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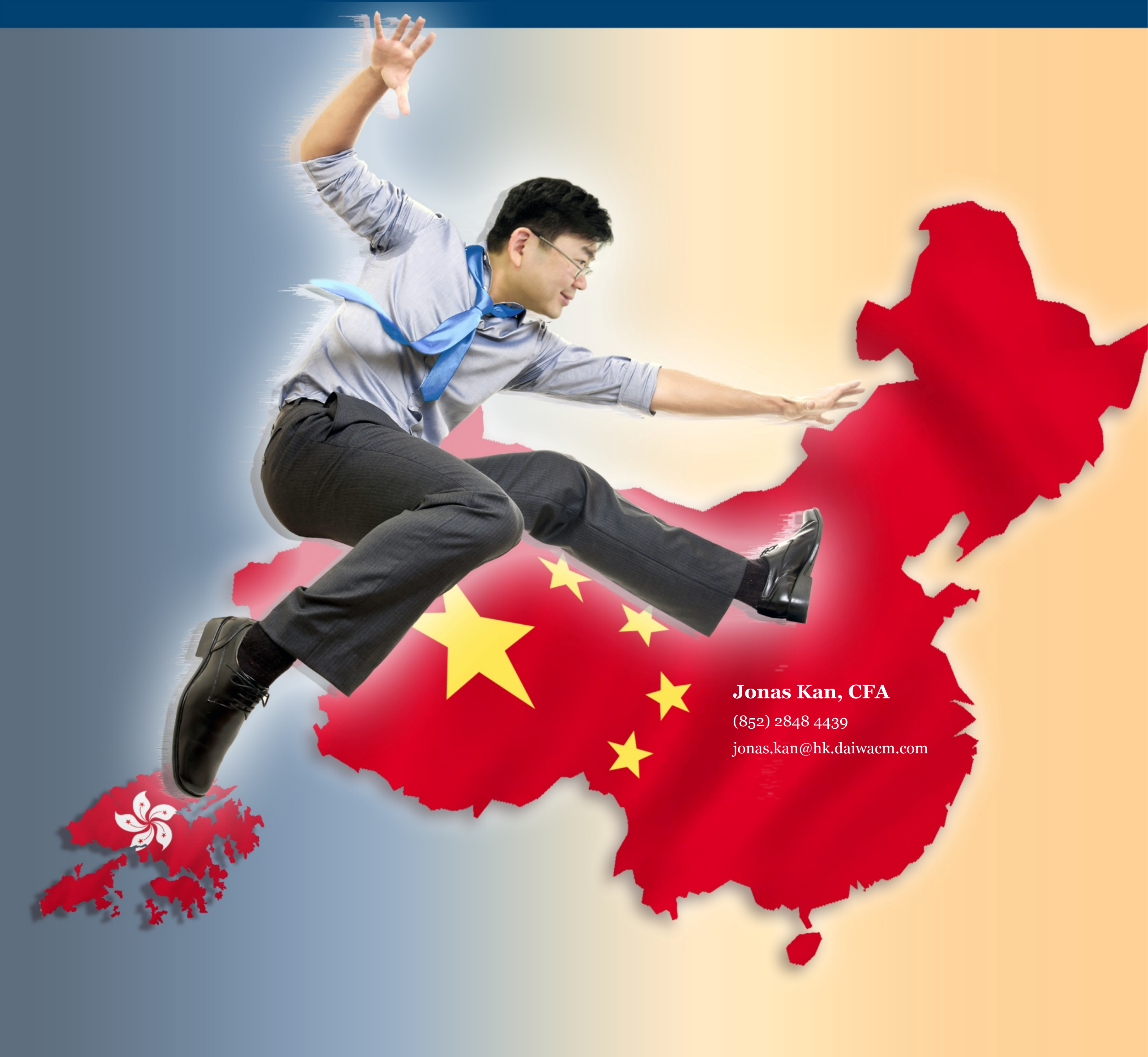
The 10-second briefing

# Is Hong Kong Inc. ready to make the jump?

- Integration with China promises to transform Hong Kong's finance, property and rail sectors
- Some Hong Kong companies are already reaping the rewards
- We highlight 30 companies that offer exposure to six integration-related investment themes for 2013 and beyond

## Hong Kong Strategy



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**See important disclosures, including any required research certifications, beginning on page 125**

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# Is Hong Kong Inc. ready to make the jump?

## Hong Kong Strategy

- Integration with China promises to transform Hong Kong**'s** finance, property and rail sectors
- Some Hong Kong companies are already reaping the rewards
- We highlight 30 companies that offer exposure to six integration-related investment themes for 2013 and beyond

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### ■ What's new

The recent correction in share prices in Hong Kong has created what we see as buying opportunities for Hong Kong companies that are facing favourable structural factors underpinned by integration with Mainland China. We believe this transformation will play out as an investment theme for the city in 2013 and beyond.

### ■ What's the impact

**Considerable opportunities ahead for Hong Kong's corporate sector.** One recurring question in our research on Hong Kong companies is whether or not Hong Kong is poised to make the jump from being a medium-sized city in Asia with a population of 6-7m into being a metropolis akin to New York or London, backed by the mega-sized economy of Mainland China.

We think the sheer scale of China's economy compared with that of Hong Kong means the integration of the latter with the former is adding an entirely new dimension to Hong Kong's corporate sector. Such a transformation should have significant implications for investor perceptions of Hong Kong companies, in our view.

The liquidity and consumption power of China are powerful forces that are already influencing the city's corporate sector. Equally important is the scale of the Mainland market, which gives some Hong Kong companies the opportunity to apply their expertise on a much larger scale, in areas such as retail-property management and rail management (in the case of MTR Corp [MTRC]).

**Hong Kong stocks constitute a special theme for investors.** We see Hong Kong companies as providing a channel through which investors can gain exposure to the economic potential of China, while at the same time offering the quality and protection provided by Hong Kong assets and governance. We regard this as a credible investment proposition. In our view, one way for investors to benefit from the rise of China's economy is through prime real-estate assets in Hong Kong.

**Do Hong Kong property companies present a good value opportunity?** One important question for the Hong Kong market in 2013 and beyond is: do property companies there represent a "value trap" or do they provide an unusual "value opportunity"? The larger NAV discounts of the Hong Kong property stocks relative to their counterparts globally exist for a reason. Still, we believe that significant value can be unlocked from these stocks and that the process has started for some of these companies. While unlocking such value won't be straightforward, we do not see this as an unsolvable issue. Indeed, some companies have made notable progress on this front.

### ■ What we recommend

We do not expect the near-term uncertainties globally to derail the positive structural forces now at work in Hong Kong.

**We have identified six major themes, and look at 30 companies in this context.** Our six investment themes are:

1) Growing recognition by investors of Hong Kong companies' China investments.
2) Hong Kong enhancing its position as an all-round international financial centre for China.
3) Transformation of several districts in Hong Kong.
4) Growing importance of suburban malls.
5) Increased recognition by investors that Hong Kong family-owned companies feature quality asset managers and savvy private – equity investors.
6) Restructuring, recovery, and transformation of some companies.

## Sector stocks: key indicators

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | EPS (local curr.) | | | | | |
| | | Share | Rating | | Target price (local curr.) | | | FY1 | | | FY2 | | |
| Company Name | Stock code | Price | New | Prev. | New | Prev. | % chg | New | Prev. | % chg | New | Prev. | % chg |
| BOC Hong Kong | 2388 HK | 26.30 | Buy | Buy | 30.00 | 30.00 | 0.0% | 2.107 | 2.107 | 0.0% | 2.181 | 2.181 | 0.0% |
| Cheung Kong | 1 HK | 111.70 | Buy | Buy | 143.70 | 143.70 | 0.0% | 11.601 | 11.601 | 0.0% | 13.505 | 13.505 | 0.0% |
| Fortune REIT | 778 HK | 6.87 | Buy | Buy | 8.20 | 8.20 | 0.0% | 0.316 | 0.316 | 0.0% | 0.359 | 0.359 | 0.0% |
| Hang Lung Properties | 101 HK | 29.20 | Buy | Buy | 34.40 | 34.40 | 0.0% | 1.597 | 1.597 | 0.0% | 1.845 | 1.845 | 0.0% |
| Henderson Land | 12 HK | 48.70 | Buy | Buy | 67.30 | 67.30 | 0.0% | 2.753 | 2.753 | 0.0% | 3.361 | 3.361 | 0.0% |
| Hong Kong Exchanges & Clearing | 388 HK | 132.70 | Outperform | Outperform | 159.60 | 159.60 | 0.0% | 4.518 | 4.518 | 0.0% | 4.803 | 4.803 | 0.0% |
| Hysan Development | 14 HK | 37.30 | Buy | Buy | 48.16 | 48.16 | 0.0% | 1.809 | 1.809 | 0.0% | 2.045 | 2.045 | 0.0% |
| Midland | 1200 HK | 3.36 | Buy | Buy | 4.10 | 4.10 | 0.0% | 0.335 | 0.335 | 0.0% | 0.413 | 0.413 | 0.0% |
| MTR Corporation | 66 HK | 30.90 | Outperform | Outperform | 33.40 | 33.40 | 0.0% | 1.582 | 1.582 | 0.0% | 2.277 | 2.277 | 0.0% |
| Orient Overseas International | 316 HK | 51.70 | Buy | Buy | 73.00 | 73.00 | 0.0% | 0.687 | 0.686 | 0.1% | 1.008 | 0.999 | 1.0% |
| Regal REIT | 1881 HK | 2.24 | Outperform | Outperform | 2.60 | 2.60 | 0.0% | 0.127 | 0.127 | 0.0% | 0.145 | 0.145 | 0.0% |
| SHK Properties | 16 HK | 106.30 | Buy | Buy | 136.50 | 136.50 | 0.0% | 9.315 | 9.315 | 0.0% | 9.988 | 9.988 | 0.0% |
| Sino Land | 83 HK | 12.66 | Buy | Buy | 16.73 | 16.73 | 0.0% | 1.012 | 1.012 | 0.0% | 1.130 | 1.130 | 0.0% |
| Soundwill | 878 HK | 19.88 | Buy | Buy | 28.40 | 28.40 | 0.0% | 2.145 | 4.394 | (51.2%) | 4.948 | 4.766 | 3.8% |
| Sunlight REIT | 435 HK | 3.40 | Buy | Buy | 4.00 | 4.00 | 0.0% | 0.155 | 0.172 | (9.6%) | 0.183 | 0.183 | 0.0% |
| The Link REIT | 823 HK | 42.50 | Outperform | Outperform | 48.00 | 48.00 | 0.0% | 1.466 | 1.466 | 0.0% | 1.653 | 1.653 | 0.0% |
| Wharf Holdings | 4 HK | 61.50 | Buy | Buy | 72.40 | 72.40 | 0.0% | 3.321 | 3.321 | 0.0% | 3.737 | 3.737 | 0.0% |

*Source: Daiwa forecasts; note: prices as of close on 19 March 2013*

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## Contents



### Company Section

# Is Hong Kong Inc. ready to make the jump?

*"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us …."*

*A Tale of Two Cities, Charles Dickens*

*"The most decisive mark of the prosperity of any country is the increase of the number of its inhabitants."*

*Adam Smith*

*"The close connection between population size and the presence of, and benefits of, certain evolved practices, institution, and forms of human interaction is hardly a new discovery."*

*F.A. Hayek*

*"It is Enterprise which builds and improves the world's possessions… If Enterprise is afoot, wealth accumulates whatever may be happening to Thrift; and if Enterprise is asleep, wealth decays whatever Thrift may be doing…"*

*John. M. Keynes*

Hong Kong has always been a city in flux. From its description by Lord Palmerson, the then foreign secretary of Britain, as "a barren island with hardly a house upon it" in 1842, Hong Kong evolved from a fishing village into an entrepot, and then a manufacturing centre. In recent years, it has become a major financial centre and the gateway to China.

Sovereignty over the city was returned to China in July 1997, and it appears that in the initial years following the handover, China has been mindful of not arousing international concern that it has not honoured the principle of "one country, two systems", and hence has been somewhat restrained in becoming involved in the development of Hong Kong.

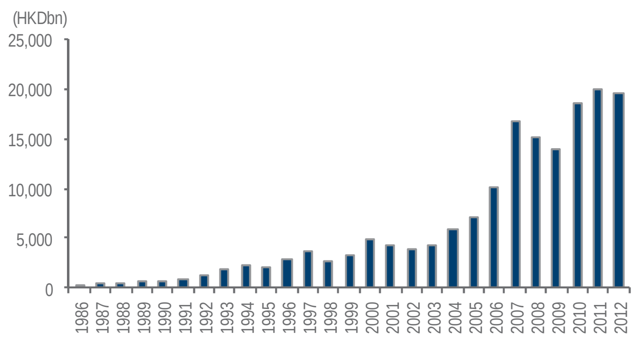
■ The evolution of Hong Kong as a city


*Source: Daiwa*

In retrospect, the six-year economic downturn in Hong Kong from 4Q97 to mid-2003 may have been the catalyst for a major change in the nature of Hong Kong as a city. Probably partly to revitalise Hong Kong, China announced the Comprehensive Economic Partnership Agreement and the Individual Visit Scheme in 2003.

Following on from this, the economic and social integration of Hong Kong and China reached a new level, with the city quickly becoming the principal capital formation centre for China's corporate sector, and also the most popular city with Chinese consumers when shopping overseas. We believe that these developments reached a milestone in 2006, when several mega-IPOs took place in Hong Kong, which elevated the city's status from a regional financial centre to an international financial centre.

■ Hong Kong: stock-market capitalisation



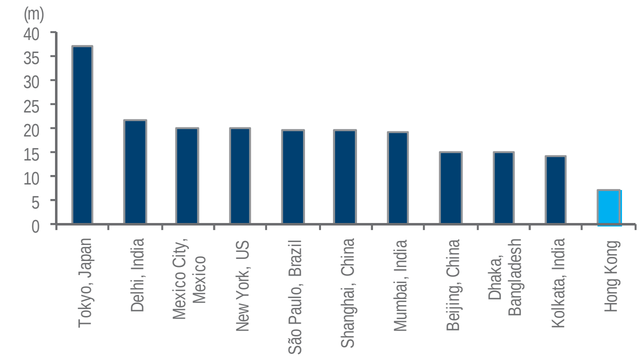

*Source: Bloomberg, Daiwa*

With the changes likely to take place in the current decade, the first Daiwa Hong Kong Corporate Summit was held in January 2011. We invited investors, major companies, and industry specialists in a range of sectors in Hong Kong to discuss, among other things, the outlook for each sector for the year and the structural trends they were seeing.

The Third Daiwa Hong Kong Corporate Summit was held in January this year. Many issues were discussed, but one over-riding theme emerged that is having an impact on numerous sectors: that Hong Kong is undergoing some unusual changes. These essentially involve it changing from a medium-sized city in Asia with a population of 6-7m into potentially one of the most important metropolises, with a mega-sized economy that could elevate it to the level of New York and London.

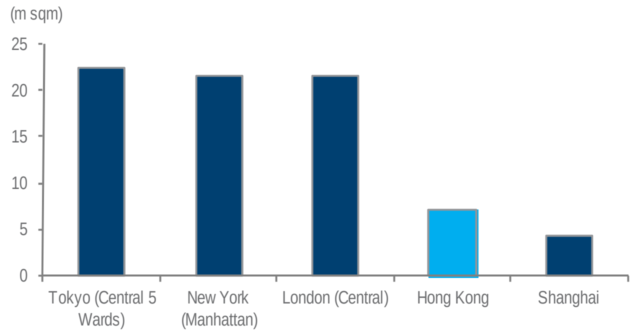
Compared with many of the world's other metropolises, Hong Kong is still moderate in scale, with respect to metrics such as population, the stock of office, retail, and residential properties (that for larger-sized residential units is particularly small), and hotel rooms. As such, there should be significant room for expansion for many of the key industries in Hong Kong, if it can continue its rise among the world's major metropolitan cities.

■ **Populations of major cities**



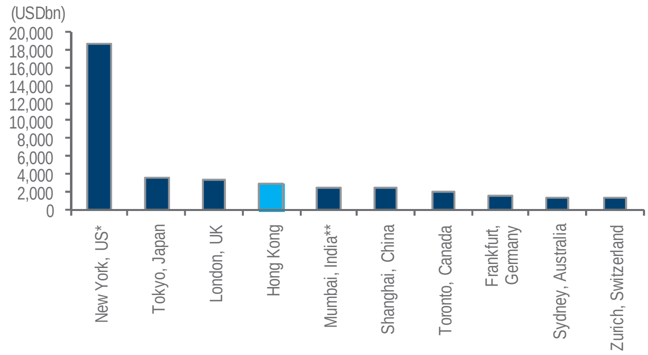

*Source: Wikipedia*

■ **Grade-A office stock: Hong Kong vs. other major cities**




*Source: DTZ*

■ **Market capitalisation of major stocks markets**

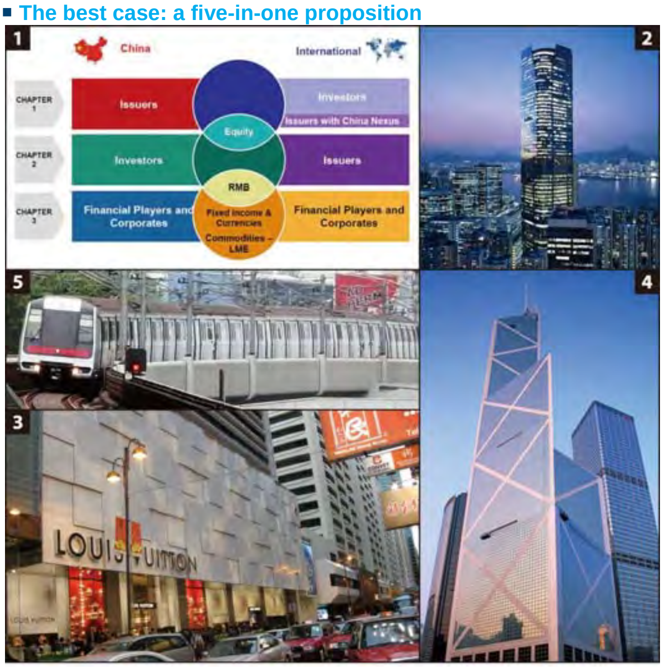



*Source: Wikipedia World Federation of Exchanges*
*Note: *NYSE & NASDAQ, ** BSE & NSE*

How well Hong Kong meets the challenges associated with such a change remains to be seen. The issues involved are complex and probably extend well beyond economics, as there are also important social and political dimensions to this process. Meanwhile, of course, many cities in China aspire to be international cities, while others are developing rapidly and could take on some functions previously performed by Hong Kong. At the same time, China's economy faces challenges, especially over the medium-to-long term, as Daiwa views that the fixed asset investment-led growth model is unsustainable.

## The best case: a five-in-one proposition

■ The best case: a five-in-one proposition




1. China's all-round international financial centre
2. The commercial gateway to China
3. The retail hub of Chinese consumers
4. Chinese corporations' springboard to overseas
5. An important force in some of China's major sectors

*Source: Daiwa*

We outline the best- and worst-case scenarios for Hong Kong in the years to come. The best-case scenario is one in which Hong Kong successfully transforms itself into one of the most important cities in China, while at the same time being:

i) the country's main international financial centre, providing a comprehensive range of services,

ii) the retail hub for Mainland consumers,

iii) the commercial gateway to China,

iv) the springboard to overseas markets for China's corporate sector, and

v) an important force in some of the country's major sectors.

This scenario would see Hong Kong being elevated into one of the world's most important metropolises, and mean that the scale of many sectors in the city would be elevated to levels not previously envisaged. Hong Kong's fortune would then rise and fall along with China's economic strength, but in times when the country's economy is strong, some sectors in Hong Kong might rank as among the best-positioned in the world.

## The worst case: a prolonged derating

That said, such a transformation would not be easy or smooth. There are bottlenecks in terms of infrastructure and land resources, and the transformation could well give rise to many social and political issues.

The challenges Hong Kong faces do not stop there and could be much greater. It could be argued that every transformation in the city's history was essentially led by free market forces. Over the past few decades, it has experienced crises, times of despair, and periods almost of hopelessness, but eventually the city has managed to get through these, contrary to the expectations of many. We have reason to believe that, apart from luck, laissez-faire market forces have played a positive role in the various transformations of the past, but there are reasons to doubt that the values required for the running of a laissez-faire free-market economy and society are being upheld by the current administration.

It appears to us that the free market is essentially complex and sophisticated system, the merits and strengths of which are not obvious and may not appeal to the media and bureaucracy.

It is therefore possible that Hong Kong may not achieve its potential. This might herald a prolonged period during which Hong Kong's position as an international city declines. However, at present, asset prices are at levels that we believe reflect expectations that the city will transform into a great metropolitan city. In some ways, if the process continues, it may resemble what happened to Venice, which went from being an influential city and commercial hub in the middles ages to mainly a tourist city nowadays.

Our base-case scenario is somewhere along this continuum. How far Hong Kong can go will depend on many evolving parameters, not least being how the corporate sector embraces the opportunities and overcomes the challenges ahead. Whatever the outcome, however, the process of Hong Kong integrating with China has started and the sheer size and scale of China relative to Hong Kong probably means that many sectors in Hong Kong will be embracing change, which will be both far-reaching and unprecedented in the years ahead.

Whether or not Hong Kong can achieve this best-case scenario, some corporates are still likely do very well in the coming years, taking them to the next level.

In this report, we highlight some of the structural trends we have discerned in some of the important sectors in Hong Kong and the implications when investing.

## Structural trends in major sectors

Below, we list the important trends that have started and are likely to continue in the years ahead, and from which come the main opportunities that various major corporate sectors in Hong Kong can benefit. We analyse them in greater detail later in the report.

1. Transport: full-scale integration with the Pearl-River Delta.
2. Exchange and securities: on the way to becoming the first stop for Mainland capital going overseas, and an all-round international financial centre for China.
3. Banking: lacklustre revenue growth but potential new opportunities from Renminbi internationalisation.
4. Retail properties: continued expansion of the established retail districts and growing opportunities for suburban malls.
5. Office properties: non-Central locations continue to be strong and a five-tier structure is taking shape.
6. Residential properties: a three-tier structure is forming, ie, Monte Carlo (for the super-wealthy), Manhattan (for the wealthy and high income groups), and the rest of Hong Kong.
7. Shipping and ports: freight rates are rising, and the larger ports should continue to gain market share from the smaller ones.
8. Hotels: there is considerable potential for boutique hotels conveniently located in the urban areas.

## Ten developments we expect to see

Based on the structural trends we see, we identify the major investment themes we expect in the coming years. These include the following.

1. Average daily turnover (ADT) continuing to rise and Hong Kong starting to become an emerging financial centre for products other than equities, such as commodities, currencies, the Renminbi, and fixed income.
2. The "floating population" (people who do not live in Hong Kong but often transit and pass through the city) in Hong Kong continues to expand.
3. Hong Kong starts to become an important centre for Renminbi borrowing and investment in Renminbi products.
4. The profiles of some suburban malls improving significantly, such that they become locations that are sought after by international retailers.
5. Non-Central core office locations become the preferred sites for non-finance multinational tenants.
6. China corporations become a more prominent force in both the renting and investment market for offices.
7. Many districts in Hong Kong undergo major transformations (including Causeway Bay, Wanchai, Tseung Kwan O, Island East, and Tuen Mun).
8. The boundary for "Manhattan prices" in residential properties spreads northward.
9. The number of boutique hotels in the urban area increases.
10. Increasing recognition by investors globally-of Hong Kong companies' China investments and expertise in certain industries.

All-in-all, we see Hong Kong as a city undergoing some unusual changes. We summarise the above trends and developments into six major investment themes and also identify 30 companies that are likely to ride on the back of these.

### ■ The six investment themes

| | Six major investment themes we expect for 2013 and beyond | Companies | Remarks |
|---|---|---|---|
| 1 | Growing recognition of HK companies' China investments | Cheung Kong | A sound business model to develop mass -market residential units, which has also been working in China |
| | | Hang Lung Properties | A solid China retail property play |
| | | Kerry Properties | Owns some of the most prime property sites in China |
| | | Lifestyle | A proven retail property manager which is also steadily rolling out its China ambitions |
| | | MTRC | Well-demonstrated expertise in managing rail operation; the largest foreign investor in China's rail sector |
| | | SHK Properties | A growing portfolio of prime commercial properties in China |
| | | Wharf | Has deployed the most capital in Mainland China; China investment are entering harvesting period |
| 2 | Hong Kong moving forward as the comprehensive international financial centre for China | BOC HK | Beneficiary of continued cross-border lending and potential rise in stock-market turnover in Hong Kong |
| | | Guotai Junan | Well-positioned to ride on opportunities related to a greater amount of investing capital from China coming to Hong Kong. |
| | | HK Exchange | Has worked for years to prepare for when more China-sourced capital is permitted to come to Hong Kong |
| | | SHK Properties | One of the two largest office landlords in Hong Kong; owns some of the most prime grade-A offices in Central, as well as Kowloon East and other areas |
| | | Swire Properties | One of the two largest office landlords in Hong Kong. We see Island East transforming into an even more important location for multinationals and Southern Wanchai merging into Pacific Place |
| | | Wharf | Owns some of the most prime office buildings in Causeway Bay and Tsimshatsui, which we expect to become more important commercial hubs |
| 3 | Growing importance of suburban malls | Fortune REIT | Should benefit from the positive spill-over related to the upgrading of first-tier malls |
| | | Henderson Land | Owns among the largest suburban malls in Tsueng Kwan O and Ma On Shan |
| | | Link REIT | Owns almost 10% of the retail space in Hong Kong |
| | | SHK Properties | Owns many of the most prime suburban malls in Hong Kong and has many suburban malls under development in Northwest New Territories |
| | | Sino Land | Tuen Mun Town Plaza is a top retail property in Tuen Mun |
| | | Sunlight REIT | Its mall in Sheung Shui is well-positioned to benefit from shopping by Mainland China visitors |
| 4 | Transformation of some districts in Hong Kong | Hopewell | A major commercial landlord and residential developer in the Wanchai area |
| | | Hysan | The largest commercial landlord in Causeway Bay, which we think is transforming into an even more important commercial hub in Hong Kong and will expand in size, both "vertically" and "horizontally" |
| | | SHK Properties | Owns sizeable land in Northwest New Territories, which is poised to become a higher-end area |
| | | Soundwill | Over 80% of its assets are in the Causeway Bay area |
| | | Swire Properties | We see Hong Kong East and Southern Wanchai becoming even more important commercial hubs in Hong Kong |
| 5 | Increased recognition that Hong Kong family companies do have "quality asset managers" and "savvy private equity companies." | Cheung Kong-Hutchison | Well-demonstrated savvy in investing and building businesses |
| | | Hang Lung Properties | Still one of the most pure, solid China retail property plays |
| | | Hongkong Land | A strong record of managing property assets, with investments in many cities starting to gain critical mass |
| | | The Link REIT | REIT structure, strong credentials to achieve sustainable DPU growth strengthen its appeal to global funds and property specialists |
| | | Swire Properties | A newcomer to global property but has a strong record of managing property assets |
| | | Wharf | Well-demonstrated expertise in managing retail properties; China investments entering fruition phase |
| 6 | Restructuring; recovery and transformation of some companies | CSI Properties | A real estate opportunity fund evolving into a real estate operating company |
| | | Great Eagle | Sitting on Champion REIT and a hotel portfolio, with value to be unlocked |
| | | Lai Sun Development | The first family-run company to try rejuvenating itself through a model of "family ownership; but professional management" |
| | | New World | Efforts to refocus on property are bearing fruit and execution for its New World Centre redevelopment project is key |
| | | OOIL | A global player which has rationalised its cost and strategy in an industry which is poised for a recovery in rates |
| | | Regal REIT | A defensive vehicle by which to gain exposure to the Hong Kong hotel sector |
| | | Sino Land | A developer which has kept on improving and is now at the threshold of the next investing phase |
| | | Soundwill | An emerging niche property play, with strong exposure to Causeway Bay |
| | | Wheelock | An emerging major developer on top of majority ownership of Wharf |
| | | Wing Tai Properties | An emerging property play, with solid rental income and a niche player in high-end properties |

*Source: Daiwa*

■ **The 30 stocks potentially affected by these six investment themes**

| | | BBG code | Rating | Remark |
|---|---|---|---|---|
| | Finance | | | |
| 1 | BOC HK | 2388 HK | 1 | A major beneficiary if Hong Kong were to become an offshore centre for Renminbi |
| 2 | Guotai Junan | 1788 HK | NR | A niche PRC securities firm positioned to seize opportunities amid growth of the Hong Kong financial market |
| 3 | HK Exchange | 388 HK | 2 | Built to ride on Hong Kong's future potential as an international financial centre |
| | Property Developers | | | |
| 4 | Cheung Kong | 1 HK | 1 | A private equity company with a sound business model for residential property and many businesses reaching fruition |
| 5 | Henderson Land | 12 HK | 1 | Harvesting time is finally coming; a play on realisation of the value of agricultural land and old buildings |
| 6 | New World | 17 HK | NR | Refocusing on property |
| 7 | SHK Properties | 16 HK | 1 | A world-class property company with world-class property assets |
| 8 | Sino Land | 83 HK | 1 | Has continued improving and now at the threshold of a new investing phase |
| | Property Investors | | | |
| 9 | Great Eagle | 41 HK | NR | Majority stake in Champion REIT plus a hotel portfolio with value to be unlocked |
| 10 | Hang Lung Properties | 101 HK | 1 | The most focused and advanced in terms of developing retail properties in China |
| 11 | Hongkong Land | HKL SP | NR | An emerging regional property company |
| 12 | Hopewell | 54 HK | NR | An emerging Wanchai play |
| 13 | Hysan Development | 14 HK | 1 | Riding on the ongoing transformation of Causeway Bay |
| 14 | Kerry Properties | 683 HK | NR | Owns abundant prime property assets in Hong Kong and China |
| 15 | Lifestyle | 1212 HK | NR | Can also be seen as a premier retail landlord in Hong Kong and China |
| 16 | Swire Properties | 1972 HK | NR | A strong asset manager expanding in Hong Kong East and Southern Wanchai. |
| 17 | Wharf | 4 HK | 1 | A solid asset play with China investments entering into harvesting period |
| | REITs | | | |
| 18 | Fortune REIT | 778 HK | 1 | Riding on the growth of suburban malls |
| 19 | Link REIT | 823 HK | 2 | A premier international REIT in the making |
| 20 | Regal REIT | 1881 HK | 2 | A neglected company offering a defensive way to gain exposure to the Hong Kong hotel sector |
| 21 | Sunlight REIT | 435 HK | 1 | Riding on several major trends in Hong Kong commercial properties |
| | Transport | | | |
| 22 | MTRC | 66 HK | 2 | A global rail operator with growing exposure to China and a favourable rail-plus-property business model |
| 23 | OOIL | 316 HK | 1 | Riding on a cyclical upturn |
| | Conglomerates | | | |
| 24 | Hutchison Whampoa | 13 HK | NR | A veteran of investing and building businesses; a private equity firm with many evolving businesses |
| 25 | Wheelock | 20 HK | NR | An emerging medium-sized developer |
| | Niche property companies | | | |
| 26 | CSI Properties | 497 HK | NR | A real estate opportunity fund |
| 27 | Lai Sun Development | 488 HK | NR | The first family-run company to try rejuvenating itself through a model of "family ownership; but professional management" |
| 28 | Midland Holdings | 1200 HK | 1 | Near-term uncertainties versus long-term franchise value and cyclical upturn potential |
| 29 | Soundwill | 878 HK | 1 | Still a deep value stock |
| 30 | Wing Tai Properties | 369 HK | NR | A niche player |

*Source: Daiwa*

## Some long-term issues: can the value of Hong Kong property companies be unlocked?

There are three other issues that we believe will have significant implications for Hong Kong stocks over the medium term. One is whether or not the valuation gap between Hong Kong property stocks and that of their international peers can be narrowed. Another is whether or not some Hong Kong companies can expand their operating scale significantly on the back of the China factor.

