

China / Hong Kong Company Update

Hysan Development

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DBS Group Research . Equity

23 Feb 2024

BUY

Last Traded Price (22 Feb 2024): HK\$13.24 (HSI: 16,743)
Price Target 12-mth: HK\$17.16 (30% upside) (Prev HK\$17.70)

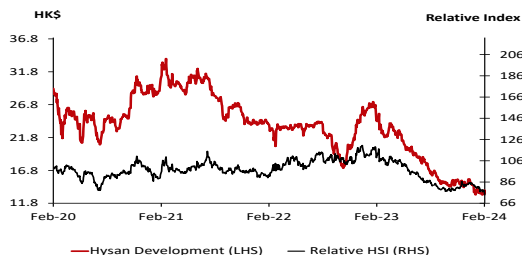
Analyst

Percy Leung +852 36684165 percycleung@dbs.com
Jeff Yau, CFA +852 36684180 jeff_yau@dbs.com
Cherie Wong cheriesumwai@dbs.com

What's New

- FY23 recurring underlying profit fell 11.2%, mainly on lower rental earnings, broadly in-line with our estimate
- Second interim DPS slashed by 31% y-o-y to HK\$0.81, full year DPS down 25% y-o-y
- Newly-renovated retail space contribution to propel near term earnings growth
- Negatives priced in, with long-term rental upside from portfolio rejuvenation; maintain BUY with TP HK\$17.16

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2022A	2023A	2024F	2025F
Turnover	3,460	3,210	3,388	3,524
EBITDA	2,593	2,315	2,488	2,599
Pre-tax Profit	2,573	2,263	2,399	2,517
Underlying Profit	2,129	1,832	1,969	2,061
Underlying Profit Gth (%)	(8.6)	(13.9)	7.4	4.7
EPS (HK\$)	2.07	1.78	1.92	2.01
EPS Gth (%)	(7.9)	(13.7)	7.4	4.7
PE (X)	6.4	7.4	6.9	6.6
P/Cash Flow (X)	5.3	5.1	5.4	5.3
EV/EBITDA (X)	18.5	20.7	19.2	18.4
DPS (HK\$)	1.44	1.08	1.08	1.08
Div Yield (%)	10.9	8.2	8.2	8.2
Net Gearing (%)	28	32	35	37
ROE (%)	3.0	2.7	2.9	3.1
Est. NAV (HK\$):			62.1	61.3
Disc. to NAV (%)			(79)	(78)
Earnings Rev (%):			(10)	(6)
Consensus EPS (HK\$):			1.77	1.90
Other Broker Recs:		B:11	S:0	H:2

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

Breathe new life into Lee Gardens

Investment Thesis

Dominant commercial landlord in Causeway Bay. Hysan Development is the largest commercial landlord in Causeway Bay. Hysan Place is a popular shopping landmark among locals and tourists while Lee Garden hub houses a cluster of renowned luxury brands. Given its proximity to the MTR station and synergy among the properties, its office portfolio is sought after by multinational firms in the finance, professional consultancy, and technology sectors.

Improving contribution from retail portfolio to offset impact from negative office reversionary growth. Rejuvenation work at Hysan Development's retail portfolio is near completion. Flagship stores by key luxury tenants are scheduled to open by stages in 2024 and 2025, with a mid-teen rental increment expected. Meanwhile, rental reversions for the retail portfolio have turned predominantly positive in 2023 and are expected to stay in FY24. These should augur well for Hysan Development's earnings recovery, despite negative reversionary growth in its office portfolio.

Portfolio rejuvenation to underpin long term value growth. Selected key luxury brands have expanded their footprint at the Lee Gardens along with the portfolio rejuvenation. Coupled with the completion of Caroline Hill Road project, Hysan Development should further solidify its leading position within the precinct. This should augur well for its long-term rental growth, and hence, share price performance.

BUY with a TP of HK\$17.16. The stock is trading at a 79% discount to our current assessed NAV, >2SD below its 10-year average of 55%. Our target price is derived by assigning a target discount of 72% to our Dec-24 NAV estimate.

Key Risks to Our View:

Any derailment in retail market recovery would impact leasing demand for retail space. Any deterioration in leasing demand for office in Causeway Bay could also drag Hysan Development's earnings and share price performance. Any prolonged interest rate hike could lead to cap rate expansion and adversely affect its valuation.

