

China / Hong Kong Company Update

Champion REIT

Bloomberg: 2778 HK EQUITY | Reuters: 2778.HK

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DBS Group Research . Equity

22 Feb 2024

HOLD

Last Traded Price (21 Feb 2024): HK\$1.77 (HSI : 16,503)
Price Target 12-mth: HK\$2.15 (22% upside) (Prev HK\$3.00)

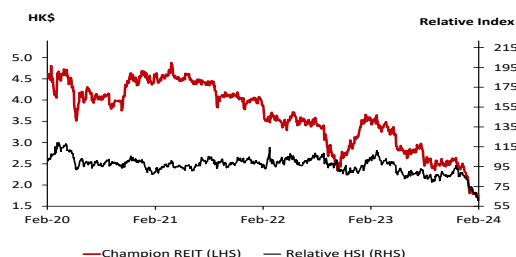
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What's New

- FY23 distributable income fell 13.6% y-o-y, in line with our estimate
- Still seeing negative reversionary growth at its office portfolio
- Turnover rent at Langham Place Mall almost doubled, led by a robust 50.5% growth in tenant sales
- Lingering concerns over Three Garden Road; maintain HOLD with lower TP of HK\$2.15

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2022A	2023A	2024F	2025F
Gross Revenue	2,625	2,576	2,536	2,444
Net Property Inc	2,031	1,946	1,913	1,804
Net Profit	(749)	221	903	853
Distribution Inc	1,168	1,012	901	867
DPU (HK\$)	0.20	0.17	0.15	0.14
DPU Gth (%)	(14)	(14)	(12)	(5)
Div Yield (%)	11.1	9.5	8.4	8.0
Gross Gearing (%)	22	23	23	23
Book Value (HK\$)	7.91	7.72	7.60	7.54
P/Book Value (x)	0.2	0.2	0.2	0.2

DPU Rev (%): (1) New
Consensus DPU (HK\$): 0.16 0.17
Other Broker Recs: B:2 S:5 H:2

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

No light at the end of the tunnel

Investment Thesis

A prime commercial REIT. Three Garden Road, representing c.61% of the REIT's total portfolio valuation, is home to numerous MNCs and Chinese corporates with a total GFA of 1.6msf. Sitting atop Mongkok station, Langham Place Office is a hub for lifestyle tenants, including fitness centres, beauty parlours and medical centres, which occupy c.74% of the property's gross lettable area. Its only retail asset, Langham Place Mall, is a popular shopping destination among locals and tourists with a GFA of 0.59msf.

Negative office reversionary growth and rising cash finance cost to weigh on distribution income. Despite a 13.9% y-o-y growth in rental income from Langham Place Mall, total rental income dropped 2% in FY23 mainly dragged by the negative rental reversions from Three Garden Road. With subdued leasing demand on one hand and upcoming supply in the neighborhood on the other, rental reversions should remain negative, thus dragging rental earnings in FY24. This, coupled with rising cash finance cost led by higher HIBOR and IRS expiry, prompts us to forecast 12% drop in FY24 DPU.

Concerns over Central office market and Three Garden Road are key challenges for the counter. Three Garden Road contributed c.56% of the REIT's NPI in FY23. Any negative news flow on Central office sector and Three Garden Road is likely to impact Champion REIT's near-term unit performance.

Maintain HOLD with DDM-based TP of HK\$2.15. The stock offers distribution yields of 8.4-8.0% for FY24-25. This translates into yield spreads of 4.1-3.7%, above its 10-yr average of 3.0%. Our target price for Champion REIT is based on the Dividend Discount Model using 8.1% discount rate and terminal growth rate of 0.5%.

Key Risks to Our View:

Any stronger-than-expected recovery of office leasing demand from MNCs and Chinese corporates should boost the income recovery of Three Garden Road and Champion REIT, and hence its unit price performance.

