

China / Hong Kong Company Update

Wharf REIC

Bloomberg: 1997 HK Equity | Reuters: 1997.HK

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DBS Group Research . Equity

24 Jan 2024

BUY

Last Traded Price (23 Jan 2024): HK\$23.00 (HSI : 15,354)
Price Target 12-mth: HK\$30.80 (34% upside) (Prev HK\$44.90)

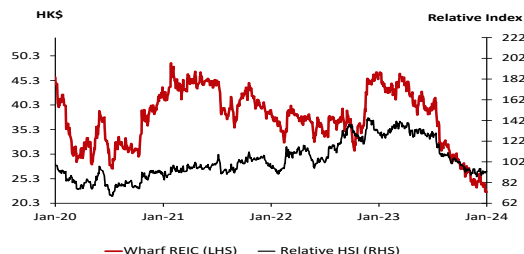
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What's New

- Retail tenants' sales continue to recover but yet to return to pre-COVID level due to high base
- Office income under pressure, particular at Times Square
- Valuation is compelling even allowing for slower-than-expected post-pandemic retail sector recovery
- Maintain BUY with HK\$30.80 TP

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2022A	2023F	2024F	2025F
Turnover	12,459	13,148	13,782	14,092
EBITDA	9,097	10,142	10,751	11,000
Pre-tax Profit	7,613	7,310	8,123	9,009
Underlying Profit	6,175	5,982	6,695	7,429
Underlying Profit Gth (%)	(5.3)	(3.1)	11.9	11.0
EPS (HK\$)	2.03	1.97	2.20	2.45
EPS Gth (%)	(5.3)	(3.1)	11.9	11.0
PE (X)	11.3	11.7	10.4	9.4
P/Cash Flow (X)	8.9	8.9	8.3	7.5
EV/EBITDA (X)	12.5	11.2	10.5	10.3
DPS (HK\$)	1.31	1.34	1.44	1.58
Div Yield (%)	5.7	5.8	6.3	6.9
Net Gearing (%)	24	20	18	16
ROE (%)	3.1	3.1	3.5	3.8
Est. NAV (HK\$):			67.2	68.4
Disc. to NAV (%)			(66)	(66)

Earnings Rev (%): (1) (1) New
Consensus EPS (HK\$): 2.09 2.36 2.63
Other Broker Recs: B:11 S:2 H:4

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

Concerns on retail scene priced in.

Investment Thesis

Prime shopping mall operator. Wharf REIC owns two signature shopping landmarks in Hong Kong, including Harbour City and Times Square, with a total retail space of c.3msf. These two malls are the 'go to' shopping destinations for tourists as well as locals alike in view of their prime locations and wide retail offerings.

Retail malls drive the earnings recovery while office portfolio remains a drag. Retail rental income should see recovery led by reduced amortised rental concessions and higher turnover rents. Thanks to post pandemic retail sales recovery, occupancy cost ratio has become healthy which should underpin positive reversionary growth and higher retail income. On the other hand, office income remains under pressure with reversionary growth staying in the negative territory. High interest expense led by the prevailing high HIBOR could also weigh on its earnings recovery in the near term.

Interest rate pivot is key to share price performance. Continued inbound tourism recovery led by flight capacity improvement should be positive for tourist spending despite changing shopping behaviour of Mainland tourists. This should facilitate Wharf REIC's retail sales growth. Any interest rate pivot could improve its earnings growth and share price performance as all its borrowings are on floating rate basis.

Negatives priced in, BUY despite lower TP of HK\$30.8.

Following the sharp share price correction, the stock is trading at 66% discount to our current NAV estimate, >2SD below its average of 39% since listing. Concerns over retail market recovery should be largely priced in. Our target price is based on a target discount of 55% to our Dec-24 NAV estimate, c.1.5SD below its average since listing.

Key Risks to Our View:

Any derailment in retail market recovery would impact leasing demand for retail space.

Any further deterioration in office leasing demand could affect the company's office income.

At A Glance

Issued Capital (m shrs)	3,036
Mkt Cap (HKm/US\$m)	69,828 / 8,927
Major Shareholders (%)	
Wheelock And Co Ltd	43.4
Free Float (%)	56.6
3m Avg. Daily Val. (US\$m)	11.0
GICS Industry: Real Estate / Real Estate Management & Development	

Wharf REIC

WHAT'S NEW**Retail reversionary growth to turn positive**

Retail occupancy at Harbour City further improved from Jun-23's 96% due to the addition of new tenants. Luxury brands staged better post-COVID sales recovery than mid-priced fashion retailers and F&B operators. However, overall tenants' sales have yet to return to pre-pandemic level due to a high base and a shift in shopping behaviour of Mainland tourists.

In addition to increased turnover rents led by tenants' sales recovery, amortised rental concession has been gradually declining, thus adding momentum to retail income recovery.

With occupancy cost ratio improving to <20% (better than pre-COVID level), retail reversionary growth should turn positive in 2024.