This brings us to a third, related issue: whether or not investors globally recognise the importance of the theme we see playing out for Hong Kong companies. This is an important issue, but due to the breadth of the subject, we provide only brief thoughts in Appendices I and II of this report.

# 1. Transport

## 2015 and 2016 should be watershed years

While sometimes not well-recognised, we believe that transport infrastructure plays a very important role in the development of a city. It is no coincidence that, historically, almost all great cities in the world are also transport hubs. We note that since China adopted its Open Door Policy in 1978, the transport links between Hong Kong and the Mainland – air, sea, road or rail – have continued to develop. Currently, Hong Kong offers direct access to a population of more than 600m in China, making the city an important hub in the network of cities linking up the whole of country.

We believe transport links between Hong Kong and China will enter a new phase in a few years' time, as a number of major transport projects, such as the Express Rail Link, the Shatin-Central Link, and the Hong Kong-Zhuhai-Macau Bridge, will be completed.

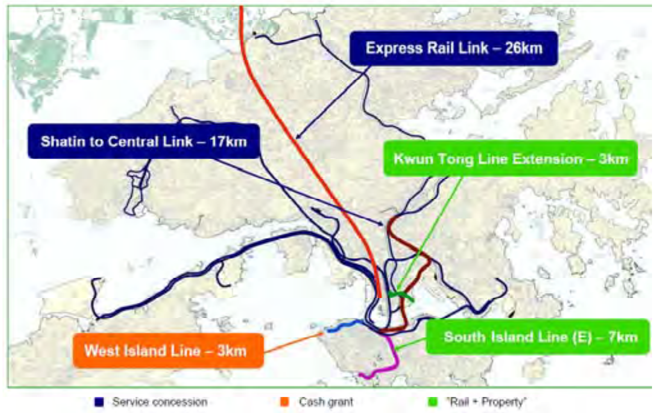
## Structural trends and factors

In terms of the city's rail network, three new lines (West Island Line, South Island Line, and Kwun Tong Line Extension) are due to be completed by 2015, which will strengthen what we see as an already comprehensive rail network, of some 231km in length in a city with an area of about 1,000 sq km. Total rail-line length in Hong Kong will rise further, to 248km, when the Shatin-Central Link is completed by 2020 (phase 1 is scheduled to start operation by about 2018), and this should mean that nearly all of the developed areas throughout Hong Kong are well-covered by rail.

■ Hong Kong: rail network


*Source: MTRC*

■ Hong Kong: new rail lines

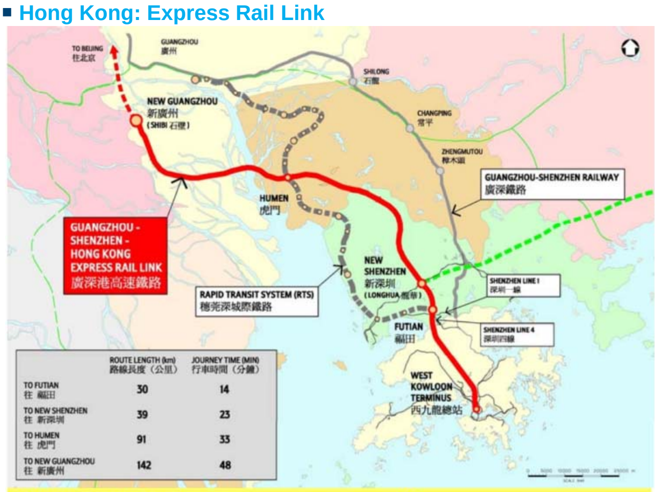



*Source: MTRC*

Meanwhile, 2015 should also be a watershed year for Hong Kong's external rail network, as the Express Rail Link – from West Kowloon to Shenzhen Futian (and taking 14 minutes) – is scheduled to start operation by 2015. This will link Hong Kong to China's high-speed train network, which has cost more than CNY1tn to build and covers much of the country.

When the Express Rail Link starts operation, the travel time to Guangzhou will be only 48 minutes (compared with about two hours currently). More importantly, it will boost Hong Kong's links with other major cities in China significantly. The train journey from Hong Kong to Shanghai should take about eight hours, while it should take about ten hours to Beijing (meaning that if a person were to board a train at night in the capital, they would arrive in Hong Kong the next morning). As the passenger-carrying capacity of rail is much greater than that of aircraft, the maximum number of people from China who can come to Hong Kong could rise significantly from 2015.

■ Hong Kong: Express Rail Link

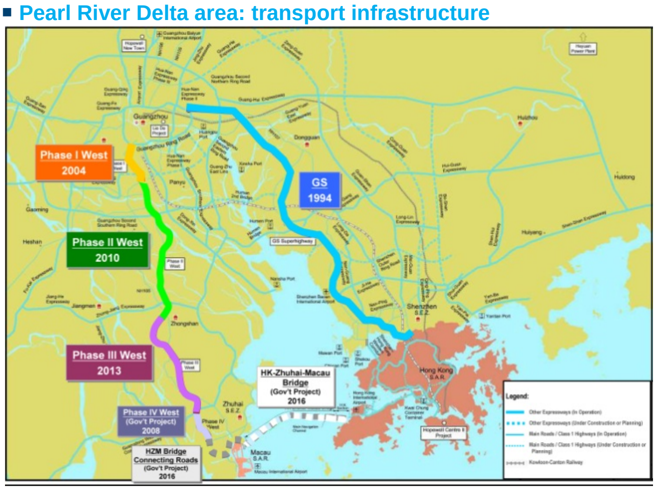



| | |
|---|---|
| Route Length (km) | 26 |
| No. of new station | 1 |

Source: MTRC

If 2015 is a landmark year for Hong Kong's rail sector, then 2016 should be a landmark year for the road infrastructure of the Pearl River Delta area. The Hong Kong-Zhuhai-Macau Bridge is scheduled to open by 2016, completing a road network that integrates Hong Kong and Macau with the entire Pearl River Delta area. By that time, it should be possible to make a round trip of the by car in just a few hours, increasing significantly connectivity between the cities there. We note that Guangdong Province has a population of more than 100m, or 15x that of Hong Kong.

■ Pearl River Delta area: transport infrastructure




Source: Hopewell

## Implications

- We believe that MTRC (66 HK, HKD30.90, Outperform [2]) offers significant exposure to this theme, as it is the only rail operator in Hong Kong, and also has the largest investment in the China rail sector among non-Mainland rail companies, with four lines in operation – in Beijing, Shenzhen, and Hangzhou – and at least one new line under construction. Meanwhile, it is either the owner or operator of the five new rail lines due to be completed in the coming years in Hong Kong, including the Express Rail Link that connects the city and the high-speed train network in China.
- We note that the MTRC has received cash grants as well as property development rights from the government to finance its investments in the new lines, and that its largest shopping mall, Elements, is the mall closest to the West Kowloon Terminal of the future Express Rail Link. While there are some in the market who see the company's rail operation as a liability, we believe it is a profitable and cash-generating business on its own. At the same time, it is a building block for many of MTRC's lucrative and attractive businesses, such as its Station Commercial operations and property businesses. It, too, is a well-regarded name in the global subway business, having won contracts to operate subways in cities such as London, Stockholm, and Melbourne. Changes in investor perceptions about MTRC's rail business could lead to a rerating of the stock.
- At a broader level, we think one implication of Hong Kong-Mainland integration is that some Hong Kong corporations could find their expertise has the opportunity to be applied to a much larger territory. We think there are a few companies in Hong Kong whose ability to manage their core businesses is world-class. The MTRC is one example of this, as we believe the standard of Hong Kong's subway service ranks high, even on a global basis. This should be especially important in the coming years, as we believe that many cities in China need a modernised and efficient subway system like that of Hong Kong or Singapore, and that subways could well be one focus of China's fixed-asset investment (FAI) in the next few years. The MTRC is so far the only foreign company to have invested directly in China's subway sector and it has investment projects in various major Chinese cities, such as Beijing, Shenzhen, Hangzhou. This China dimension vis-à-vis the MTRC has probably not yet been fully appreciated by the market, in our view.
- Hopewell Highway Infrastructure (HHI) (737 HK, HKD4.00, Hold [3]) fits into this theme, given that it has been a pioneer in terms of investing in the road infrastructure in the Pearl River Delta area. Even though it has not directly invested in the Hong Kong-Zhuhai-Macau bridge, its recently opened West Delta Route Phase III will connect to the Hong Kong-Zhuhai-Macau bridge, which would be a critical pathway for visitors from Hong Kong to the

Zhongshan area, or connecting Guangzhou and Zhuhai.

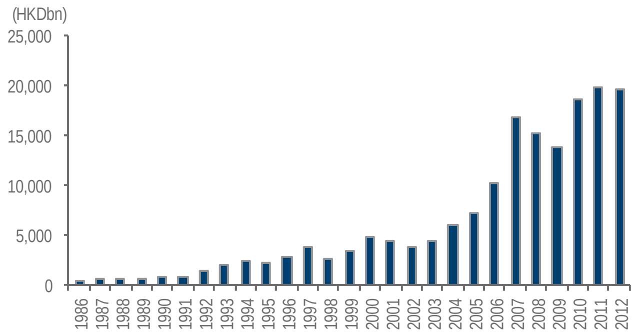
- For the same reason, Hopewell Highway Infrastructure's (HHI) parent company, Hopewell Holdings (Not rated), also fits into this theme, given that its 68.1% stake in HHI has a current market value of HKD8.3bn, which translates into HKD9.48 per share for Hopewell Holdings. In addition, Hopewell Holdings owns property and other power assets in the Pearl River Delta.
- Shun Tak Holdings (Not rated) also fits into this theme as it owns many major assets in Macau and the accessibility of this enclave will be significantly enhanced by the ongoing improvement in transport infrastructure in the area.

# 2. Exchange and securities

## The LME acquisition may see Hong Kong becoming China's international financial centre

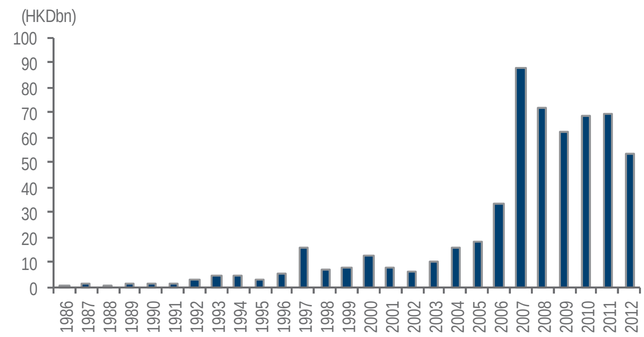
We believe that the stock exchange and securities industry in Hong Kong has been one of the major beneficiaries of the growth of the China economy. Over the past 20 years, China's corporate sector has used Hong Kong as its main centre for tapping international capital, resulting in phenomenal growth in the city's stock market, in terms of market capitalisation, ADT, the amount of capital raised, and the number of listed companies.

■ Hong Kong stock market: market capitalisation



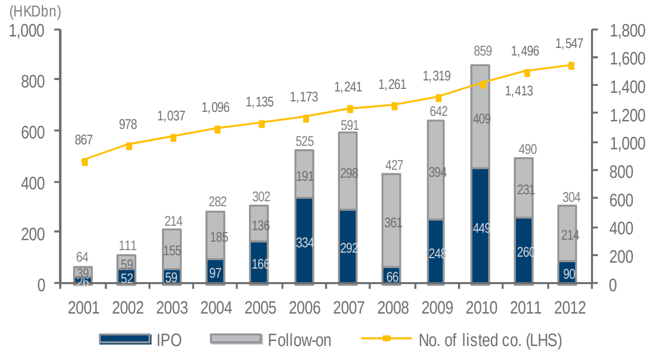

*Source: Bloomberg, Daiwa*

■ Hong Kong stock market: average daily turnover




*Source: Bloomberg, Daiwa*

■ Hong Kong stock market: capital raised and number of listed companies




*Source: HKEx*

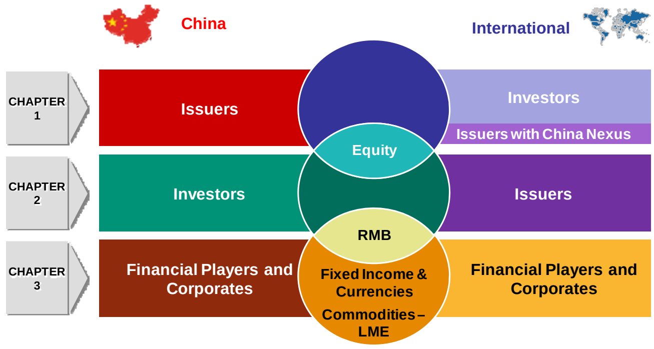
We expect this process to enter a new phase, with China determined to strengthen its presence in the global economy and develop Hong Kong as an offshore centre for the Renminbi.

The acquisition of the London Metal Exchange (LME) by Hong Kong Exchanges & Clearing (HKEx) (388 HK, HKD132.70, Outperform [2]) is a landmark deal for Hong Kong, and may symbolise that the city is moving beyond a capital-formation role for China. It could become the country's international financial centre, with the scope of business extending beyond equities to include fixed income, commodities, and currency products, all of which could be denominated in both Hong Kong Dollars and Renminbi.

## Structural trends and factors

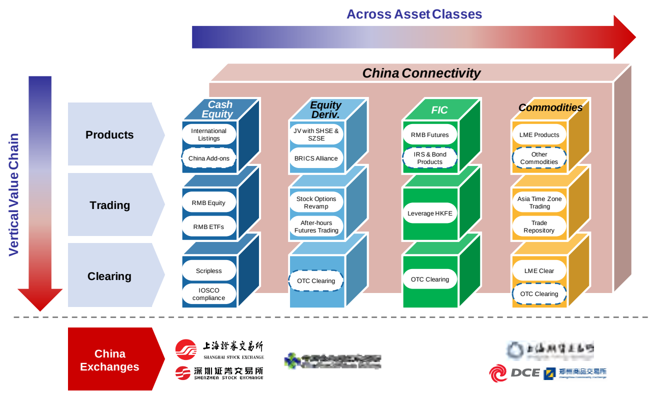
There has been an evolution in the strategy of HKEx in recent years. It has achieved huge increases in both earnings and market capitalisation by benefitting from Hong Kong's position as China's capital-formation centre. Recently, HKEx has sought to move beyond this and play a major role in the process of China becoming a capital-export country, integrating the exchange more into the global financial sector.

■ The three chapters of HK Exchange




Source: HKEx

■ The business strategy of HK Exchange

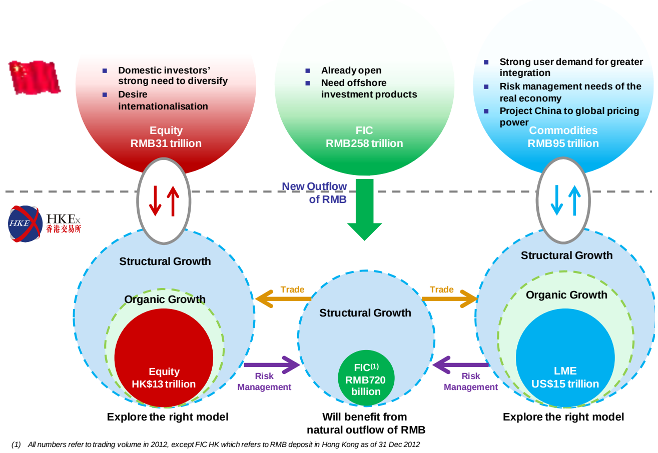



Source: HKEx

We believe progress is being made on internationalising the Renminbi, with a notable sharp rise in the pool of Renminbi in Hong Kong in recent years, and continued expansion in the number of Renminbi products. Moreover, we see HKEx's acquisition of the LME as a transformational deal that should expand the company's and Hong Kong's role beyond being a capital-formation centre for China's corporate sector.

It is now almost certain that Hong Kong will have a role to play in the commodities sector of China, and over time, it is not inconceivable that this could expand to fixed income and currencies. If this is the case, Hong Kong's depth and scope as a financial centre would still have considerable room to expand.

■ The scope of HK Exchange's 3 key businesses




Source: HKEx

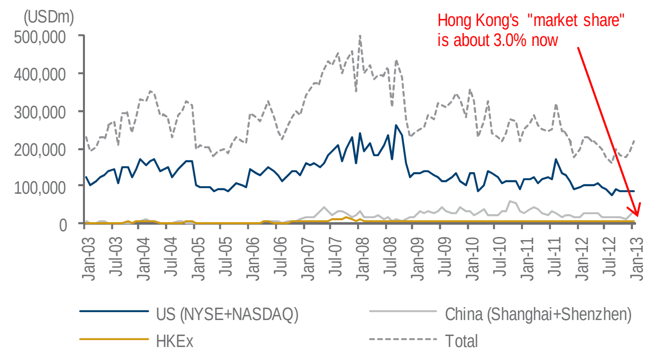
*Note: (1) Fixed income & currencies, (2) HKEx plans to selectively penetrate some of these 27 "business blocks" over time.*

**We see it as an ambitious strategy to ride on the trend of internationalization of CNY and CNY becoming a new source of investing capital in the global capital markets (M2 in China is over USD10tn and is the world's largest)*

# Implications

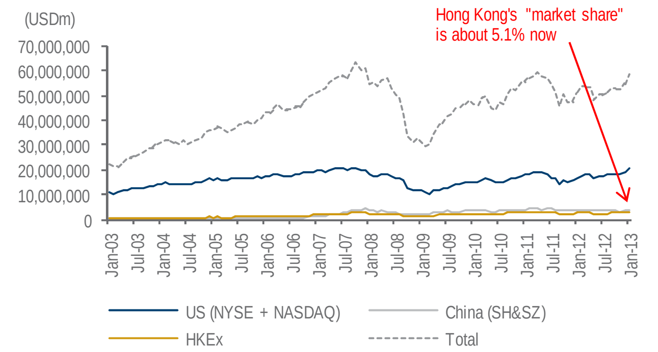
- We believe HKEx will benefit the most from this theme, given that it is arguably the company driving the development of the industry. We believe there is considerable scope for ADT to increase, given that Hong Kong's shares of global stock market capitalisation and ADT for stocks globally are still modest.

■ ADT in Hong Kong stock market vs. major exchanges




Source: WFE, CEIC, Daiwa

**■ Market capitalisation of Hong Kong stock market vs. major exchanges**




*Source: WFE, CEIC, Daiwa*

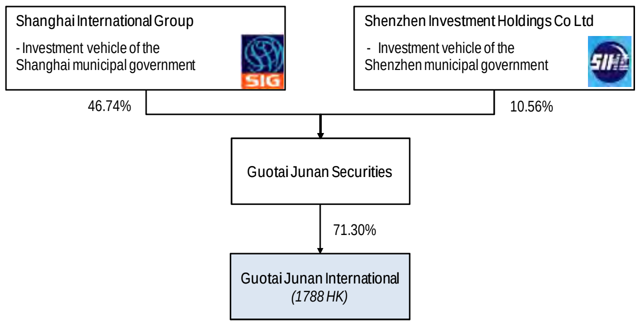
- Past experience suggests that once an upward or downward trend in ADT forms, it tends to last for years. In retrospect, ADT in Hong Kong has been contracting since 2008, probably reflecting risk aversion globally and the outflow of capital from equities into bonds and from emerging markets back to developed markets. We note that there have been signs recently that the multi-year contraction in ADT in Hong Kong could have ended; if so, it could constitute an "upside catalyst" that we advise investors to note.

- In addition, we continue to see option value in the LME, as we believe that its profit in the past has not been commensurate with its position as the dominant player in the industry. While it accounts for an 80% market share in the metal-trading business, its 2011 profit represented about 2% of that of HKEx for the same year, and HKEx has only about a 2-3% share of the turnover in stocks globally. Given that there is significant operating gearing in the exchange business, and that LME has yet to develop its business in the markets of China and other Asia countries, we believe there is significant upside in the earnings potential of the LME over time. Moreover, we believe the acquisition of the LME will be a catalyst for the China Government allowing more investment capital to flow to Hong Kong, which could provide a significant positive boost to ADT.

- Guotai JunAn International Holdings (Guotai Junan) (Not rated) is a company that also appears to be in an interesting position. It has had a presence in Hong Kong since the mid-1990s, and unlike most of its peers it has focused on developing its online-trading platform. The operating costs for this platform are more lean than the traditional account-executive based model, and the market share of online trading in Hong Kong has been expanding, accounting for about 25.8% of retail investor trading and 6.6% of overall cash-market turnover for 2011.

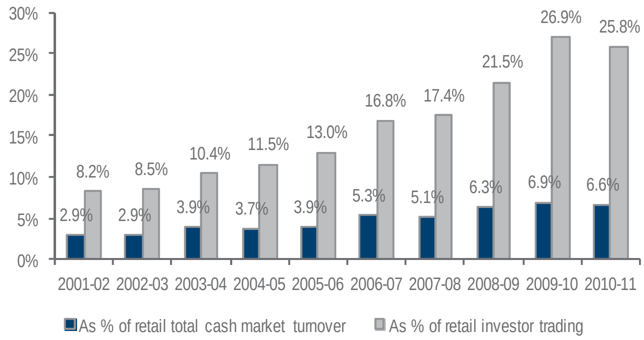
- Guotai Junan could be a beneficiary should China allow greater investment capital to flow into Hong Kong given its shareholder background and strong presence in online trading. The company might also benefit from a gradual closure of the Shenzhen B-share market, as some of the companies listed there may be interested in listing in Hong Kong, where Guotai Junan has been a pioneer in the business of helping B share companies to list in Hong Kong.

**■ Guotai Junan: corporate structure**




*Source: Guotai Junan, Daiwa*

**■ Online-trading as a % of retail-investor trading in the Hong Kong market**



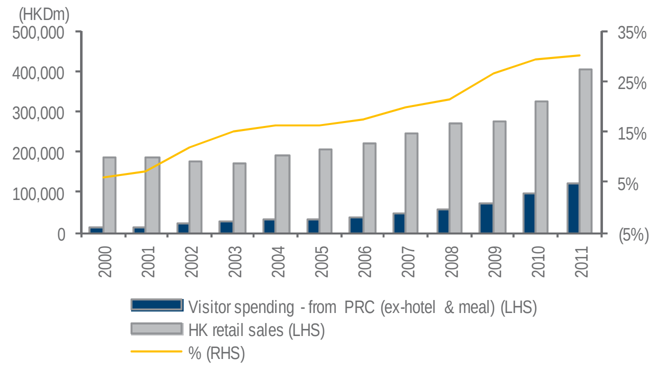

*Source: Guotai Junan*

# 3. Retail properties

## The existing stock of prime retail properties in the key retail districts is very small

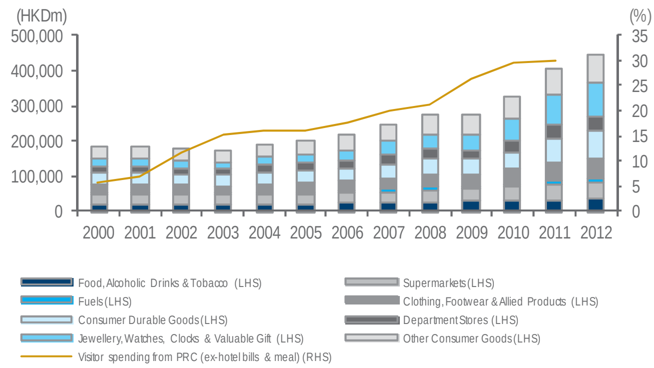
We believe that the Individual Visit Scheme (IVS) has transformed Hong Kong's retail property sector, as it has expanded the "catchment area" of retail properties from mainly just the city's population to potentially almost the entire population of China. In other words, it has expanded the retail property market in Hong Kong from one for a population of 7m into one of up to 1bn or more consumers.

■ **Hong Kong: retail-sales growth and contribution of Mainland visitors**




*Source: CEIC, Daiwa*

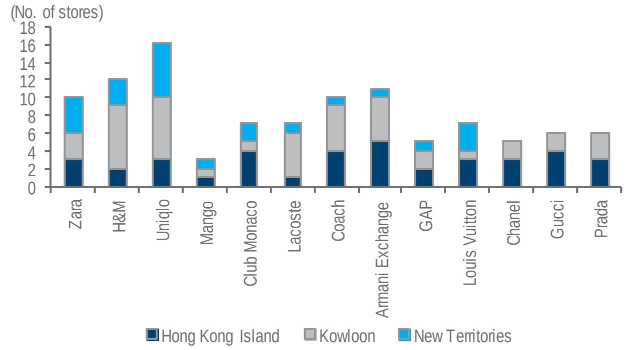
■ **Hong Kong: retail-sales growth**




*Source: CEIC, Daiwa*

This has also changed the importance of the Hong Kong retail market to international retailers, as the city has become the key first step to entering the China market. This has resulted in, among other things, many international retailers expanding significantly their presence in Hong Kong.

■ **Hong Kong: number of stores of international retailers**




*Source: Savills, Daiwa*

*Note: *Excluding stores in department stores, duty free stores, and the departure hall at the airport*

## Structural trends and factors

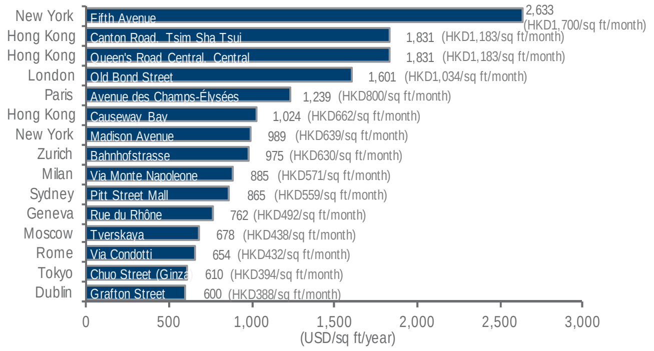
The established retail districts in Hong Kong should expand, both horizontally and vertically. In our opinion, relative to the scale of retail spending that could take place in Hong Kong, the existing stock of prime retail properties in the top retail districts is too small. As such, the sharp rise in retail spending in Hong Kong has boosted retail sales significantly in the prime shopping malls in the key retail districts over the past few years, and the ground-floor spaces of Hong Kong's key retail districts are already filled with major international brands, many of them flagship stores that occupy several storeys.

■ **Current occupiers of retail spaces in Canton Road, Tsimshatsui**


*Source: Jones Lang LaSalle*

It goes without saying that the strong demand from international retailers has pushed up the achieved rents in the prime retail spaces to among the highest in the world. In our opinion, market forces will cause this to lead to a positive spillover effect to credible alternative areas. As a result, we expect the previously non-prime areas of the key retail districts (Tsimshatsui, Causeway Bay, Mongkok, Central) to receive greater attention, and more upper floor spaces in these areas to be used for retail. Indeed, many second-tier streets in Causeway Bay, Tsimshatsui, and Central are undergoing a transformation, with rents starting to catch up with those for first-tier streets.

**■ Ranking of achieved rents for the world's major high streets (2012)**

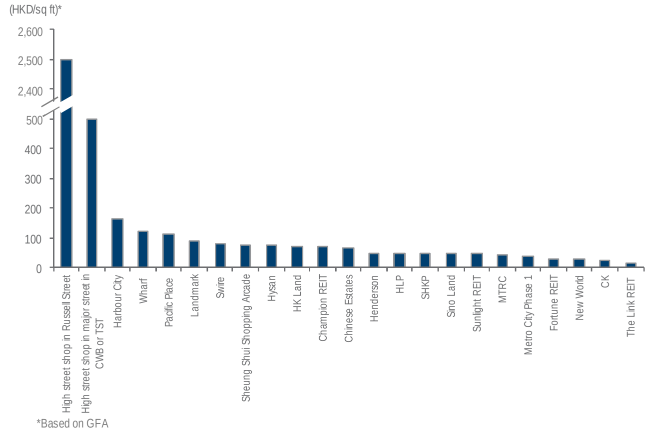



Source: Colliers, Daiwa

*The retail triangle in Causeway Bay is taking shape and south Causeway Bay is set to become a very prominent retail area.* In the past few years, the growth in retail spending in Causeway Bay has lagged behind that of Tsimshatsui, but we expect Causeway Bay to catch up in the coming years. Hysan Place mall opened in August 2012. We reiterate our view that the completion of Hysan Place is positive to the development of the whole area, as it has quite a few brands and trades that previously were not available in Causeway Bay, and so it should help to attract more consumers to the area. Moreover, many new developments are due to be completed in the area (such as the Times Square renovation, Mid-town, and The SHARP) over the coming 6-24 months, which should boost the variety of offerings in the area. We believe Causeway Bay could develop into an area like London's West End over time (see our initiation report on Hysan Development [Hysan], *Ready for take-off*). Moreover, we believe Hysan's latest plan to redevelop Sunning Court and Sunning Plaza will strengthen the attractiveness of the whole southern Causeway Bay area as well as the company's Causeway Bay portfolio (see *Lee Gardens Three in the making?*).