At A Glance

Issued Capital (m shrs)	6,014
Mkt Cap (HKm/US\$m)	10,645 / 1,361
Major Shareholders (%)	
Great Eagle Holdings Ltd	59.6
Eagle Asset Management (CP) Ltd.	9.6
Free Float (%)	30.8
3m Avg. Daily Val. (US\$m)	0.5
GICS Industry: Real Estate / Equity Real Estate Investment	

Champion REIT

WHAT'S NEW

Negatives from the office portion outweigh the uplift from the revival of tourist spending

FY23 distributable income fell 13.6% y-o-y, in line with our estimate. Champion REIT's FY23 distributable income dropped 13.6% y-o-y to HK\$1.12bn, mainly dragged by lower office rental earnings and higher cash finance cost. The result is in line with our forecast. Final DPU declined 15.3% y-o-y to HK\$0.0756. This brought the full year DPU down 13.9% y-o-y to HK\$0.1683. Payout ratio was slightly higher at 90.2% (FY22: 90%).

Shortfall in office earnings more than offset the growth from Langham Place Mall. Despite a 13.9% y-o-y growth in rental income from Langham Place Mall, total rental income, excluding building management fee income, dropped 2% to HK\$2.31bn. This was mainly dragged by Three Garden Road, which recorded a 9.2% decline in rental income in FY23. Langham Place Office, which contributed c.15% of the REIT's total rental income in FY23, also registered a mild rental decline of 3.7% in the same period. Due to increases in building management expenses, promotional expenses and rental commission, net property operating expenses jumped 11.5% y-o-y to HK\$366m. This brought the net expense ratio 1.9ppts higher at 15.8% (FY22: 13.9%), and hence, net property income fell by a larger 4.2% to HK\$1.95bn.

Negative office reversionary growth to continue. Three Garden Road recorded negative rental reversion in FY23 as tenants stayed cautious in expansion amid a sluggish financial market performance. This brought the passing rent down 3.8% h-o-h to HK\$91.7psf as of Dec-23. Yet, thanks to in-house expansion of tenants in the financial sector which offset the departures, occupancy at Three Garden Road was maintained at 82.8% in Dec-23 (Jun-23: 82.2%). Subdued demand, coupled with upcoming supply in the neighborhood, should put further rental pressure at Three Garden Road. Spot rents have retreated to HK\$70-80psf. With high expiring rent, we expect rental reversions for the 18.9% of leases expiring in FY24 to remain in the negative territory, and thus, drag the property's rental income in the near term. Langham Place Office delivered a rather steady performance with occupancy and passing rent stable at 93.3% and HK\$45.9psf as of Dec-23. However, leasing enquiries and inspection activities, especially from medical and beauty tenants, has slowed as the demand from Mainland tourists was weaker-than-expected. With 32.2% of floor area scheduled for roll over, Langham Office Tower should see mildly negative reversionary growth in FY24.

Langham Place Mall staged robust sales performance, reversionary growth turning positive. Following the full border reopening in early 2023, footfall at Langham Place Mall rebounded 27% y-o-y, recovering to c.90% of 2019's level. Thanks to a revival

of tourist spending, tenant sales at the mall jumped 50.5% y-o-y in 2023, and outperformed the overall Hong Kong retail market's 16.2% and represented 80-90% of 2018's level. This was mainly driven by the strong recovery in the beauty segment, where sales soared over two-fold in the period. This has resulted in a 91.9% surge in turnover rent to HK\$224m in FY23. Hence, total rental income at Langham Place Mall rose 13.9% y-o-y to HK\$740m, despite a c.5% decline in base rent. The mall was 98.6% let as of Dec-23, with less than 1% of tenants paying turnover rent only. With rent-to-sales ratio dropping to a level similar to pre-COVID times, we expect rental reversions to turn positive for FY24, and hence, fueling the rental growth of the mall.