To boost its competitiveness, Wharf REIC is refining the trade and tenant mix at Times Square which is experiencing slower post-COVID tenants' sales recovery.

Office occupancy at Harbour City remains broadly stable with increased demand from insurance companies following the border re-opening. Manulife Financials is a case in point. Times Square is impacted by the departure of ByteDance. Overall office income should remain under pressure, dragged by negative reversionary growth and rental void. We project office income of Harbour City and Times Square to fall 10% and 17% in FY23 followed by 3% and 5% decline in FY24.

Marco Hotels in Tsim Sha Tsui staged a decent post-pandemic recovery. However, F&B revenue remains weaker than pre-COVID times.

While the interest rate upcycle is nearing an end, HIBOR is expected to stay high in the near term. With all borrowings mainly on floating rate basis, Wharf REIC should inevitably suffer from the prevailing high interest rates. This would moderate the company's earnings recovery.

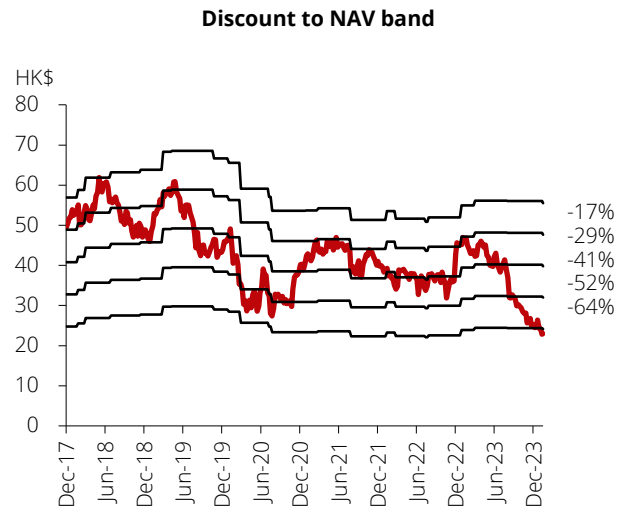
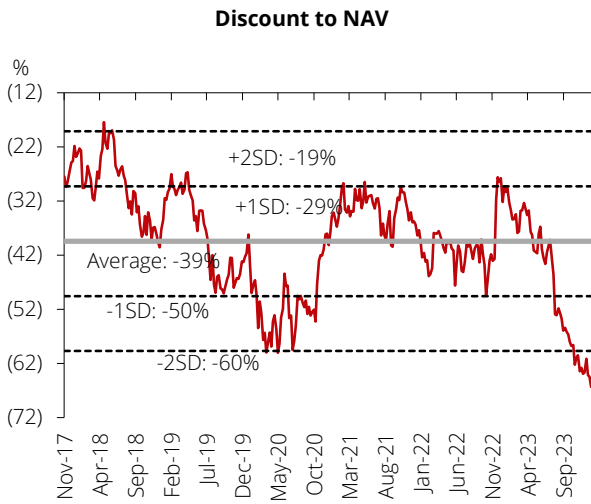
In the past six months, shares of Wharf REIC fell 42%, underperforming the broad market by 14ppts, mainly due to slower-than-expected tourist spending recovery. Meanwhile, the stock is trading at 66% discount to our assessed current NAV, against its average discount of 39% since its listing. Estimated dividend yields stand at 5.8% and 6.3% for FY23 and FY24. We believe concerns over retail market recovery should be largely discounted following the share price correction. The current low valuation should cushion further downside risk. Any interest rate pivot could improve its earnings outlook and share price performance. By applying a target discount of 55% (c.1.5SD below its mean since its listing) to our Dec-24 NAV estimate, we set our TP at HK\$30.8 and thus our BUY call.

Company Background

Listed in Nov-17 by way of introduction, Wharf REIC is a leading commercial property landlord in Hong Kong which boasts a sizeable completed investment property portfolio. Major rental properties include Harbour City and Times Square. Wharf REIC also owns a 72% stake in Harbour Centre Development.

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Discount to NAV



Source: Bloomberg Finance L.P., DBS HK

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Key Assumptions (%)

	2024F	2025F
Office rental - HK	(5)	0
Retail rental (Shopping centre) - HK	5	5

Source: DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenues (HK\$ m)					
Investment Property	10,859	10,629	10,932	11,321	11,518
Development Property	3,722	282	44	0	0
Hotels	838	932	1,587	1,911	2,056
Others	624	616	585	550	517
Total	16,043	12,459	13,148	13,782	14,092