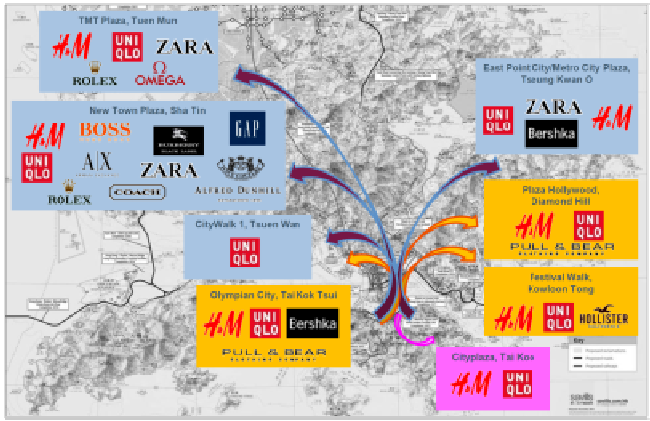
*Significant opportunities await suburban malls and managers that can upgrade the properties.* One result of the increasing number of international retailers coming to Hong Kong is that many previous occupiers of prime retail spaces have found they can no longer afford to stay in these retail spaces. As such, many of them are looking for alternatives, which should present significant opportunities to suburban malls. One feature of the Hong Kong retail property market is that the range of achieved retail rents is wide, and this should provide considerable opportunities for the suburban malls and managers that can upgrade their properties to attract tenants that have a high rent-paying ability. This trend should be reinforced by the fact that the location preference of new players in the retail market – Mainland consumers – could be very different from that of the Hong Kong locals.

**■ Hong Kong: achieved rents of the major retail properties**




Source: Companies, Daiwa

**■ International retailers have started coming to the New Territories**




Source: Savills

Moreover, while some international retailers have expanded into the New Territories initially to test the water, some of them have found that the productivity of some of the suburban malls (in terms of retail sales per sq ft) has been quite good and may not be that much lower than those of the premier urban retail spaces. Given that many international retailers now want larger floor spaces and are keen to scale up their presence in Hong Kong, we expect more of them to start considering building up their presence in the New Territories more seriously. This would be a long-term structural change that would favour the development of suburban malls in Hong Kong, in our view.

Note that retail properties require intensive management and consumer habits and perception change slowly. Hence, it could take 3-5 leasing cycles or more for some suburban retail districts to reach the limit of what they can achieve in terms of the tenants' profile. That said, we believe that sufficient progress and changes have been achieved in some suburban areas (such as Shatin, Tuen Mun, Tseung Kwan O), leading us to declare that a new chapter for suburban malls has already started. We also think this trend will be reinforced by new players in the Hong Kong retail market – Mainland consumers – preferring different locations to those of Hong Kong locals.

Given the wide rental gap between the achieved rents in the New Territories and the prime retail districts, we think retail property managers will be able to extract significant value from the malls in the New Territories in the next few years.

## Implications

- The Wharf (Holdings) (Wharf) (4 HK, HKD61.50, Buy [1]) offers significant exposure to Hong Kong's retail property sector given that its two major malls – Harbour City and Times Square – now rank among the city's top performers in terms of achieved retail sales. Moreover, the group is now working on replicating its retail property franchise in Hong Kong in various cities in China. The Chengdu IFS will be the first to open in 1Q14, and will be followed by four more IFS's, which will be completed in 2014-17.
- Lifestyle (Not rated) has continued to improve its retail sales despite the physical constraints it has faced (it is a "vertical mall" with a total GFA limited to 0.4m sq ft), attesting to the group's retail management expertise. Like Wharf, Lifestyle is also working on replicating its retail property franchise in China. Retail sales at its Shanghai Jiujiang store have risen significantly in terms of retail sales (an over three-fold increase from year one levels to over HKD2bn within five years), and its Suzhou store has passed the start-up phase. The company's Shenyang mall is due to open in 2014, and another Shanghai mall is now under construction. If all these projects are completed, the group's retail property GFA would rise to more than 7m sq ft.
- Hysan (14 HK, HKD37.3, Buy [1]). We see Hysan as a company that is sitting on a commercial-property portfolio that has strong earnings potential. In our view, the company appears poised to start extracting greater commercial value from its portfolio. We regard the completion of Hysan Place as just the start, which has been confirmed by its recent announcement to redevelop Sunning Court and Sunning Plaza (we estimate that this will add HKD2.02/share to its NAV).

  Most importantly, we see it as a positive sign that in the company's latest results announcement it articulated a strategy for its retail property, with the aim of having "a multifaceted, yet integrated shopping environment that combines significant street frontage with shopping malls of different characteristics, complemented by a vibrant landscape". We see this as a strategy that should help to maximise the value of Hysan's retail portfolio and address some of the issues it is facing (see *Hysan Development: Initiation: ready for take-off*).
- Soundwill Holdings (Soundwill) (878 HK, HKD19.88, Buy [1]). We think the company is a quality niche player that has seized upon the opportunities offered by the transformation of Causeway Bay as a commercial district and the recent improvement in sentiment in the strata-title market in Hong Kong for commercial properties. The company's recent sale of the upper floor spaces in The SHARP, in Sharp Street, Causeway Bay, resulted in a significant profit and led to an NAV enhancement (HKD700m in profit and HKD7.30/share in terms of a higher NAV, based on our estimates). The transaction should enhance development profit for FY15. Meanwhile, the preleasing of the Soundwill Plaza II-Midtown project is making progress and our forecast for its end-2013 NAV is HKD71.20. *Building property and investment value*.
- The Link REIT (823 HK, HKD42.50, Outperform [2]). Owning almost 10% of Hong Kong's retail space, The Link REIT should be well-positioned to capture opportunities linked to the city's suburban malls. While there are some concerns in the market that rental growth in its malls will peak after it has completed the asset-enhancement initiatives (AEI) for most of its top-50 malls, we do not think this will be the case. We believe the completion of an AEI is the beginning of another stage of the life of a retail property asset, rather than an end. In our view, the number of malls for which The Link REIT has finished AEIs is reaching critical mass and its efforts to revitalise its retail property portfolio are gaining momentum. This should underpin its DPU growth in the next few years, in our view.
- Fortune REIT (878 HK, HKD6.87, Buy [1]). We believe Fortune REIT offers significant exposure to Hong Kong's suburban malls given that we think Fortune City One, a suburban mall in Shatin, has considerable potential for an upgrade, and that the REIT is still at the beginning stage of extracting the full commercial potential of this mall. Moreover, we

think it has several malls, such as those in Tseung Kwan O, Shatin, Tuen Mun, and Sheung Shui, that are benefitting from attracting tenants with a high rent-paying ability from the nearby major suburban malls.

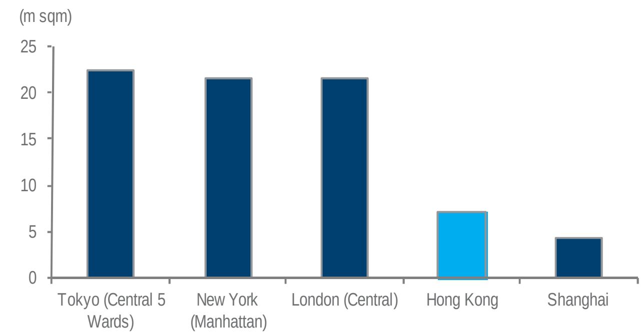
- Sunlight REIT (435 HK, HKD3.40, Buy [1]) has also been a beneficiary of the development of Hong Kong's retail property sector in recent years. An increase in Mainland retail spending has turned its Sheung Shui mall into a niche mall that appeals to Mainland consumers, from previously being a fringe mall. The REIT is also embarking on major AEI for its mall in Tseung Kwan O, which would help underpin its DPU growth in the next few years.

# 4. Office properties

## The Hong Kong office market is evolving into a five-tier structure

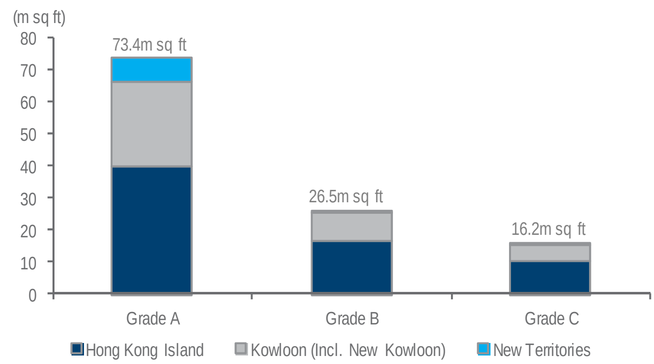
An important point to note about the Hong Kong office market is that there have not been any major new completions in the core areas in recent years. While Hong Kong grade-A office stock is not small in size relative to other cities in Asia, when compared with the world's major financial hubs, the scale of the territory's office sector is still moderate. Indeed, the current size of the grade-A office stock in Hong Kong should be still smaller than that in San Francisco.

■ Grade-A office stock in Hong Kong versus other major cities



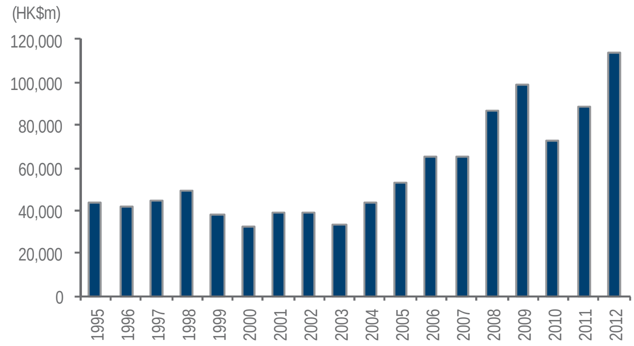

*Source: DTZ*

■ Structure of the Hong Kong's office-property stock




*Source: DTZ*

■ Corporate profit tax paid




*Source: HKSAR Government, Daiwa*

■ Number of overseas companies establishing offices in Hong Kong

| | Regional HQ (no. of cos.) | Regional offices (no. of cos.) | Local offices (no. of cos.) | Total (no. of cos.) |
|---|---|---|---|---|
| 2001 | 944 | 2,293 | 1,230 | 4,467 |
| 2002 | 948 | 2,171 | 1,748 | 4,867 |
| 2003 | 966 | 2,241 | 2,207 | 5,414 |
| 2004 | 1,098 | 2,511 | 2,334 | 5,943 |
| 2005 | 1,167 | 2,631 | 2,474 | 6,272 |
| 2006 | 1,228 | 2,617 | 2,509 | 6,354 |
| 2007 | 1,246 | 2,644 | 2,550 | 6,440 |
| 2008 | 1,298 | 2,584 | 2,730 | 6,612 |
| 2009 | 1,252 | 2,328 | 2,817 | 6,397 |
| 2010 | 1,285 | 2,353 | 2,923 | 6,561 |
| 2011 | 1,340 | 2,412 | 3,196 | 6,948 |
| 2012 | 1,367 | 2,516 | 3,367 | 7,250 |

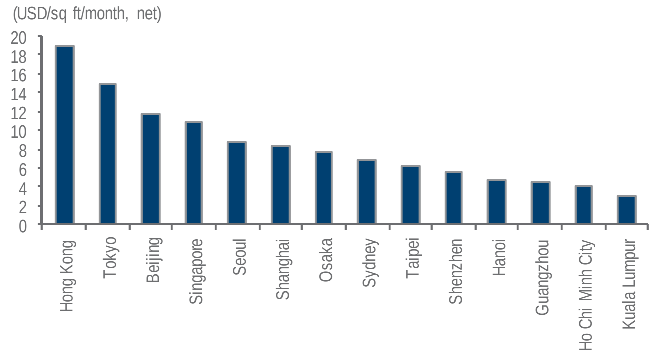
*Source: HKSAR Government, Daiwa*

## Structural trends and factors

While it is well-known that grade-A office rents in Hong Kong have become the world's highest, investors should not lose sight of the fact that office rents of around USD18/sq ft exist only within a handful of AAA grade-A office buildings in Central. We think there is considerable depth in the grade-A office sector in Hong Kong in that there are many different types of buildings with varying level of rents for office occupiers. Indeed, we think the range in Hong Kong is among the widest in the world.

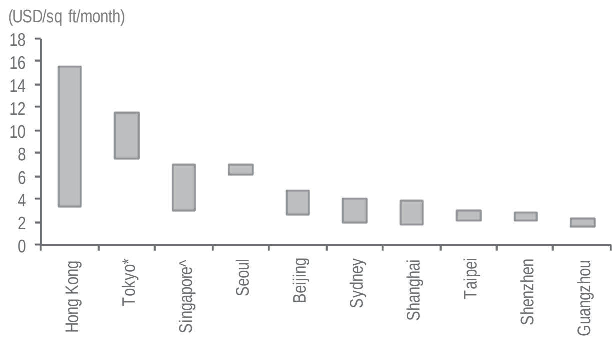
In other words, while rents for some office buildings in Central are among the world's highest, office occupiers do not lack choice. Indeed, outside the CBD area, grade-A office rents in Hong Kong do not appear to be more expensive than those in Singapore.

■ **Ranking of grade-A office rents (for top-5 buildings) in the world's major cities**



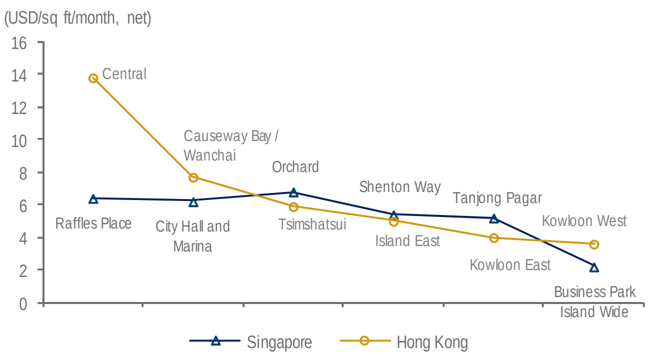

*Source: Savills*

■ **Range of regional grade-A office rents, by Savills**



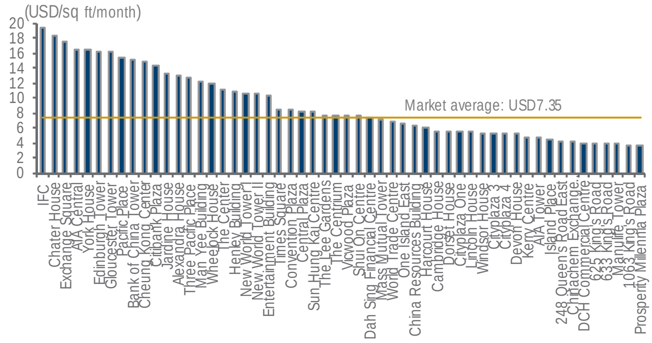

*Source: Savills*
*Note: * Tokyo comprises five wards; ^Singapore comprises the CBD*

■ **Grade-A office rents in various districts in Hong Kong and Singapore**




*Source: Savills*

■ **Grade-A office rents on Hong Kong Island**




*Source: Savills*

Further features of Hong Kong's grade-A office sector, in our view, are that there are sophisticated long-term players in the industry and that market forces are at work to address some of the issues.

## The beginning of an end to the correction of the anomaly in 2005-11?

In the broadest sense, we view the Hong Kong office sector as one where the supply of land has been relatively restrained, and as a sector continuing to evolve to accommodate the growth in underlying demand. In retrospect, aggressive expansion by investment banks since 2005 has resulted in an unusually wide gap between rents in Central and other areas. The market has then responded to this by 'creating' alternative office locations for major international corporations, with the ICC having successfully positioned itself as an alternative grade-A office location for investment banks and financial institutions, while Kowloon East has emerged as an alternative office address for MNCs, especially those in the insurance sector.

In our opinion, the ICC attracting three major investment banks to relocate there could be seen as a watershed event in the Hong Kong grade-A office market, in that this has broken the 'psychological barrier' for some MNCs in relation to relocating to Kowloon. This trend was further reinforced by the completion of several high-quality grade-A office buildings in Kowloon East in the late 2000s. What has happened since then, in our view, may be characterised as kind of redistribution of vacant space in many buildings across various districts in Hong Kong. And the result is that nearly all non-Central districts have come out as winners (in terms of rental resilience and net absorption), while Central has suffered.

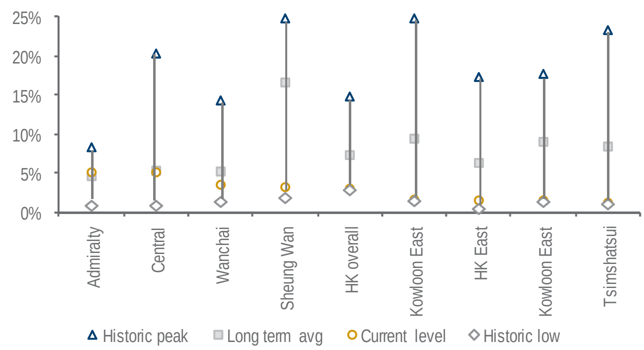
The result of this exodus to Kowloon has been dramatic. According to CBRE, while the area of Kowloon East accounted for the largest portion of vacant grade-A office area in Hong Kong in November in 2011, the situation had almost reversed a year later, with the premier buildings in Kowloon East all having vacancy rates of below 3%, and the achieved rents having now risen to mid-30s territory. By way of contrast, Central has become the location accounting for the largest amount of vacant space in the sector.

In our view, what has happened in the Hong Kong office market over the past few years – and the weakness in the Central grade-A office market during this period – represents merely a correction of the anomaly in 2005-11, when the rental gap between Central and other areas widened to unprecedented high levels.

We see this is as a natural and healthy development in the market and as essentially more a cyclical rather than structural problem. Moreover, we think the 'beginning of an end' to the correction of this anomaly may have already started.

We believe that several points are worth noting. First, vacancy rates in many districts outside Central are at record lows. We reckon that asking rents in the most-prime grade-A office buildings in Kowloon East, such as Landmark East, have continued to edge up, and there is no longer much of a difference between rents in Kowloon East and those for the second-tier buildings in core areas such as Tsimshatsui.

■ **Vacancy rates in various districts in Hong Kong**




*Source: CBRE*

Meanwhile, rents in Central have fallen by more than 20% since mid-2011 and quite a few buildings are already offering rents below HKD80/sq ft. As such, if rents in non-Central areas continue to go up, the rents for some buildings in Causeway Bay or Wanchai may begin to exceed the lower tier buildings in Central.

More importantly, we think BoA Merrill Lynch's decision to move to Cheung Kong Center is not bad for the sector, as Citibank Plaza should have over 15 months to lease out the vacated space (see *our flash on Champion REIT, BoA lease: not bad for sector*).

Moreover, after BoA's joining, the Cheung Kong Center should be largely filled, leaving Citibank Plaza as the main building with sizeable vacant space. We hence expect this deal to mark the end of fierce competition among some landlords in Central.

In addition, the Hong Kong stock market turnover has picked up and we expect this to stimulate IPO activity this year, which should eventually result in a positive spill-over for office demand in Central. However, we are of the view that in the years ahead, office spaces in Central are more likely to be filled up gradually by companies that may need only a few thousand sq ft of space rather than by those which need many floors.

### A five-tier structure is forming

In our opinion, the redistribution of office space from Central to non-Central areas is coming to an end, and we think Hong Kong's grade-A office market is now entering a new chapter. We believe that the following four structural trends are ongoing and that they will result in the Hong Kong office market evolving into one that has five tiers (for further details, see *Opportunities beyond the near-term uncertainties*).

1. Admiralty and southern Wanchai are merging into Central,
2. Island East is establishing itself as an alternative office location for multinationals,
3. West Kowloon is emerging as an extension of Central, and
4. Causeway Bay and Tsimshatsui are becoming more important as office hubs.

■ **Hong Kong office market: five potential tiers – by size**

| | | Current size (m sq ft)* | Size by 2019E (m sq ft)* | Size by 2029E (m sq ft)* |
|---|---|---|---|---|
| 1 | Greater Central | 23.3 | 24.2 | 28.6 |
| 2 | The four established core office areas | 23.5 | 24.8 | 27.2 |
| 3 | Kowloon East | 9.3 | 13.5 | 25.5 |
| 4 | The five satellite office areas | 7.8 | 8.9 | 9.4 |
| 5 | Rest of the market | 1.0 | 1.7 | 1.7 |
| | | 65.0 | 73.1 | 92.4 |
| | Central | 13.6 | 14.4 | 15.8 |
| | Admiralty & Pacific Place's Wanchai extension | 4.7 | 4.8 | 4.8 |
| | Sheung Wan | 3.2 | 3.2 | 3.2 |
| | West Kowloon | 1.9 | 1.9 | 4.9 |
| | | 23.3 | 24.2 | 28.6 |
| | Wanchai | 6.3 | 6.5 | 7.8 |
| | Causeway Bay | 3.4 | 3.5 | 3.5 |
| | Tsimshatsui | 6.0 | 6.3 | 6.3 |
| | Island East | 7.7 | 8.4 | 9.5 |
| | | 23.5 | 24.8 | 27.2 |
| | Kowloon East | 9.3 | 13.5 | 25.5 |
| | Kwai Chung & Tsuen Wan | 1.5 | 1.9 | 2.2 |
| | Tsimshatsui East | 3.5 | 3.5 | 3.5 |
| | Cheung Sha Wan | 0.6 | 0.9 | 0.9 |
| | Mongkok | 1.2 | 1.2 | 1.2 |
| | Hunghom | 1.0 | 1.4 | 1.6 |
| | | 7.8 | 8.9 | 9.4 |
| | Other areas | 1.0 | 1.7 | 1.7 |
| | Total | 65.0 | 73.1 | 92.4 |

*Source: Daiwa*

*Note: Greater Central: Central, Admiralty, Pacific Place's Wanchai extension, West Kowloon, Sheung Wan*

*Four established core office areas: Wanchai, Causeway Bay, Tsimshatsui, Island East*

*Kowloon East: Kowloon Bay, Kwun Tong and Kai Tak redevelopment*

*Five satellite office areas: Mongkok, Hunghom, Tsimshatsui East, Kwai Chung & Tsuen Wan; Cheung Sha Wan*

*Rest of the market: Wong Chuk Hang, Tuen Mun, Shatin, Sheung Shui, etc*

**Net floor area*

■ **Hong Kong office market: five potential tiers – by relative positioning**

| Major office markets | Areas | Remarks |
|---|---|---|
| Greater Central: | Central, Admiralty, Pacific Place's Wanchai extension, West Kowloon, Sheung Wan | Central is the core, but will expand and integrate into neighbourhood areas that offer different and complementary office options |
| Four established core office areas: | Wanchai, Causeway Bay, Tsimshatsui, Island East | Offering alternatives to corporations that may not be finance-centric; Causeway Bay and Tsimshatsui could offer special appeal to retail and fashion-related corporations |
| Kowloon East: | Kowloon Bay, Kwun Tong and Kai Tak redevelopment | Offering alternative office options to corporations in addition to the four established core office areas |
| | | Could meet the owner-occupation demand from premier corporations |
| Five satellite office areas: | Mongkok, Hunghom, Tsimshatsui East, Kwai Chung & Tsuen Wan; Cheung Sha Wan | Offering additional and likely cheaper alternatives to corporations |
| | | Could fit those companies moving out of the above locations |
| | | Could satisfy some of the ownership demand for offices |
| Rest of the market: | Wong Chuk Hang, Tuen Mun, Shatin, Sheung Shui etc. | Do not have sufficient critical mass in their own right, but could satisfy the niche demand of some specific industries |

*Source: Daiwa*

■ **The Kowloon East development area**


*Source: CBRE*

■ **The West Kowloon Development Area**


*Source: CBRE*

## Implications

- Swire Properties (Not rated): offers significant exposure to the Hong Kong office property sector given that it is one of the two largest grade-A office landlords in Hong Kong. Moreover, it is also one of the few that could expand its office portfolio in the coming years, with the continued addition to its Pacific Place portfolio through the completion of new properties in the south Wanchai area. It is also redeveloping its "techno-centres" in Island East into grade-A offices, due to be completed by about the end of this decade.

- From the perspective of the longer-term evolution of the Hong Kong office sector, we believe that Island East will see good opportunities as we believe that if the area continues to be upgraded, it could become the largest grade-A office portfolio in Hong Kong Island outside Central. We believe it could take 10-15 years for Kowloon East to really mature, which means the current rising rents in Kowloon East should strengthen the appeal of Swire's Island East portfolio.

- Hongkong Land (Not rated). Hongkong Land appears to have adopted a relatively defensive strategy: it does not appear to want to attract the investment banks, which tend to occupy large spaces and pay the highest rent; instead, it seems to focus more on other financial-service companies that tend to be more stable in terms of their office-space demand. We think this strategy served it well during the recent difficult period in the Central office market. Meanwhile, we believe that Central has become more important as a retail location. This, together with its growing investment in China, should bode well for the group.

- SHK Properties (16 HK, HKD106.30, Buy [1]): also offers significant exposure to the Hong Kong office sector, as it owns one of the most important portfolios in Central and Kowloon East. In addition, it also owns and develops offices in non-core areas, such as Cheung Sha Wan, Kwai Chung, Tsuen Wan, which should enable it to benefit from the pick-up in strata-title sales of office properties in recent years.
- Wharf (4 HK, HKD60.45, Buy [1]) is currently one of the largest owners of grade-A offices in Tsimshatsui and Causeway Bay. We believe that the rents in these two areas are still competitive relative to those in Central, and that the company should be one of the main beneficiaries of the office-decentralisation trend, especially if it can continue to improve the quality of its office properties in Tsimshatsui and Causeway Bay.
- Hysan (14 HK, HKD37.30, Buy [1]) is currently the largest owner of grade-A offices in Causeway Bay. We see Southern Causeway Bay as potentially a niche area for high-quality grade-A offices and there is likely to be considerable room for achieved rents in its portfolio to improve over time.
- Wing Tai (Not rated). While Wing Tai's focus is more on developing high-end residential properties for sale, it does offer significant exposure to the grade-A office sector; we see Landmark East as a top-quality building in the Kowloon East sub-market. We estimate the market value of this building alone to be over HKD10bn.

