

# Hang Lung Properties

101 HK

Target (HKD): 34.40 → 34.40

Upside: 31.8%

3 Oct price (HKD): 26.10

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

## Time to take another look

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- Fairly promising debut for Center 66
- Sustained growth in rental income looks under way
- Reaffirm Buy

### ■ What's new

Following our visit to Hang Lung Properties' (HLP) newly opened Center 66 in Wuxi and Parc 66 in Jinan, we believe sustained growth in rental income is under way, and that this should override any share-price impact of a likely more spread-out recognition of property-sales profits.

### ■ What's the impact

**Centre 66 and Parc 66 should help restore investor confidence in its ability to build premier malls in second-tier cities.** Centre 66 is in the heart of the Wuxi City. The competitive landscape for it looks similar to Parc 66 in Jinan, as both are the first large-scale modern malls to open in their respective cities. About half of the approximate 250 tenants in Center 66 are new to Wuxi City.

We believe Center 66 has had a fairly promising debut and that the situation for Parc 66 is even better. It will enter into the second leasing cycle in 2014 and its ability to achieve higher rents looks promising. Its retail sales in its first year of operation already surpassed CNY1bn (it has taken Grand Gateway 66 and Plaza 66 about three years to achieve this milestone) and so far its achieved sales are up

about 30% YoY. We believe HLP's valuation in recent years has been affected adversely by the weak response to its Palace 66 in Shenyang, but that these two malls should help restore investor confidence in its mall-building capabilities.

**Strong rental-income growth prospects.** Execution risk for HLP is diminishing, our view, as in recent years the group has opened four malls in second-tier cities (out of a total of eight scheduled), all of which were leased up to 95% or more on opening. We believe sustained growth in the group's rental income is under way and estimate its gross rental income is on track to reach HKD10bn by about 2018 (vs. HKD6.1bn for 2012.).

**Property-sales profits should be more spread out.** HLP has uploaded the sales brochure for the Long Beach and we believe it may relaunch this project if the coming sale of The Austin (by Wheelock) stirs up interest in units in West Kowloon. That said, as the Cullinan (SHK Properties) might also be launched at the same time, we no longer assume HLP will sell any units of HarbourSide in the rest of 2013. Due to market demand uncertainties, we now assume HLP will sell its remaining units in both the Long Beach and Harbourside over 2013-17, instead of 2013-15. As such, we reduce our 2013-15 net profit forecasts by 28-33%.

As the all-in cost for HLP's 1,417 remaining units in the Long Beach and HarbourSide is very low at HKD3,300/sq ft or less, we estimate the property-sales profits to be realised from them should be substantial (over HKD17bn), with the uncertainty being the timing. Still, we believe the market has already changed to value HLP mainly on its recurrent earnings and outlook.

### ■ What we recommend

We believe HLP has strong rental-income growth prospects and reaffirm our Buy (1) rating, with a six-month target price of HKD34.40, based on a 25% discount applied to our end-2014E NAV of HKD45.90 (the same as 2013E used formerly, see pg. 2). Risks would include execution risk related to upcoming project roll-outs.

### ■ How we differ

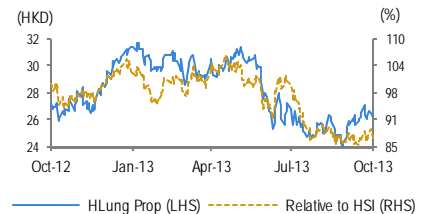
Unlike some in the market, we think the weak response to Palace 66 should not be generalised for HLP's other properties.

### Forecast revisions (%)

Year to 31 Dec	13E	14E	15E
Revenue change	(28.5)	(27.9)	(28.5)
Net profit change	(33.1)	(29.3)	(27.9)
Core EPS (FD) change	(33.1)	(29.3)	(27.9)

