China / Hong Kong Company Update

Sunlight REIT

Bloomberg: 435 HK Equity | Reuters: 0435.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

28 Feb 2024

BUY

Last Traded Price (27 Feb 2024): HK$1.82 (HSI : 16,791)
Price Target 12-mth: HK$2.67 (47% upside) (Prev HK$3.43)

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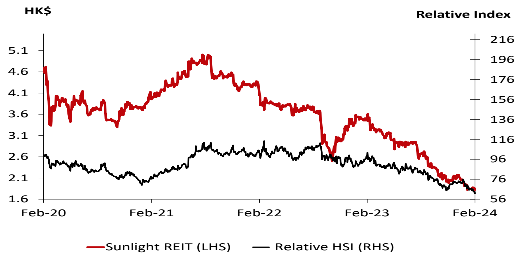
What's New

- 1HFY24 distributable income declined 18% y-o-y, c.7% below our estimate, mainly due to a provision of HK$6.3m in credit losses for debt securities.
- Balanced portfolio to underpin rental earnings resilience
- No refinancing need until mid-2025
- Correction overdone; BUY despite a lower DDM-based TP of HK$2.67

Price Relative



Forecasts and Valuation

FY Jun (HK$ m)	2022A	2023A	2024F*	2025F#
Gross Revenue	803	783	1,262	856
Net Property Inc	642	624	977	664
Net Profit	103	(28)	427	323
Distribution Inc	420	372	481	363
DPU (HK$)	0.25	0.22	0.28	0.21
DPU Gth (%)	(2)	(12)	(15)^	11^
Div Yield (%)	13.7	12.1	10.3^	11.4
Gross Gearing (%)	23	25	25	25
Book Value (HK$)	8.36	8.06	8.07	8.19
P/Book Value (x)	0.2	0.2	0.2	0.2
DPU Rev (%):			n.a.	n.a.

**Covering the period from Jul-23 to Dec-24*
^FY24 DPU on annualized basis
#FY Dec

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

Negatives priced in

Investment Thesis

Balanced exposure to office and retail assets. Sunlight REIT holds a balanced mix of office and retail assets in major commercial districts in Hong Kong. This enables it to demonstrate income resilience across economic cycles. Its extensive Grade B office portfolio, housing mainly SMEs and service trade tenants, has made the REIT less vulnerable to subdued office leasing demand amid global economic uncertainties. Given its proximity to the border, Sheung Shui Centre Shopping Arcade (SSC) is well positioned to tap on cross-border spending.

Stable rental income outlook, high financing cost an earnings drag. Excluding new contributions from West 9 Zone Kids, total rental and car park income was broadly stable, as lower office income was compensated by the improvement from the retail portfolio. While near-term office rental income should be dragged by continued negative rental reversions from Dah Sing Financial Centre, positive retail reversionary growth should underpin retail income recovery. This should point to stable rental earnings in the near term. Yet, high cash finance cost should remain an earnings drag in the near term.

Potential resumption of multiple-entry visa scheme a near-term catalyst. SSC contributes c.20% of Sunlight REIT's NPI. Given its proximity to the border, this shopping arcade stands to benefit from increased foot traffic and cross border spending if the multiple-entry visa scheme for Shenzhen residents resumes. This should bode well for Sunlight REIT's earnings and unit price performance.

BUY with TP of HK$2.67. Sunlight REIT offers a distribution yield of 10.3-11.4% for FY24-25. This translates into yield spreads of 6.0-7.1%, c.2SD above its 10-yr average of 3.9%. Negatives should be priced in following the unit price pullback. Our TP of HK$2.67 is based on the Discounted Dividend Model (DDM) using a discount rate of 7.7%.

Key Risks to Our View:

Any derailment of retail market recovery would impact leasing demand for retail space. Heightened global macro uncertainties would dampen office leasing demand.

Any prolonged interest rate hikes could also weigh on its earnings and valuations.