Source: DBS HK

Income Statement (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Turnover	16,043	12,459	13,148	13,782	14,092
EBITDA	9,370	9,097	10,142	10,751	11,000
Depr / Amort	(330)	(280)	(291)	(303)	(315)
EBIT	9,040	8,817	9,850	10,449	10,685
Associates Inc	0	0	(146)	0	0
Interest (Exp)/Inc	(712)	(1,204)	(2,306)	(2,326)	(1,676)
Exceptionals	0	0	(88)	0	0
Pre-tax Profit	8,328	7,613	7,310	8,123	9,009
Tax	(1,599)	(1,368)	(1,249)	(1,340)	(1,487)
Minority Interest	(211)	(70)	(80)	(88)	(93)
Underlying Profit	6,518	6,175	5,982	6,695	7,429
Sales Gth (%)	3	(22)	6	5	2
Net Profit Gth (%)	(13)	(5)	(3)	12	11
EBITDA Margins (%)	58	73	77	78	78
EBIT Margin (%)	56	71	75	76	76
Tax Rate (%)	19	18	17	17	17

Source: DBS HK

Wharf REIC

Balance Sheet (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Fixed Assets	251,142	235,874	234,004	233,951	236,109
Long-term Investments	13,870	13,130	8,130	8,130	8,130
Other LT Assets	0	322	322	322	322
Deferred Tax Asset	884	594	594	594	594
Associates/JVs	983	835	689	689	689
Bank Balance/Cash & Liquid	1,800	1,340	2,674	1,735	2,874
Inventory	2,325	1,809	1,721	1,721	1,721
Debtors	1,161	1,338	1,343	1,348	1,353
Other Non Cash Current	103	7	7	7	7
Total Assets	272,268	255,249	249,485	248,497	251,799
ST Debt	4,500	3,580	12,100	11,500	11,501
Creditors	7,717	6,812	6,797	6,782	6,767
Other Current Liab	762	936	936	936	936
LT Debt	44,834	42,909	28,389	25,489	23,688
Deferred Tax Liabilities	2,599	2,715	2,715	2,715	2,715
Other LT Liabilities	980	3,416	3,416	3,416	3,416
Minority Interests	4,770	4,517	4,501	4,493	4,493
Shareholder's Equity	206,106	190,364	190,631	193,166	198,283
Total Cap. & Liab.	272,268	255,249	249,485	248,497	251,799
Share Capital (m)	3,036	3,036	3,036	3,036	3,036
Net Cash/(Debt)	(47,534)	(45,149)	(37,815)	(35,254)	(32,315)
Working Capital	(7,590)	(6,834)	(14,088)	(14,407)	(13,249)
Net Gearing (%)	23	24	20	18	16

Source: DBS HK

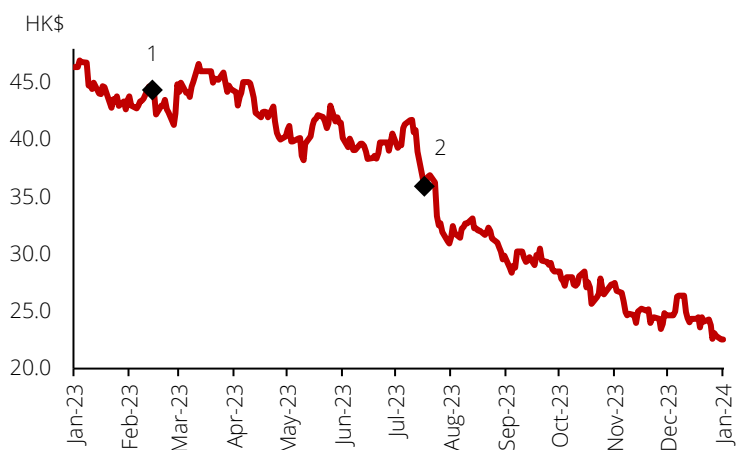
Cash Flow Statement (HK\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
EBIT	9,040	8,817	9,850	10,449	10,685
Tax Paid	(1,380)	(1,197)	(1,249)	(1,340)	(1,487)
Depr/Amort	330	280	291	303	315
Chg in Wkg.Cap	812	(121)	(20)	(20)	(20)
Other Non-Cash	(834)	(1,091)	(2,306)	(2,326)	(1,676)
Operating CF	7,968	6,688	6,567	7,065	7,818
Net Capex	(393)	(204)	(250)	(250)	(200)
Investments	592	(1,954)	5,000	0	0
Associates & JVs	(1)	0	0	0	0
Investing CF	199	(2,158)	4,750	(250)	(200)
Net Chg in Debt	(4,318)	(775)	(6,000)	(3,500)	(1,800)
New Capital	0	0	0	0	0
Dividend	(4,339)	(4,127)	(3,982)	(4,255)	(4,679)
Other Financing CF	0	0	0	0	0
Financing CF	(8,657)	(4,902)	(9,982)	(7,755)	(6,479)
Chg in Cash	(490)	(372)	1,334	(939)	1,139

Source: DBS HK

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Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	8-Mar-23	HK\$44.25	HK\$49.30	BUY
2	8-Aug-23	HK\$36.75	HK\$44.90	BUY

Source: DBS HK

Analyst: Percy Leung

Jeff Yau

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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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