Source: Daiwa forecasts

### Share price performance



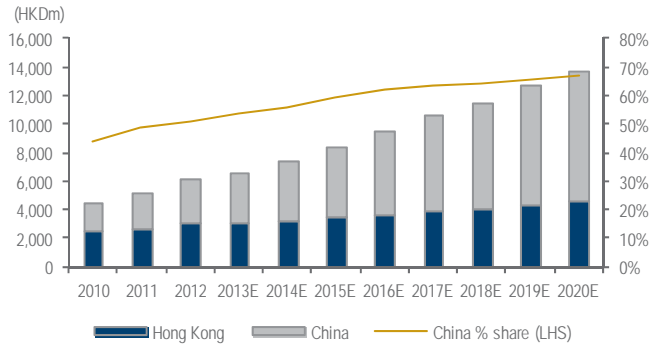
12-month range	24.05-31.25	
Market cap (USDbn)	15.07	
3m avg daily turnover (USDm)	17.95	
Shares outstanding (m)	4,477	
Major shareholder	Hang Lung Group (52.6%)	

### Financial summary (HKD)

Year to 31 Dec	13E	14E	15E
Revenue (m)	9,584	11,065	12,685
Operating profit (m)	6,807	8,245	9,414
Net profit (m)	4,780	5,840	6,700
Core EPS (fully-diluted)	1.068	1.304	1.497
EPS change (%)	(22.6)	22.2	14.7
Daiwa vs Cons. EPS (%)	16.9	1.4	(3.1)
PER (x)	24.4	20.0	17.4
Dividend yield (%)	3.1	3.3	3.4
DPS	0.800	0.850	0.900
PBR (x)	1.0	1.0	0.9
EV/EBITDA (x)	18.2	15.4	13.8
ROE (%)	4.0	4.8	5.4

Source: FactSet, Daiwa forecasts

■ **Hang Lung Properties: gross rental income from Hong Kong and China**



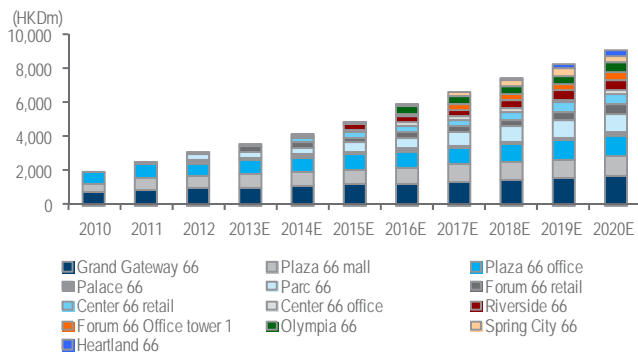
Source: Company, Daiwa forecasts

■ **Outside view of Center 66 in Wuxi**



Source: Daiwa

■ **Hang Lung Properties: gross rental income from China properties**



Source: Company, Daiwa forecasts

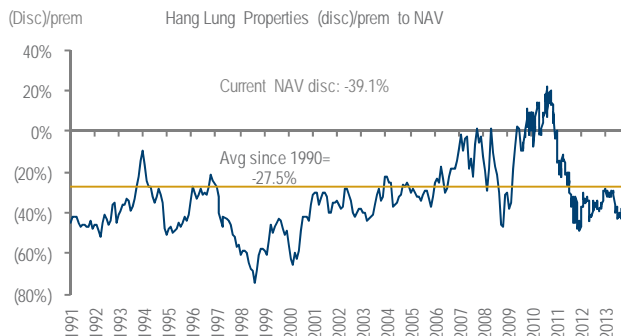
■ **Hang Lung Properties: revisions to property-sales profit forecasts**

	Previous (HKDm)	Revised (HKDm)	Change
2013E	4,722	1,379	-71%
2014E	5,735	2,295	-60%
2015E	6,924	2,980	-57%

Remarks: we now assume sales of the remaining units in Long Beach and HarbourSide will be spread over 2013-17 instead of 2013-15.

