

Champion REIT

2778 HK

Target (HKD): 3.75 → 3.75

Upside: 0.3%

12 Dec price (HKD): 3.74

- 1 Buy
- 2 Outperform
- 3 Hold (unchanged)
- 4 Underperform
- 5 Sell

BoA lease: not bad for sector

Jonas Kan, CFA
(852) 2848 4439
jonas.kan@hk.daiwacm.com

- Apparent BoA relocation would create near-term uncertainty for Champion
- However, the move should not be bad news for the sector
- Should offer long-term value but near-term upside may be capped; maintain Hold

■ What's new

News reports indicate that BoA Merrill Lynch (BoA) is going to relocate from Citibank Plaza to Cheung Kong Centre.

■ What's the impact

Not unexpected. According to the *Hong Kong Economic Times*, BoA has leased seven floors (about 150,000 sq ft) in Cheung Kong Centre starting from September 2013, at about HKD90-100/sq ft. We see this as the realisation of an overhang, as the possibility that BoA could vacate Citibank Plaza has been known for some time. We believe the change would cause near-term uncertainty for Champion REIT (Champion), as BoA takes up about 15% of the office space in the building. If the BoA space is not leased, Citibank Plaza's vacancy rate could rise to about 25%.

Negative impact of move may be overstated, for three reasons. First, we estimate that the vacancy rate at Cheung Kong Centre would fall below 4% with BoA as a tenant. This would mean that asking rents at

Cheung Kong Centre and other premier office buildings in Central could become more firm, which could result in some tenants relocating to Citibank Plaza where the spot rent is over 20% lower. This was the experience when Barclays Capital moved to Cheung Kong Centre a few years ago. We assume the area being vacated can be leased at about HKD80/sq ft in 2014; hence, we are not any making earnings or DPU revisions.

Second, while BoA's new lease may commence in September 2013, its lease at Citibank Plaza will not end until 2H14. This means that Champion should have more than 18 months to lease the space.

Third, we estimate that the rent BoA pays is not particularly high, at about HKD80/sq ft, which is in line with the current spot rents.

Should be good news for the sector. Given BoA's relocation costs and that its existing lease does not expire until 2H14, we think BoA's rent is not low at all and that cost-savings were not the priority for the deal. It also means that the 'problem' in the Central office market should become confined mainly to one building and that landlords should not be competing fiercely for tenants.

■ What we recommend

While we believe Champion offers long-term value on a PBR basis, we think it will take time for the uncertainties brought about by this development to be removed. We believe Great Eagle (parent of Champion; Not rated) represents an alternative vehicle for exposure to the long-term value of Champion REIT (see our 21 November report, [Champion REIT on top of hotel assets](#)). We thus maintain our Hold

(3) rating and target price of HKD3.75 based on our 10-year DDM model, translating into a 2013E DPU yield of 5.6%. The upside risk would be a sudden surge in demand for grade-A offices in Central; downside risks would be major corporate failures.

■ How we differ

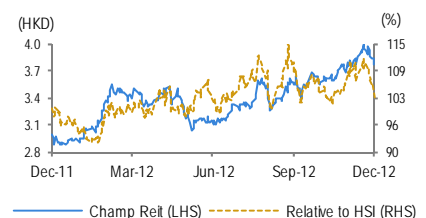
Unlike the market, we believe the Central office market's current weakness is more cyclical than structural (see Daiwa-CBRE's 29 October report, [A 2020 vision for Hong Kong's office market](#)).

