

Prosperity REIT

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DBS Group Research . Equity

15 Jan 2024

BUY

Last Traded Price (12 Jan 2024): HK\$1.36 (HSI : 16,245)
Price Target 12-mth: HK\$1.92 (42% upside) (Prev HK\$2.10)

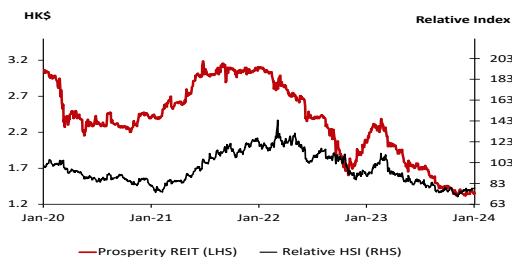
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What's New

- Portfolio occupancy softened slightly to c.95% from Jun-23's 97%
- Reversionary growth in FY23 should become less negative than 1H23's -2.6%
- Forecast cash finance cost to jump by 34% in FY24 due to higher average HIBOR and lower hedging ratio
- Negatives largely factored in given low valuation, BUY with HK\$1.92 TP

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2022A	2023F	2024F	2025F
Gross Revenue	434	435	434	436
Net Property Inc	338	334	331	332
Net Profit	75	153	124	144
Distribution Inc	245	211	183	203
DPU (HK\$)	0.16	0.14	0.12	0.13
DPU Gth (%)	(8)	(14)	(15)	9
Div Yield (%)	12.0	10.3	8.8	9.5
Gross Gearing (%)	23	24	24	24
Book Value (HK\$)	4.71	4.58	4.43	4.33
P/Book Value (x)	0.3	0.3	0.3	0.3

DPU Rev (%): 1 (2) New

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

Negatives priced in.

Investment Thesis

Quality decentralized commercial REIT. Prosperity REIT owns a diversified portfolio of seven office, commercial and industrial properties in decentralized locations in Hong Kong with total gross rentable area of c.1.3m sf. The REIT's proactive portfolio management contributes to high portfolio occupancy and retention rates. This helps to underpin income resilience despite market volatility.

Increased cash finance cost a near-term earnings drag. In FY24, we estimate cash finance cost will surge by 34% due to higher average HIBOR and lower hedging ratio, a drag on its distribution income.

Interest rate pivot key to unit price performance. Interest rate upcycle should be close to an end. Interest rate movement should dictate its unit price performance.

Maintain BUY with DDM-based TP of HK\$1.92. Prosperity REIT is trading at 8.8-9.5% distribution yields for FY24-25. This translates into yield spread of 4.8-5.6%, above its 10-year average of 4.1%. We believe concerns over challenging earnings outlook has largely factored in. Maintain BUY despite lower TP of HK\$1.92, based on a dividend discount model (DDM) using a discount rate of 7.1%.

Key Risks to Our View:

Any further deterioration in leasing demand for decentralised office space could drag its earnings outlook and unit price performance.

Any prolonged interest rate hikes would adversely impact its distribution income and valuation.

At A Glance

Issued Capital (m shrs)	1,511
Mkt Cap (HKm/US\$m)	2,025 / 259
Major Shareholders (%)	
CK Asset Holdings Limited	18.2
Free Float (%)	81.8
3m Avg. Daily Val. (US\$m)	0.21
GICS Industry: Real Estate / Equity Real Estate Investment	

Prosperity REIT

WHAT'S NEW**Portfolio occupancy softened slightly with reversionary growth becoming less negative**

Portfolio occupancy has softened to c.95% (Jun-23: 97%) due to longer downtime experienced as a result of slower leasing activities. The Metropolis Tower, Prosperity Millennia Plaza and 9 Chong Yip Street should see marginally lower occupancies in 2H23, while occupancy at Prosperity Place improved slightly from Jun-23's 93.8% thanks to solid demand from service trades tenants, particularly beauty centres.

Given high expiring rents, office reversionary growth for The Metropolis Tower and Prosperity Millennia Plaza should stay in the negative territory in 2H23. This should be partly offset by positive reversionary growth from service-trade and industrial tenants at other commercial and industrial properties. Overall, the portfolio's reversionary growth should become less negative in FY23 compared to 1H23's -2.6%.