Source: Daiwa forecasts

■ **Hang Lung Properties: price/NAV**



Source: Datastream, Daiwa forecasts

■ **Hang Lung Properties: NAV breakdown for end-2014E**

	(HKDm)	(HKD/share)
<b>Established property assets</b>		
Hong Kong luxury residential properties	39,966	8.9
Hong Kong investment properties	72,611	16.2
Grand Gateway 66	17,825	4.0
Plaza 66 mall	14,916	3.3
Plaza 66 offices	13,750	3.1
	<b>159,067</b>	<b>35.5</b>
<b>New malls being nurtured</b>		
Palace 66	2,583	0.6
Parc 66	7,396	1.7
Forum 66	5,180	1.2
Center 66 mall	4,723	1.1
	<b>19,882</b>	<b>4.4</b>
<b>Properties under development</b>		
Forum 66 @ cost	9,356	2.1
Centre 66 Phase II @ cost	2,939	0.7
Olympia 66 @ cost	5,705	1.3
Spring City 66 @ cost	6,171	1.4
Heartland 66 @ cost	5,645	1.3
	<b>29,816</b>	<b>6.7</b>
<b>Enterprise value</b>	<b>208,766</b>	<b>46.7</b>
Net cash on hand/ (debt)	(3,502)	(0.8)
<b>NAV</b>	<b>205,264</b>	<b>45.9</b>

Source: Daiwa forecasts

■ **Hang Lung Properties: PBR trend**



Source: Datastream, Daiwa

## Financial summary

### ■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Gross rental income (HKDm)	3,745	4,162	4,546	5,161	6,098	6,642	7,445	8,465
Rental EBIT (HKDm)	3,046	3,441	3,726	4,194	4,896	5,186	5,731	2,105
Property sales profit (HKDm)	3,552	3	5,256	2	846	1,379	2,295	2,980

### ■ Profit and loss (HKDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Rental income	3,745	4,162	4,546	5,161	6,098	6,642	7,445	8,465
Property sales	6,335	11	7,511	3	2,994	2,942	3,620	4,220
Other Revenue	0	0	0	0	(1,720)	0	0	0
<b>Total Revenue</b>	<b>10,080</b>	<b>4,173</b>	<b>12,057</b>	<b>5,164</b>	<b>7,372</b>	<b>9,584</b>	<b>11,065</b>	<b>12,685</b>
Other income	281	157	35	231	2,774	825	842	858
COGS	(3,482)	(729)	(3,075)	(968)	(1,630)	(3,019)	(3,038)	(3,462)
SG&A	(361)	(383)	(456)	(512)	(626)	(583)	(624)	(667)
Other op.expenses	0	0	0	0	0	0	0	0
<b>Operating profit</b>	<b>6,518</b>	<b>3,218</b>	<b>8,561</b>	<b>3,915</b>	<b>7,890</b>	<b>6,807</b>	<b>8,245</b>	<b>9,414</b>
Net-interest inc./(exp.)	(150)	(69)	(47)	(93)	(348)	(437)	(454)	(472)
Assoc/forex/extraord./others	129	23	166	98	105	106	110	117
<b>Pre-tax profit</b>	<b>6,497</b>	<b>3,172</b>	<b>8,680</b>	<b>3,920</b>	<b>7,647</b>	<b>6,476</b>	<b>7,901</b>	<b>9,059</b>
Tax	(926)	(476)	(1,432)	(815)	(944)	(1,134)	(1,460)	(1,716)
Min. int./pref. div./others	(448)	(308)	(574)	(364)	(525)	(562)	(601)	(643)
<b>Net profit (reported)</b>	<b>5,123</b>	<b>2,388</b>	<b>6,674</b>	<b>2,741</b>	<b>6,178</b>	<b>4,780</b>	<b>5,840</b>	<b>6,700</b>
<b>Net profit (adjusted)</b>	<b>5,123</b>	<b>2,388</b>	<b>6,674</b>	<b>2,741</b>	<b>6,178</b>	<b>4,780</b>	<b>5,840</b>	<b>6,700</b>
EPS (reported)(HKD)	1.236	0.576	1.605	0.613	1.380	1.068	1.304	1.497
EPS (adjusted)(HKD)	1.236	0.576	1.605	0.613	1.380	1.068	1.304	1.497
EPS (adjusted fully-diluted)(HKD)	1.226	0.576	1.605	0.613	1.380	1.068	1.304	1.497
DPS (HKD)	0.660	0.660	0.710	0.710	0.740	0.800	0.850	0.900
<b>EBIT</b>	<b>6,518</b>	<b>3,218</b>	<b>8,561</b>	<b>3,915</b>	<b>7,890</b>	<b>6,807</b>	<b>8,245</b>	<b>9,414</b>
<b>EBITDA</b>	<b>6,518</b>	<b>3,218</b>	<b>8,561</b>	<b>3,915</b>	<b>7,890</b>	<b>6,807</b>	<b>8,245</b>	<b>9,414</b>