Forecast revisions (%)

Year to 31 Dec	12E	13E	14E
Revenue change	-	-	-
Net-property-income chg	-	-	-
DPU change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	2.88-3.95
Market cap (USDbn)	2.74
3m avg daily turnover (USDm)	3.00
Shares outstanding (m)	5,673
Major shareholder	Great Eagle Holdings (57.7%)

Financial summary (HKD)

Year to 31 Dec	12E	13E	14E
Revenue (m)	2,040	2,113	2,197
Net property income (m)	1,694	1,770	1,841
Distribution (m)	1,197	1,222	1,268
DPU	0.211	0.214	0.221
DPU change (%)	(5.9)	1.5	3.2
Daiwa vs Cons. EPS (%)	(1.0)	5.5	15.1
DPU yield (%)	5.6	5.7	5.9
PER (x)	18.9	19.7	19.8
Core EPU (fully-diluted)	0.198	0.190	0.189
P/BV (x)	0.5	0.5	0.5
ROE (%)	2.7	2.7	2.7

Source: FactSet, Daiwa forecasts

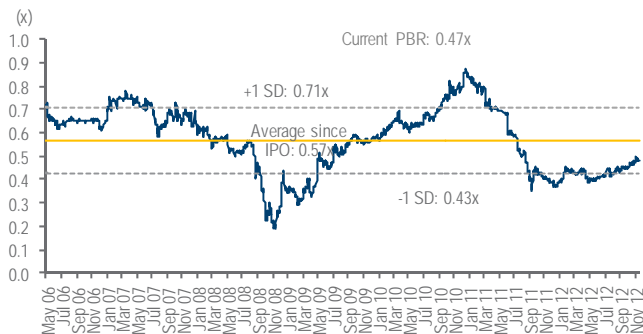
■ **Great Eagle: NAV breakdown with Champion REIT stake valued at its current unit price**

	HKDm	HKD/share
Investment properties in Hong Kong	6,343	10.0
Investment properties overseas	2,180	3.5
Hotel assets in Hong Kong	6,963	11.0
Hotel assets overseas	11,026	17.5
Hotel and other property assets in China	1,184	1.9
Champion REIT stake based on unit price of HKD3.75	12,275	19.4
Gross NAV	40,135	63.6
Net debt	(3,017)	(4.8)
NAV	37,118	58.5

Source: Company, Daiwa estimates

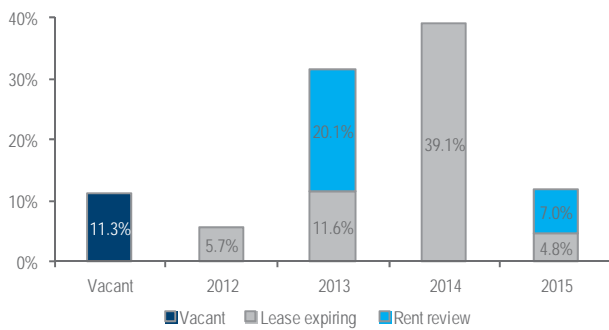
Note: NAV is estimated as at 30 October 2012; Champion REIT's unit price is as at 12 December 2012

■ **Champion REIT: PBR trend**



Source: Bloomberg, Company, Daiwa

■ **Champion REIT: Citibank Plaza expiries (end-June 2012)**



Source: Company, compiled by Daiwa

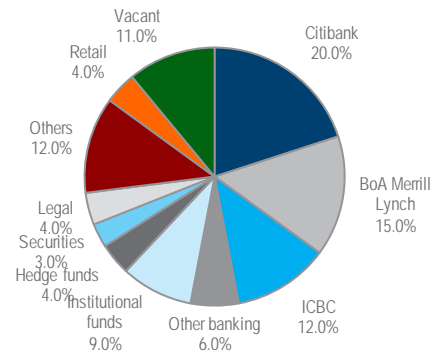
■ **Great Eagle: NAV breakdown with Champion REIT stake valued at its asset value**

	HKDm	HKD/share
Investment properties in Hong Kong	6,343	10.0
Investment properties overseas	2,180	3.5
Hotel assets in Hong Kong	6,963	11.0
Hotel assets overseas	11,026	17.5
Hotel and other property assets in China	1,184	1.9
Champion REIT stake based on value of underlying assets	24,143	38.2
Gross NAV	51,838	82.1
Net debt	(3,017)	(4.8)
NAV	48,821	77.3

