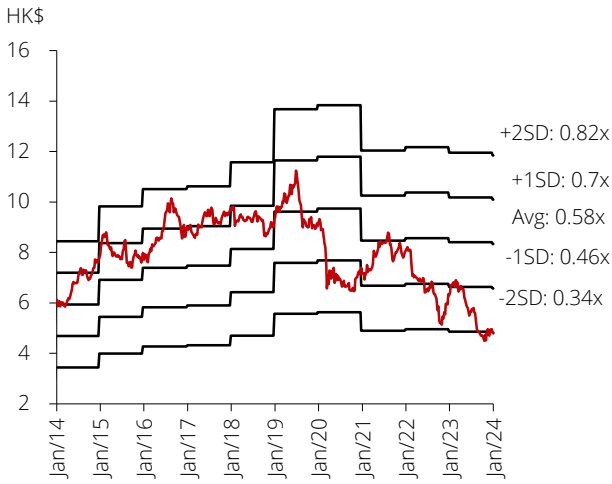
Company Background

Fortune REIT owns 16 suburban malls in Hong Kong with a gross rental area of c.3m sf. The malls are mostly located near densely populated residential areas which ensure a certain level of foot traffic.

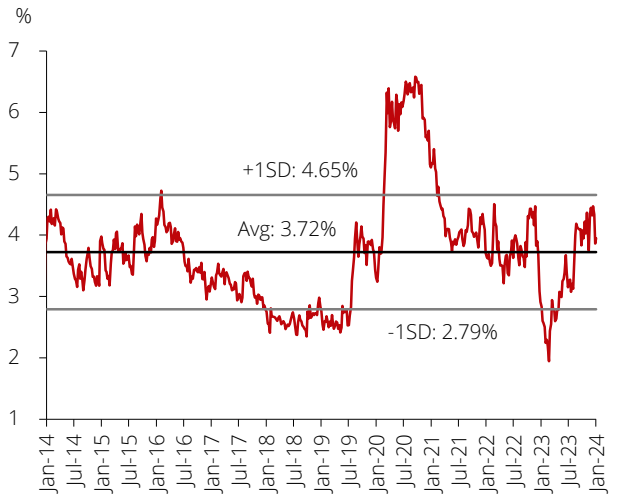
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Price to book NAV band and historical yield spread

Price to book NAV band



Historical yield spread



Source: Bloomberg Finance L.P. DBS HK

Fortune REIT

Key Assumptions (%)

	2024F	2025F
Retail Rental (Shopping Center) - HK	5	5

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenues (HK\$ m)					
Base rent & other income	1,567	1,532	1,553	1,568	1,591
Charge-out collections	239	232	245	250	257
Total	1,806	1,764	1,798	1,818	1,848

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Gross revenue	1,806	1,764	1,798	1,818	1,848
Property expenses	(466)	(474)	(489)	(492)	(500)
Net Property Income	1,340	1,290	1,309	1,326	1,348
Other expenses	(131)	(124)	(132)	(134)	(137)
Interest (Exp)/Inc	(193)	(242)	(333)	(401)	(341)
Exceptionals	505	(147)	0	0	0
Pre-Tax Profit	1,521	777	844	790	870
Tax	(204)	(275)	(179)	(169)	(184)
Net Profit	1,318	503	665	621	686
Distribution income	883	877	818	777	845
Revenue Gth (%)	(2)	(2)	2	1	2
NPI Gth (%)	(3)	(4)	1	1	2
Dist. Inc Growth (%)	(4)	(1)	(7)	(5)	9
DPU Growth (%)	(5)	(2)	(8)	(6)	7

Source: Company, DBS HK

Fortune REIT

Balance Sheet (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Fixed Assets	39,500	39,503	39,837	40,714	41,605
Other LT Assets	21	510	510	510	510
Bank Balance/Cash & Liquid	118	207	179	219	273
Debtors	77	116	117	118	119
Other Non Cash Current	9	0	0	0	0
Total Assets	39,725	40,335	40,642	41,559	42,506
ST Debt	1,600	2,098	0	2,500	3,800
Creditors	1,078	1,127	1,134	1,141	1,148
Other Current Liab	0	19	19	19	19
LT Debt	7,241	7,480	9,778	7,478	6,378
Deferred Tax Liabilities	562	684	684	684	684
Other LT Liabilities	61	0	0	0	0
Unitholders' funds	29,183	28,927	29,027	29,737	30,477
Total Capital	39,725	40,335	40,642	41,559	42,506
Share Capital (m)	1,974	1,992	2,015	2,040	2,066
Gross Debt	(8,841)	(9,578)	(9,778)	(9,978)	(10,178)
Working Capital	(2,474)	(2,922)	(857)	(3,324)	(4,576)
Book NAV (HK\$)	14.79	14.52	14.41	14.58	14.75
Gross Gearing (%)	22	24	24	24	24

Source: DBS HK

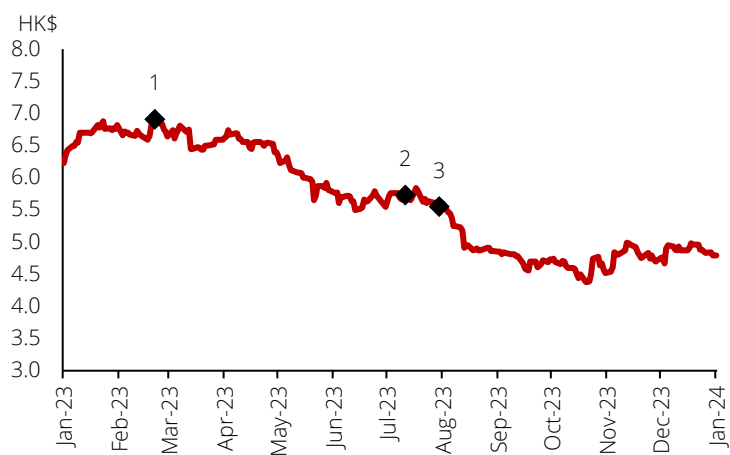
Cash Flow Statement (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Income	1,521	777	844	790	870
Tax Paid	(209)	(125)	(179)	(169)	(184)
Chg in Wkg.Cap.	(27)	12	5	5	5
Other Non-Cash	(194)	507	453	524	466
Operational CF	1,091	1,172	1,124	1,150	1,156
Net Capex	(67)	(673)	(150)	(150)	(150)
Net change in asso/jv	0	0	0	0	0
Investment CF	(67)	(673)	(150)	(150)	(150)
Net Chg in Debt	62	693	200	200	200
Distribution Paid	(972)	(849)	(868)	(759)	(811)
Other Financing CF	(173)	(254)	(333)	(402)	(341)
Financing CF	(1,083)	(410)	(1,001)	(961)	(952)
Chg in Cash	(59)	89	(28)	39	54

Source: Company, DBS HK

Fortune REIT

Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	3-Mar-23	HK\$6.82	HK\$8.05	BUY
2	21-Jul-23	HK\$5.68	HK\$7.31	BUY
3	9-Aug-23	HK\$5.57	HK\$7.36	BUY

Source: DBS HK

Analyst: Percy Leung
 Jeff Yau, CFA
 Cherie Wong

Fortune 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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