At A Glance

Issued Capital (m shrs)	1,027
Mkt Cap (HKm/US\$m)	13,597 / 1,738
Major Shareholders (%)	
Lee Hysan Company Ltd	42.2
Silchester International Investors, L.L.P.	8.1
First Eagle Investment Management, L.L.C.	5.1
Free Float (%)	44.6
3m Avg. Daily Val. (US\$m)	2.11
GICS Industry: Real Estate / Real Estate Management & Development	

Hysan Development

WHAT'S NEW

Portfolio rejuvenation disrupted earnings

Recurring earnings down 11.2% y-o-y, second interim dividend slashed by 31%, broadly within expectations. Excluding the one-off exchange gain of HK\$66m led by the settlement of the acquisition in Lee Gardens Shanghai in 2022, Hysan Development's FY23 underlying profit declined 11.2% y-o-y to HK\$1.83bn, mainly dragged by lower rental earnings. The result was broadly in line with our estimate. Hysan Development reset its second interim DPS to HK\$0.81, down 31% from FY22's HK\$1.17. This brought full year DPS to HK\$1.08, down 25% y-o-y. We believe this is a prudent approach for the company to preserve cash under the current challenging market.

Portfolio rejuvenation and negative reversionary growth to dent rental income. Gross rental receipts dropped 7.2% y-o-y to HK\$3.21bn, dragged by lower contribution from all office, retail, and residential portfolio. Negative reversionary growth continued to work its way through its office portfolio, where its rental income sank 6.7% y-o-y to HK\$1.47bn, accounting for c.46% of the company's total rental income. Meanwhile, despite a 45% surge in turnover rents to HK\$154m, rental contribution from the retail portfolio shrank 6.7% to HK\$1.53bn, led by the disruption from the ongoing portfolio rejuvenation, where c.10% of the total retail space were closed for enhancement works during the period. Residential income fell 14.2% y-o-y to HK\$205m on lower average occupancy and negative rental reversions. Occupancy at the Bamboo Grove remained low at c.60% as of Dec-23 (Jun-23: 61%). With a 9.5% growth in property expenses led by a significant increase in electricity tariff, rental earnings fell by a larger 10.5% y-o-y to HK\$2.59bn. Including administrative expenses, rental margin squeezed by 3ppt to 71% (FY22: 74%). Excluding the negative turnover impact of the Lee Gardens rejuvenation project, rental margin would have been higher at 72.7% on a like-for-like basis.

Office rental income to remain on a downward trend. Flight-to-quality trend remained prevalent under the office market downturn. Hermes and the medical group Adventist & Procure leased new floors in Lee Garden One and Lee Garden Two respectively, while UOB and Chanel expanded their offices in Lee Gardens. This put the office occupancy firm at 89% (Jun-23: 89%) despite sluggish office demand amid global macro uncertainties. Banking, Finance and Wealth Management firms remain the largest tenant group within the portfolio, occupying c.21.4% of the total office area. Meanwhile, the portion of medical and health tenants has increased to 8.2% in Dec-23, from Dec-22's 6.4%, led by the uptick in business following the border reopening with Mainland China. In FY24, about 20% of leases, in terms of floor

area, are scheduled for renewal with expiring rent similar to FY23. Given the prevailing market sentiment, we expect office reversionary growth to remain negative in FY24.

Retail reversionary growth turned predominantly positive, with contribution from the completed portfolio rejuvenation to further propel growth. Since the second quarter of 2023, tenant sales growth at Hysan Development's retail portfolio has moderated. Overall tenant sales have yet to return to the pre-COVID level in 2018. Sales of luxury brands, representing c.40% of the total portfolio, has exceeded the pre-COVID level while the remaining trades still saw sales lagging behind by 20-30%. Nonetheless, thanks to a healthy occupancy cost ratio of c.15%, rental reversions for the retail portfolio, which was 97% let as of Dec-23 (Jun-23: 98%), was predominantly positive in 2023. Major enhancement works at Lee Garden One were completed with the arcade area reopened in late 2023. A mid-teens rental increment is expected upon the scheduled phased opening of flagship stores by key luxury tenants in 2024 and 2025. This should further reinforce Lee Gardens as a prime shopping destination among tourists and local alike. Coupled with positive reversionary growth, the retail portfolio should see growing rental contribution in the year ahead.