Source: Company, Daiwa estimates

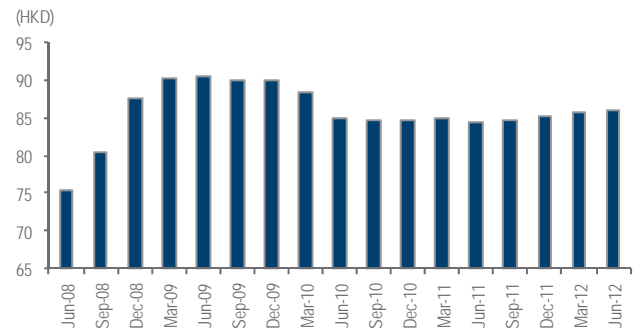
Note: NAV is estimated as at 30 October 2012

■ **Champion REIT: Tenant profile (end-June 2012)**



Source: Company

■ **Champion REIT: passing office rents at Citibank Plaza**



Source: Company

Financial summary

■ Key assumptions

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Interest cover ratio (x)	1.7	1.8	2.0	1.7	2.4	6.5	5.7	4.8
Interest service ratio (x)	1.0	0.9	1.9	1.1	1.1	1.1	1.3	1.0
Average portfolio cap rate (%)	3.0	4.0	4.6	3.7	3.5	3.8	3.9	4.1
Funds from operations (m)	3,238	(2,877)	3,745	5,309	6,493	1,053	1,078	1,121
Adj. funds from operations (m)	2,548	(3,070)	3,709	5,308	6,493	1,019	1,045	1,087

■ Profit and loss (HKDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Total revenue	839	1,614	2,035	1,876	1,940	2,040	2,113	2,197
Operating expenses	(158)	(280)	(326)	(367)	(378)	(346)	(343)	(357)
Net property income	681	1,334	1,709	1,509	1,562	1,694	1,770	1,841
Other income	0	0	2	0	0	0	0	0
Management fees	(82)	(160)	(205)	(181)	(187)	(212)	(215)	(217)
Other operating expenses	(11)	(17)	(16)	(14)	(16)	(16)	(16)	(16)
Depreciation and amortisation	0	0	0	0	0	0	0	0
EBIT	588	1,157	1,490	1,314	1,359	1,466	1,539	1,608
Net-int. income/(expenses)	(355)	(627)	(752)	(751)	(565)	(227)	(271)	(338)
Share of associates	0	0	0	0	0	0	0	0
Revaluation gains/(loss)	3,696	(3,678)	3,562	4,924	5,883	0	0	0
Except./other inc./exp.)	2	0	0	0	0	0	0	42
Profit before tax	3,931	(3,148)	4,300	5,487	6,677	1,239	1,268	1,311
Taxation	(693)	271	(556)	(178)	(184)	(186)	(190)	(190)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit	3,238	(2,877)	3,745	5,309	6,493	1,053	1,078	1,121
Total return	233	492	650	496	681	1,053	1,078	1,079
Adjustments	418	546	663	588	488	168	169	215
Distributable income	650	1,038	1,312	1,084	1,170	1,221	1,247	1,294
Distribution rate	1.00	1.00	0.95	0.95	1.00	0.98	0.98	0.98
Distribution	650	1,038	1,242	1,029	1,170	1,197	1,222	1,268
EPU (HKD)	0.078	0.131	0.108	0.078	0.138	0.198	0.190	0.189
DPU (HKD)	0.340	0.318	0.261	0.216	0.224	0.211	0.214	0.221

■ Cash flow (HKDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Profit before tax	233	530	738	562	794	1,239	1,268	1,269
Depreciation and amortisation	0	0	0	0	0	0	0	0
Net-interest expenses	355	627	752	751	565	227	271	338
Share of associate	0	0	0	0	0	0	0	0
Change in working capital	38	36	(19)	68	(20)	120	54	62
Tax paid	(144)	(5)	(84)	(109)	(46)	(186)	(190)	(190)
Other operating CF items	82	160	205	113	112	127	129	0
Cash flow from operation	563	1,348	1,592	1,386	1,406	1,528	1,531	1,479
Capex	(690)	(193)	(35)	(1)	0	(34)	(34)	(34)
Net investment and sale of FA	0	(8,298)	0	0	0	0	0	0
Other investing CF items	57	26	11	42	71	(518)	0	0
Cash flow from investing	(633)	(8,465)	(25)	41	71	(552)	(34)	(34)
Change in debt	56	7,047	863	1,247	(1,902)	0	0	0
Equity raised/(repaid)	0	5,634	0	0	0	0	0	0
Distribution paid	(526)	(1,188)	(541)	(941)	(1,055)	(1,185)	(917)	(1,233)
Other financing CF items	(97)	(3,866)	(1,173)	(1,527)	739	(186)	(230)	(295)
Cash flow from financing	(568)	7,628	(851)	(1,221)	(2,217)	(1,372)	(1,147)	(1,528)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(637)	510	717	206	(740)	(395)	351	(82)