In 2024, about 37% of leases, in terms of gross rental income, are scheduled for renewal, with more lease expiries taking place in The Metropolis Tower and Prosperity Millennia Plaza. Given the current leasing sentiment, we expect overall rental reversion to remain slightly negative in FY24.

Facelift at office floors at The Metropolis Tower is progressing well with scheduled completion by end-2024. Rejuvenation work at the lift lobby and corridors at Prosperity Millennia Plaza has just started. Elsewhere, Prosperity REIT plans to replace a chiller plant at The Metropolis Tower in 2024.

Prosperity REIT has no refinancing needs until Nov-25. Hedging ratio should drop from Jun-23's 55% following the IRS expiry in early 2024. We expect hedging ratio to stay at c.30% in 2024, factoring in the HK\$100m IRS that will take effect in Mar-24. Given a lower hedging ratio, we forecast cash finance cost to jump further by 34% to HK\$122m in FY24. This leads to our projected 13% decline in distribution income.

Share price of Prosperity REIT has dropped by 19% over the past six months. Despite the distribution income shortfall led by expected higher cash finance costs, Prosperity REIT is trading at a distribution yield of 8.8% for FY24 which should rise further to 9.5% in FY25. This translates into yield spread of 4.8-5.6%, above its 10-year average of 4.1%. Current valuation is attractive with negatives largely factored in. Maintain BUY with a DDM-based TP of HK\$1.92. Any interest rate pivot should improve the sentiment towards the counter.

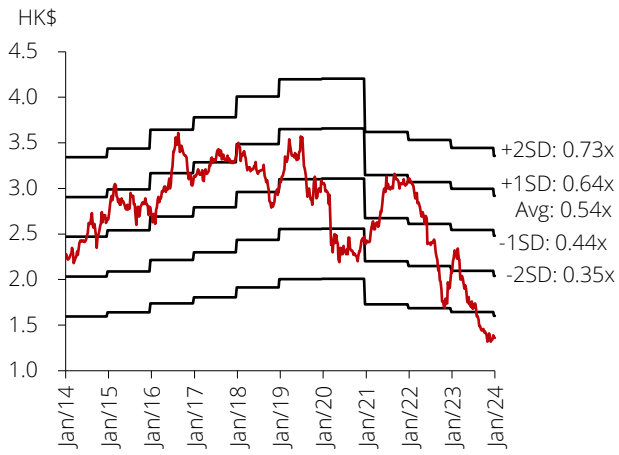
Company Background

Listed in Dec-05, Prosperity REIT was the first private sector REIT listed on the Hong Kong Stock Exchange. In Jan-14, Prosperity REIT made its first major acquisition of 9 Chong Yip Street, a Grade A office building in Kwun Tong. In Mar-17, the REIT sold Harbourfront Landmark in Hong Hum. The REIT currently owns a diverse portfolio of seven office/commercial, industrial/office and industrial properties in decentralised business districts of Hong Kong.

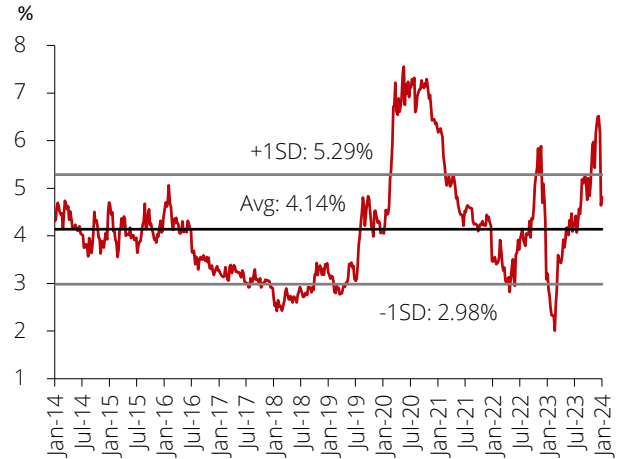
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Price to book NAV band and historical yield spread

Price to book NAV band



Historical yield spread



Source: Bloomberg Finance L.P. DBS HK

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Key Assumptions (%)

	2024F	2025F
Office rental - HK	(5)	0

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenues (HK\$ m)					
Rental income	351	333	327	325	325
Carpark income	31	31	32	32	33
Rental-related income	63	70	75	77	78
Total	445	434	435	434	436