## ■ The positioning of various office landlords over the next few years

Major companies with exposure to the office sector and the main opportunities they face in the coming years

| | Main office sector exposure | Main opportunities in the office sector |
|---|---|---|
| SHK Properties | Has worked on building up its office portfolio in Hong Kong since the late 1980s and is now the largest office landlord in Hong Kong in terms of portfolio size. Its most important office properties are IFC, ICC and its Kowloon East portfolio. Has natural interest in office-investment opportunities in West Kowloon and the sales proceeds it can raise from the sale of residential and non-core offices could help fund its investment in office-related opportunities in Kowloon East. | Owns some of the most prime office properties in Hong Kong and Shanghai. Well-demonstrated credentials in executing large-scale integrated commercial property developments in both Hong Kong and China. Also has many projects in Kowloon East, which could be used for both sale or long-term investment. |
| Swire Properties | Has worked on building its Admiralty and Island East portfolio since the mid-1980s and is now one of the two largest office landlords in Hong Kong in terms of portfolio size. Its Island East portfolio is the single largest decentralised office portfolio in Hong Kong, and it should have a natural interest in office investment opportunities in the Kowloon East area. | Dominant position in Island East, which has the potential to further improve its position in the Hong Kong office sector. |
| Wharf | Owns two main office property assets, namely, Harbour City and Times Square, both of which are benefiting from increased demand for premier offices outside Central and office demand from retail and fashion brands. Also has residential and other properties in the Kowloon East area, where sales proceeds could help fund its potential investment relating to the office sector in Kowloon East or West Kowloon, which could benefit its Canton Road portfolio. | We think prime office properties in both Causeway Bay and Tsimshatsui have the potential for further upgrades and the strong retail markets in both retail districts is an additional favourable point for office properties in these two areas. |
| HK Land | Still has a strong position in the core Central grade-A office market. Its portfolio has many long-time tenants and is not that exposed to the investment banking industry. Has also been replicating its expertise in office markets in Singapore and other cities in the region. | Strong position in the Central market and has been using the cash flow from rental in Hong Kong to invest in commercial property projects across various cities in the region. |
| Henderson Land | Office property is not its main focus but does own quality office buildings in Central (IFC) and Kowloon East (Manulife Financial Plaza). Could take on opportunities in the office sector when the opportunity arises. | Owns some prime office properties in Hong Kong and China. Some non-core office properties are upgradable and it could monetise their value when the opportunity arises. |
| Hutchison | Tends to focus on industries in which it can have a dominant market position and may not see office investment opportunities as the top priority. That said, both it and Cheung Kong have strong recurrent cash flows and may take on office investment if the land cost is attractive enough. | Has a meaningful presence in the Central office market and its position could be further enhanced by a potential redevelopment of Hutchison House. The government car park next to the Hutchison House could also be offered for sale in the coming years. |
| Sino Land | Tends to focus more on the residential-property development business. That said, it has worked on growing its recurrent income base in recent years and it has also monetised the value of its property asset in Kowloon East through the sale of 18 East Kowloon to China Construction Bank in 2012. | Has a sizeable presence in the Kowloon East area and would likely work on the conversion of industrial buildings into office use or take on office investment opportunities in East Kowloon – it acquired the Exchange Tower site in a land auction in the mid-2000s. |
| Hysan | Main focus is likely to fall on extracting greater value from its Causeway Bay portfolio and appears unlikely to be keen about venturing into investments in new areas. | Hysan and Wharf own most of the grade-A offices in southern Causeway Bay, which we think has the credentials to move up further in the Hong Kong office sector – this should be helped by the completion of Hysan Place. |
| Hang Lung Properties | Main focus is China and appears unlikely to be keen on capital-intensive office investment projects in Hong Kong unless the land cost is very low. | Could monetise the value of its office properties to raise funds to finance its China investments. |
| Wing Tai Properties | Given its modest capital base, it is unlikely to be keen on pursuing major office investment opportunities in the office sector. That said, its Landmark East is currently one of the most prime office building in the Kowloon East area. | Should have considerable room for positive rental reversion as it goes on to renew Landmark East's low-rent leases contracted in the previous market trough. |
| Champion REIT | Owns mainly the Citibank Plaza in Central plus the Langham Place, which is a niche office property in Mongkok. | Vulnerable to downsizing in the investment banking industry in the near term, but Citibank Plaza should remain a major office property in Central for many years to come. |
| Lai Sun Development | Owns two grade-A offices in Central, namely AIA Centre and China Construction Bank Building, and some offices in the Cheung Sha Wan area. | Fringe office markets such as Cheung Sha Wan or Kwai Chung/Tsuen Wan could benefit from positive over-flow of office demand and investment interest if other office locations begin to focus more on multinational tenants. |
| Cheung Kong | Focuses more on the residential property development business but does own The Centre in Sheung Wan, which is one of the most important buildings in this sub-market. | Could take on investment opportunities in the office sector if the land cost is low enough. Meanwhile, The Centre is one of the few buildings in Hong Kong that has the potential to be sold on an en-bloc basis. |
| Prosperity REIT | Its Metropolis and Prosperity Millennia Plaza are niche office properties for multinationals and its other industrial buildings have the potential to be upgraded into higher grade properties. | One opportunity in the current office cycle is for lower-grade properties to be upgraded into higher-grade ones through AEI and tenant repositioning. |
| Chinese Estates | Owns some sizeable office buildings in Wanchai and Causeway Bay. | We expect Wanchai and Causeway Bay to remain markets that could benefit from multinationals seeking alternative office locations to Central. |
| Hopewell | Owns offices in Southern Wanchai and has a sizeable property in Kowloon East, which is currently used as an office and retail property. | The southern part of Wanchai is undergoing changes and a major part of Queen's Road East is likely to be transformed into an extension of Pacific Place. |
| Sunlight REIT | Queen's Road 248 is the single largest property asset in its portfolio and on top of this, it also owns some offices in fringe Central. | Queen's Road 248 should benefit from an ongoing transformation of southern Wanchai into a higher-end area and we do see the room for fringe Central/ Sheung Wan to evolve into an office area for smaller financial investment firms and financial institutions. |
| Kerry Properties | Owns office property in Kowloon Bay and the largest shopping mall in the area. Its office portfolio size is moderate in Hong Kong but it has a sizeable office and commercial property portfolio in various major cities in China. | Will have a natural interest in office investment opportunities in Kowloon East. |
| New World | Owns some office properties in Central and has New World Centre in Tsimshatsui now under redevelopment. | New World Centre is a sizeable waterfront property in the Tsimshatsui area. How well it executes this redevelopment project will be important to its future prospects. |
| MTRC | Owns some floors of Two IFC and its self-used headquarters are also located in Kowloon Bay. | Could be involved in the building of the Light Rail System in Kowloon Bay, which may result in it having property development rights for projects in the area. |
| Tai Cheung | A pioneer in developing niche office properties in non-core areas such as Tuen Mun, Wong Chuk Hang, Hunghom. | Has a net cash position and could take on again office investment opportunities in the non-core areas. |
| Wheelock | An upcoming property company. While its main focus is likely to be residential development, it does have a sizeable project in Hunghom and Kowloon East, and it also has a past record of successfully marketing an office project in the Wong Chuk Hang area (One Island South). | Has a natural interest in office investment opportunities in Kowloon East and West Kowloon given Wharf's presence in both areas and that Wheelock has residential and other projects nearby. |
| Great Eagle | Apart from its stake in the Champion REIT, it currently owns mainly office spaces in Great Eagle Centre, and its hotels. | Has a past record of acquiring the Citibank Plaza site during the uncertain time in 1989 and it could take on office investment when the opportunity arises. |

*Source: Daiwa*

## 5. Residential properties

### The residential property market is on its way to becoming a multi-tier market

In its most recent property-market measures, implemented in late February, the government doubled the stamp duty on property transactions (except for first-time home-buyers and those selling their existing properties within six months of purchasing a new one). These measures, together with moves by local banks to raise mortgage rates, suggest that the residential property market is entering a period of consolidation — one that is arguably overdue, with residential property prices up by almost 30% since the beginning of 2012 to the recent peak in February 2013.

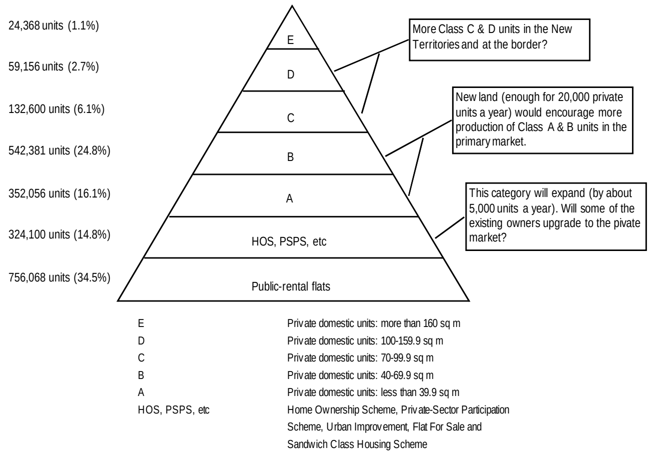
Over the coming one to two months, we expect to see some transactions where home owners reduce prices in order to sell units. But, we do not expect a major correction, since we do not believe there are large numbers of flat owners who are keen to sell. Given that many flat owners are currently paying mortgage rates of 1% of less, and that mortgage rates for new units are over 2%, we believe that many flat owners would be reluctant to sell, especially with the stamp duty having doubled.

Overall, we expect a 5-10% correction in overall prices over the coming months as these keen sellers clear their units. Once these units have been taken up, however, we do not expect to see much selling in the market. At this stage, we do not expect to change our full-year forecast for a 5% correction in prices.

On the whole, we see the government's non-market approach to managing the residential property market as a concern. But at this stage, this is not a big enough factor to alter the structural trends at play within the sector.

In the broadest sense, we see Hong Kong's residential property sector as one where the supply of land has not been able to match the growth in wealth and income. For while Hong Kong ranks quite highly globally in terms of wealth and income, homes are small by international standards, with half of households living in units with a useable area of less than 50 sq m – units of more than 100 sq m account for just less than 10% of Hong Kong's entire 1.1m private residential property stock.

■ Structure of Hong Kong's residential property stock



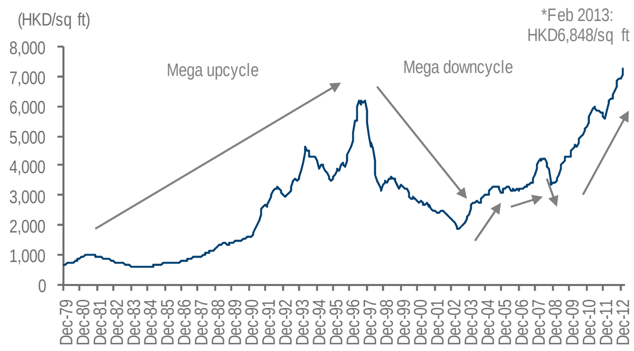

*Source: CEIC, Daiwa*

Superimposed on the above, in our view, are three major events.

One was the 10-year negative real interest rate in Hong Kong from the late 1980s to 1997. The sharp rise in residential property prices during that period widened significantly the wealth gap between those who had bought property early and those who did not own property.

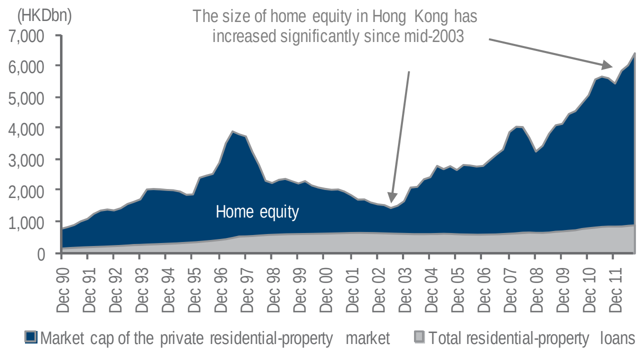
The second was the deep and prolonged decline in residential property prices from 4Q97-mid 2003 and the subsequent rise in prices after mid-2003. What this means is that many financially weaker home-owners are likely to have already sold out the units, and the units now are held by either people who either survived the ordeal from 4Q97-mid 2003 or those who bought them as a result of residential property prices plunging. Both scenarios augur well for the holding power of the current owners of residential units, in our view.

■ Residential property prices in Hong Kong




*Source: Midland, Daiwa*
*Note: * Provisional figure*

■ **Home equity in the residential property market**




*Source: CEIC, Daiwa*

However, it is probably the third factor that has greater implications for the sector over the long term. We think this is related to the rise in demand for quality units as a result of Hong Kong being increasingly integrated into Mainland China, and the city becoming a more important international financial centre.

We note that the three aforementioned events are related to structural fundamental factors, and are not related to the monetary backdrop, which has been very favourable.

## Structural trends and factors

### Becoming a multi-tier market

In our opinion, the residential property market is on its way to becoming more internationalised and the city's development as a more important international financial centre is bound to have implications for the property market.

Overall, we believe that the residential property market is on its way to becoming a five-tier market: the first tier is for the super-wealthy, the second is for the wealthy and high-income groups, the third comprises the middle class. Below these, we believe there will be two more tiers of subsidised housing: one of subsidised housing for sale, and one of subsidised housing for rent. Broadly speaking, we think the private residential property market in Hong Kong will consist of three main parts: 'Monte Carlo', 'Manhattan', and the rest of Hong Kong.

Monte Carlo refers to the segment occupied by the super-wealthy. In terms of size, we expect it to remain small relative to the overall private housing sector. As such, broadly speaking, Hong Kong's housing sector will comprise two main parts: Manhattan, and the rest of Hong Kong.

We think a large part of Hong Kong Island, as well as some parts of Kowloon, already have Manhattan prices. We believe an important question for the residential property sector going forward is what will be the boundary for the area where "Manhattan prices" can be achieved.

In the following map we show what we see as the future landscape of the residential property sector. We believe Zone 2 will have Manhattan prices eventually, and that some parts of Zones 3 and 4 will too. Herein lies one opportunity for the developers, in our view, as the achieved margin for the projects could widen significantly if they can turn an ordinary "rest-of-Hong Kong" project into a product that commands Manhattan prices.

■ **Residential property prices in Hong Kong**


Zone 1: Already has "Manhattan prices"
Zone 2: Likely to have "Manhattan prices"
Zone 3: Some projects may be able to get 'Manhattan prices"
Zone 4: "Rest of HK prices" although selected projects could command significant premium versus those in vicinity

*Source: Daiwa*

### Land supply is likely to increase over time

Our read on Chief Executive C.Y. Leung's Policy Address is that the current administration is determined to find more land to increase land supply and to build up a land reserve for future use. As such, the government could become very active in seeking ways to get land. Given this, there could be breakthroughs in the conversion of agricultural land, as this should be one of the main ways to increase the supply of land in the coming years.

## ■ Our take on the current administration's housing policy

| Issues | Our take |
|---|---|
| Property price | The government is not managing the absolute price level of private residential properties. Its main focus is to pre-empt systematic risks for the banking sector and the whole economy. It has stated that its strategy is "counter-cyclical" and that the measures are "exceptional measures for exceptional circumstances". In this light, it is conceivable that the government would want to review its measures if property prices were to undergo a natural consolidation and correction which would lead it to judge whether systematic risk faced by the sector has diminished appreciably. |
| Relationship with developers | It does not seem like the government is trying to target developers to win popular support. |
| Land supply | The government looks determined to 'create land'. We think its ability to create land over the medium-to-long term should not be underestimated given Mr. Leung's comment that his team has solved the co-ordination problem related to the six departments involved in the process. |
| | However, we think the government's focused determination to 'create land' is driven by a perception that the current 'shortage' is large, and that Hong Kong really needs to build up a land reserve for contingency purposes and long-term development rather than a desire to reduce prices. |
| High-end/luxury market | Could be willing to let it be driven by market forces, as long as there is no sharp rise in speculation. |
| Mass market | We think the government is hoping that increased land supply, increased pre-sale supply, and very prudent lending policies will prevent mass residential property prices from increasing significantly. It does not look as if the government is aiming to reduce prices even for mass units, as Mr. Leung has said that the government would consider providing subsidies to households with a monthly income of more than HKD40,000 to buy at some point. |
| Supply of private units | We think private residential supply will move from a situation of very low completion rates to moderately low completion rates. It is still far from an oversupply, in our view. |
| Further government measures | Could announce 'harsh measures' if the situation is judged to be against the healthy and long-term development of the sector and the well-being of the public. However, if such a threat is not judged to be serious, the government could look to market forces to sort things out. |

*Source: Daiwa*

## ■ Remarks by Chief Executive C.Y. Leung

| Issue | Remarks by CY Leung* |
|---|---|
| Flat prices have continued to increase | Residential property prices are determined by many factors. |
| Wealth distribution in Hong Kong | The wealthy getting wealthy isn't a problem. The problem is the poor getting poorer. |
| Guiding principles for housing policy | My two main principles are: speeding up people getting public rental flats and helping the middle class to own units. |
| Foreign demand for residential units | When supply is inadequate, we think our priority should be to take care of Hong Kong residents first. |
| On the issue that the middle class cannot afford its desired units | I want to build a housing ladder. For households with over HKD40,000 in income that cannot afford to buy what they see as suitable units in the private market, it is possible that over time the government could provide some kind of subsidy. But this is an issue of lower priority. |
| | For the gap between market prices and affordability, the government would try to find ways to fill it. Before supply becomes adequate, using subsidies to help the middle class buy units could backfire, as this might result in a further boost to prices. When the supply issue has been addressed, I will look into the various ways to help on this issue. |
| On the supply of subsidised housing | The Greenview Villa was 30x oversubscribed. If we can find 30 sites of similar size, we can satisfy this demand quickly, as the design may take just several months and we can pre-sell quickly. |
| Pre-sale of residential units | The new administration has already approved pre-sale consents for 7,885 units. Together with some 12,089 units under application, the total number of pre-saleable units will reach about 20,000 units, which is about double the 9,800 units being completed in 2012. We will pre-sell the subsidised units as soon as possible. |
| On the issue of agricultural-land conversion and Henderson Land chairman's proposal to offer agricultural land for the government to build small subsidised units quickly | I want to hear more about the details. In principle, I welcome any way to increase the supply of land and flats, especially subsidised housing. We welcome anyone with any suggestion, but for issues of this kind, we need more information on the practical details. |
| On the proportion of public/private participation in the development of new towns | Based on a lot of studies, it may not be favourable to the development of the new town if the public component is too large. |

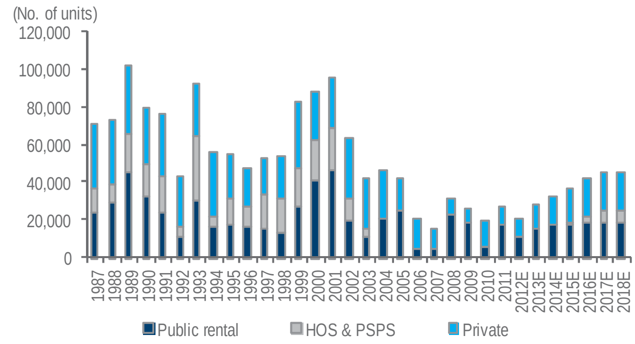
*Source: HK SAR Government, Daiwa*
*Note: *From press conferences and TV forums*

## ■ Supply outlook

| | Latest figures | Other remarks |
|---|---|---|
| Public rental units | 75,000 units over the next five years | The government will work on completing them as early as possible. |
| Subsidies flats | 17,000 units over the next four years | The government will complete them and pre-sell them as early as possible. |
| | | May be able to increase this figure if it can get more land or raise the plot ratio for some sites. |
| Private units | 67,000 units for completion in the coming years | The government has outlined 10 ways to get up to 128,700 units. |
| | | The current administration has worked on increasing the number of units eligible for pre-sale. |

*Source: Daiwa*

■ **Residential unit completions in Hong Kong**




*Source: CEIC, Midland, Daiwa*

Against the backdrop of a likely increase in the supply and availability of land from the Government in the years to come, we expect developers to focus more on asset turnover, especially for the mass market units where they can replenish their landbanks. A three-tier market is already developing. One is the mass market, in which developers focus more on asset turnover, another is the high-end/luxury market, in which the developers' focus is on the profit margin and ASP. The third is the super-luxury segment. On the whole, we think there will be some changes in the operating environment for the residential property sector, but we do not think this will lead to any deterioration in the profitability of the sector. If anything, having both a mass market and a high-end market may well work better for developers in terms of cash flow and risk management, as well as profitability over time.

Indeed, we think small property companies could see increased opportunities in the years to come, as a likely increase in the availability of land would provide them with more resources to expand to the next level.

Meanwhile, the existence of a Manhattan or even Monte Carlo market in Hong Kong would mean that those niche players that can build some very high-quality products could be able to achieve sizeable gains. We have observed that, over the past few years, several niche property companies have become stronger financially, and we believe that one theme in 2013 and beyond will be previously niche property companies becoming more prominent players.

■ **Industry outlook**

| | |
|---|---|
| Prices | Prices are poised for a 5-15% near-term correction after a 26% increase since the end of 2011. We see that as arguably a healthy correction and do not expect prices to plunge especially given that we expect the supply of units in the secondary market would be tight after the units from keen sellers are taken up in the coming 1-3 months. At the moment, we prefer to maintain our forecast of a 5% rise in prices for 2013 – they have risen by 5.4% YTD, according to the Centa-City leading index as of 15 March 2013. |
| Supply | The abnormal situation of fewer than 10,000 units completed in 2012 is not likely to last. However, we think the sector is just moving from a very low completion level to a more normal level. In our view, the industry is far from a situation where there is an oversupply of land or units. |
| Demand | Speculative demand for residential properties now almost cannot exist while upgrade and investment demand, as well demand from foreigners, is restrained. End-user demand from mainly Hong Kong local residents is likely to be the mainstream source of demand until various government measures are lifted. |
| Primary market | This market is in a pretty good position, in our view, as the time for getting pre-sale consent approval could be shorter and the government may even relax the rules governing pre-sale consent to more than the current level of 20 months before completion. Primary-market units look well positioned to take market share from the secondary market given that many existing homeowners are reluctant to sell and that the payment terms for new units are likely to be much more favourable and flexible for buyers. |
| Conversion of land usage in HK | It looks like the government may adopt a fairly open-minded and pragmatic stance toward the conversion of land usage in Hong Kong. We think it is in the interests of all parties and Hong Kong's future that there be an open, fair and transparent mechanism for dealing with issues relating to the conversion of land in Hong Kong. |
| Developers' strategy | If there is a large increase in the availability of land and much improved visibility about the supply of land from land conversion, we expect developers to focus a lot more on asset turnover for projects in suburban areas, which do not have many differentiated features. |
| | For projects in the urban areas or prime sites in the New Territories, however, we believe that the developers will focus more on margins and develop them mostly into luxury developments. |
| The issue of policy risk | We believe the new administration's main focus is not the absolute price level. Rather, it is to pre-empt systematic risks for the banking sector and the whole economy. It has stated that its strategy is "counter-cyclical" and that measures are "exceptional measures for exceptional circumstances". It has also explicitly stated that it believes that the ultimate solution to the issue is for more supply of land and units. In this light, it is conceivable that it would rather review its measures if property prices were to undergo a natural consolidation and correction and after seeing that a greater supply of land and units are assured. |

*Source: Daiwa*

## Implications

- Henderson Land (12 HK, HKD48.70, Buy [1]) is well-positioned in the Hong Kong residential property sector for the next few years as it is both the largest owner of old building redevelopment projects and the largest owner of agricultural land.
- We see both products as having promising potential in the next few years. While many of Henderson Land's old building projects are in Zone 2 rather than Zone 1 of the urban areas, our view is that Zone 2 will see prices similar to those in Manhattan as well, although the area could resemble Manhattan more in terms of ASP than unit price.
- In our opinion, the convenience offered by the urban areas will always command a premium in the Hong Kong residential property space. We expect Hong Kong to have a growing floating population, many of whom may not need much more than a convenient and comfortable small hotel room. For a number of Henderson Land's old building redevelopment

projects, we do not expect many to fetch a Manhattan-level unit price of USD1.5-2m. That said, as many of the group's old building projects comprise units ranging in size from 270sq ft to 600sq ft, it is conceivable that they could fetch an ASP of HKD15,000/sq ft or more.

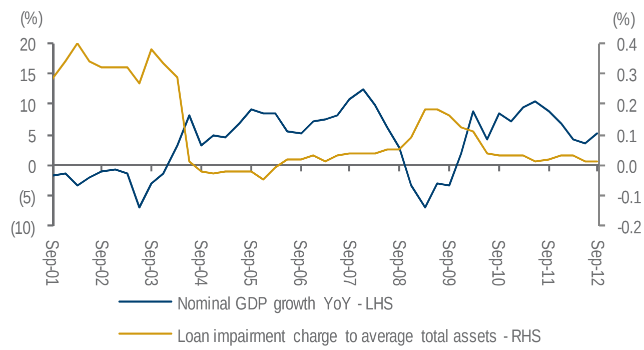
- Cheung Kong (1 HK, HKD111.7, Buy [1]) has been able to maintain a strong market-share position in the Hong Kong residential property sector throughout the years, and we believe it has a business model that enables it to make decent profit from selling even mass-market projects at mass-market prices. This model is unique to Cheung Kong. We see it as a low-risk and conservative way to run a property development business and expect it will secure for the group a strong position in the overall sector in the years to come.
- SHK Properties (16 HK, HKD106.30, Buy [1]) excels in terms of asset quality and brand recognition in the Hong Kong market, which we expect to be sustained for the foreseeable future. We reckon it has built up a sizeable position in urban area landbank in Hong Kong and that many of its New Territories projects have the potential to be developed and marketed as higher-grade ones. This would underpin its earnings prospects and market share in Hong Kong, in our view
- Sino Land (83 HK, HKD12.66, Buy [1]) did well in 2005-07 in terms of landbank replenishment, and we believe it has done well in terms of marketing those projects as premium products. That said, one challenge it might face is that it has not yet bought much land in Hong Kong, while land prices in major Hong Kong projects appear to be on the rise.

## 6. Banks

### We expect the Hong Kong banks' liquidity and balance sheets to remain strong

In general, banks in Hong Kong have been prudent in terms of lending since the economy moved out of recession in mid-2003. This has protected the banks' balance sheets, and loan-impairment charges for the banks have been low throughout the past 10 years. This was underpinned by a low unemployment rate in Hong Kong, as well as low loan-to-value (LTV) ratios on mortgages. We understand that most banks have a running LTV ratio of less than 40% on their outstanding mortgages.

**■ Hong Kong banks: loan-impairment charges**




*Source: Census and Statistics Department, HKMA*

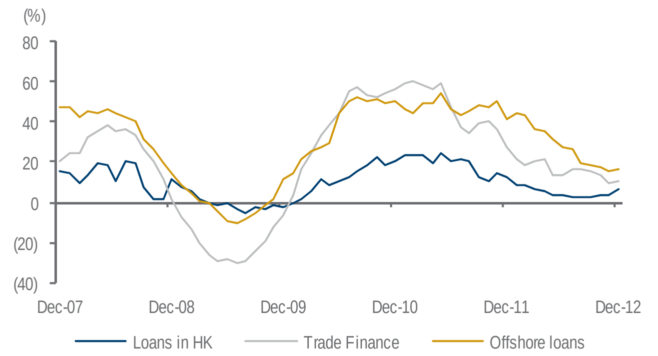
### Structural trends

We think one issue faced by the Hong Kong Banks Sector is that incremental loan demand is limited. The growth in loans over the 2010-11 period was primarily driven by trade finance and offshore loans. Mainland corporates, using pledged Renminbi deposits and/or bank guarantees in China, borrowed Hong Kong Dollars and US Dollars in Hong Kong to take advantage of the interest rate and exchange rate arbitrage between Hong Kong and Mainland China.

As such, arbitrage lending unwound in 2012, loan growth has reverted back to single-digit levels, and we expect only mid-single-digit percentage loan growth for 2013. Domestically, the fact that the current government housing policy discourages investment demand for properties and restrains upgrade demand should make increasing mortgage loan books a challenging task for the banks.

As a consequence, we expect the Hong Kong banks' liquidity and balance sheets to remain strong. Coupled with Basel III implementation, starting from this year which could be positive for the Hong Kong banks given the more relaxed treatment of unrealised gains on property revaluations, we would not be surprised if some of them opted for high pay-out ratios in the coming years.

**■ Hong Kong: loan growth (YoY change)**




*Source: CEIC*

**■ Hong Kong: equity breakdown at major banks (1H12)**

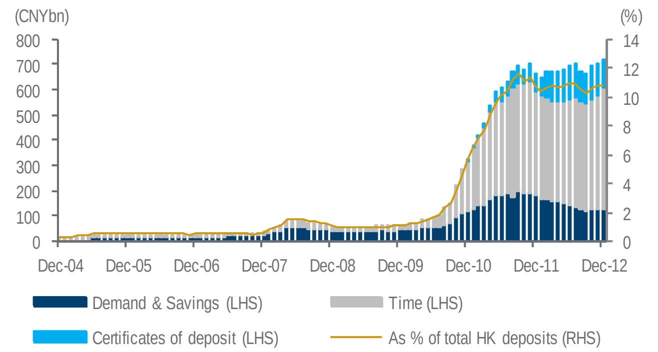
| (% of total equity) | HSB | BOCHK | WHB | DSF | BEA |
|---|---|---|---|---|---|
| Share capital | 11.3 | 37.6 | 6.7 | 20.5 | 35.6 |
| Capital reserve | 0.1 | 0.0 | 1.5 | 0.0 | 0.5 |
| Property revaluation reserve | 15.2 | 19.2 | 12.0 | 11.7 | 1.9 |
| Investment revaluation reserve | 0.1 | 2.5 | 1.7 | -2.2 | 1.0 |
| Regulatory reserve | 5.5 | 5.1 | 7.4 | 7.5 | 8.4 |
| Retained earnings | 59.3 | 35.1 | 57.1 | 61.3 | 15.7 |
| Other reserves | 8.5 | 0.5 | 13.6 | 1.2 | 36.9 |
| Total equity | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

*Source: Companies*

*Note: HSB – Hang Seng Bank, BOCHK – Bank of China (Hong Kong), WHB – Wing Hang Bank, DSF – Dah Sing Financial, BEA – Bank of East Asia*

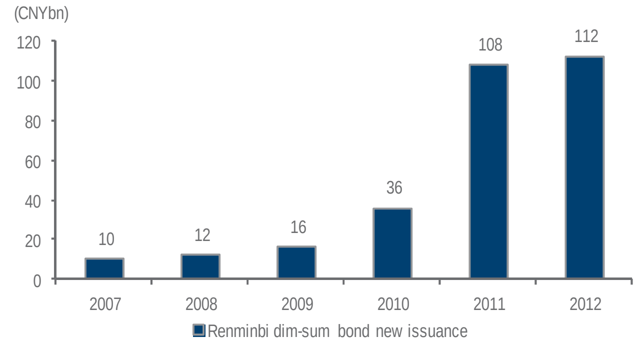
Another important development to note for the Hong Kong Banks Sector, in our view, is the sharp rise in Renminbi deposits over the past few years. We see the China Government's plan to develop the Qianhai area in Shenzhen as an indication that it committed to building an offshore centre for Renminbi. This could serve as a potential opportunity for the Hong Kong Banks Sector over the medium term.

**■ Renminbi deposits in Hong Kong**




*Source: CEIC*

■ Renminbi bonds issued in Hong Kong




*Source: HKMA*

## Implications

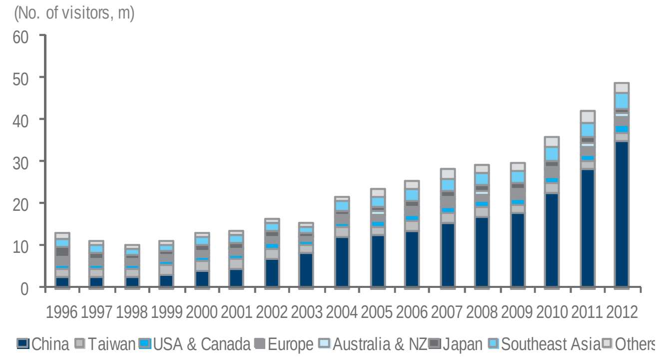
- We believe 2013 will be another year of revenue challenges for Hong Kong banks, given the lacklustre loan growth and NIM outlook. However, we expect solid yields on the back of strong earnings visibility from robust asset quality, which should continue to support the sector.
- We remain bullish on the overall asset quality in Hong Kong, despite our cautious view on domestic GDP growth, as experience suggests that the Hong Kong Banks Sector only experiences a meaningful pick-up in loan-impairment charges when GDP growth turns negative.
- We believe Bank of China (Hong Kong) stands to benefit most from offshore-Renminbi developments, with an estimated 30% market share in offshore Renminbi deposits in Hong Kong. Its capital strength also suggests there could be more DPS upside over our forecast period, with a tier 1 capital adequacy ratio of 12.96% as at the end of 1H12.
- The risks for the sector, in our view, are rapid and significant money outflows, and contagion risk from Europe investment exposure. We note that the Hong Kong banks have been derisking their investments and cutting their Europe exposure significantly since the 2008 global financial crisis. However, given that the sector still has sizeable exposure to the UK, France, and Germany, which in turn have significant exposure to the economies of the PIIGS, there remains contagion risk if the European debt crisis were to spread.