At A Glance

Issued Capital (m shrs)	1,703
Mkt Cap (HKm/US$m)	3,099 / 396
Major Shareholders (%)	
Shau Kee Financial Enterprise Ltd.	22.0
Henderson Sunlight Asset Management Limited	12.1
Silchester International Investors, L.L.P.	10.9
Henderson Land Development Co Ltd	8.5
Free Float (%)	46.6
3m Avg. Daily Val. (US$m)	0.4
GICS Industry: Real Estate / Equity Real Estate Investment	

ed- PJ / sa- CS /AH

WHAT'S NEW

Dampened by upsurge in cash finance cost

Interim result missed expectations due to provision for credit losses on debt securities. Sunlight REIT's 1HFY24 distributable income declined 18.1% y-o-y to HK$162.3m, as higher rental earnings were more than offset by increased cash finance cost. The result was c.7% below our estimate, mainly due to a HK$6.3m provision made for credit losses on debt securities. With a slightly higher payout ratio of 94.4% (1HFY23: 93.7%), distribution income was 17.5% lower at HK$153.2m. Interim DPU fell 18.2% y-o-y to HK$0.09.

New contributions from West 9 Zone Kids (W9ZK) more than offset by increased cash finance cost. Total rental and car park income increased 5.7% to HK$343.7m, primarily reflecting the full period contribution from W9ZK acquired in Apr-23. Stripping out the contribution from W9ZK, total rental and car park income would have been broadly stable at c.HK$325m, as the shortfall in office income was compensated by the improvement from the retail portfolio. Including a rental related income of HK$75.5m (1HFY23: HK$63.4m), total revenue rose 7.9% y-o-y to HK$419.2m. Property operating expenses were 18.6% higher – or 10.4% if excluding operating costs relating to W9ZK – led by higher rental commission and lower pandemic-related fiscal concessions. With cost-to-income ratio higher at 22.9% (1HFY23: 20.8%), net property income grew by smaller 5.1% to HK$323.2m. However, this was more than offset by a 90% surge in cash finance cost to HK$111.3m due to HIBOR hikes and additional borrowings for financing the acquisition of W9Z.

Office portfolio delivers mixed performance. Office rental income dropped 3% to HK$155.8m. While rental growth of 3.3% was achieved on renewing leases, mainly for service trade tenants at Grade B offices, average passing rent dropped 0.9% h-o-h to HK$34.3psf in Dec-23, dragged by lower rents upon reletting. Overall office portfolio occupancy was stable at 93.1% as of Dec-23. Increased leasing activities for relocation or expansions has driven the occupancy at its rental flagship, Dah Sing Financial Centre (DSFC), slightly higher at 91.9% in Dec-23, from Jun-23's 90.4%. Occupancies at Righteous Centre and The Harvest stood firm at 97.5% and 100% respectively, underpinned by solid demand from service trade tenants. On the other hand, dampened by cautious sentiment of SME tenants, occupancies at Strand 50 and 135 Bonham Strand Trade Centre softened to 90.5% and 94.5% in Dec-23 from Jun-23's 94.4% and 100% respectively. In 2HFY24, 24% of leases at DSFC are scheduled for renewal. Given the prevailing challenges in the Grade A office market, rental reversions should stay negative, thus weighing on overall office income.

Retail portfolio on the road to recovery. Excluding W9ZK, rental and car park income from the retail portfolio improved c.3.2% y-o-y, led by the gradual recovery from Sheung Shui Centre Shopping Arcade (SSC) and Metro City Phase I (MCPI) which recorded respective reversionary growths of 4.8% and 4.1%. Average passing rent for the retail portfolio climbed 1.1% h-o-h to HK$66.3psf in Dec-23. Were it not for negative reversionary growth from property agency tenants, retail portfolio would have seen stronger income growth. As of Dec-23, overall retail portfolio was 93.2% let. (Jun-23: 93.5%) Occupancy at SSC moderated 6.9ppt to 90.7% in Dec-23 due to the departure of a kindergarten tenant. On the other hand, following the completion to the phase 1 asset enhancement work, MCPI saw its occupancy improving to 94.7% in Dec-23 from Jun-23's 92.2%.