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Gross revenue	445	434	435	434	436
Property expenses	(93)	(96)	(101)	(104)	(104)
Net Property Income	352	338	334	331	332
Other expenses	(58)	(58)	(57)	(57)	(57)
Interest (Exp)/Inc	(53)	(65)	(90)	(120)	(97)
Exceptionals	(142)	(94)	0	0	0
Pre-Tax Profit	98	121	187	154	177
Tax	(41)	(46)	(34)	(29)	(33)
Net Profit	57	75	153	124	144
Distribution income	268	245	211	183	203
Revenue Gth (%)	(2)	(2)	0	0	0
NPI Gth (%)	(2)	(4)	(1)	(1)	0
Dist. Inc Growth (%)	(2)	(8)	(14)	(13)	11
DPU Growth (%)	(2)	(8)	(14)	(15)	9

Source: Company, DBS HK

Prosperity REIT

Balance Sheet (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Fixed Assets	9,967	9,801	9,687	9,634	9,661
Other LT Assets	0	32	32	32	32
Bank Balance/Cash & Liquid	206	100	28	14	17
Debtors	13	11	11	11	11
Other Non Cash Current	0	38	38	38	38
Total Assets	10,186	9,983	9,797	9,730	9,759
ST Debt	1,535	0	0	938	800
Creditors	191	181	183	185	187
Other Current Liab	173	145	129	123	133
LT Debt	788	2,307	2,307	1,369	1,507
Other LT Liabilities	236	251	262	273	284
Unitholders' funds	7,263	7,098	6,916	6,843	6,849
Total Capital	10,186	9,983	9,797	9,730	9,759
Share Capital (m)	1,504	1,508	1,511	1,546	1,582
Gross Debt	(2,340)	(2,340)	(2,340)	(2,340)	(2,340)
Working Capital	(1,680)	(177)	(235)	(1,183)	(1,055)
Book NAV (HK\$)	4.83	4.71	4.58	4.43	4.33
Gross Gearing (%)	23	23	24	24	24

Source: DBS HK

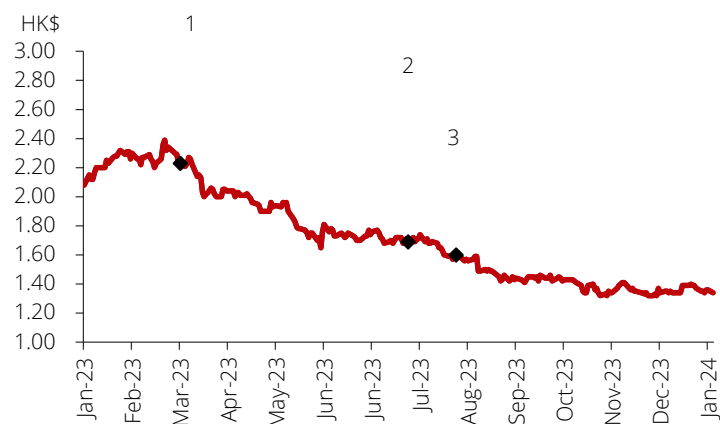
Cash Flow Statement (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Income	98	121	187	154	177
Tax Paid	(36)	(20)	(23)	(18)	(22)
Chg in Wkg.Cap.	5	(10)	2	2	2
Other Non-Cash	245	210	137	168	145
Operational CF	312	301	303	305	303
Net Capex	(7)	(21)	(20)	(10)	(10)
Net Change in Investments	0	0	0	0	0
Assoc, MI, Invsmt	1	0	1	1	1
Investment CF	(6)	(20)	(19)	(9)	(9)
Net Chg in Debt	0	0	0	0	0
New issues/Unit Buyback	(119)	(43)	(38)	0	0
Distribution Paid	(275)	(261)	(227)	(189)	(193)
Other Financing CF	(59)	(83)	(91)	(121)	(98)
Financing CF	(452)	(386)	(356)	(311)	(292)
Chg in Cash	(146)	(106)	(72)	(14)	2

Source: Company, DBS HK

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Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	10-Mar-23	HK\$2.23	HK\$2.49	Buy
2:	21-Jul-23	HK\$1.71	HK\$2.10	Buy
3:	18-Aug-23	HK\$1.58	HK\$2.10	Buy

Source: DBS HK

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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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