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (HKDm)

As at 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & cash equivalent	605	1,115	1,832	2,038	1,293	902	1,253	1,301
Accounts receivable	43	116	103	108	180	117	121	126
Other current assets	0	0	0	61	2	0	0	0
Total current assets	648	1,231	1,935	2,207	1,475	1,019	1,374	1,427
Investment properties	28,343	40,049	44,241	50,223	54,857	53,792	53,819	53,846
Fixed assets	0	0	0	0	0	0	0	0
Associates	0	0	0	0	0	0	0	0
Goodwill and intangible assets	0	0	0	0	0	0	0	0
Other long-term assets	709	105	98	6	0	0	0	0
Total assets	29,700	41,385	46,274	52,436	56,332	54,811	55,193	55,272
Short-term debt	0	0	0	7,898	0	0	0	0
Accounts payable	1,111	1,413	1,381	1,521	1,575	1,632	1,690	1,758
Other current liabilities	411	665	681	608	667	0	0	0
Total current liabilities	1,522	2,078	2,063	10,027	2,242	1,632	1,690	1,758
Long-term debt	7,785	14,832	15,695	9,044	15,040	13,525	13,525	13,525
Other non-current liabilities	849	647	1,156	1,987	294	294	294	294
Total liabilities	10,156	17,557	18,914	21,058	17,576	15,452	15,510	15,577
Unitholders' funds	19,544	23,829	27,360	31,377	38,756	39,359	39,683	39,695
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	29,700	41,385	46,274	52,436	56,332	54,811	55,193	55,272
Book Value per unit	6.977	5.373	5.672	6.364	7.819	6.938	6.954	6.916

■ Key ratios (%)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Total revenue (YoY)	n.a.	92.4	26.1	(7.8)	3.4	5.2	3.6	4.0
Net property income (YoY)	n.a.	95.9	28.1	(11.7)	3.6	8.5	4.5	4.0
Net profit (YoY)	n.a.	111.3	32.1	(23.6)	37.2	54.5	2.4	0.1
Distribution (YoY)	n.a.	59.6	19.6	(17.1)	13.6	2.3	2.1	3.8
EPU (YoY)	n.a.	67.5	(17.7)	(27.5)	75.8	43.7	(4.3)	(0.5)
DPU (YoY)	n.a.	(6.3)	(18.0)	(17.2)	3.7	(5.9)	1.5	3.2
ROE	1.2	2.3	2.5	1.7	1.9	2.7	2.7	2.7
ROA	0.8	1.4	1.5	1.0	1.3	1.9	2.0	2.0
ROCE	2.2	3.5	3.6	2.9	2.7	2.7	2.9	3.0
ROIC	1.8	3.5	3.2	2.8	2.6	2.4	2.5	2.6
Debt to asset	24.2	33.1	30.0	28.4	24.4	23.0	22.2	22.1
Net debt to equity	36.7	57.6	50.7	47.5	35.5	32.1	30.9	30.8
Effective tax rate	17.6	n.a.	12.9	3.2	2.8	15.0	15.0	14.5

Source: FactSet, Daiwa forecasts

■ Company profile

Champion REIT is the second-largest REIT in Hong Kong and also one of the largest in Asia. Originally, it had only Citibank Plaza, and then became a REIT with two prime commercial-property assets after acquiring the retail and office areas of Langham Place from its parent company, Great Eagle (Not rated).

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