### ■ Cash flow (HKDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	6,497	3,172	8,680	3,920	7,647	6,476	7,901	9,059
Depreciation and amortisation	0	13	23	25	27	29	31	33
Tax paid	(288)	(474)	(1,131)	(735)	(1,018)	(1,134)	(1,460)	(1,716)
Change in working capital	1,658	544	1,414	620	554	(61)	740	780
Other operational CF items	(76)	26	(182)	(73)	171	256	264	270
<b>Cash flow from operations</b>	<b>7,791</b>	<b>3,281</b>	<b>8,804</b>	<b>3,757</b>	<b>7,381</b>	<b>5,566</b>	<b>7,476</b>	<b>8,426</b>
Capex	(1,347)	(2,230)	(3,666)	(5,982)	(8,088)	(8,358)	(6,620)	(6,680)
Net (acquisitions)/disposals	0	0	0	0	0	0	0	0
Other investing CF items	451	869	119	124	129	134	136	140
<b>Cash flow from investing</b>	<b>(896)</b>	<b>(1,361)</b>	<b>(3,547)</b>	<b>(5,858)</b>	<b>(7,959)</b>	<b>(8,224)</b>	<b>(6,484)</b>	<b>(6,540)</b>
Change in debt	(375)	0	0	0	0	0	0	0
Net share issues/(repurchases)	24	6	137	10,896	0	0	0	0
Dividends paid	(2,404)	(2,736)	(2,820)	(3,014)	(3,183)	(3,582)	(3,671)	(3,805)
Other financing CF items	(568)	(1,033)	(386)	(392)	(415)	(430)	(442)	(460)
<b>Cash flow from financing</b>	<b>(3,323)</b>	<b>(3,763)</b>	<b>(3,069)</b>	<b>7,490</b>	<b>(3,598)</b>	<b>(4,012)</b>	<b>(4,113)</b>	<b>(4,265)</b>
Forex effect/others	0	0	0	0	0	0	0	0
<b>Change in cash</b>	<b>3,572</b>	<b>(1,843)</b>	<b>2,188</b>	<b>5,389</b>	<b>(4,177)</b>	<b>(6,670)</b>	<b>(3,121)</b>	<b>(2,379)</b>
Free cash flow	6,444	1,051	5,138	(2,225)	(707)	(2,792)	856	1,746

Source: FactSet, Daiwa forecasts

## Financial summary continued ...

### ■ Balance sheet (HKDm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	10,578	8,931	11,535	27,202	36,025	33,923	26,741	24,362
Inventory	6,817	7,683	5,855	5,963	6,109	5,780	4,680	3,520
Accounts receivable	1,366	686	1,494	1,983	1,270	1,320	1,450	1,490
Other current assets	0	0	0	0	452	250	262	270
<b>Total current assets</b>	<b>18,761</b>	<b>17,300</b>	<b>18,884</b>	<b>35,148</b>	<b>43,856</b>	<b>41,273</b>	<b>33,133</b>	<b>29,642</b>
Fixed assets	64,844	70,336	96,291	107,646	122,955	133,229	139,593	146,241
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	737	872	993	1,888	1,053	1,130	1,280	1,290
<b>Total assets</b>	<b>84,342</b>	<b>88,508</b>	<b>116,168</b>	<b>144,682</b>	<b>167,864</b>	<b>175,632</b>	<b>174,006</b>	<b>177,173</b>
Short-term debt	0	1,500	1,480	4,500	1,113	310	330	330
Accounts payable	1,726	2,028	3,076	3,430	4,811	4,910	4,960	5,030
Other current liabilities	829	831	1,132	1,196	392	398	420	450
<b>Total current liabilities</b>	<b>2,555</b>	<b>4,359</b>	<b>5,688</b>	<b>9,126</b>	<b>6,316</b>	<b>5,618</b>	<b>5,710</b>	<b>5,810</b>
Long-term debt	5,919	4,661	4,978	12,236	28,623	33,993	29,913	29,913
Other non-current liabilities	7,217	8,158	12,876	8,396	8,947	9,010	9,068	9,120
<b>Total liabilities</b>	<b>15,691</b>	<b>17,178</b>	<b>23,542</b>	<b>29,758</b>	<b>43,886</b>	<b>48,621</b>	<b>44,691</b>	<b>44,843</b>
Share capital	4,145	4,146	4,159	4,472	4,477	4,477	4,477	4,477
Reserves/R.E./others	62,232	63,892	83,785	105,247	113,451	115,849	118,018	120,913
<b>Shareholders' equity</b>	<b>66,377</b>	<b>68,038</b>	<b>87,944</b>	<b>109,719</b>	<b>117,928</b>	<b>120,326</b>	<b>122,495</b>	<b>125,390</b>
Minority interests	2,274	3,292	4,682	5,205	6,050	6,685	6,820	6,940
<b>Total equity &amp; liabilities</b>	<b>84,342</b>	<b>88,508</b>	<b>116,168</b>	<b>144,682</b>	<b>167,864</b>	<b>175,632</b>	<b>174,006</b>	<b>177,173</b>
EV	114,465	117,372	116,455	111,589	116,611	123,915	127,172	129,671
<b>Net debt/(cash)</b>	<b>(4,659)</b>	<b>(2,770)</b>	<b>(5,077)</b>	<b>(10,466)</b>	<b>(6,289)</b>	<b>380</b>	<b>3,502</b>	<b>5,881</b>
<b>BVPS (HKD)</b>	<b>16.018</b>	<b>16.411</b>	<b>21.145</b>	<b>24.535</b>	<b>26.341</b>	<b>26.877</b>	<b>27.361</b>	<b>28.008</b>