Higher cash finance cost likely to weigh on DPU. Cash finance cost surged 41% y-o-y to HK\$590m mainly on higher average HIBOR. Total debt was stable at HK\$14.6bn as of Dec-23, translating into a gearing ratio of 22.8% (Jun-23: 22.7%). The portion of fixed rate debt stood at 54.5% as of Dec-23, but is expected to drop significantly to c.35% upon the HK\$2.9bn IRS expiry in Jun-24. This should further drive up the cash finance cost of the REIT in FY24, which we forecast to rise by 17%. Hence, this will weigh on its DPU outlook.

Loan refinancing under discussion. Champion REIT is in discussions with banks for refinancing syndicated loans of c.HK\$5bn maturing in mid-24. With standby committed facilities of HK\$3.6bn which could be used to meet the upcoming refinancing requirement, refinancing risk should not be overly concerned.

Stable portfolio valuation, cap rates unchanged. Total portfolio valuation dropped by 0.3% h-o-h, mainly led by lower rental assumptions at Three Garden Road and Langham Place Office. Cap rates for Three Garden Road, Langham Place Office and Langham Place Mall were unchanged at 3.7%, 4.1% and 4.0% respectively.

Inexpensive valuation, yet office market uncertainties to continue to weigh on unit price performance. In the past six months, unit price of Champion REIT tumbled 28%, underperforming its peers by 1-29%. Following the heavy sell-off, Champion REIT is trading at 8.4-8.0% distribution yields for FY24-25. This translates into a yield spread of 4.1-3.7%, above its 10-year average of 3.0%. While current valuation is inexpensive from a historical perspective, uncertainties over Three Garden Road, which contributed c.56% of the REIT's NPI in FY23, should continue to weigh on the sentiment towards the counter. Hence, we maintain our HOLD call at this stage with a DDM-based TP of HK\$2.15.

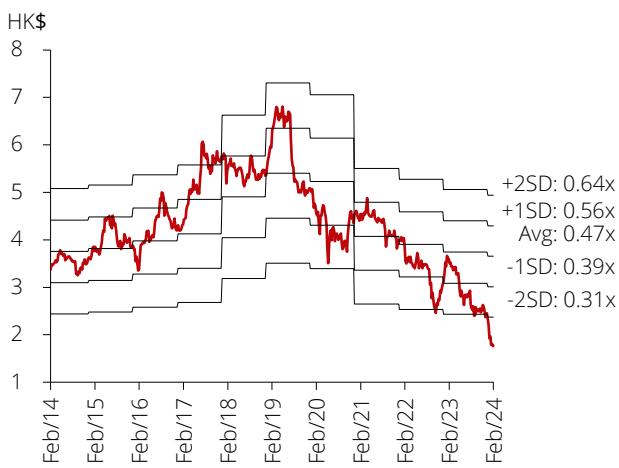
Champion REIT

Company Background

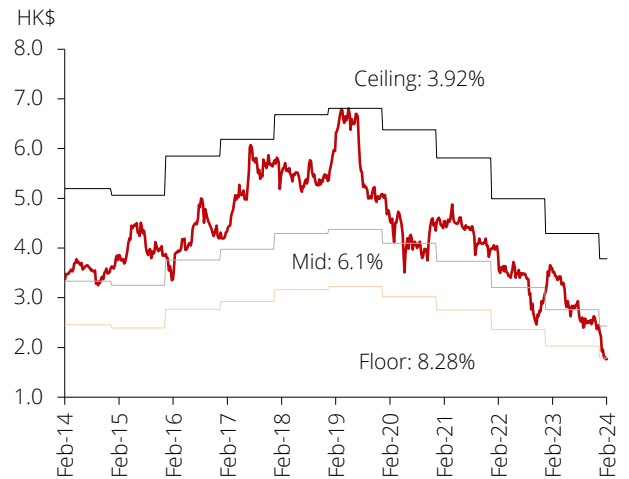
Champion REIT has exposure to both office and retail sectors. Listed in May-2006, the REIT owns Three Garden Road in Central and Langham Place's office and retail portions in Mong Kok with total GRA of 2.93m sf. Champion REIT also owns 27% stake in 66 Shoe Lane, an office property in London.