# 7. Hotels

## The IVS has transformed the hotel sector

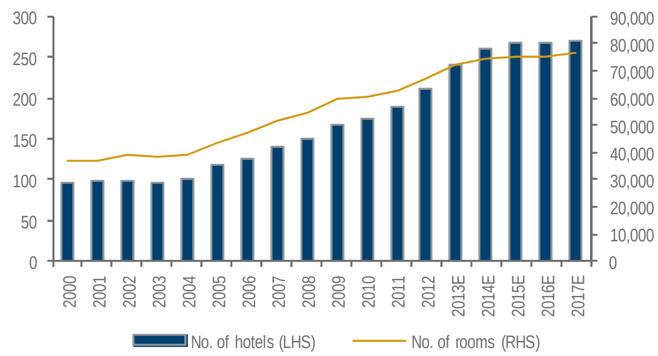
As with the retail property sector, the IVS has transformed the hotel sector. With tourist arrivals increasing at the rate faster that of hotel rooms, occupancy rate has been running at more than 80% in recent years, one of the highest levels in the world.

■ **Breakdown of visitors to Hong Kong**




*Source: CEIC*

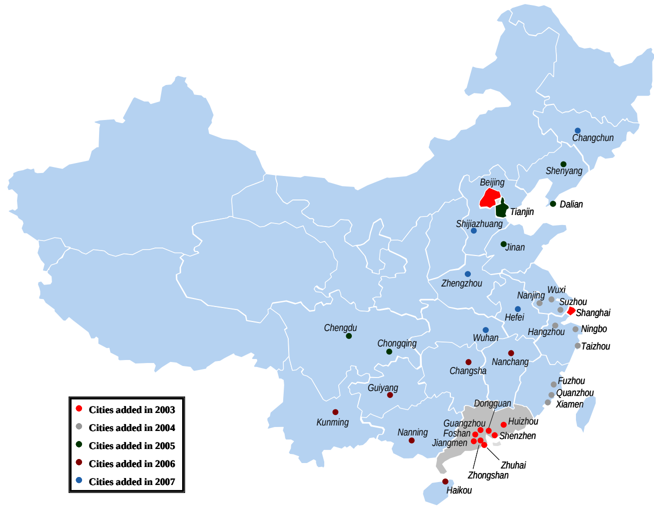
■ **Hotel room supply in Hong Kong**




*Source: CEIC Hong Kong Tourism Board*

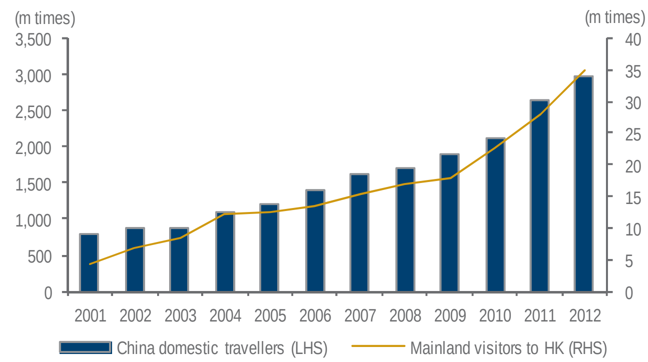
While there has already been phenomenal growth in the number of Mainland tourist arrivals to Hong Kong, we hesitate to say that the figure has peaked. After all, total Mainland tourist arrivals to Hong Kong represent only about 10% of the total domestic travellers in China. Moreover, there are still many cities not included in the IVS. In addition, transport links between Hong Kong and China will improve significantly from 2015-16. In all likelihood, hotel room supply will remain tight relative to demand in the coming years.

■ **Cities included in the IVS**



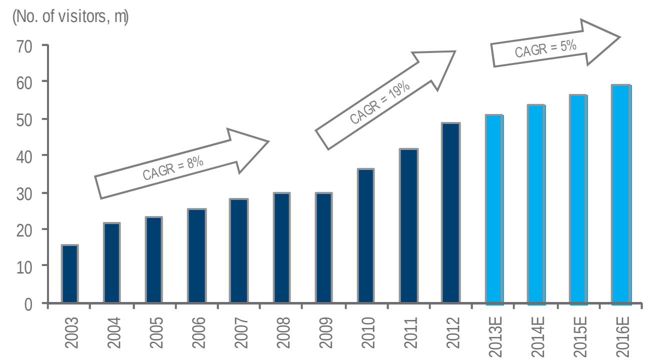

*Source: Daiwa*

■ **Mainland visitors to Hong Kong vs. Mainland domestic travellers**




*Source: CEIC*

■ **Hong Kong: tourist arrivals**



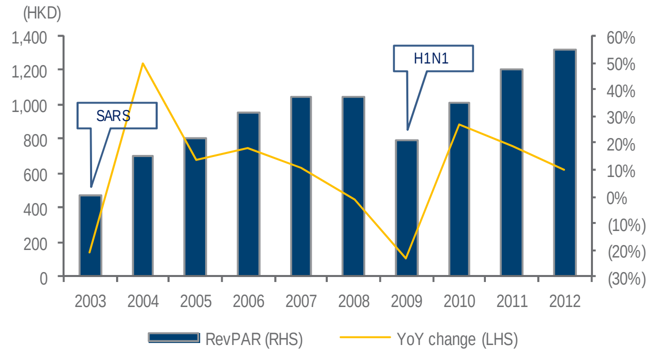

*Source: Regal REIT*

## Structural trends

Another point to note is that the number of top-tier leisure or business travellers coming to Hong Kong has also been rising fast in recent years. As a result, room rates at the top-tier hotels in Hong Kong have risen to levels not far below the premier hotels in New York and

London. This is despite the fact that financial markets and economies globally have not been strong in recent years.

■ Revenue per available room (revPAR) for all hotels in Hong Kong




*Source: CEIC*

However, we think the number of corporations and individuals that can afford room rates of USD500 or more is limited. With many hotels in the Central business district achieving room rates at this level, we expect many corporations and travellers to seek alternatives. This should provide opportunities for hotels not previously in the top-tier segment to upgrade.

Another trend that is emerging is the increasing presence of boutique hotels in the urban area, some of which are from the redevelopment or conversion of old buildings. Compared with the traditional hotel format, these hotels tend to be smaller (many have fewer than 200 rooms) and do not have many amenities and restaurants (some may just have a gym or a self-service business centre). Yet, they are often located in convenient locations in the urban area and offer good value-for-money compared with the high-end business hotels.

Another development we expect to see is the serviced-apartment or serviced-suite segments gain in importance, as we believe some executives or corporate clients will shift to renting serviced apartments or residential units instead of staying in hotels. Indeed, we see increasing numbers of new residential projects being positioned as serviced apartments, which we believe are often purchased by investors to be rented to business travellers.

One important development to reckon with, in our view, is that many travellers to Hong Kong from the Mainland are day-trippers. We also think that high hotel room rates in Hong Kong may well result in some travellers choosing to stay in Shenzhen instead. As such, the tourist arrival figures could overstate the demand for hotel rooms. In this light, we believe that an important factor for the Hong Kong hotel market is whether business travellers from China and other countries can increase in a sustained way, which would provide the necessary demand for transforming some hotels previously targeting travel groups into those for business travellers.

## Implications

- Regal REIT (1881 HK, HKD2.24, Outperform [2]) is one of the largest owners of hotel rooms in Hong Kong. Although in the past its main business hotel was the Regal Hong Kong in Causeway Bay, several of its hotels have a growing proportion of business travellers, and its Regal i-Club hotel in Wanchai is aimed at business travellers. We note that the revPAR achieved by Regal REIT's five initial hotels is still far below the hotel industry average in Hong Kong, and see room for its achieved revPAR rising if it can continue to upgrade its hotel assets. Moreover, since its parent company has various hotel sites under development, and they could be positioned as boutique hotels in the urban area. This could be an area for expansion for Regal REIT.
- Great Eagle (Not rated) is another major hotel owner in Hong Kong, with 1,610 rooms in Hong Kong and 4,095 rooms overseas. The revPAR of its Eaton hotel has picked up in recent years, and it should be one of the hotels that can ride on the aforementioned trend. The company has already filed a registration with the Hong Kong Stock Exchange about spinning-off its hotels.
- Magnificent (Not rated) is a niche player in the Hong Kong hotel business, owning some 2,300 hotel rooms, most of which are in the urban area and with one hotel in Macau. It has been expanding its hotel portfolio and the scale of this expansion has increased compared with a few years ago.

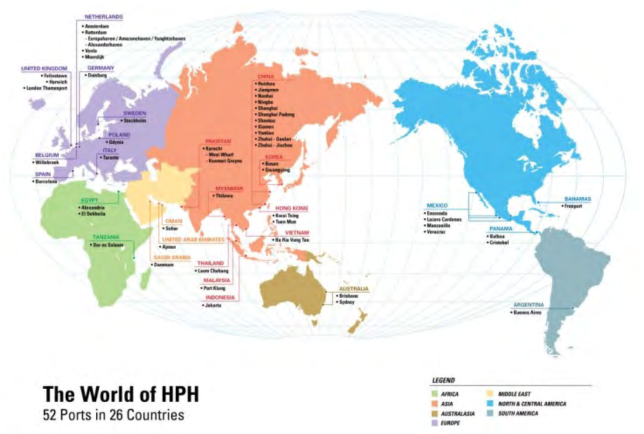
# 8. Shipping and ports

## Shipping is one of the city's few truly internationalised corporate sectors

Unlike the aviation sector, the shipping companies have become global companies and their businesses are more dependent on the global environment than the situation in Hong Kong. As such, shipping is one of the few truly internationalised corporate sectors in the city.

To some extent, this is also true of the port sector, in that some home-grown port operators have become companies operating on a global scale. For example, Hutchison Port Holdings, which owns Hutchison Port Holding Trust (HPHT) (HPHT SP, SGD0.825, Hold [3]) in Singapore, operates 52 ports in 26 countries.

■ **The port network of Hutchison Port Holdings**




*Source: Company*

## Structural trends and factors

Following difficult times in 2011 and 1H12, there have been some signs that the operating performances of the shipping carriers should improve in 2013, with more of them turning a profit, due to better demand growth on transpacific routes and rises in freight rates.

According to Shanghai Containerised Freight Index, the average overall freight rates have improved by around 14% YoY (YTD through 15 March). The main factor underpinning strong freight rates is capacity discipline. However, there may be an upside surprise in demand for the market given the recent strong macroeconomic data from China and the US. We believe the next focus of the market will be transpacific rate negotiations (March-May), from which we forecast an average increase of 15%.

Compared with the shipping sector, the port industry in Hong Kong is more focused on transshipments, rather than origin-to-destination (O&D) traffic. As many of the ports in Hong Kong are already quite mature, we expect the growth rate in their throughput to be slower than the overall industry globally in the near future. That said, the throughout growth for ports in the Bohai Rim and Yangtze River Delta areas is higher than that for the Pearl River Delta and some large ports are benefiting from the fact that some shipping companies are shifting their focus to the large main ports.

## Implications

- We believe Orient Overseas International (316 HK, HKD51.7, Buy [1]) will benefit from the capacity discipline of the major liners in 2013. We expect the completion of US contract negotiations (by May) to be a positive share-price catalyst for the stock due to its high exposure to the transpacific route. Also, we expect intra-Asia trade to remain robust and forecast an 8% YoY increase for 2013.
- We expect Yantian port, under HPHT to benefit from global economic recovery and record better O&D traffic in 2013 versus 2012. This should help to improve the ASP of HPHT. For Hong Kong, we expect throughput growth to remain stable in 2013.

# Appendix I: The six investment themes

We believe that Hong Kong-China integration is an important theme that is now under way but will take many years to unfold.

While the process promises to have far-reaching implications for many sectors, we highlight below six major themes.

## 1. Growing recognition of Hong Kong companies' Mainland China investments

Hong Kong companies started investing in China in the 1980s. Admittedly, most did not see major success in the initial years, and it was probably not until the mid-2000s that major Hong Kong companies took the view that China was a market to which they should deploy billions of dollars of capital and commit significant management resources.

As it stands, the Hong Kong-derived earnings of major Hong Kong companies are simply too large to be replaced by their earnings generated in Mainland China. But, Hong Kong companies have, after many years of trial and error, finally found ways in recent years to make material profits in the Mainland.

Judging from the most recent results announcements, many Hong Kong companies have achieved notable growth in their China earnings, with commercial property one area in which they have been particularly strong. Our view is that most Mainland China property companies do not yet have the capital base or skillset needed to build and manage prime commercial properties, and this could be an area in which Hong Kong companies have a clear edge, in our view.

■ Hong Kong companies' gross rental income from China

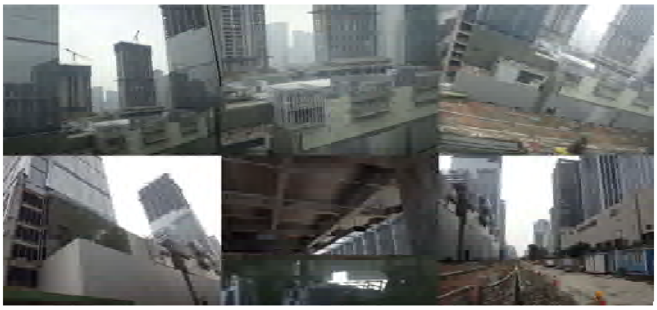
| China gross rental income | Interim/ Final | Dec 11 (HKDm) | Dec 12 (HKDm) | Change YoY (%) |
|---|---|---|---|---|
| Hang Lung Properties | F | 3,014 | 3,526 | 17.0% |
| Swire Properties | F | 782 | 1,373 | 75.6% |
| SHK Properties | I | 743 | 987 | 32.8% |
| Kerry Properties | F | 893 | 965 | 8.1% |
| New World Development | I | 173 | 279 | 61.4% |

*Source: Companies, Daiwa*

One important event to watch for in 2013 is the planned completion of Wharf's Chengdu IFS (International Financial Square) project. In terms of total investment (about USD2bn, we estimate), this is probably the largest ever made by a Hong Kong company. Having visited this project several times in recent years, our view is that the opening of the retail mall (likely to be in 1Q14, we estimate) will underline the depth of international retailers' interest in the Mainland China market, as well as their confidence in Hong Kong's premier manager of property assets.

We think this project will also serve to highlight what Hong Kong companies are capable of doing in the Mainland. Our view is that Hong Kong companies should be among the strongest players in China's commercial property sector, and may even become one of the principal shaping forces in China's commercial property landscape.

■ Wharf's Chengdu IFS project



*Source: Daiwa*

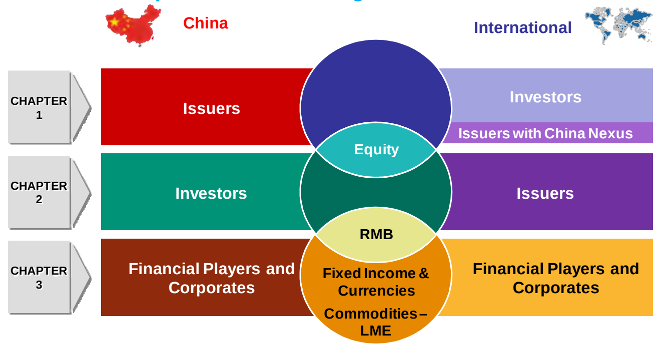
## 2. Hong Kong moving forward as an all-round international financial centre for Mainland China

In our opinion, securing the role of international financial centre is necessarily a long-term proposition, since it depends greatly on the trust and confidence of foreign investors, which can take years to accumulate.

Given the scale of the Mainland China economy, the pace at which it has been growing, and the government's stated intention to embark on Renminbi internationalisation, China has a clear need for a strong, vibrant international financial centre. That said, we think it is unrealistic to expect Shanghai to be transformed into a vibrant international financial centre in 2-3 years.

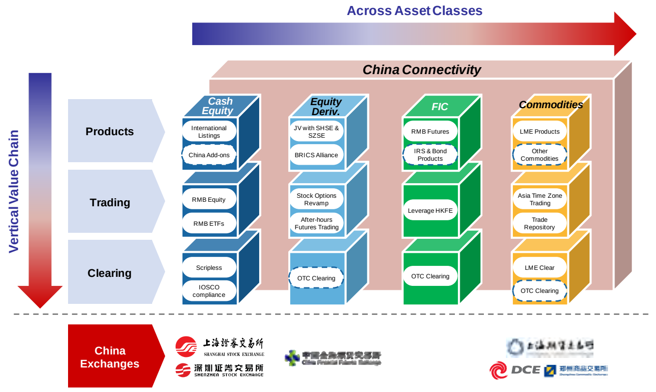
Hong Kong is in an interesting position in this regard. We think the finance sector in Hong Kong is full of related possibilities, and it is really up to the individual companies to define what those opportunities are. Hong Kong Exchange (HKEx) has sought to be at the forefront of this process, and has embarked on several initiatives which go beyond equities into commodities and fixed income. It appears to us that HKEx has ambitions to be one of the forces driving Hong Kong to become an all-round international financial centre for Mainland China, with its business scope extending well beyond equities. We see this as an important development. If HKEx is successful in only half of what it has set out to achieve, then it will probably already secure for Hong Kong an important position in the future financial architecture of China as a whole, in our view.

**The three chapters of HK Exchange**



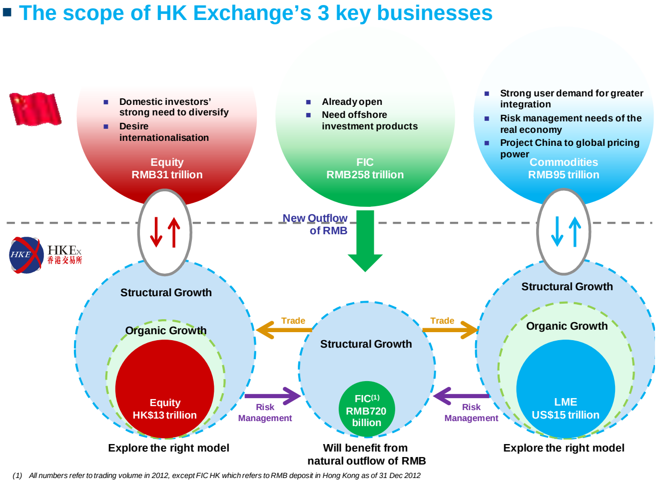

Source: HKEx

**The business strategy of HK Exchange**




Source: HKEx

**The scope of HK Exchange's 3 key businesses**



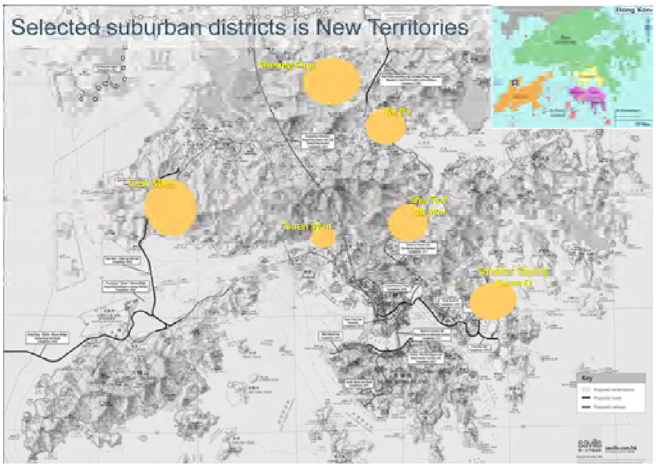

Source: HKEx

## 3. Growing importance of suburban malls

We think the surge in achieved rents of some prime high-street shops and retail properties in Hong Kong could be seen as the market's way of saying that the existing stock of retail property assets in Hong Kong is just not enough to cope with the surge in retail spending and there is significant demand for credible alternatives.

In our view, suburban malls should be front and centre in this theme, since we believe many retailers are keen to seek alternative retail space for expansion. In our opinion, there are a lot of possibilities for suburban malls, and it is up to individual asset managers to seize and define these opportunities.

**International retailers have started coming to the New Territories**




Source: Savills

## 4. Transformation of some districts in Hong Kong

In our opinion, Hong Kong could well end up having to accommodate and serve a multiple of the 6-7m people it has historically been configured for. We are already seeing related changes at the district level, and we think this process will only accelerate in the years to come.

Essentially, we think many established commercial districts in Hong Kong will expand horizontally (through pushing forward boundaries to merge into major districts nearby) and vertically (through converting floor space on the upper floors of buildings into usage of higher economic use).

Against this backdrop, we expect the transformation of Southern Causeway Bay, Southern Wanchai and the Canton Road area to continue, thereby creating considerable opportunities for property companies.

■ Causeway Bay portfolio and the retail triangle


*Source: Hysan, Daiwa*

## 5. Increased recognition that Hong Kong family companies include quality asset managers and savvy private equity investors

The nature of Hong Kong family-run property companies is an intriguing issue. We believe that international investors' lack of confidence in, and familiarity with, Hong Kong families could be one reason why Hong Kong property companies do not command valuations comparable to those given to the premier companies of overseas developed markets (see Appendix II).

We do not expect international investors' perceptions to change in the near future. That said, we think there are factors that could prompt the stock market to move away from its broad-brushed view of Hong Kong family-run property companies to a sharper focus on the bottom-up factors facing each company.

One potential driver of such a change, in our view, is that some Hong Kong companies have proven their competence at managing property assets. We believe that companies such as Swire Properties, Hongkong Land, SHK Properties, Wharf, Hang Lung Properties, and Link REIT have done an impressive job as managers of property assets. We believe that global investors could be prepared to pay higher valuations for companies which not only own assets but can manage property assets well. Hence, recognition of Hong Kong companies' expertise in managing property assets could serve as one catalyst for a narrowing of NAV discounts for such stocks, in our view.

Another potential driver is a possible change in the way Hong Kong family-run property companies are viewed. We think an alternative way to analyse Hong Kong family-run companies is to see them as private equity companies with significant investments in real estate. We think such a change in perspective would lead people to see that some of these companies are savvy investors, have been prudent and sensible in managing the business, and have not acted counter to the interests of minority shareholders. Moreover, these companies are savvy in realising the value of their assets, such that there should be value opportunities for them to embark on initiatives such as asset sales, spin-offs, using proceeds from the sale of non-core assets to buy back shares, raising capital from issuing perpetual bonds to buy back shares, etc., when the difference between their share prices and underlying NAV is large enough.

The third factor is a possible evolution in terms of capital management. We think there is a disconnect between physical property prices and stock prices. One way this gap could be narrowed is through the sale of non-core assets at market value and the buyback of shares at a notable discount. While companies should always look for ways to deploy capital to promote growth, it is a requirement of professional capital management to keep this option in hand. It would probably take a significant change in market perception and the strategy of family-run property companies to accept this, but in recent years, Sunlight REIT has been arguably the first to articulate this as a conscious strategy. We also see Swire Properties' decision in 2011 to dispose of Festival Walk at market prices in the physical market, instead of issuing new shares at a notable discount to NAV, as a move along this line (ie, arbitraging between prices in the physical market and share prices). We see this approach as one way in which the NAV discounts currently ascribed to Hong Kong family-run property companies could narrow.

## 6. Restructuring, recovery and transformation of some property companies

We believe that many family-run companies are changing. Lai Sun (not rated), for example, could be the first such company to adopt a model whereby it is family owned but managed by professional managers. This pragmatic approach could be one way to align the interests of the major shareholders with those of institutional investors, and address some of the issues weighing on the valuations of Hong Kong family-run property companies. In other words, we think this innovation could unlock some of the value embedded in the asset class of Hong Kong family-run property companies.

■ The six investment themes

| | Six major investment themes we expect for 2013 and beyond | Companies | Remarks |
|---|---|---|---|
| 1 | Growing recognition of HK companies' China investments | Cheung Kong | A sound business model to develop mass -market residential units, which has also been working in China |
| | | Hang Lung Properties | A solid China retail property play |
| | | Kerry Properties | Owns some of the most prime property sites in China |
| | | Lifestyle | A proven retail property manager which is also steadily rolling out its China ambitions |
| | | MTRC | Well-demonstrated expertise in managing rail operation; the largest foreign investor in China's rail sector |
| | | SHK Properties | A growing portfolio of prime commercial properties in China |
| | | Wharf | Has deployed the most capital in Mainland China; China investment are entering harvesting period |
| 2 | Hong Kong moving forward as the comprehensive international financial centre for China | BOC HK | Beneficiary of continued cross-border lending and potential rise in stock-market turnover in Hong Kong |
| | | Guotai Junan | Well-positioned to ride on opportunities related to a greater amount of investing capital from China coming to Hong Kong. |
| | | HK Exchange | Has worked for years to prepare for when more China-sourced capital is permitted to come to Hong Kong |
| | | SHK Properties | One of the two largest office landlords in Hong Kong; owns some of the most prime grade-A offices in Central, as well as Kowloon East and other areas |
| | | Swire Properties | One of the two largest office landlords in Hong Kong. We see Island East transforming into an even more important location for multinationals and Southern Wanchai merging into Pacific Place |
| | | Wharf | Owns some of the most prime office buildings in Causeway Bay and Tsimshatsui, which we expect to become more important commercial hubs |
| 3 | Growing importance of suburban malls | Fortune REIT | Should benefit from the positive spill-over related to the upgrading of first-tier malls |
| | | Henderson Land | Owns among the largest suburban malls in Tsueng Kwan O and Ma On Shan |
| | | Link REIT | Owns almost 10% of the retail space in Hong Kong |
| | | SHK Properties | Owns many of the most prime suburban malls in Hong Kong and has many suburban malls under development in Northwest New Territories |
| | | Sino Land | Tuen Mun Town Plaza is a top retail property in Tuen Mun |
| | | Sunlight REIT | Its mall in Sheung Shui is well-positioned to benefit from shopping by Mainland China visitors |
| 4 | Transformation of some districts in Hong Kong | Hopewell | A major commercial landlord and residential developer in the Wanchai area |
| | | Hysan | The largest commercial landlord in Causeway Bay, which we think is transforming into an even more important commercial hub in Hong Kong and will expand in size, both "vertically" and "horizontally" |
| | | SHK Properties | Owns sizeable land in Northwest New Territories, which is poised to become a higher-end area |
| | | Soundwill | Over 80% of its assets are in the Causeway Bay area |
| | | Swire Properties | We see Hong Kong East and Southern Wanchai becoming even more important commercial hubs in Hong Kong |
| 5 | Increased recognition that Hong Kong family companies do have "quality asset managers" and "savvy private equity companies." | Cheung Kong-Hutchison | Well-demonstrated savvy in investing and building businesses |
| | | Hang Lung Properties | Still one of the most pure, solid China retail property plays |
| | | Hongkong Land | A strong record of managing property assets, with investments in many cities starting to gain critical mass |
| | | The Link REIT | REIT structure, strong credentials to achieve sustainable DPU growth strengthen its appeal to global funds and property specialists |
| | | Swire Properties | A newcomer to global property but has a strong record of managing property assets |
| | | Wharf | Well-demonstrated expertise in managing retail properties; China investments entering fruition phase |
| 6 | Restructuring; recovery and transformation of some companies | CSI Properties | A real estate opportunity fund evolving into a real estate operating company |
| | | Great Eagle | Sitting on Champion REIT and a hotel portfolio, with value to be unlocked |
| | | Lai Sun Development | The first family-run company to try rejuvenating itself through a model of "family ownership; but professional management" |
| | | New World | Efforts to refocus on property are bearing fruit and execution for its New World Centre redevelopment project is key |
| | | OOIL | A global player which has rationalised its cost and strategy in an industry which is poised for a recovery in rates |
| | | Regal REIT | A defensive vehicle by which to gain exposure to the Hong Kong hotel sector |
| | | Sino Land | A developer which has kept on improving and is now at the threshold of the next investing phase |
| | | Soundwill | An emerging niche property play, with strong exposure to Causeway Bay |
| | | Wheelock | An emerging major developer on top of majority ownership of Wharf |
| | | Wing Tai Properties | An emerging property play, with solid rental income and a niche player in high-end properties |

*Source: Daiwa*

■ 30 stocks exposed to these six investment themes

| | | BBG code | Rating | Remark |
|---|---|---|---|---|
| | Finance | | | |
| 1 | BOC HK | 2388 HK | 1 | A major beneficiary if Hong Kong were to become an offshore centre for Renminbi |
| 2 | Guotai Junan | 1788 HK | NR | A niche PRC securities firm positioned to seize opportunities amid growth of the Hong Kong financial market |
| 3 | HK Exchange | 388 HK | 2 | Built to ride on Hong Kong's future potential as an international financial centre |
| | Property Developers | | | |
| 4 | Cheung Kong | 1 HK | 1 | A private equity company with a sound business model for residential property and many businesses reaching fruition |
| 5 | Henderson Land | 12 HK | 1 | Harvesting time is finally coming; a play on realisation of the value of agricultural land and old buildings |
| 6 | New World | 17 HK | NR | Refocusing on property |
| 7 | SHK Properties | 16 HK | 1 | A world-class property company with world-class property assets |
| 8 | Sino Land | 83 HK | 1 | Has continued improving and now at the threshold of a new investing phase |
| | Property Investors | | | |
| 9 | Great Eagle | 41 HK | NR | Majority stake in Champion REIT plus a hotel portfolio with value to be unlocked |
| 10 | Hang Lung Properties | 101 HK | 1 | The most focused and advanced in terms of developing retail properties in China |
| 11 | Hongkong Land | HKL SP | NR | An emerging regional property company |
| 12 | Hopewell | 54 HK | NR | An emerging Wanchai play |
| 13 | Hysan Development | 14 HK | 1 | Riding on the ongoing transformation of Causeway Bay |
| 14 | Kerry Properties | 683 HK | NR | Owns abundant prime property assets in Hong Kong and China |
| 15 | Lifestyle | 1212 HK | NR | Can also be seen as a premier retail landlord in Hong Kong and China |
| 16 | Swire Properties | 1972 HK | NR | A strong asset manager expanding in Hong Kong East and Southern Wanchai. |
| 17 | Wharf | 4 HK | 1 | A solid asset play with China investments entering into harvesting period |
| | REITs | | | |
| 18 | Fortune REIT | 778 HK | 1 | Riding on the growth of suburban malls |
| 19 | Link REIT | 823 HK | 2 | A premier international REIT in the making |
| 20 | Regal REIT | 1881 HK | 2 | A neglected company offering a defensive way to gain exposure to the Hong Kong hotel sector |
| 21 | Sunlight REIT | 435 HK | 1 | Riding on several major trends in Hong Kong commercial properties |
| | Transport | | | |
| 22 | MTRC | 66 HK | 2 | A global rail operator with growing exposure to China and a favourable rail-plus-property business model |
| 23 | OOIL | 316 HK | 1 | Riding on a cyclical upturn |
| | Conglomerates | | | |
| 24 | Hutchison Whampoa | 13 HK | NR | A veteran of investing and building businesses; a private equity firm with many evolving businesses |
| 25 | Wheelock | 20 HK | NR | An emerging medium-sized developer |
| | Niche property companies | | | |
| 26 | CSI Properties | 497 HK | NR | A real estate opportunity fund |
| 27 | Lai Sun Development | 488 HK | NR | The first family-run company to try rejuvenating itself through a model of "family ownership; but professional management" |
| 28 | Midland Holdings | 1200 HK | 1 | Near-term uncertainties versus long-term franchise value and cyclical upturn potential |
| 29 | Soundwill | 878 HK | 1 | Still a deep value stock |
| 30 | Wing Tai Properties | 369 HK | NR | A niche player |

*Source: Daiwa*

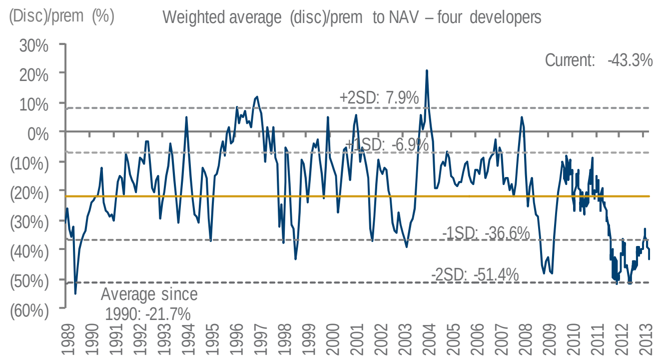
# Appendix II: Investment perspective on Hong Kong's family-run property companies

We believe that Hong Kong-family property companies constitute an intriguing investment case. In terms of the physical market, Hong Kong has arguably one of the world's strongest physical property markets. Yet Hong Kong property stocks' valuations are among the lowest in developed markets. Historically, Hong Kong property companies have traded at notable discounts to NAV. In many other markets, property stocks can trade at close to NAV or even above it. Why is there seemingly a disconnect between the physical market and stock prices?