Flexible marketing strategy to move sales in Villa Lucca. In view of the subdued residential market sentiment, Hysan Development, together with its JV partner HKR International, has adopted a flexible pricing strategy to boost sales. The consortium has leased out available units while offering tenants an option to buy. As a result, over 60 houses and apartments were sold or leased in 2023, representing c.23% of the total units. In FY23, a loss of HK\$23m was booked from this joint venture project.

Lee Gardens Shanghai seeing progress. Enhancement work at the office tower of Lee Gardens Shanghai was completed in 2023, with tenants starting to move in in 1Q23. Commitment rate reached c.30%, with another 30-40% under negotiation. Renovation work at the retail portion is scheduled to complete in 2024, with the first tenant expected to move in during 1H24.

No significant near-term refinancing needs. Net debt rose mildly to HK\$21.7bn as of Dec-23 from Jun-23's HK\$21.2bn, mainly due to capex incurred for the portfolio rejuvenation and Caroline Hill Road project. This represented c.32.3% of its shareholders' fund (Jun-23: 30.8%). Hysan Development has no significant near-term refinancing need, with only HK\$158m debts maturing in 2024. Hedging ratio was maintained at c.62% as of Dec-23 (Jun-23: 61%).

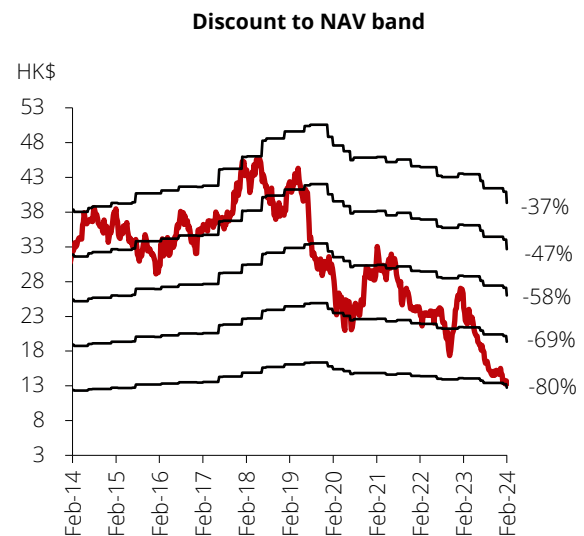
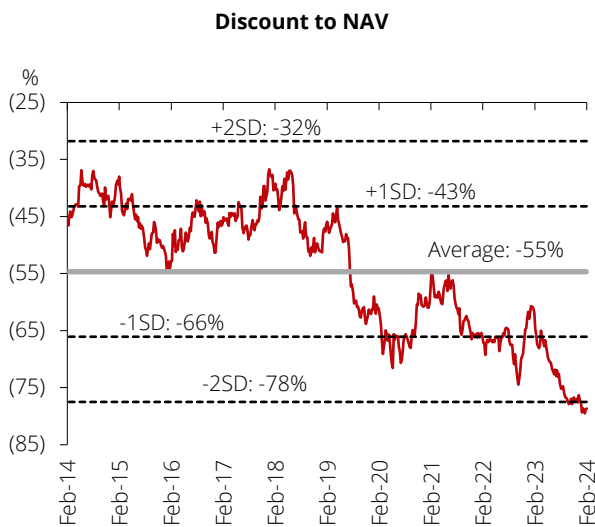
Hysan Development

Negatives priced in, uplift from portfolio rejuvenation to bode well for near term earnings outlook. The stock is trading at a 79% discount to our current assessed NAV, >2SD below its 10-year average of 55%. We believe further share price correction is limited given its cheap valuation. Hysan Development should see higher rental earnings led by growing contribution from the retail portfolio, despite negative reversionary growth from the office portfolio. The rejuvenation should solidify its leading position as a prime shopping destination within the precinct, and hence, augur well for its long-term rental growth. Maintain BUY with TP of HK\$17.16. This is premised on target discount of 72% (1.5SD below its 10-year average) to our Dec-24 NAV estimate.