No refinancing need until mid-2025. Total borrowings stood at HK$5.01bn as of Dec-23 (Jun-23: HK$5.02bn). This represented 26.3% of its total asset (Jun-23: 26.1%). Sunlight REIT has no refinancing need until mid-2025. With the expiry of interest rate swaps (IRS), interest hedging ratio reduced to 32% as of Dec-23 from Jun-23's 42%. However, the ratio has increased to c.42% upon the execution of IRS with an aggregate notional amount of HK$500m since Jan-24.

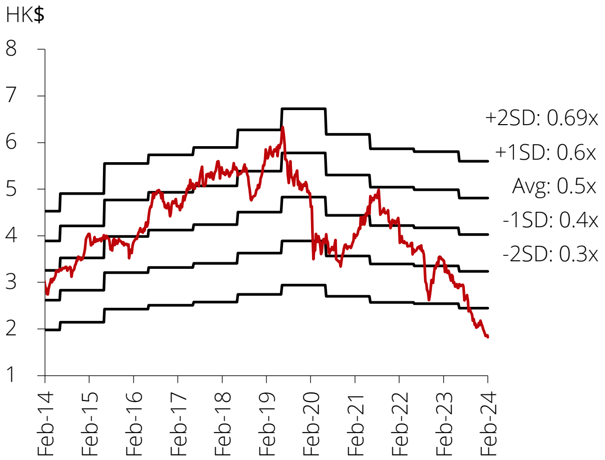
Negatives priced in; BUY with TP of HK$2.67. In the past six months, Sunlight REIT's unit price plummeted 32%, underperforming the broad market as well as most of its peers. Meanwhile, Sunlight REIT is trading at an annualized distribution yield of 10.3% for FY24 and 11.4% for FY25. This translates into yield spread of 6.0-7.1%, c.2SD above its 10-year average of 3.9%. We believe concerns over its earnings outlook should be priced in following the heavy sell-down. Improving contribution from its retail portfolio should help offset weaker office income, and hence, pointing to rental earnings resilience. Potential resumption of the multiple-entry visa for Shenzhen residents should be positive for earnings prospects of SSC, which contributed c.20% of the REIT's NPI. Any interest rate pivot should improve sentiments towards the counter. Maintain BUY, despite lower DDM-based TP of HK$2.67.

Company Background

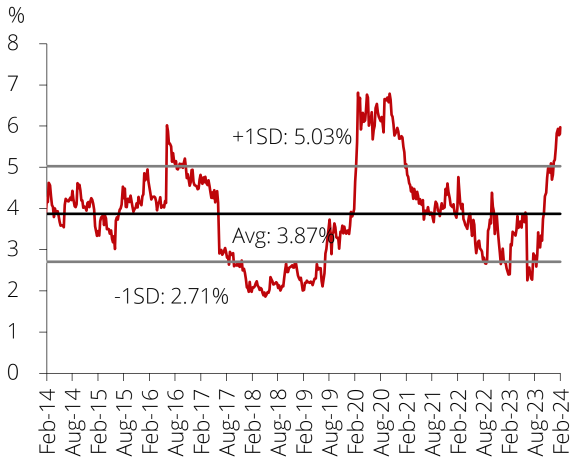
Sunlight REIT is the first Hong Kong REIT with exposure to both the office and retail sectors. Listed in December 2006, the REIT now owns a diverse portfolio of 16 office and retail properties. Its three major properties are Sunlight Tower in Wanchai, Sheung Shui Centre Shopping Arcade in Sheung Shui, and the Metro City Ph 1 property in Tseung Kwan O.