## Why do Hong Kong property companies trade at a large NAV discount?

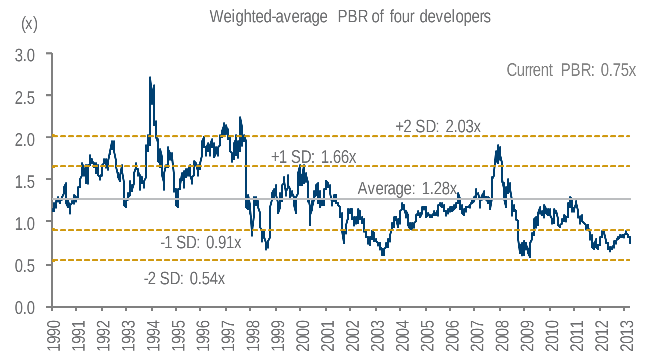
This is a complex question which probably goes beyond the scope of this report. Still, we sketch out our views on this subject, since it has important implications for the investment value of Hong Kong property companies.

■ **Hong Kong's major property developers: price-to-NAV**




*Source: Datastream, Daiwa estimates*

■ **Hong Kong's major property developers: PBR**




*Source: Datastream, Daiwa*

In our opinion, one central issue is that Hong Kong family-run property companies seem to constitute a distinct asset class in the investment universe, and many international investors may have yet to fully grasp their nature or their pros and cons. We estimate that the total market capitalisation of Hong Kong property companies is over USD200bn. This is not small, but nor is it so large that global funds cannot afford to ignore it. Indeed, our impression is that, historically, Hong Kong has not been seen as an important component for global funds. Hong Kong's weighting in the benchmark used by global funds should be well under 2%, meaning that it doesn't matter that much whether one is right or wrong on the Hong Kong component of a global portfolio.

■ **Market capitalisation of Hong Kong property companies**

| Developers | Market cap. (HKDbn) | Investors | Market cap. (HKDbn) | H-REITs | Market cap. (HKDbn) |
|---|---|---|---|---|---|
| SHKP | 317.0 | Wharf | 195.7 | Link REIT | 97.2 |
| Cheung Kong | 275.4 | Swire Prop. | 166.7 | Hui Xin REIT | 26.3 |
| Henderson Land | 129.0 | Hang Lung Prop. | 134.1 | Champion REIT | 22.9 |
| Sino Land | 80.5 | HK Land | 141.5 | Fortune REIT | 11.6 |
| New World | 82.9 | Hysan | 40.7 | Sunlight REIT | 5.6 |
| Totals | 884.8 | | 678.6 | | 163.6 |

*Source: Companies, Daiwa; note: data as of 19 March 2013*

We believe the issue is further complicated by the fact that the largest portion of global investing capital comes from the US, and many large property players in the US are REITs. Compared with Asian family-run companies, REITs appear to be more "analysable" entities and there are many REITs with sizeable market capitalisations in developed markets. Large global funds have many choices and do not necessarily have to invest in family-run property companies in Hong Kong or indeed Asia.

For real-estate dedicated funds, the situation is more nuanced, since Hong Kong property companies represent some of the world's largest real-estate companies by market capitalisation. To this niche segment of the global investment community, Hong Kong property companies are an important asset class. That said, they still have choices and do not necessarily have to invest significantly in family-run property companies in Hong Kong or Asia.

Against this backdrop, one major source of investing capital for Hong Kong family-run property company shares comprises Hong Kong, Greater China or regional funds, which see Hong Kong property stocks as part of their overall portfolio and tend to take monthly, quarterly or multi-month views of stocks. In this light, one issue that Hong Kong family-run property companies face is that there is not a sufficient pool of anchored investing capital to take bottom-up multi-year views on companies within the sector.

At the same time, the family-run companies themselves have characteristics which may not fit well with some international investors' expectations. The Hong Kong property industry is known to be very capital intensive, and some Hong Kong family-run property companies may be seen as having over-used equity capital or been too opportunistic in their share placements. International investors may also have concerns about how controlling shareholders of family-run property companies will treat institutional shareholders and whether they will allocate capital efficiently and effectively.

All things considered, we think the higher NAV discounts of Hong Kong property companies exist for a reason. But, this doesn't mean that the phenomenon cannot change.

## Three phenomena worth noting

We highlight three recent phenomena involving listed property stocks.

First, there has been a significant re-rating of the Link REIT, which is now the largest REIT in Asia. In terms of DPU yield, it is arguably one of the most expensive REITs in Asia, though relative to premier REITs in the US, its valuation does not look unreasonable — a premium to NAV and a 3% yield or below are not uncommon. Moreover, the shareholder base of the Link REIT includes some of the world's largest global funds and institutional investors.

Second, Hang Lung Properties has undergone a significant re-rating since the mid-2000s, and during 2009-11 the stock sustained a premium to NAV. When we examine Hang Lung Properties' shareholder base, we find it also includes some of the world's major institutional funds and value investors.

Third, we think several Hong Kong property companies have demonstrated that they are quality asset managers, such that the skills shown by Swire Properties, Hongkong Land, Wharf and SHK Properties in the management of their property assets may not be appreciably inferior to those of the likes of Simon Property, Westfield or Boston Properties. Indeed, Harbour City is by far the world's most productive shopping mall in terms of achieved retail sales. Meanwhile, Sogo HK is probably the world's number one department store in terms of achieved sales per sq ft.

China's commercial property market is in an early stage of development and one cannot rule out that in the future, China's commercial properties could become an important component of global commercial real estate. If this proves to be the case, then Hong Kong property companies represent arguably a low-risk way to gain exposure to this important market.

## HK prime properties are in good position to get exposure to the scale of the Chinese economy

Adam Smith opined that "the most decisive mark of the prosperity of any country is the increase of the number of its inhabitants". We think this puts an interesting spin on Hong Kong real estate. It can be argued that Hong Kong's real estate has historically been for a base of 6-7m people, with the value of the most prime property assets being determined by the city's most wealthy individuals and profitable companies.

But now, with the integration process between Hong Kong and Mainland China, it can be argued that the city's real estate is for more than that base of 6-7m people. Over time, it is therefore conceivable that the value of the most prime property assets in the city may be determined by the most wealthy individuals and most profitable companies within the whole of China. Indeed, one could argue that the retail property assets of Hong Kong are already serving well over 100m people, and its existing catchment area is over 10x the size of what it was in the past.

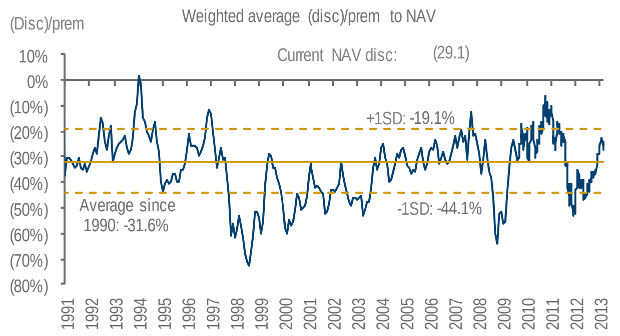
In sum, our view is that real estate offers special leverage to the growth in scale and wealth of an economy. It is also an asset class where management counts a great deal in determining value. This is especially the case for retail property assets, an area where Hong Kong's family-run property companies have made considerable progress in recent years.

## Four qualities may help to narrow the NAV discount for HK property companies

In summary, we think some Hong Kong companies may be in a position to unlock value and bring about a narrowing of their NAV discounts. We highlight four qualities that we believe could give family-run property companies an opportunity to break out from the status quo in terms of valuation.

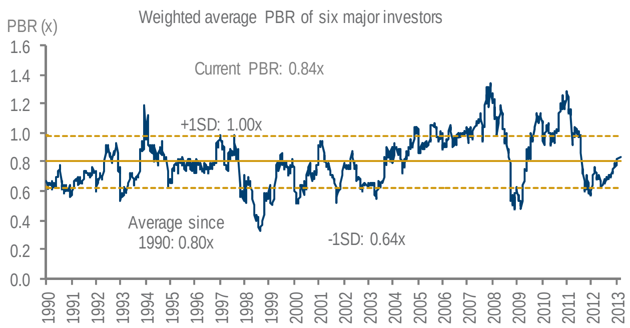
First is competence in managing property assets. We think international investors recognise there is a difference between passive owners of property assets and competent managers which can manage property assets well and create value. We think there is significant scope for value creation for property managers with the requisite skills, especially for retail property assets.

**■ Hong Kong's major property investors: price-to-NAV**




*Source: Datastream, Daiwa estimates*

**■ Hong Kong's major property investors: PBR**




*Source: Datastream, Daiwa*

Second is a track record of being savvy in investments related to property and other fields. We believe that one alternative way to analyse Hong Kong family-run property companies is to see them as private-equity companies which happen to have considerable investments in real estate. Cheung Kong-Hutchison is probably the best example of this. It is generally accepted that the group is savvy, being a veteran builder and investor of businesses. To the extent that such companies can create value or monetise their NAVs, their underlying NAVs should not be ignored entirely, in our view.

The third quality we look for is companies which are exhibiting increased professionalism in management. Since concerns over the family structure and governance are a contributing factor in the relatively high NAV discounts of Hong Kong property companies, increased professionalism in management, together with a proven commitment to treating investors as long-term business partners, could be expected to reduce a stock's NAV discount, in our view.

Last but not least, we see capital management being an important factor for Hong Kong property companies in the coming years. We think there is a clear disconnect between physical market and stock prices. Swire Properties' sale of Festival Walk demonstrated that even a USD2.2bn asset can be monetised. We believe that selling non-core assets at physical market prices and then buying back shares at a significant discount is one way to arbitrage between the two. So far, Sunlight REIT seems to be the only player to have adopted this strategy, and our view is that while companies should also use capital to create value for the company, buying back shares should be considered an option. In our opinion, this represents an effective way to lower the NAV discount of Hong Kong property companies.

Daiwa Capital Markets

Company



The 10-second briefing

# BOC Hong Kong

2388 HK

Target (HKD): **30.00 → 30.00**
Upside: **14.1%**
19 Mar price (HKD): **26.30**

## Riding on offshore flows and improved market turnover

- Beneficiary of continued cross-border lending and rising market turnover in Hong Kong
- Strongest capital position (and likely higher after Basel III is implemented) enables both growth and yield upside
- Our top sector pick among the Hong Kong banks

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

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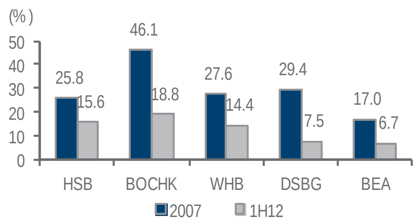
### ■ What's new

We believe the initial Qianhai loan quota could reach CNY50bn over the next few years, from the pilot CNY2bn in project loans that were signed in January 2013. This compares to about CNY70bn in offshore Renminbi loans in Hong Kong as at the end of November 2012. We believe that BOCHK, with a one-third share of the offshore Renminbi deposit market, stands to benefit most from the increase in offshore Renminbi lending.

### ■ What's the impact

Although the Qianhai loan quota is small relative to Hong Kong's offshore Renminbi liquidity pool of over CNY700bn currently, we believe continued developments to deploy Hong Kong's excess offshore Renminbi deposits will boost investor sentiment for BOCHK. Further, as well as brokers and HKEx, we believe BOCHK will benefit from an increase in market turnover. At the peak in 2007, BOCHK's brokerage fees accounted for nearly half of its fee income.

**■ BOCHK: brokerage as a % of fee income vs. peers**




*Source: Company, Daiwa*

### ■ What we recommend

We reiterate our Buy (1) rating on BOCHK and maintain our Gordon Growth Model-based six-month target price of HKD30.00. The key downside risk would be policy changes in China, which could limit the redeployment of BOCHK's offshore Renminbi funds.

### ■ How we differ

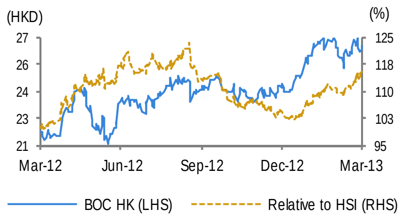
Our 2013-14 EPS forecasts are 7-8% higher than those of the Bloomberg consensus, as we are more confident about BOCHK's margin and fee outlook. We also see potential yield upside for BOCHK, from a higher dividend payout given its capital strength, as we believe BOCHK's capital adequacy ratio (core and total CAR of 13.0% and 17.4%, respectively, for 1H12) will be even higher under Basel III, which will come into effect in 2013.

**Forecast revisions (%)**

| Year to 31 Dec | 12E | 13E | 14E |
|---|---|---|---|
| PPOP change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 21.10-27.00 |
| Market cap (USDbn) | 35.83 |
| 3m avg daily turnover (USDm) | 45.92 |
| Shares outstanding (m) | 10,573 |
| Major shareholder | Bank of China (66.1%) |

**Financial summary (HKD)**

| Year to 31 Dec | 12E | 13E | 14E |
|---|---|---|---|
| Total operating income (m) | 37,538 | 41,346 | 44,957 |
| Pre-provision operating profit(m) | 25,948 | 28,796 | 31,527 |
| Net profit (m) | 22,282 | 23,063 | 25,147 |
| Core EPS (fully-diluted) | 2.107 | 2.181 | 2.378 |
| EPS change (%) | 9.1 | 3.5 | 9.0 |
| Daiwa vs Cons. EPS (%) | 9.1 | 6.9 | 8.2 |
| PER (x) | 12.5 | 12.1 | 11.1 |
| Dividend yield (%) | 4.9 | 5.1 | 5.6 |
| DPS | 1.296 | 1.341 | 1.462 |
| PBR (x) | 1.9 | 1.8 | 1.7 |
| ROE (%) | 16.2 | 15.5 | 15.8 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## Key assumptions

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Reported net interest margin (%) | 2.07 | 2.00 | 1.69 | 1.49 | 1.32 | 1.59 | 1.69 | 1.79 |
| Fee to income ratio (%) | 23.0 | 20.3 | 25.0 | 25.6 | 25.4 | 22.6 | 22.9 | 23.2 |
| Expense to income ratio (%) | 28.5 | 34.4 | 46.6 | 34.8 | 25.5 | 30.9 | 30.4 | 29.9 |
| Loan growth (%) | 19.0 | 11.5 | 11.8 | 19.1 | 14.1 | 8.0 | 7.0 | 7.0 |
| Deposit growth (%) | 14.2 | 1.1 | 5.0 | 21.9 | 11.6 | 6.0 | 7.0 | 7.0 |
| Loan/deposit (%) - incl. trade bills | 52.7 | 58.3 | 62.2 | 62.8 | 66.0 | 65.9 | 66.0 | 66.1 |
| NPL (%) | 0.4 | 0.5 | 0.3 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 |
| Tier-1 CAR (%) | 12.2 | 10.9 | 11.6 | 11.3 | 12.5 | 13.3 | 13.6 | 13.1 |
| Total CAR (%) | 13.1 | 16.2 | 16.9 | 16.1 | 16.9 | 17.7 | 17.9 | 17.0 |

## Profit and loss (HKDm)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Net-interest income | 19,395 | 20,157 | 17,932 | 18,734 | 21,979 | 25,781 | 28,585 | 30,988 |
| Net fees & commission | 6,274 | 5,179 | 6,508 | 7,044 | 7,833 | 8,495 | 9,448 | 10,431 |
| Trading and other income | 2,599 | 2,008 | 1,157 | 3,234 | 2,203 | 4,462 | 4,113 | 4,337 |
| Net insurance income | (1,014) | (1,818) | 458 | (1,504) | (1,169) | (1,200) | (800) | (800) |
| Total operating income | 27,254 | 25,526 | 26,055 | 27,508 | 30,846 | 37,538 | 41,346 | 44,957 |
| Personnel expenses | (4,656) | (4,554) | (5,091) | (5,357) | (6,038) | (6,508) | (7,015) | (7,431) |
| Other expenses | (3,117) | (4,217) | (7,050) | (4,227) | (1,824) | (5,082) | (5,535) | (5,999) |
| Total expenses | (7,773) | (8,771) | (12,141) | (9,584) | (7,862) | (11,590) | (12,550) | (13,430) |
| Pre-provision operating profit | 19,481 | 16,755 | 13,914 | 17,924 | 22,984 | 25,948 | 28,796 | 31,527 |
| Total provision | 685 | (661) | (103) | 70 | (379) | (408) | (863) | (1,068) |
| Operating profit after prov. | 20,166 | 16,094 | 13,811 | 17,994 | 22,605 | 25,540 | 27,933 | 30,459 |
| Non-operating income | (1,040) | (12,016) | 2,913 | 1,748 | 2,075 | 1,475 | 30 | 30 |
| Profit before tax | 19,126 | 4,078 | 16,724 | 19,742 | 24,680 | 27,015 | 27,963 | 30,489 |
| Tax | (3,309) | (1,071) | (2,473) | (3,052) | (3,867) | (4,176) | (4,323) | (4,713) |
| Min. int./pref. div./other items | (371) | 336 | (321) | (494) | (383) | (557) | (577) | (629) |
| Net profit | 15,446 | 3,343 | 13,930 | 16,196 | 20,430 | 22,282 | 23,063 | 25,147 |
| Adjusted net profit | 15,446 | 3,343 | 13,930 | 16,196 | 20,430 | 22,282 | 23,063 | 25,147 |
| EPS (HKD) | 1.461 | 0.316 | 1.318 | 1.532 | 1.932 | 2.107 | 2.181 | 2.378 |
| EPS (adjusted) (HKD) | 1.461 | 0.316 | 1.318 | 1.532 | 1.932 | 2.107 | 2.181 | 2.378 |
| EPS (adjusted fully-diluted) (HKD) | 1.461 | 0.316 | 1.318 | 1.532 | 1.932 | 2.107 | 2.181 | 2.378 |
| DPS (HKD) | 0.915 | 0.438 | 0.855 | 0.972 | 1.188 | 1.296 | 1.341 | 1.462 |

## Change (YoY %)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Net-interest income | 22.5 | 3.9 | (11.0) | 4.5 | 17.3 | 17.3 | 10.9 | 8.4 |
| Non-interest income | 43.6 | (31.7) | 51.3 | 8.0 | 1.1 | 32.6 | 8.5 | 9.5 |
| Total operating income | 27.9 | (6.3) | 2.1 | 5.6 | 12.1 | 21.7 | 10.1 | 8.7 |
| Total expenses | 18.5 | 12.8 | 38.4 | (21.1) | (18.0) | 47.4 | 8.3 | 7.0 |
| Pre-provision operating profit | 32.1 | (14.0) | (17.0) | 28.8 | 28.2 | 12.9 | 11.0 | 9.5 |
| Total provisions | n.a. | n.a. | (84.4) | n.a. | n.a. | 7.6 | 111.8 | 23.7 |
| Operating profit after provisions | 21.9 | (20.2) | (14.2) | 30.3 | 25.6 | 13.0 | 9.4 | 9.0 |
| Profit before tax | 11.6 | (78.7) | 310.1 | 18.0 | 25.0 | 9.5 | 3.5 | 9.0 |
| Net profit (adjusted) | 10.3 | (78.4) | 316.7 | 16.3 | 26.1 | 9.1 | 3.5 | 9.0 |
| EPS (adjusted, FD) | 10.3 | (78.4) | 316.7 | 16.3 | 26.1 | 9.1 | 3.5 | 9.0 |
| Gross loans | 19.0 | 11.5 | 11.8 | 19.1 | 14.1 | 8.0 | 7.0 | 7.0 |
| Deposits | 14.2 | 1.1 | 5.0 | 21.9 | 11.6 | 6.0 | 7.0 | 7.0 |
| Total assets | 14.9 | 7.5 | 5.7 | 37.0 | 4.7 | (0.7) | 6.1 | 6.3 |
| Total liabilities | 15.5 | 9.3 | 4.1 | 39.5 | 4.1 | (1.6) | 6.0 | 6.2 |
| Shareholders' equity | 9.7 | (10.9) | 25.9 | 10.6 | 12.7 | 11.4 | 6.5 | 6.7 |
| Avg interest-earning assets | 12.5 | 10.8 | 6.7 | 22.1 | 31.6 | (6.5) | 5.0 | 2.5 |
| Avg risk-weighted assets | 12.0 | 13.0 | 6.5 | 8.7 | 4.2 | 0.5 | 5.1 | 10.4 |

*Source: FactSet, Daiwa forecasts*

## Financial summary continued …

### Balance sheet (HKDm)

| As at 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Cash & equivalent | 215,442 | 246,725 | 226,402 | 458,222 | 388,879 | 292,009 | 310,638 | 331,752 |
| Investment securities | 350,100 | 355,121 | 375,933 | 453,914 | 452,387 | 474,924 | 482,846 | 491,321 |
| Net loans and advances | 411,677 | 458,146 | 512,703 | 610,908 | 696,549 | 752,052 | 804,041 | 859,527 |
| Fixed assets | 31,351 | 30,522 | 35,650 | 41,391 | 52,091 | 57,300 | 63,030 | 69,333 |
| Goodwill | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other assets | 59,067 | 56,730 | 62,106 | 96,605 | 148,604 | 150,631 | 170,964 | 194,122 |
| Total assets | 1,067,637 | 1,147,244 | 1,212,794 | 1,661,040 | 1,738,510 | 1,726,915 | 1,831,519 | 1,946,056 |
| Customers deposits | 795,560 | 803,435 | 842,321 | 1,027,033 | 1,145,951 | 1,214,708 | 1,299,738 | 1,390,719 |
| Borrowing | 60,599 | 88,779 | 99,647 | 313,784 | 236,694 | 117,357 | 108,862 | 101,188 |
| Debentures | 0 | 27,339 | 26,776 | 26,877 | 28,656 | 28,656 | 28,656 | 28,656 |
| Other liabilities | 116,420 | 143,159 | 137,135 | 175,057 | 194,026 | 218,171 | 236,724 | 257,593 |
| Total liabilities | 972,579 | 1,062,712 | 1,105,879 | 1,542,751 | 1,605,327 | 1,578,892 | 1,673,979 | 1,778,157 |
| Share capital | 52,864 | 52,864 | 52,864 | 52,864 | 52,864 | 52,864 | 52,864 | 52,864 |
| Reserves & others | 39,978 | 29,855 | 51,315 | 62,317 | 76,901 | 91,639 | 101,050 | 111,300 |
| Shareholders' equity | 92,842 | 82,719 | 104,179 | 115,181 | 129,765 | 144,503 | 153,914 | 164,164 |
| Minority interests | 2,216 | 1,813 | 2,736 | 3,108 | 3,418 | 3,521 | 3,626 | 3,735 |
| Total equity & liabilities | 1,067,637 | 1,147,244 | 1,212,794 | 1,661,040 | 1,738,510 | 1,726,915 | 1,831,519 | 1,946,056 |
| Avg interest-earning assets | 876,341 | 970,742 | 1,035,346 | 1,263,730 | 1,662,499 | 1,554,845 | 1,631,854 | 1,673,200 |
| Avg risk-weighted assets | 500,828 | 565,955 | 602,794 | 655,117 | 682,381 | 685,481 | 720,405 | 795,215 |
| BVPS (HKD) | 8.781 | 7.824 | 9.854 | 10.894 | 12.273 | 13.667 | 14.558 | 15.527 |

### Key ratios (%)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Loan/deposit | 52.0 | 57.4 | 61.1 | 59.7 | 61.0 | 62.2 | 62.2 | 62.2 |
| Tier-1 CAR | 12.2 | 10.9 | 11.6 | 11.3 | 12.5 | 13.3 | 13.6 | 13.1 |
| Total CAR | 13.1 | 16.2 | 16.9 | 16.1 | 16.9 | 17.7 | 17.9 | 17.0 |
| NPLs/gross loans | 0.4 | 0.5 | 0.3 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 |
| Total loan-loss prov./NPLs | 76.8 | 107.6 | 128.3 | 266.6 | 398.6 | 329.7 | 299.0 | 269.4 |
| ROAA | 1.5 | 0.3 | 1.2 | 1.1 | 1.2 | 1.3 | 1.3 | 1.3 |
| ROAE | 17.4 | 3.8 | 14.9 | 14.8 | 16.7 | 16.2 | 15.5 | 15.8 |
| Net-interest margin | 2.1 | 2.0 | 1.7 | 1.5 | 1.3 | 1.6 | 1.7 | 1.8 |
| Gross yield | 5.3 | 3.6 | 2.1 | 1.9 | 1.9 | 2.3 | 2.4 | 2.5 |
| Cost of funds | 3.3 | 1.7 | 0.4 | 0.4 | 0.7 | 0.7 | 0.7 | 0.7 |
| Net-interest spread | 1.9 | 1.9 | 1.7 | 1.5 | 1.4 | 1.6 | 1.6 | 1.8 |
| Total cost/total income | 28.5 | 34.4 | 46.6 | 34.8 | 25.5 | 30.9 | 30.4 | 29.9 |
| Effective tax | 17.3 | 26.3 | 14.8 | 15.5 | 15.7 | 15.5 | 15.5 | 15.5 |
| Dividend-payout | 62.6 | 138.5 | 64.9 | 63.5 | 61.5 | 61.5 | 61.5 | 61.5 |

*Source: FactSet, Daiwa forecasts*

### Company profile

BOC Hong Kong (BOCHK) was established in 2001 and is now the second-largest commercial banking group in Hong Kong. BOCHK offers a comprehensive range of financial products and services to retail and corporate customers in Hong Kong, as well as in the Mainland to provide cross-border banking services to customers. BOCHK was appointed by the PBOC as a clearing bank for the Renminbi business in Hong Kong.

The 10-second briefing

# Cheung Kong

1 HK

Target (HKD): **143.70 → 143.70**
Upside: **28.6%**
19 Mar price (HKD): **111.70**

# A savvy, veteran investor and business builder

- Cheung Kong has a strong position in Hong Kong and a growing presence in China
- Strong free cash flow from high-quality businesses
- Reaffirm Buy rating

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

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## ■ What's new

We believe Cheung Kong has solid credentials that merit a rerating of the stock. The group has been one of the most astute property investors in Asia over recent years and should generate strong and growing free cash flow in the next few years, in our view, which the market should gradually come to recognise.

## ■ What's the impact

**A strong homebuilder in Hong Kong which has made considerable progress in China.** We think the Cheung Kong group runs its residential development business in a distinct way, which we see as a low-risk and profitable model for mass-market products. Such a model works in Hong Kong and may suit the China market well.

The group now looks to be one of the most advanced among the Hong Kong players in terms of penetrating China's residential property market, and we believe attributable pre-tax profit from China could exceed HKD3bn for 2012.

**Value creation at Cheung Kong level overshadowed by Hutchison Whampoa concerns.** We believe Cheung Kong has also made considerable progress in building up its hotel/serviced suites business, and the stub value of the group has continued to increase.

The stock's overall performance has been dragged down by Hutchison Whampoa due to the latter's exposure to Europe and telecom businesses, but we believe market concerns about this exposure could be coming to an end.

## ■ What we recommend

We reiterate our Buy (1) rating and six-month target price of HKD143.70, based on a 20% discount applied to our end-2013E NAV of HKD180.40. We see hidden value to unlock, triggered by strong and rising cash flow in prospect for the next few years.

Risks to our call would include a sharp decline in property demand in Hong Kong.