Company Background

Hysan Development is a leading commercial landlord with most of its portfolio in Causeway Bay. The company's completed investment property portfolio covers c.4.5m sf of gross floor area (GFA). Hysan Development derives most of its rental income from the retail and office segments with the remaining portion from residential apartments. Key properties include Hysan Place, Lee Theater Plaza, Leighton Centre, Lee Gardens One to Lee Gardens Six, One Hysan Avenue, and Bamboo Grove. In 2021, the company teamed up with Chinachem to secure the Caroline Hill Road commercial site which provides GFA of 1.08msf upon project completion.

Discount to NAV



Source: Bloomberg Finance L.P., DBS HK

Hysan Development

Result Summary

FY Dec (HK\$m)	FY22	FY23	% Chg	Comments
Retail	1,643	1,533	(7)	FY23: dragged by rejuvenation at Hysan Place & Lee Gardens, despite higher turnover rent of HK\$154m (FY22: HK\$106m)
Office	1,578	1,472	(7)	FY23: due to negative rental reversion
Residential	239	205	(14)	FY23: led by lower average occupancy and negative rental reversion
Turnover	3,460	3,210	(7)	
Property expenses	(567)	(621)	10	
Gross profit	2,893	2,589	(11)	
Other income				
Investment income	248	261	5	
Other gains and losses	(1)	1	<i>n.a.</i>	
Administrative expenses	(332)	(307)	(8)	
Finance costs	(423)	(478)	13	FY23: Effective interest rate rose to 4.2% from FY22's 2.8%
Fair value changes on investment properties	(3,213)	(2,763)	(14)	
Fair value changes on other financial investmen	(1)	(267)	26,600	
Share of results of associates	274	270	(1)	FY23: Excluding the fair value change on investment properties, contributions from Grand Gateway 66 would have fallen 1.5%
Share of results of JV	(52)	(37)	(29)	
Profit before taxation	(607)	(731)	20	
Taxation	(342)	(295)	(14)	
Non-controlling interest	242	596	146	
Perpetual capital securities holders	(450)	(442)	(2)	
Net profit	(1,157)	(872)	(25)	
Underlying profit	2,129	1,832	(14)	
Recurring underlying profit	2,063	1,832	(11)	

Source: Hysan Development

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Key Assumptions (%)

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

Source: DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Revenues (HK\$ m)					
Property rental income	3,608	3,460	3,210	3,388	3,524
Total	3,608	3,460	3,210	3,388	3,524

Source: DBS HK

Income Statement (HK\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Turnover	3,608	3,460	3,210	3,388	3,524
EBITDA	2,864	2,593	2,315	2,488	2,599
Depr / Amort	(29)	(32)	(33)	(33)	(33)
EBIT	2,835	2,561	2,282	2,455	2,566
Associates Inc	283	211	222	244	252
Interest (Exp)/Inc	(314)	(199)	(241)	(300)	(300)
Exceptionals	0	0	0	0	0
Pre-tax Profit	2,804	2,573	2,263	2,399	2,517
Tax	(358)	(342)	(295)	(323)	(349)
Minority Interest	(116)	(102)	(136)	(108)	(107)
Holder of Perpetual Securities	(459)	(450)	(442)	(442)	(442)
Net Profit	1,871	1,679	1,390	1,527	1,619
Underlying Profit	2,330	2,129	1,832	1,969	2,061
Sales Gth (%)	(3)	(4)	(7)	6	4
Net Profit Gth (%)	(11)	(10)	(17)	10	6
EBITDA Margins (%)	79	75	72	73	74
EBIT Margin (%)	79	74	71	72	73
Tax Rate (%)	13	13	13	13	14