### ■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	129.7	(58.6)	188.9	(57.2)	42.8	30.0	15.5	14.6
EBITDA (YoY)	135.9	(50.6)	166.0	(54.3)	101.5	(13.7)	21.1	14.2
Operating profit (YoY)	135.9	(50.6)	166.0	(54.3)	101.5	(13.7)	21.1	14.2
Net profit (YoY)	150.1	(53.4)	179.5	(58.9)	125.4	(22.6)	22.2	14.7
Core EPS (fully-diluted) (YoY)	141.4	(53.0)	178.6	(61.8)	125.1	(22.6)	22.2	14.7
Gross-profit margin	65.5	82.5	74.5	81.3	77.9	68.5	72.5	72.7
EBITDA margin	64.7	77.1	71.0	75.8	107.0	71.0	74.5	74.2
Operating-profit margin	64.7	77.1	71.0	75.8	107.0	71.0	74.5	74.2
Net profit margin	50.8	57.2	55.4	53.1	83.8	49.9	52.8	52.8
ROAE	8.5	3.6	8.6	2.8	5.4	4.0	4.8	5.4
ROAA	6.7	2.8	6.5	2.1	4.0	2.8	3.3	3.8
ROCE	9.5	4.2	9.7	3.4	5.5	4.3	5.1	5.8
ROIC	9.4	4.1	9.2	3.2	6.2	4.6	5.2	5.6
Net debt to equity	net cash	net cash	net cash	net cash	net cash	0.3	2.9	4.7
Effective tax rate	14.3	15.0	16.5	20.8	12.3	17.5	18.5	18.9
Accounts receivable (days)	39.9	89.7	33.0	122.9	80.5	49.3	45.7	42.3
Current ratio (x)	7.3	4.0	3.3	3.9	6.9	7.3	5.8	5.1
Net interest cover (x)	43.5	46.6	182.1	42.1	22.7	15.6	18.2	19.9
Net dividend payout	53.4	114.6	44.2	115.8	53.6	74.9	65.2	60.1
Free cash flow yield	5.5	0.9	4.4	n.a.	n.a.	n.a.	0.7	1.5

Source: FactSet, Daiwa forecasts

### ■ Company profile

Hang Lung Properties is the property arm of Hang Lung Group (10 HK) which, prior to the 1980s, was one of the largest property developers in Hong Kong. Since the property market downturn in 1982-84, however the group's corporate strategy shifted to focusing more on developing investment properties. In recent years, the group has embarked on a strategy of focusing on developing retail properties in China, and has secured seven projects in addition to its two existing ones in Shanghai.

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