## ■ How we differ

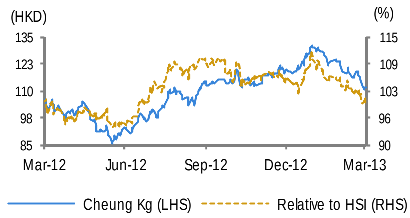
We believe the consensus has yet to recognise Cheung Kong's credentials as one of Asia's most astute property investors and the strong cash flow outlook we see for the group.

### Forecast revisions (%)

| Year to 31 Dec | 12E | 13E | 14E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

*Source: Daiwa forecasts*

### Share price performance




| | |
|---|---|
| 12-month range | 86.30-131.40 |
| Market cap (USDbn) | 33.34 |
| 3m avg daily turnover (USDm) | 64.74 |
| Shares outstanding (m) | 2,316 |
| Major shareholder | Li Ka Shing (43.3%) |

### Financial summary (HKD)

| Year to 31 Dec | 12E | 13E | 14E |
|---|---|---|---|
| Revenue (m) | 48,865 | 54,321 | 59,980 |
| Operating profit (m) | 18,265 | 20,416 | 22,673 |
| Net profit (m) | 26,870 | 31,280 | 35,510 |
| Core EPS (fully-diluted) | 11.601 | 13.505 | 15.331 |
| EPS change (%) | 8.8 | 16.4 | 13.5 |
| Daiwa vs Cons. EPS (%) | 10.6 | 14.7 | 20.3 |
| PER (x) | 9.6 | 8.3 | 7.3 |
| Dividend yield (%) | 3.0 | 3.3 | 3.6 |
| DPS | 3.400 | 3.700 | 4.000 |
| PBR (x) | 0.8 | 0.7 | 0.7 |
| EV/EBITDA (x) | 2.7 | 1.9 | 1.2 |
| ROE (%) | 8.5 | 9.3 | 9.8 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## ■ Key assumptions

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Rental EBIT (HKDm) | 1,231 | 1,449 | 1,739 | 1,817 | 1,698 | 1,968 | 2,283 | 2,602 |
| Property sales profit (HKDm) | 5,630 | 6,547 | 8,396 | 8,902 | 11,218 | 13,020 | 14,560 | 16,220 |

## ■ Profit and loss (HKDm)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Property sales | 13,406 | 13,889 | 21,513 | 29,297 | 38,143 | 42,320 | 49,350 | 54,450 |
| Rental income | 792 | 945 | 1,155 | 1,264 | 1,377 | 1,542 | 1,727 | 1,917 |
| Other Revenue | 1,244 | 1,602 | 1,625 | 2,302 | 2,839 | 5,003 | 3,244 | 3,613 |
| Total Revenue | 15,442 | 16,436 | 24,293 | 32,863 | 42,359 | 48,865 | 54,321 | 59,980 |
| Other income | 0 | 0 | 0 | 0 | 1,070 | 0 | 0 | 0 |
| COGS | (2,745) | (6,974) | (10,740) | (18,042) | (25,904) | (28,220) | (31,334) | (34,652) |
| SG&A | (825) | (944) | (1,032) | (1,590) | (1,810) | (1,950) | (2,120) | (2,190) |
| Other op.expenses | (257) | (284) | (349) | (398) | (400) | (430) | (451) | (465) |
| Operating profit | 11,615 | 8,234 | 12,172 | 12,833 | 15,315 | 18,265 | 20,416 | 22,673 |
| Net-interest inc./(exp.) | (984) | (454) | (233) | (222) | (372) | (387) | (402) | (422) |
| Assoc/forex/extraord./others | 15,709 | 8,716 | 7,381 | 12,496 | 29,718 | 12,968 | 15,709 | 18,201 |
| Pre-tax profit | 26,340 | 16,496 | 19,320 | 25,107 | 44,661 | 30,846 | 35,723 | 40,452 |
| Tax | (1,226) | (2,202) | (2,910) | (3,330) | (3,343) | (3,741) | (4,187) | (4,656) |
| Min. int./pref. div./others | (294) | (201) | (242) | (323) | (204) | (235) | (256) | (286) |
| Net profit (reported) | 24,820 | 14,093 | 16,168 | 21,454 | 41,114 | 26,870 | 31,280 | 35,510 |
| Net profit (adjusted) | 24,820 | 14,093 | 16,168 | 21,454 | 24,693 | 26,870 | 31,280 | 35,510 |
| EPS (reported)(HKD) | 10.716 | 6.085 | 6.980 | 9.263 | 17.751 | 11.601 | 13.505 | 15.331 |
| EPS (adjusted)(HKD) | 10.716 | 6.085 | 6.980 | 9.263 | 10.661 | 11.601 | 13.505 | 15.331 |
| EPS (adjusted fully-diluted)(HKD) | 10.716 | 6.085 | 6.980 | 9.263 | 10.661 | 11.601 | 13.505 | 15.331 |
| DPS (HKD) | 2.450 | 2.450 | 2.700 | 2.950 | 3.160 | 3.400 | 3.700 | 4.000 |
| EBIT | 11,615 | 8,234 | 12,172 | 12,833 | 15,315 | 18,265 | 20,416 | 22,673 |
| EBITDA | 11,872 | 8,518 | 12,521 | 13,231 | 15,715 | 18,695 | 20,867 | 23,138 |

## ■ Cash flow (HKDm)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 26,340 | 16,496 | 19,320 | 25,107 | 44,661 | 30,846 | 35,723 | 40,452 |
| Depreciation and amortisation | 257 | 284 | 349 | 398 | 400 | 430 | 451 | 465 |
| Tax paid | 0 | (914) | (713) | (824) | (3,456) | (1,088) | (1,230) | (1,350) |
| Change in working capital | 299 | (3,827) | 7,713 | 11,036 | 9,280 | 5,560 | 5,850 | 5,920 |
| Other operational CF items | (10,097) | (697) | 2,572 | (4,710) | (26,048) | (6,882) | (9,267) | (11,399) |
| Cash flow from operations | 16,799 | 11,342 | 29,241 | 31,007 | 24,837 | 28,866 | 31,527 | 34,088 |
| Capex | (12,676) | (11,045) | (6,520) | (12,450) | (35,155) | (20,650) | (22,250) | (23,250) |
| Net (acquisitions)/disposals | 7,041 | (994) | 2,034 | 562 | 3,400 | 735 | 780 | 790 |
| Other investing CF items | (1,235) | (346) | (2,726) | (1,094) | (1,294) | (1,365) | (1,450) | (1,490) |
| Cash flow from investing | (6,870) | (12,385) | (7,212) | (12,982) | (33,049) | (21,280) | (22,920) | (23,950) |
| Change in debt | (2,677) | 0 | (11,760) | 0 | 0 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends paid | (5,368) | (5,233) | (5,233) | (6,254) | (7,064) | (7,875) | (8,338) | (9,033) |
| Other financing CF items | (1,606) | (825) | (786) | (712) | (740) | (760) | (780) | (790) |
| Cash flow from financing | (9,651) | (6,058) | (17,779) | (6,966) | (7,804) | (8,635) | (9,118) | (9,823) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 278 | (7,101) | 4,250 | 11,059 | (16,016) | (1,049) | (511) | 315 |
| Free cash flow | 4,123 | 297 | 22,721 | 18,557 | (10,318) | 8,216 | 9,277 | 10,838 |

*Source: FactSet, Daiwa forecasts*

## Financial summary continued …

### ■ Balance sheet (HKDm)

| As at 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Cash & short-term investment | 5,609 | 7,173 | 11,423 | 25,147 | 19,894 | 18,845 | 18,334 | 18,649 |
| Inventory | 58,418 | 61,211 | 62,999 | 65,679 | 68,932 | 79,448 | 89,896 | 100,361 |
| Accounts receivable | 0 | 0 | 2,799 | 2,459 | 2,805 | 2,985 | 3,020 | 3,280 |
| Other current assets | 5,799 | 6,784 | 2,010 | 592 | 375 | 389 | 430 | 465 |
| Total current assets | 69,826 | 75,168 | 79,231 | 93,877 | 92,006 | 101,667 | 111,680 | 122,755 |
| Fixed assets | 26,057 | 27,294 | 30,129 | 31,569 | 36,413 | 41,164 | 44,923 | 47,920 |
| Goodwill & intangibles | 0 | 0 | 4 | 4 | 0 | 0 | 0 | 0 |
| Other non-current assets | 180,739 | 186,170 | 188,106 | 203,183 | 244,767 | 252,956 | 263,539 | 276,607 |
| Total assets | 276,622 | 288,632 | 297,470 | 328,633 | 373,186 | 395,787 | 420,142 | 447,282 |
| Short-term debt | 8,872 | 8,991 | 7,210 | 13,127 | 22,897 | 12,897 | 12,897 | 12,897 |
| Accounts payable | 0 | 0 | 12,078 | 18,298 | 9,701 | 12,130 | 13,560 | 14,310 |
| Other current liabilities | 8,186 | 7,518 | 3,488 | 3,280 | 2,433 | 3,480 | 3,590 | 3,640 |
| Total current liabilities | 17,058 | 16,509 | 22,776 | 34,705 | 35,031 | 28,507 | 30,047 | 30,847 |
| Long-term debt | 27,655 | 35,258 | 25,279 | 22,027 | 23,020 | 33,020 | 33,020 | 33,020 |
| Other non-current liabilities | 1,300 | 1,359 | 2,011 | 2,390 | 850 | 880 | 895 | 910 |
| Total liabilities | 46,013 | 53,126 | 50,066 | 59,122 | 58,901 | 62,407 | 63,962 | 64,777 |
| Share capital | 1,158 | 1,158 | 1,158 | 1,158 | 1,158 | 1,158 | 1,158 | 1,158 |
| Reserves/R.E./others | 226,045 | 230,006 | 242,441 | 264,538 | 305,267 | 324,262 | 346,972 | 373,217 |
| Shareholders' equity | 227,203 | 231,164 | 243,599 | 265,696 | 306,425 | 325,420 | 348,130 | 374,375 |
| Minority interests | 3,406 | 4,342 | 3,805 | 3,815 | 7,860 | 7,960 | 8,050 | 8,130 |
| Total equity & liabilities | 276,622 | 288,632 | 297,470 | 328,633 | 373,186 | 395,787 | 420,142 | 447,282 |
| EV | 123,321 | 119,739 | 102,952 | 78,994 | 56,343 | 49,635 | 39,958 | 26,954 |
| Net debt/(cash) | 30,918 | 37,076 | 21,066 | 10,007 | 26,023 | 27,072 | 27,583 | 27,268 |
| BVPS (HKD) | 98.093 | 99.803 | 105.172 | 114.712 | 132.296 | 140.497 | 150.302 | 161.633 |

### ■ Key ratios (%)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | 0.6 | 6.4 | 47.8 | 35.3 | 28.9 | 15.4 | 11.2 | 10.4 |
| EBITDA (YoY) | 44.4 | (28.3) | 47.0 | 5.7 | 18.8 | 19.0 | 11.6 | 10.9 |
| Operating profit (YoY) | 44.3 | (29.1) | 47.8 | 5.4 | 19.3 | 19.3 | 11.8 | 11.1 |
| Net profit (YoY) | 54.9 | (43.2) | 14.7 | 32.7 | 15.1 | 8.8 | 16.4 | 13.5 |
| Core EPS (fully-diluted) (YoY) | 54.9 | (43.2) | 14.7 | 32.7 | 15.1 | 8.8 | 16.4 | 13.5 |
| Gross-profit margin | 82.2 | 57.6 | 55.8 | 45.1 | 38.8 | 42.2 | 42.3 | 42.2 |
| EBITDA margin | 76.9 | 51.8 | 51.5 | 40.3 | 37.1 | 38.3 | 38.4 | 38.6 |
| Operating-profit margin | 75.2 | 50.1 | 50.1 | 39.1 | 36.2 | 37.4 | 37.6 | 37.8 |
| Net profit margin | 160.7 | 85.7 | 66.6 | 65.3 | 58.3 | 55.0 | 57.6 | 59.2 |
| ROAE | 11.6 | 6.1 | 6.8 | 8.4 | 8.6 | 8.5 | 9.3 | 9.8 |
| ROAA | 9.4 | 5.0 | 5.5 | 6.9 | 7.0 | 7.0 | 7.7 | 8.2 |
| ROCE | 4.5 | 3.0 | 4.3 | 4.4 | 4.6 | 4.9 | 5.2 | 5.5 |
| ROIC | 4.4 | 2.7 | 3.8 | 4.1 | 4.6 | 4.6 | 4.8 | 5.1 |
| Net debt to equity | 13.6 | 16.0 | 8.6 | 3.8 | 8.5 | 8.3 | 7.9 | 7.3 |
| Effective tax rate | 4.7 | 13.3 | 15.1 | 13.3 | 7.5 | 12.1 | 11.7 | 11.5 |
| Accounts receivable (days) | 0.0 | 0.0 | 21.0 | 29.2 | 22.7 | 21.6 | 20.2 | 19.2 |
| Current ratio (x) | 4.1 | 4.6 | 3.5 | 2.7 | 2.6 | 3.6 | 3.7 | 4.0 |
| Net interest cover (x) | 11.8 | 18.1 | 52.2 | 57.8 | 41.2 | 47.2 | 50.8 | 53.7 |
| Net dividend payout | 22.9 | 40.3 | 38.7 | 31.8 | 17.8 | 29.3 | 27.4 | 26.1 |
| Free cash flow yield | 1.6 | 0.1 | 8.8 | 7.2 | n.a. | 3.2 | 3.6 | 4.2 |

*Source: FactSet, Daiwa forecasts*

### ■ Company profile

Cheung Kong is one of the two largest property companies in Hong Kong. It is also the largest shareholder in Hutchison Whampoa, which has diversified investments in ports, telecom, property, retail and infrastructure businesses in Hong Kong and overseas. In Hong Kong, Cheung Kong concentrates more on the residential-property development business.

The 10-second briefing

# Fortune REIT

778 HK

Target (HKD): **8.20 → 8.20**
Upside: **19.4%**
19 Mar price (HKD): **6.87**

## Riding on the growing importance of suburban malls

- Benefits of its first round of AEI are materialising
- The REIT is expanding the scope of its AEI and this bodes well for its ability to sustain DPU growth in the medium term
- Unit price becoming attractive again after consolidation of unit price; reaffirm Buy (1) rating and target price of HKD8.20

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

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### ■ What's new

Fortune REIT's suburban malls are benefiting from its extensive AEI programme, as well as the increase in the number of Mainlanders shopping on the outskirts of town. We expect both trends to continue.

### ■ What's the impact

*Fortune REIT malls to benefit from the positive spill-over effect of rising rents in top-tier malls in the district.* We see a promising outlook for suburban malls, as rising retail rents in Hong Kong's prime areas are driving many retailers to consider suburban malls.

We do not expect the major international retailers to seek space in Fortune REIT's malls yet, but believe the group will ultimately benefit from the positive spill-over. In particular, we note that New Town Plaza in Shatin is becoming increasingly upmarket, and we believe Fortune City One mall has potential to be upgraded and attract a higher quality of tenant over time, given that it is one of the few sizeable malls in the Shatin area. Likewise, we think the REIT's Ma On Shan Plaza and Waldorf will benefit from the upgrading of nearby Tuen Mun Town Plaza and Sunshine City.

*AEI work is showing promising results and REIT's efforts are likely to accelerate in the next few years.* The rental reversion for Fortune REIT's malls reached 19.8% in 2012, the highest on record. We think the REIT is still in the early stages of reaping the benefits of its AEI work, and believe it will take 2-3 or more leasing cycles for the full benefits to be reflected in its financial results. As such, we believe Fortune REIT will remain in a business-growth phase over the next few years.

### ■ What we recommend

After the recent unit-price consolidation, we think the units are attractive once again. We maintain our six-month target price of HKD8.20, based on our 10-year Dividend Discount Model. This would translate into a 2014E DPU yield of 4.9%. We reaffirm our Buy (1) rating. The key risk to our call would be if the main unit-holders exit the units following the strong price surge in 2012.

### ■ How we differ

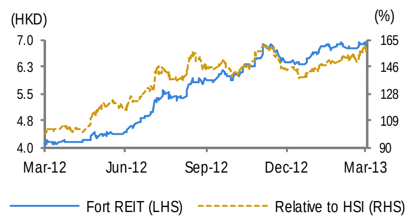
We believe Fortune is in the early phase of extracting the full potential of its portfolio and this has yet to be widely recognised.

**Forecast revisions (%)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net-property-income chg | - | - | - |
| DPU change | - | - | - |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 4.12-6.92 |
| Market cap (USDbn) | 1.52 |
| 3m avg daily turnover (USDm) | 3.28 |
| Shares outstanding (m) | 1,715 |
| Major shareholder | Cheung Kong Holdings (24.3%) |

**Financial summary (HKD)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 1,208 | 1,311 | 1,423 |
| Net property income (m) | 879 | 980 | 1,093 |
| Distribution (m) | 623 | 699 | 781 |
| DPU | 0.363 | 0.404 | 0.448 |
| DPU change (%) | 12.3 | 11.2 | 10.8 |
| Daiwa vs Cons. EPS (%) | 2.6 | 7.5 | 9.7 |
| DPU yield (%) | 5.3 | 5.9 | 6.5 |
| PER (x) | 21.7 | 19.1 | 16.7 |
| Core EPU (fully-diluted) | 0.316 | 0.359 | 0.411 |
| P/BV (x) | 0.8 | 0.8 | 0.8 |
| ROE (%) | 3.6 | 4.1 | 4.8 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## ■ Key assumptions

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Interest cover ratio (x) | 4.5 | 4.9 | 4.0 | 3.5 | 5.0 | 5.3 | 5.7 | 6.4 |
| Interest service ratio (x) | 1.0 | 1.4 | 1.1 | 1.2 | 1.2 | 1.1 | 1.1 | 1.1 |
| Average portfolio cap rate (%) | 7.4 | 6.1 | 6.3 | 5.5 | 5.5 | 6.0 | 6.5 | 7.0 |
| Funds from operations (HKDm) | (855) | 1,113 | 2,019 | 3,363 | 2,238 | 540 | 619 | 714 |
| Adj. funds from operations (HKDm) | (875) | 1,060 | 1,980 | 3,313 | 2,124 | 491 | 570 | 665 |

## ■ Profit and loss (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Total revenue | 637 | 701 | 837 | 909 | 1,114 | 1,208 | 1,311 | 1,423 |
| Operating expenses | (174) | (207) | (240) | (267) | (325) | (329) | (331) | (330) |
| Net property income | 463 | 495 | 597 | 642 | 788 | 879 | 980 | 1,093 |
| Other income | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Management fees | (28) | (28) | (37) | (46) | (58) | (61) | (61) | (61) |
| Other operating expenses | (12) | 3 | (38) | (22) | (31) | (31) | (31) | (31) |
| Depreciation and amortisation | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| EBIT | 423 | 469 | 522 | 574 | 700 | 788 | 889 | 1,001 |
| Net-int. income/(expenses) | (93) | (96) | (131) | (166) | (141) | (148) | (157) | (157) |
| Share of associates | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Revaluation gains/(loss) | (1,131) | 806 | 1,706 | 3,047 | 1,792 | 0 | 0 | 0 |
| Except./other inc./(exp.) | (0) | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Profit before tax | (801) | 1,179 | 2,097 | 3,456 | 2,350 | 640 | 732 | 845 |
| Taxation | (54) | (66) | (78) | (92) | (112) | (99) | (113) | (131) |
| Min. int./pref. div./others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net profit | (855) | 1,113 | 2,019 | 3,363 | 2,238 | 540 | 619 | 714 |
| Total return | 281 | 322 | 328 | 338 | 470 | 540 | 619 | 714 |
| Adjustments | 22 | 15 | 78 | 104 | 80 | 83 | 81 | 68 |
| Distributable income | 303 | 338 | 406 | 442 | 549 | 623 | 699 | 781 |
| Distribution rate | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Distribution | 303 | 338 | 406 | 442 | 549 | 623 | 699 | 781 |
| EPU (HKD) | 0.344 | 0.321 | 0.197 | 0.202 | 0.277 | 0.316 | 0.359 | 0.411 |
| DPU (HKD) | 0.369 | 0.302 | 0.243 | 0.263 | 0.324 | 0.363 | 0.404 | 0.448 |

## ■ Cash flow (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 330 | 373 | 391 | 409 | 559 | 640 | 732 | 845 |
| Depreciation and amortisation | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net-interest expenses | 101 | 96 | 132 | 174 | 147 | 148 | 157 | 157 |
| Share of associate | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in working capital | (6) | 144 | 23 | 92 | 57 | 15 | 31 | 34 |
| Tax paid | (45) | (66) | (61) | (71) | (89) | (99) | (113) | (131) |
| Other operating CF items | 28 | 28 | 37 | 46 | 58 | 61 | 61 | 61 |
| Cash flow from operation | 408 | 576 | 522 | 650 | 732 | 764 | 867 | 965 |
| Capex | (20) | (53) | (39) | (50) | (114) | (49) | (49) | (49) |
| Net investment and sale of FA | 1 | (2,003) | 0 | 0 | (1,900) | 0 | 0 | 0 |
| Other investing CF items | 8 | 1 | (79) | (53) | (3) | 0 | 0 | 0 |
| Cash flow from investing | (11) | (2,055) | (118) | (103) | (2,018) | (49) | (49) | (49) |
| Change in debt | 4 | 516 | 43 | 363 | 1,620 | 0 | 0 | 0 |
| Equity raised/(repaid) | 0 | 1,811 | 0 | 0 | 0 | 0 | 0 | 0 |
| Distribution paid | (292) | (314) | (381) | (417) | (495) | (591) | (660) | (739) |
| Other financing CF items | (104) | (169) | (110) | (112) | (129) | (130) | (139) | (139) |
| Cash flow from financing | (393) | 1,844 | (447) | (165) | 996 | (721) | (798) | (877) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 4 | 365 | (44) | 381 | (290) | (5) | 20 | 39 |

*Source: FactSet, Daiwa forecasts*

# Financial summary continued ...

## Balance sheet (HKDm)

| As at 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Cash & cash equivalent | 243 | 515 | 506 | 882 | 578 | 573 | 593 | 632 |
| Accounts receivable | 37 | 48 | 63 | 50 | 55 | 83 | 90 | 97 |
| Other current assets | (1) | 0 | 0 | 0 | 0 | 0 | 0 | 1 |
| Total current assets | 279 | 563 | 569 | 932 | 633 | 655 | 683 | 730 |
| Investment properties | 8,602 | 11,500 | 13,300 | 16,388 | 20,208 | 20,208 | 20,208 | 20,208 |
| 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 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total assets | 8,881 | 12,063 | 13,869 | 17,320 | 20,841 | 20,863 | 20,891 | 20,938 |
| Short-term debt | 0 | 2,786 | 79 | 420 | 940 | 940 | 940 | 940 |
| Accounts payable | 194 | 276 | 270 | 348 | 411 | 453 | 492 | 533 |
| Other current liabilities | 21 | 34 | 211 | 235 | 296 | 312 | 350 | 391 |
| Total current liabilities | 215 | 3,097 | 560 | 1,003 | 1,647 | 1,705 | 1,781 | 1,864 |
| Long-term debt | 2,343 | 0 | 2,772 | 2,794 | 3,879 | 3,879 | 3,879 | 3,879 |
| Other non-current liabilities | 168 | 133 | 203 | 295 | 338 | 193 | 193 | 193 |
| Total liabilities | 2,726 | 3,230 | 3,536 | 4,092 | 5,864 | 5,776 | 5,853 | 5,936 |
| Unitholders' funds | 6,156 | 8,833 | 10,334 | 13,228 | 14,978 | 15,087 | 15,038 | 15,001 |
| Minority interests | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total equity & liabilities | 8,882 | 12,063 | 13,869 | 17,320 | 20,841 | 20,863 | 20,891 | 20,937 |
| Book Value per unit | 7.500 | 5.316 | 6.182 | 7.855 | 8.809 | 8.795 | 8.690 | 8.593 |

## Key ratios (%)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Total revenue (YoY) | 3.6 | 10.1 | 19.4 | 8.6 | 22.5 | 8.5 | 8.5 | 8.5 |
| Net property income (YoY) | 2.9 | 6.8 | 20.7 | 7.6 | 22.8 | 11.5 | 11.5 | 11.5 |
| Net profit (YoY) | 9.3 | 14.7 | 1.8 | 3.0 | 38.9 | 15.1 | 14.5 | 15.4 |
| Distribution (YoY) | 6.3 | 11.6 | 20.3 | 8.8 | 24.2 | 13.4 | 12.2 | 11.8 |
| EPU (YoY) | 8.5 | (6.7) | (38.7) | 2.4 | 37.5 | 14.2 | 13.5 | 14.4 |
| DPU (YoY) | 5.2 | (18.2) | (19.5) | 8.0 | 23.2 | 12.3 | 11.2 | 10.8 |
| ROE | 9.1 | 4.1 | 3.4 | 2.9 | 3.3 | 3.6 | 4.1 | 4.8 |
| ROA | 6.3 | 3.0 | 2.5 | 2.2 | 2.5 | 2.6 | 3.0 | 3.4 |
| ROCE | 10.0 | 4.5 | 4.2 | 3.9 | 3.9 | 4.0 | 4.5 | 5.0 |
| ROIC | 10.0 | 4.4 | 4.2 | 3.9 | 3.8 | 3.4 | 3.9 | 4.4 |
| Debt to asset | 23.6 | 18.8 | 16.9 | 13.5 | 20.3 | 20.4 | 20.2 | 20.0 |
| Net debt to equity | 34.1 | 25.7 | 22.7 | 17.6 | 28.3 | 28.1 | 28.1 | 27.9 |
| Effective tax rate | n.a. | 5.6 | 3.7 | 2.7 | 4.8 | 15.5 | 15.5 | 15.5 |

*Source: FactSet, Daiwa forecasts*

## Company profile

Fortune REIT holds only retail properties in Hong Kong. It was listed on the Singapore Stock Exchange in 2003 and then gained a dual listing in Hong Kong in April 2010. It started by acquiring the retail-property assets of the Cheung Kong group. The current REIT manager is ARA Asset Management (Not rated), which is listed in Singapore.

Daiwa Capital Markets

Company

Financials / Hong Kong
22 March 2013

The 10-second briefing

# Hang Lung Properties

101 HK

Target (HKD): **34.40 → 34.40**
Upside: **17.8%**
19 Mar price (HKD): **29.20**

# Still a solid, pure China retail property play

- Repositioning Palace 66; other China projects on track
- An acceleration of the group's Hong Kong property sales would be positive for earnings
- A laggard among property investors, and concerns about Palace 66 in Shenyang appear overdone; reaffirm Buy

1 Buy (unchanged)
2 Outperform
3 Hold
4 Underperform
5 Sell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## ■ What's new

We do not think there are as yet many players in the business of managing commercial properties for the long term in China, and as such we see Hang Lung Properties as a winner in the sector.

## ■ What's the impact

**Execution risk for initial rollout of new China projects on the decline**. Since 2010, Hang Lung Properties has opened three sizeable new malls in China, all of which were almost fully leased before opening. It has built up a critical mass of retailers as partners in China, and this should reduce the execution risk related to the initial rollout of its remaining projects.

**Some initial hitches in Shenyang, but issues being addressed.** We have visited Palace 66 several times since it opened in 2010 and believe Hang Lung Properties is actively repositioning it as a mall for the younger generation of the wealthy. The property's rental income rose by 7.6% HoH for 2H12 despite a fall in the occupancy rate to 88% (vs. 93% in 1H12). We believe the worst is probably over for this mall.

In our opinion, the key to retail properties is management, and it is normal for a new mall to take 2-3 leasing cycles to mature. Parc 66 in Jinan is progressing well with an initial yield on cost at 7-9%, compared with its original budget of about 5%, while Forum 66 has built up a market image as a high-end mall in Shenyang.

## ■ What we recommend

Hang Lung Properties' current valuation is notably cheaper compared with its level in recent years. Moreover, we think an acceleration of property sales in Hong Kong would be positive for Hang Lung's earnings. We expect the shares catch up with those of other landlord companies in the coming months, and reaffirm our Buy (1) rating with a six-month target price of HKD34.40, based on a 25% discount applied to our end-2013E NAV of HKD45.9.

Risks to our call would include execution risk related to the rollout of upcoming projects.

## ■ How we differ

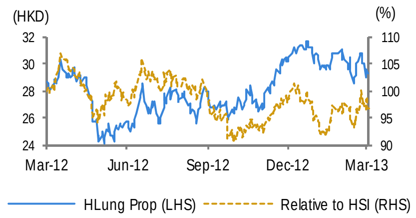
Unlike some in the market, we do not believe the initial difficulties at Palace 66 suggest the company's business model cannot work outside Shanghai, or that Shenyang is a poor market for retail property.