Source: DBS HK

Hysan Development

Balance Sheet (HK\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Fixed Assets	95,579	97,410	96,599	97,853	101,209
Long-term Investments	843	992	900	900	900
Other LT Assets	3,624	2,860	2,709	2,709	2,709
Deferred Tax Asset	90	96	96	96	96
Associates/JVs	7,736	9,459	9,970	9,693	9,945
Bank Balance/Cash & Liquid	8,404	7,771	3,854	3,898	3,792
ST Investments	171	15	94	94	94
Debtors	887	562	304	289	299
Other Non Cash Current	39	0	0	0	0
Total Assets	117,373	119,165	114,526	115,532	119,044
ST Debt	531	3,244	158	2,772	2,088
Creditors	820	1,026	1,097	1,117	1,117
Other Current Liab	586	633	552	552	552
LT Debt	18,126	24,033	25,406	24,292	26,976
Deferred Tax Liabilities	1,091	1,171	1,271	1,271	1,271
Other LT Liabilities	8,334	5,647	6,351	6,351	6,351
Perpetual Securities	10,657	10,224	10,224	10,224	10,224
Minority Interests	3,358	2,987	2,285	2,266	2,343
Shareholder's Equity	73,870	70,200	67,182	66,687	68,122
Total Cap. & Liab.	117,373	119,165	114,526	115,532	119,044
Share Capital (m)	1,034	1,027	1,027	1,027	1,027
Net Cash/(Debt)	(10,253)	(19,506)	(21,710)	(23,166)	(25,272)
Working Capital	7,564	3,445	2,445	(160)	428
Net Gearing (%)	14	28	32	35	37

Source: DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
EBIT	2,835	2,561	2,282	2,455	2,566
Tax Paid	(369)	(196)	(295)	(323)	(349)
Depr/Amort	29	32	33	33	33
Chg in Wkg.Cap	(27)	(9)	329	35	(10)
Other Non-Cash	8	7	0	0	0
Operating CF	2,476	2,395	2,349	2,200	2,240
Net Capex	(22,334)	(3,081)	(1,669)	(1,567)	(1,767)
Investments	(1,236)	(439)	303	0	0
Associates & JVs	(237)	(2,017)	(279)	521	0
Others	8,760	(3,079)	4,177	200	150
Investing CF	(15,047)	(8,616)	2,533	(846)	(1,617)
Net Chg in Debt	(401)	9,211	(1,713)	1,500	2,000
New Capital	(146)	(162)	(1)	0	0
Dividend	(1,618)	(1,593)	(1,585)	(1,188)	(1,187)
Other Financing CF	6,885	(5,284)	(1,560)	(1,622)	(1,542)
Financing CF	4,720	2,172	(4,859)	(1,310)	(729)
Chg in Cash	(7,851)	(4,049)	23	44	(106)

Source: DBS HK

Hysan Development

Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	17-Jul-23	HK\$18.90	HK\$26.70	Buy
2:	11-Aug-23	HK\$17.78	HK\$22.80	Buy
3:	25-Jan-24	HK\$13.72	HK\$17.70	Buy

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)

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SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

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DBS Bank (Hong Kong) Limited

13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

Tel: (852) 3668-4181, Fax: (852) 2521-1812

Hysan Development

DBS Regional Research Offices

HONG KONG

DBS Bank (Hong Kong) Ltd

Contact: Dennis Lam

13th Floor One Island East,

18 Westlands Road, Quarry Bay, Hong Kong

Tel: 852 3668 4181

Fax: 852 2521 1812

e-mail: dbsvhk@dbs.com

SINGAPORE

DBS Bank Ltd

Contact: Andy Sim

12 Marina Boulevard,

Marina Bay Financial Centre Tower 3

Singapore 018982

Tel: 65 6878 8888

e-mail: groupresearch@dbs.com

Company Regn. No. 196800306E

INDONESIA

PT DBS Vickers Sekuritas (Indonesia)

Contact: Maynard Priajaya Arif

DBS Bank Tower

Ciputra World 1, 32/F

Jl. Prof. Dr. Satrio Kav. 3-5

Jakarta 12940, Indonesia

Tel: 62 21 3003 4900

Fax: 6221 3003 4943

e-mail: indonesiaresearch@dbs.com

THAILAND

DBS Vickers Securities (Thailand) Co Ltd

Contact: Chanpen Sirithanarattanakul

989 Siam Piwat Tower Building,

9th, 14th-15th Floor

Rama 1 Road, Pathumwan,

Bangkok Thailand 10330

Tel. 66 2 857 7831

Fax: 66 2 658 1269

e-mail: research@th.dbs.com

Company Regn. No 0105539127012

Securities and Exchange Commission, Thailand