Price to book NAV band and historical yield spread

Price to book NAV band



Historical yield spread



Source: Bloomberg Finance L.P. DBS HK

Result Summary

FY Jun (HK$m)	1HFY23	1HFY24	% chg	Comments
Rental income	308.0	324.5	5	
- Office	160.5	155.8	(3)	1HFY24: dragged by lower average rent
- Retail	147.4	168.7	14	1HFY24: mainly due to maiden contribution of W9Z
Car park income	17.1	19.2	12	
Rental related income	63.4	75.5	19	
Turnover	388.5	419.2	8	
Property operating expenses	(81.0)	(96.1)	19	1HFY24: reflecting higher rental commission and lower COVID-related fiscal concessions
Net property income	307.6	323.2	5	1HFY24: Cost-to-income ratio edged up to 22.9% from 1HFY23's 20.8%
Other income	8.4	5.9	(30)	
Administrative expenses	(52.3)	(54.1)	3	
Net change in fair value of investment properties	(448.4)	(53.0)	(88)	
Profit from operations	(184.8)	222.0	n.a.	
Finance costs on interest bearing liabilities	(55.3)	(114.5)	107	1HFY24: Cash finance cost rose 90% mainly on higher HIBOR and additional borrowings for financing the acquisition of W9Z
Profit before tax	(240.1)	107.5	n.a.	
Income tax	(34.3)	(27.7)	(19)	
Net profit	(274.4)	79.7	n.a.	
Net change in fair value of investment properties	448.4	53.0	(88)	
Manager's fee paid or payable in the form of units	22.5	23.1	3	
Non-cash finance costs on interest bearing liabilities	2.0	2.4	20	
Deferred tax	5.0	2.9	(42)	
Cash flow hedges reclassified from net assets attributable to unitholders	(5.3)	0.8	n.a.	
Depreciation	0.0	0.4	2,825	
Total distributable income	198.2	162.3	(18)	
Total distribution income	185.7	153.2	(17)	1HFY24: Payout ratio of 94.4% (1HFY23: 93.7%)
Interim DPU (HK$)	0.110	0.090	(18)	

Source: Sunlight REIT

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 Jun	2021A	2022A	2023A	2024F*	2025F#
Revenues (HK$ m)					
Rental income	645	643	618	976	663
Carpark income	32	34	35	58	40
Rental-related income	121	127	131	227	153
Total	799	803	783	1,262	856

**Covering the period from Jul-23 to Dec-24*
#FY Dec
Source: Company, DBS HK

Income Statement (HK$ m)

FY Jun	2021A	2022A	2023A	2024F*	2025F#
Gross revenue	799	803	783	1,262	856
Property expenses	(160)	(161)	(159)	(284)	(192)
Net Property Income	640	642	624	977	664
Other expenses	(108)	(106)	(106)	(163)	(110)
Interest (Exp)/Inc	(85)	(93)	(125)	(316)	(176)
Exceptionals	(605)	(264)	(354)	0	0
Pre-Tax Profit	(158)	179	39	498	377
Tax	(76)	(76)	(67)	(71)	(55)
Net Profit	(234)	103	(28)	427	323
Distribution income	427	420	372	481	363
Revenue Gth (%)	(6)	0	(2)	7^	2^
NPI Gth (%)	(7)	0	(3)	4^	2^
Dist. Inc Growth (%)	(4)	(2)	(11)	(14)^	13^
DPU Growth (%)	(5)	(2)	(12)	(15)^	11^

**Covering the period from Jul-23 to Dec-24*
^ FY24 numbers on annualized basis
#FY Dec
Source: Company, DBS HK

Balance Sheet (HK$ m)