Price to book NAV band and historical yield band

Price to book NAV band



Historical yield band



Source: Bloomberg Finance L.P. DBS HK

Champion REIT

Result Summary

FY Dec (HK\$m)	2022	2023	Chg (%)	Comments
Rental income	2,286	2,229	(2.5)	FY23: Mainly dragged by lower contribution from Three Garden Road and Langham Place Office Tower
Carpark income	44	50	15.0	
Building management fee	266	264	(1.0)	
Rental related income	29	33	11.3	
Total revenue	2,625	2,576	(1.9)	
Property operating expenses	(595)	(630)	5.9	FY23: Due to higher building management expenses, promotional expenses and rental commission
Net property income	2,031	1,946	(4.2)	FY23: Net expense ratio was higher at 15.8% (FY22: 13.9%)
Interest income	26	51	94.4	
Change in fair value of investment properties	(1,749)	(641)	(63.3)	FY23: Due to lower rental rate assumptions. Cap rate for Three Garden Road, Langham Place Office and Langham Place Mall remained unchanged at 3.7%, 4.1% and 4% respectively
Change in fair value of financial assets	(20)	0	n.a.	
Manager's fee	(246)	(236)	(4.1)	
Trust and other expenses	(27)	(22)	(19.6)	
Finance costs	(448)	(619)	38.4	FY23: Cash finance cost rose 41% to HK\$590m due to higher HIBOR
Allowance for credit losses on note receivables/interest receivables	(48)	0	n.a.	
Share of results of a joint venture	(43)	(69)	63.2	FY23: reflected revaluation loss of 66 Shoe Lane in London
Profit before tax	(524)	409	n.a.	
Income taxes	(225)	(188)	(16.4)	
Net profit	(749)	221	n.a.	
Distributable income	1,298	1,122	(13.6)	
Distribution amount	1,168	1,012	(13.4)	FY23: Payout ratio increased slightly to 90.2% (FY22: 90%)
DPU (HK\$)	0.1954	0.1683	(13.9)	

Source: Champion REIT

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Key Assumptions (%)

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

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Revenues (HK\$ m)					
Rental income	2,417	2,286	2,229	2,179	2,078
Carpark income	47	44	50	52	53
Building management fee	274	266	264	271	279
Rental related income	31	29	33	34	35
Total	2,769	2,625	2,576	2,536	2,444

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Gross revenue	2,769	2,625	2,576	2,536	2,444
Property expenses	(572)	(595)	(630)	(623)	(640)
Net Property Income	2,197	2,031	1,946	1,913	1,804
Other expenses	(290)	(273)	(258)	(252)	(239)
Joint ventures	22	(43)	(69)	19	19
Interest (Exp)/Inc	(349)	(421)	(568)	(633)	(577)
Exceptionals	(2,156)	(1,818)	(641)	0	0
Pre-Tax Profit	(575)	(524)	409	1,047	1,006
Tax	(256)	(225)	(188)	(144)	(153)
Net Profit	(831)	(749)	221	903	853
Distribution income	1,353	1,168	1,012	901	867
Revenue Gth (%)	(5)	(5)	(2)	(2)	(4)
NPI Gth (%)	(6)	(8)	(4)	(2)	(6)
Dist. Inc Growth (%)	(8)	(14)	(13)	(11)	(4)
DPU Growth (%)	(9)	(14)	(14)	(12)	(5)

Source: Company, DBS HK

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Balance Sheet (HK\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Fixed Assets	65,296	63,555	62,950	62,650	62,660
Long-term Investments	301	253	46	46	46
Other LT Assets	16	112	0	0	0
Associates/JVs	313	239	189	189	189
Bank Balance/Cash & Liquid Debtors	1,629	735	981	1,081	1,148
Other Non Cash Current	33	102	108	108	108
Total Assets	67,873	65,229	64,466	64,266	64,343
ST Debt	2,026	3,717	5,159	1,654	3,150
Creditors	1,505	1,423	1,415	1,415	1,415
Other Current Liab	1,387	1,275	1,239	1,240	1,223
LT Debt	13,262	10,802	9,351	12,855	11,359
Deferred Tax Liabilities	0	0	0	0	0
Other LT Liabilities	730	784	887	887	887
Unitholders' funds	48,963	47,228	46,415	46,215	46,309
Total Capital	67,873	65,229	64,466	64,266	64,343
Share Capital (m)	5,937	5,974	6,014	6,080	6,143
Gross Debt	(15,289)	(14,519)	(14,509)	(14,509)	(14,509)
Working Capital	(2,971)	(5,344)	(6,532)	(2,928)	(4,340)
Book NAV (HK\$)	8.25	7.91	7.72	7.60	7.54
Gross Gearing (%)	23	22	23	23	23

Source: DBS HK

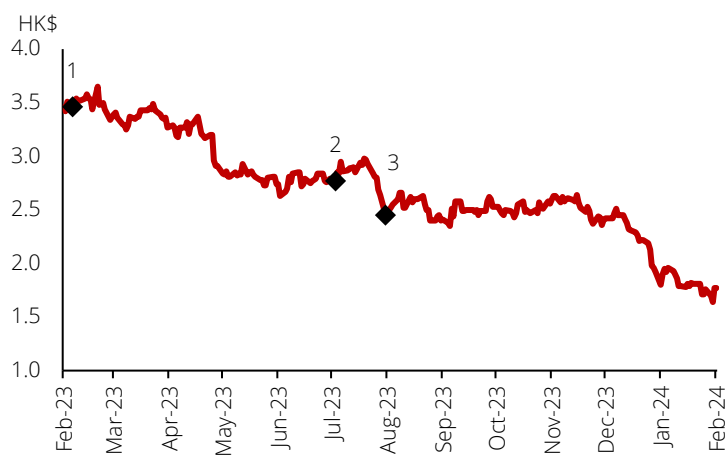
Cash Flow Statement (HK\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Pre-Tax Income	(575)	(524)	409	1,047	1,006
Tax Paid	(269)	(100)	(188)	(144)	(153)
Joint Venture	(22)	43	69	(19)	(19)
Chg in Wkg.Cap.	136	(112)	34	0	0
Other Non-Cash	2,226	1,960	708	58	63
Operational CF	1,495	1,267	1,032	943	898
Net Capex	(27)	(8)	(15)	(15)	(10)
Net change in asso/jv	(291)	0	0	0	0
Associates' div	2	4	(69)	19	19
Assoc, MI, Invsmt	1,441	(176)	383	56	45
Investment CF	1,125	(180)	298	60	54
Net Chg in Debt	(1,170)	(771)	(10)	0	0
New issues/Unit Buyback	0	0	0	0	0
Distribution Paid	(1,463)	(1,276)	(1,090)	(903)	(884)
Other Financing CF	0	0	0	0	0
Financing CF	(2,633)	(2,047)	(1,100)	(903)	(884)
Chg in Cash	(13)	(960)	230	100	67

Source: Company, DBS HK

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Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	27-Feb-23	HK\$3.51	HK\$3.51	HOLD
2	24-Jul-23	HK\$2.79	HK\$3.09	HOLD
3	21-Aug-23	HK\$2.64	HK\$3.00	HOLD

Source: DBS HK

Analyst: Percy Leung,
 Jeff Yau, CFA
 Cherie Wong

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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

Completed Date: 22 Feb 2024 14:29:38 (HKT)

Dissemination Date: 22 Feb 2024 16:14:02 (HKT)

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