FY Jun	2021A	2022A	2023A	2024F#	2025F#
Fixed Assets	18,342	18,095	18,513	18,735	19,153
Long-term Investments	141	104	81	81	81
Other LT Assets	38	53	59	59	59
Deferred Tax Asset	0	1	0	0	0
Bank Balance/Cash & Liquid	623	631	485	431	437
Debtors	55	65	53	53	53
Other Non Cash Current	0	11	26	26	26
Total Assets	19,200	18,960	19,218	19,385	19,809
ST Debt	2,003	1,299	707	1,500	2,700
Creditors	71	69	75	75	75
Other Current Liab	337	286	290	290	290
LT Debt	2,398	2,990	4,164	3,371	2,171
Deferred Tax Liabilities	205	218	242	242	242
Other LT Liabilities	61	47	71	71	71
Unitholders' funds	14,124	14,051	13,669	13,837	14,261
Total Capital	19,200	18,960	19,218	19,385	19,809
Share Capital (m)	1,672	1,682	1,695	1,716	1,742
Gross Debt	(4,401)	(4,289)	(4,871)	(4,871)	(4,871)
Working Capital	(1,733)	(947)	(508)	(1,355)	(2,549)
Book NAV (HK$)	8.45	8.36	8.06	8.07	8.19
Gross Gearing (%)	23	23	25	25	25

#FY Dec
Source: DBS HK

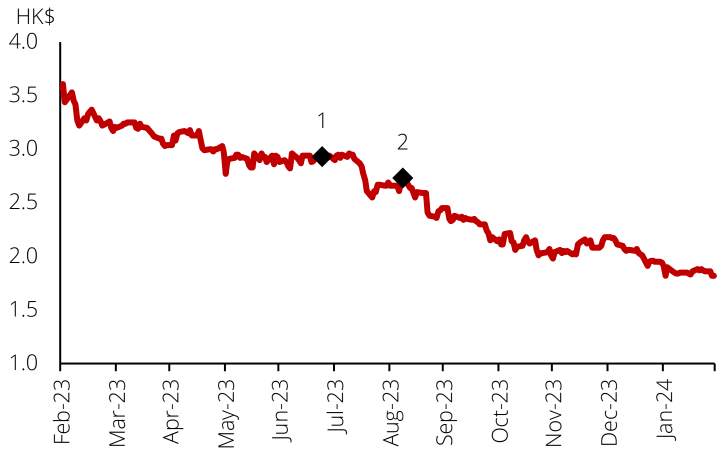
Cash Flow Statement (HK$ m)

FY Jun	2021A	2022A	2023A	2024F*	2025F#
Pre-Tax Income	(158)	179	39	498	377
Tax Paid	(16)	(68)	(64)	(71)	(55)
Depr/Amort	0	0	0	0	0
Chg in Wkg.Cap.	(27)	(14)	25	0	0
Other Non-Cash	737	403	525	387	224
Operational CF	536	500	525	814	547
Net Capex	(28)	(19)	(766)	(45)	(30)
Net Change in Investments	(25)	34	10	0	0
Assoc, MI, Invsmt	(255)	93	91	21	13
Investment CF	(309)	108	(665)	(24)	(17)
Net Chg in Debt	166	(5)	607	0	0
New issues/Unit Buyback	(6)	(5)	0	0	0
Distribution Paid	(434)	(424)	(401)	(506)	(334)
Other Financing CF	(93)	(81)	(140)	(338)	(189)
Financing CF	(368)	(514)	66	(844)	(524)
Chg in Cash	(141)	93	(74)	(54)	6

**Covering the period from Jul-23 to Dec-24*
#FY Dec
Source: Company, DBS HK

Live more, Bank less

Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	24-Jul-23	HK$2.92	HK$3.57	BUY
2	7-Sep-23	HK$2.71	HK$3.43	BUY

Source: DBS HK

Analyst: Jeff Yau
Percy Leung
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: 28 Feb 2024 14:00:38 (HKT)
Dissemination Date: 28 Feb 2024 16:07:13 (HKT)

Sources for all charts and tables are DBS HK unless otherwise specified.

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