### Forecast revisions (%)

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

Source: Daiwa forecasts

### Share price performance




| | |
|---|---|
| 12-month range | 24.10-31.25 |
| Market cap (USDbn) | 16.85 |
| 3m avg daily turnover (USDm) | 26.56 |
| Shares outstanding (m) | 4,477 |
| Major shareholder | Hang Lung Group (52.6%) |

### Financial summary (HKD)

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 13,411 | 15,343 | 17,745 |
| Operating profit (m) | 9,547 | 10,947 | 12,249 |
| Net profit (m) | 7,150 | 8,260 | 9,290 |
| Core EPS (fully-diluted) | 1.597 | 1.845 | 2.075 |
| EPS change (%) | 15.7 | 15.5 | 12.5 |
| Daiwa vs Cons. EPS (%) | 12.0 | 15.4 | 22.9 |
| PER (x) | 18.3 | 15.8 | 14.1 |
| Dividend yield (%) | 2.7 | 2.9 | 3.1 |
| DPS | 0.800 | 0.850 | 0.900 |
| PBR (x) | 1.1 | 1.0 | 1.0 |
| EV/EBITDA (x) | 14.0 | 12.4 | 11.1 |
| ROE (%) | 6.0 | 6.7 | 7.2 |

Source: FactSet, Daiwa forecasts

# 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 | 5,519 | 6,098 | 6,666 | 7,150 | 7,854 |
| Rental EBIT (HKDm) | 3,046 | 3,441 | 3,726 | 4,194 | 4,896 | 5,318 | 5,697 | 6,213 |
| Property sales profit (HKDm) | 3,552 | 3 | 5,256 | 2 | 2,994 | 4,722 | 5,735 | 6,924 |

## ■ 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 | 6,666 | 7,150 | 7,854 |
| Property sales | 6,335 | 11 | 7,511 | 3 | 2,994 | 4,722 | 5,735 | 6,924 |
| Other Revenue | 0 | 0 | 0 | 0 | (1,720) | 2,023 | 2,458 | 2,967 |
| Total Revenue | 10,080 | 4,173 | 12,057 | 5,164 | 7,372 | 13,411 | 15,343 | 17,745 |
| Other income | 281 | 157 | 35 | 231 | 2,774 | 235 | 237 | 250 |
| COGS | (3,482) | (729) | (3,075) | (968) | (1,630) | (3,427) | (3,943) | (5,016) |
| SG&A | (361) | (383) | (456) | (512) | (626) | (672) | (690) | (730) |
| Other op.expenses | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Operating profit | 6,518 | 3,218 | 8,561 | 3,915 | 7,890 | 9,547 | 10,947 | 12,249 |
| Net-interest inc./(exp.) | (150) | (69) | (47) | (93) | (348) | (376) | (406) | (440) |
| Assoc/forex/extraord./others | 129 | 23 | 166 | 98 | 105 | 106 | 110 | 118 |
| Pre-tax profit | 6,497 | 3,172 | 8,680 | 3,920 | 7,647 | 9,277 | 10,651 | 11,927 |
| Tax | (926) | (476) | (1,432) | (815) | (944) | (1,577) | (1,811) | (2,028) |
| Min. int./pref. div./others | (448) | (308) | (574) | (364) | (525) | (550) | (580) | (610) |
| Net profit (reported) | 5,123 | 2,388 | 6,674 | 2,741 | 6,178 | 7,150 | 8,260 | 9,290 |
| Net profit (adjusted) | 5,123 | 2,388 | 6,674 | 2,741 | 6,178 | 7,150 | 8,260 | 9,290 |
| EPS (reported)(HKD) | 1.236 | 0.576 | 1.605 | 0.613 | 1.380 | 1.597 | 1.845 | 2.075 |
| EPS (adjusted)(HKD) | 1.236 | 0.576 | 1.605 | 0.613 | 1.380 | 1.597 | 1.845 | 2.075 |
| EPS (adjusted fully-diluted)(HKD) | 1.226 | 0.576 | 1.605 | 0.613 | 1.380 | 1.597 | 1.845 | 2.075 |
| DPS (HKD) | 0.660 | 0.660 | 0.710 | 0.710 | 0.740 | 0.800 | 0.850 | 0.900 |
| EBIT | 6,518 | 3,218 | 8,561 | 3,915 | 7,890 | 9,547 | 10,947 | 12,249 |
| EBITDA | 6,518 | 3,218 | 8,561 | 3,915 | 7,890 | 9,547 | 10,947 | 12,249 |

## ■ 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 | 9,277 | 10,651 | 11,927 |
| Depreciation and amortisation | 0 | 13 | 23 | 25 | 27 | 29 | 31 | 33 |
| Tax paid | (288) | (474) | (1,131) | (735) | (1,018) | (1,580) | (1,890) | (2,010) |
| Change in working capital | 1,658 | 544 | 1,414 | 620 | 554 | 720 | 740 | 780 |
| Other operational CF items | (76) | 26 | (182) | (73) | 171 | 195 | 216 | 237 |
| Cash flow from operations | 7,791 | 3,281 | 8,804 | 3,757 | 7,381 | 8,641 | 9,748 | 10,967 |
| Capex | (1,347) | (2,230) | (3,666) | (5,982) | (8,088) | (7,158) | (7,820) | (7,980) |
| Net (acquisitions)/disposals | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other investing CF items | 451 | 869 | 119 | 124 | 129 | 134 | 136 | 140 |
| Cash flow from investing | (896) | (1,361) | (3,547) | (5,858) | (7,959) | (7,024) | (7,684) | (7,840) |
| 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) | (3,288) | (3,520) | (3,696) |
| Other financing CF items | (568) | (1,033) | (386) | (392) | (415) | (430) | (442) | (460) |
| Cash flow from financing | (3,323) | (3,763) | (3,069) | 7,490 | (3,598) | (3,718) | (3,962) | (4,156) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 3,572 | (1,843) | 2,188 | 5,389 | (4,177) | (2,102) | (1,898) | (1,029) |
| Free cash flow | 6,444 | 1,051 | 5,138 | (2,225) | (707) | 1,483 | 1,928 | 2,987 |

*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 | 32,025 | 30,996 |
| Inventory | 6,817 | 7,683 | 5,855 | 5,963 | 6,109 | 4,980 | 3,320 | 2,310 |
| 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 |
| Total current assets | 18,761 | 17,300 | 18,884 | 35,148 | 43,856 | 40,473 | 37,057 | 35,066 |
| Fixed assets | 64,844 | 70,336 | 96,291 | 107,646 | 122,955 | 130,825 | 139,197 | 147,043 |
| Goodwill & intangibles | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other non-current assets | 737 | 872 | 993 | 1,888 | 1,053 | 1,230 | 1,280 | 1,290 |
| Total assets | 84,342 | 88,508 | 116,168 | 144,682 | 167,864 | 172,528 | 177,534 | 183,399 |
| Short-term debt | 0 | 1,500 | 1,480 | 4,500 | 1,113 | 1,113 | 1,113 | 1,113 |
| 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 |
| Total current liabilities | 2,555 | 4,359 | 5,688 | 9,126 | 6,316 | 6,421 | 6,493 | 6,593 |
| Long-term debt | 5,919 | 4,661 | 4,978 | 12,236 | 28,623 | 28,623 | 28,623 | 28,623 |
| Other non-current liabilities | 7,217 | 8,158 | 12,876 | 8,396 | 8,947 | 9,010 | 9,068 | 9,120 |
| Total liabilities | 15,691 | 17,178 | 23,542 | 29,758 | 43,886 | 44,054 | 44,184 | 44,336 |
| 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 | 117,312 | 122,053 | 127,646 |
| Shareholders' equity | 66,377 | 68,038 | 87,944 | 109,719 | 117,928 | 121,789 | 126,530 | 132,123 |
| Minority interests | 2,274 | 3,292 | 4,682 | 5,205 | 6,050 | 6,685 | 6,820 | 6,940 |
| Total equity & liabilities | 84,342 | 88,508 | 116,168 | 144,682 | 167,864 | 172,528 | 177,534 | 183,399 |
| EV | 128,343 | 131,250 | 130,333 | 125,467 | 130,489 | 133,226 | 135,259 | 136,408 |
| Net debt/(cash) | (4,659) | (2,770) | (5,077) | (10,466) | (6,289) | (4,187) | (2,289) | (1,260) |
| BVPS (HKD) | 16.018 | 16.411 | 21.145 | 24.535 | 26.341 | 27.203 | 28.262 | 29.512 |

## 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 | 81.9 | 14.4 | 15.7 |
| EBITDA (YoY) | 135.9 | (50.6) | 166.0 | (54.3) | 101.5 | 21.0 | 14.7 | 11.9 |
| Operating profit (YoY) | 135.9 | (50.6) | 166.0 | (54.3) | 101.5 | 21.0 | 14.7 | 11.9 |
| Net profit (YoY) | 150.1 | (53.4) | 179.5 | (58.9) | 125.4 | 15.7 | 15.5 | 12.5 |
| Core EPS (fully-diluted) (YoY) | 141.4 | (53.0) | 178.6 | (61.8) | 125.1 | 15.7 | 15.5 | 12.5 |
| Gross-profit margin | 65.5 | 82.5 | 74.5 | 81.3 | 77.9 | 74.4 | 74.3 | 71.7 |
| EBITDA margin | 64.7 | 77.1 | 71.0 | 75.8 | 107.0 | 71.2 | 71.3 | 69.0 |
| Operating-profit margin | 64.7 | 77.1 | 71.0 | 75.8 | 107.0 | 71.2 | 71.3 | 69.0 |
| Net profit margin | 50.8 | 57.2 | 55.4 | 53.1 | 83.8 | 53.3 | 53.8 | 52.4 |
| ROAE | 8.5 | 3.6 | 8.6 | 2.8 | 5.4 | 6.0 | 6.7 | 7.2 |
| ROAA | 6.7 | 2.8 | 6.5 | 2.1 | 4.0 | 4.2 | 4.7 | 5.1 |
| ROCE | 9.5 | 4.2 | 9.7 | 3.4 | 5.5 | 6.1 | 6.8 | 7.4 |
| ROIC | 9.4 | 4.1 | 9.2 | 3.2 | 6.2 | 6.5 | 7.1 | 7.6 |
| Net debt to equity | net cash | net cash | net cash | net cash | net cash | net cash | net cash | net cash |
| Effective tax rate | 14.3 | 15.0 | 16.5 | 20.8 | 12.3 | 17.0 | 17.0 | 17.0 |
| Accounts receivable (days) | 39.9 | 89.7 | 33.0 | 122.9 | 80.5 | 35.2 | 32.9 | 30.2 |
| Current ratio (x) | 7.3 | 4.0 | 3.3 | 3.9 | 6.9 | 6.3 | 5.7 | 5.3 |
| Net interest cover (x) | 43.5 | 46.6 | 182.1 | 42.1 | 22.7 | 25.4 | 27.0 | 27.8 |
| Net dividend payout | 53.4 | 114.6 | 44.2 | 115.8 | 53.6 | 50.1 | 46.1 | 43.4 |
| Free cash flow yield | 4.9 | 0.8 | 3.9 | n.a. | n.a. | 1.1 | 1.5 | 2.3 |

*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.

Daiwa Capital Markets

Company



The 10-second briefing

# Henderson Land

12 HK

Target (HKD): **67.30 → 67.30**
Upside: **38.2%**
19 Mar price (HKD): **48.70**

# Entering a harvesting period; still 'option' value to unlock

- Pre-sales of Double Cove and The Reach could underpin Henderson's property sales profits up to 2015
- Projects from redeveloping old buildings and agricultural land conversion should create option value in the shares
- Reaffirm Buy rating

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

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## What's new

We believe Henderson's abundant landbank in agricultural land and old buildings should position it well to capitalise on opportunities in the Hong Kong residential property market in coming years.

## What's the impact

**Two major agricultural land conversions expected to underpin profit to 2015.** Double Cove phase one has sold well (over 85% sold), and sales of The Reach have picked up notably in recent weeks (over 1,250 units sold). These projects should help underpin Henderson's profit on property assets out to 2015 or even beyond.

**Harvesting years of investments in assembling old buildings.** The group has finally started to accelerate new launches due in the next few months, with High Place in Kowloon City and two projects in Boundary Street still to be officially launched. We believe Henderson pipeline can enable it to launch a new project almost every 1-2 months over the next two years, and we see the projects involving redeveloping old buildings in the urban areas as both profitable and low-risk. An improvement in news flow related to upcoming new launches would be positive for the shares, in our view.

**Considerable option value to unlock, in our view.** Apart from old buildings, we believe agricultural land is another source of option value for the shares, as facilitating the conversion of agricultural land is one of the most effective ways for the government to boost supply. In addition, Henderson Land has other sites that are pending land conversion (a joint-venture project in Yau Tong Bay, for example), which we believe represent another source of hidden value.

## What we recommend

We reaffirm our Buy (1) rating and six-month target price of HKD67.30, based on a 30% discount to our end-2013E NAV of HKD180.4.

Risks to our call would include a sharp fall in property demand in Hong Kong.

## How we differ

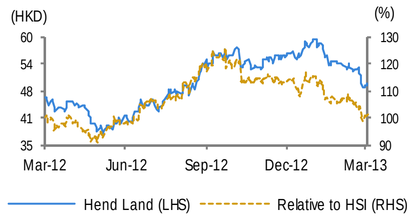
We believe Henderson Land is entering a harvesting period that the market may not yet have discounted.

**Forecast revisions (%)**

| Year to 31 Dec | 12E | 13E | 14E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 37.85-59.35 |
| Market cap (USDbn) | 14.91 |
| 3m avg daily turnover (USDm) | 29.48 |
| Shares outstanding (m) | 2,376 |
| Major shareholder | Lee Shau Kee (62.2%) |

**Financial summary (HKD)**

| Year to 31 Dec | 12E | 13E | 14E |
|---|---|---|---|
| Revenue (m) | 15,443 | 19,041 | 22,083 |
| Operating profit (m) | 5,438 | 6,773 | 7,896 |
| Net profit (m) | 6,540 | 7,986 | 9,190 |
| Core EPS (fully-diluted) | 2.753 | 3.361 | 3.868 |
| EPS change (%) | 11.4 | 22.1 | 15.1 |
| Daiwa vs Cons. EPS (%) | (10.1) | 3.6 | 12.6 |
| PER (x) | 17.7 | 14.5 | 12.6 |
| Dividend yield (%) | 2.5 | 2.7 | 3.0 |
| DPS | 1.200 | 1.300 | 1.450 |
| PBR (x) | 0.6 | 0.6 | 0.6 |
| EV/EBITDA (x) | 16.4 | 12.9 | 10.5 |
| ROE (%) | 3.5 | 4.2 | 4.7 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## Key assumptions

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Property sales profit (HKDm) | 1,565 | 2,737 | 3,171 | 539 | 2,079 | 2,850 | 3,910 | 4,690 |
| Rental EBIT (HKDm) | 1,600 | 1,741 | 2,621 | 3,382 | 4,169 | 4,620 | 5,040 | 5,490 |

## Profit and loss (HKDm)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Property sales | 4,658 | 9,173 | 8,673 | 2,522 | 9,692 | 9,500 | 12,613 | 15,129 |
| Rental income | 2,484 | 2,625 | 4,178 | 3,157 | 3,920 | 4,273 | 4,657 | 5,077 |
| Other Revenue | 1,214 | 1,694 | 2,379 | 1,413 | 1,576 | 1,670 | 1,771 | 1,877 |
| Total Revenue | 8,356 | 13,492 | 15,230 | 7,092 | 15,188 | 15,443 | 19,041 | 22,083 |
| Other income | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| COGS | (3,647) | (7,345) | (7,767) | (2,415) | (8,418) | (7,994) | (10,086) | (11,890) |
| SG&A | (481) | (703) | (1,536) | (1,024) | (1,045) | (1,060) | (1,098) | (1,120) |
| Other op.expenses | (887) | (809) | (723) | (806) | (1,178) | (951) | (1,084) | (1,177) |
| Operating profit | 3,341 | 4,635 | 5,204 | 2,847 | 4,547 | 5,438 | 6,773 | 7,896 |
| Net-interest inc./(exp.) | (508) | (576) | (1,341) | (970) | (1,169) | (1,309) | (1,365) | (1,420) |
| Assoc/forex/extraord./others | 4,949 | 2,974 | 3,443 | 4,058 | 3,548 | 3,697 | 4,122 | 4,482 |
| Pre-tax profit | 7,782 | 7,032 | 7,306 | 5,935 | 6,926 | 7,826 | 9,530 | 10,958 |
| Tax | (396) | (678) | (1,005) | (711) | (1,310) | (1,174) | (1,429) | (1,644) |
| Min. int./pref. div./others | (1,503) | (646) | (213) | (182) | (56) | (112) | (115) | (124) |
| Net profit (reported) | 5,883 | 5,707 | 6,088 | 5,042 | 5,560 | 6,540 | 7,986 | 9,190 |
| Net profit (adjusted) | 5,883 | 5,707 | 6,088 | 5,042 | 5,560 | 6,540 | 7,986 | 9,190 |
| EPS (reported)(HKD) | 3.110 | 2.781 | 2.967 | 2.317 | 2.471 | 2.753 | 3.361 | 3.868 |
| EPS (adjusted)(HKD) | 3.110 | 2.781 | 2.967 | 2.317 | 2.471 | 2.753 | 3.361 | 3.868 |
| EPS (adjusted fully-diluted)(HKD) | 3.110 | 2.781 | 2.967 | 2.317 | 2.471 | 2.753 | 3.361 | 3.868 |
| DPS (HKD) | 1.100 | 1.100 | 1.100 | 1.000 | 1.100 | 1.200 | 1.300 | 1.450 |
| EBIT | 3,341 | 4,635 | 5,204 | 2,847 | 4,547 | 5,438 | 6,773 | 7,896 |
| EBITDA | 3,456 | 4,808 | 5,350 | 2,995 | 4,699 | 5,602 | 6,944 | 8,074 |

## Cash flow (HKDm)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 7,782 | 7,032 | 7,306 | 5,935 | 6,926 | 7,826 | 9,530 | 10,958 |
| Depreciation and amortisation | 115 | 173 | 146 | 148 | 152 | 164 | 171 | 178 |
| Tax paid | (298) | (804) | (863) | (917) | (973) | (1,050) | (1,080) | (1,140) |
| Change in working capital | 0 | 212 | 235 | 252 | 268 | 285 | 290 | 313 |
| Other operational CF items | (2,903) | (955) | (264) | (521) | 46 | 774 | 403 | 448 |
| Cash flow from operations | 4,697 | 5,659 | 6,560 | 4,897 | 6,419 | 7,999 | 9,314 | 10,757 |
| Capex | (4,520) | (27,848) | (9,625) | (23,368) | (8,546) | (8,620) | (8,950) | (7,380) |
| Net (acquisitions)/disposals | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other investing CF items | 1,822 | 1,931 | 2,162 | 2,962 | 4,379 | 2,499 | 2,560 | 2,620 |
| Cash flow from investing | (2,698) | (25,917) | (7,463) | (20,406) | (4,167) | (6,121) | (6,390) | (4,760) |
| Change in debt | 0 | 3,312 | 383 | 0 | 0 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 5,500 | 12,579 | 0 | 0 | 10,000 | 0 | 0 | 0 |
| Dividends paid | (2,234) | (2,429) | (2,362) | (2,362) | (2,362) | (2,645) | (2,860) | (3,205) |
| Other financing CF items | (980) | (1,093) | (2,269) | (1,345) | (1,567) | (1,721) | (1,817) | (1,872) |
| Cash flow from financing | 2,286 | 12,369 | (4,247) | (3,707) | 6,072 | (4,366) | (4,677) | (5,077) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 4,285 | (7,890) | (5,150) | (19,215) | 8,324 | (2,488) | (1,753) | 920 |
| Free cash flow | 177 | (22,189) | (3,065) | (18,471) | (2,127) | (621) | 364 | 3,377 |

*Source: FactSet, Daiwa forecasts*

# Financial summary continued ...

## Balance sheet (HKDm)

| As at 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Cash & short-term investment | 9,520 | 15,675 | 10,525 | 9,916 | 19,364 | 9,364 | 7,611 | 8,531 |
| Inventory | 29,383 | 37,624 | 41,541 | 60,717 | 68,204 | 69,250 | 70,320 | 71,560 |
| Accounts receivable | 3,525 | 5,072 | 7,365 | 4,497 | 4,495 | 5,210 | 5,560 | 5,840 |
| Other current assets | 2,522 | 4,997 | 6,136 | 6,925 | 8,433 | 8,620 | 8,752 | 8,890 |
| Total current assets | 44,950 | 63,368 | 65,567 | 82,055 | 100,496 | 92,444 | 92,243 | 94,821 |
| Fixed assets | 52,831 | 59,912 | 69,320 | 84,068 | 92,771 | 95,433 | 96,974 | 98,836 |
| Goodwill & intangibles | 0 | 268 | 508 | 512 | 516 | 523 | 565 | 580 |
| Other non-current assets | 35,116 | 51,369 | 55,847 | 63,677 | 68,687 | 72,410 | 76,645 | 80,660 |
| Total assets | 132,896 | 174,917 | 191,242 | 230,312 | 262,470 | 260,810 | 266,427 | 274,897 |
| Short-term debt | 3,007 | 3,307 | 4,858 | 7,516 | 19,699 | 4,699 | 4,699 | 4,699 |
| Accounts payable | 4,397 | 4,589 | 5,359 | 5,812 | 9,030 | 10,795 | 11,092 | 13,342 |
| Other current liabilities | 738 | 879 | 752 | 733 | 798 | 802 | 832 | 850 |
| Total current liabilities | 8,142 | 8,775 | 10,969 | 14,061 | 29,527 | 16,296 | 16,623 | 18,891 |
| Long-term debt | 15,263 | 32,319 | 31,151 | 47,099 | 36,041 | 43,529 | 43,529 | 43,529 |
| Other non-current liabilities | 8,749 | 9,622 | 11,612 | 4,729 | 6,977 | 7,043 | 7,175 | 7,325 |
| Total liabilities | 32,154 | 50,716 | 53,732 | 65,889 | 72,545 | 66,868 | 67,327 | 69,745 |
| Share capital | 3,885 | 4,294 | 4,294 | 4,352 | 4,738 | 4,738 | 4,738 | 4,738 |
| Reserves/R.E./others | 88,334 | 116,929 | 128,833 | 154,686 | 180,598 | 184,524 | 189,612 | 195,594 |
| Shareholders' equity | 92,219 | 121,223 | 133,127 | 159,038 | 185,336 | 189,262 | 194,350 | 200,332 |
| Minority interests | 8,525 | 2,978 | 4,383 | 5,385 | 4,589 | 4,680 | 4,750 | 4,820 |
| Total equity & liabilities | 132,898 | 174,917 | 191,242 | 230,312 | 262,470 | 260,810 | 266,427 | 274,897 |
| EV | 101,282 | 90,856 | 93,298 | 106,867 | 92,837 | 92,005 | 89,728 | 84,918 |
| Net debt/(cash) | 8,750 | 19,951 | 25,484 | 44,699 | 36,376 | 38,864 | 40,617 | 39,697 |
| BVPS (HKD) | 47.462 | 56.462 | 62.006 | 73.087 | 78.003 | 79.656 | 81.797 | 84.315 |

## Key ratios (%)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | 23.4 | 61.5 | 12.9 | (53.4) | 114.2 | 1.7 | 23.3 | 16.0 |
| EBITDA (YoY) | 21.6 | 39.1 | 11.3 | (44.0) | 56.9 | 19.2 | 24.0 | 16.3 |
| Operating profit (YoY) | 22.8 | 38.7 | 12.3 | (45.3) | 59.7 | 19.6 | 24.5 | 16.6 |
| Net profit (YoY) | 11.7 | (3.0) | 6.7 | (17.2) | 10.3 | 17.6 | 22.1 | 15.1 |
| Core EPS (fully-diluted) (YoY) | 7.1 | (10.6) | 6.7 | (21.9) | 6.7 | 11.4 | 22.1 | 15.1 |
| Gross-profit margin | 56.4 | 45.6 | 49.0 | 65.9 | 44.6 | 48.2 | 47.0 | 46.2 |
| EBITDA margin | 41.4 | 35.6 | 35.1 | 42.2 | 30.9 | 36.3 | 36.5 | 36.6 |
| Operating-profit margin | 40.0 | 34.4 | 34.2 | 40.1 | 29.9 | 35.2 | 35.6 | 35.8 |
| Net profit margin | 70.4 | 42.3 | 40.0 | 71.1 | 36.6 | 42.3 | 41.9 | 41.6 |
| ROAE | 6.9 | 5.3 | 4.8 | 3.5 | 3.2 | 3.5 | 4.2 | 4.7 |
| ROAA | 4.5 | 3.7 | 3.3 | 2.4 | 2.3 | 2.5 | 3.0 | 3.4 |
| ROCE | 2.9 | 3.3 | 3.1 | 1.5 | 2.0 | 2.2 | 2.8 | 3.2 |
| ROIC | 2.9 | 3.3 | 2.9 | 1.3 | 1.7 | 2.0 | 2.4 | 2.8 |
| Net debt to equity | 9.5 | 16.5 | 19.1 | 28.1 | 19.6 | 20.5 | 20.9 | 19.8 |
| Effective tax rate | 5.1 | 9.6 | 13.8 | 12.0 | 18.9 | 15.0 | 15.0 | 15.0 |
| Accounts receivable (days) | 150.9 | 116.3 | 149.0 | 305.2 | 108.0 | 114.7 | 103.2 | 94.2 |
| Current ratio (x) | 5.5 | 7.2 | 6.0 | 5.8 | 3.4 | 5.7 | 5.5 | 5.0 |
| Net interest cover (x) | 6.6 | 8.0 | 3.9 | 2.9 | 3.9 | 4.2 | 5.0 | 5.6 |
| Net dividend payout | 35.4 | 39.5 | 37.1 | 43.2 | 44.5 | 43.6 | 38.7 | 37.5 |
| Free cash flow yield | 0.2 | n.a. | n.a. | n.a. | n.a. | n.a. | 0.3 | 2.9 |

*Source: FactSet, Daiwa forecasts*

## Company profile

Henderson Land is one of the largest property companies in Hong Kong and has diversified investments in the residential-, office- and retail-property sectors. It is the largest holder of agricultural land in Hong Kong currently and also the largest shareholder in HK and China Gas as well as Miramar Hotel and HK Ferry. In recent years, Henderson Land has been increasing its investment in China property, and has a landbank of more than 100m sq ft in the country currently.

The 10-second briefing

# Hong Kong Exchanges & Clearing

388 HK

Target (HKD): **159.60 → 159.60**
Upside: **20.3%**
19 Mar price (HKD): **132.70**

## A play on Hong Kong's prospects as a finance centre

- The two-year downward spiral in ADT seems to have ended
- We think there is a fair chance that some investing capital from China will be allowed to flow out in 6-12 months
- There is upside potential to both ADT and London Metal Exchange profitability over the medium term

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

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### ■ What's new

With ADT seeming to have turned the corner and the London Metal Exchange (LME) deal potentially strengthening Hong Kong as a finance centre for China, we see significant opportunities for HKEx over the next few years.

### ■ What's the impact

**The two-year downturn in ADT appears to have ended.** ADT in Hong Kong has been on a downward trend since 2010, which we attribute to the flow of investing capital from equities into bonds and from developing markets back to the developed markets. While it is too early to say whether such a trend has reversed, ADT in Hong Kong in 2013 year-to-date suggests that the two-year downward spiral in ADT may have ended.

**Whether China liquidity flows out is a wild card for 2013.** Apart from a potential inflow of liquidity from Western markets into Asia, another wild card for ADT in 2013 and beyond is whether the PRC Government allows some liquidity in China to flow out, which would be consistent with its national policy. However, we see a fair chance of China allowing investing capital to flow to Hong Kong this year, which would benefit HKEx.

**LME represents another source of option value.** While market opinions relating to the LME deal seem to be generally negative, we see this deal as an affordable investment that could bring Hong Kong to the next level in terms of becoming an all-round international financial centre for China. In any case, we believe the financing risk related to the deal has been addressed by the group's share placement and issuance of zero coupon bonds, and we see significant room for the profitability of LME to be enhanced over time.

### ■ What we recommend

We see upside risk in ADT in Hong Kong in 2013 and beyond. Our six-month target price for HKEx of HKD159.60 is based on a 30x 2013E PER, assuming ADT in Hong Kong reaches HKD85bn in 2013. We maintain our Outperform rating on the stock. The key risk to our call would be a plunge in ADT due to another crisis in the global financial markets.

### ■ How we differ

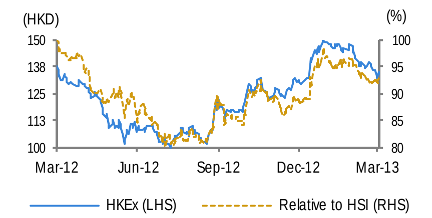
Unlike the consensus, we see upside risk for ADT in Hong Kong and for LME profitability medium term.

**Forecast revisions (%)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 100.30-149.90 |
| Market cap (USDbn) | 19.66 |
| 3m avg daily turnover (USDm) | 87.30 |
| Shares outstanding (m) | 1,150 |
| Major shareholder | Government of the HK SAR (5.8%) |

**Financial summary (HKD)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 8,836 | 9,347 | 9,690 |
| Operating profit (m) | 6,374 | 6,803 | 7,076 |
| Net profit (m) | 5,195 | 5,522 | 5,740 |
| Core EPS (fully-diluted) | 4.518 | 4.803 | 4.992 |
| EPS change (%) | 19.9 | 6.3 | 3.9 |
| Daiwa vs Cons. EPS (%) | 0.0 | (4.6) | (8.4) |
| PER (x) | 29.4 | 27.6 | 26.6 |
| Dividend yield (%) | 3.1 | 3.3 | 3.4 |
| DPS | 4.066 | 4.322 | 4.493 |
| PBR (x) | 8.3 | 8.1 | 7.9 |
| EV/EBITDA (x) | 22.5 | 21.1 | 20.2 |
| ROE (%) | 28.8 | 29.8 | 30.0 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## ■ Key assumptions

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Avg. daily mkt turnover (local curr. m) | 72,000 | 62,300 | 69,100 | 69,400 | 53,900 | 65,000 | 70,000 | 85,000 |
| Hong Kong market cap. (HKDtn) | 10.3 | 17.7 | 20.9 | 17.5 | 21.8 | 25.0 | 28.0 | 30.0 |
| EBITDA-LME | n.a. | n.a. | n.a. | n.a. | 30 | 521 | 560 | 650 |

## ■ Profit and loss (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Trading fees and tariffs Revenues | 2,803 | 2,586 | 2,843 | 2,936 | 2,718 | 3,350 | 3,507 | 3,690 |
| Clearing and settlement Revenues | 1,405 | 1,425 | 1,569 | 1,663 | 1,599 | 1,971 | 2,063 | 2,140 |
| Other Revenue | 2,273 | 2,403 | 2,682 | 2,758 | 2,128 | 3,515 | 3,777 | 3,860 |
| Total Revenue | 6,481 | 6,414 | 7,094 | 7,357 | 6,445 | 8,836 | 9,347 | 9,690 |
| Other income | 999 | 621 | 472 | 498 | 766 | 816 | 845 | 890 |
| COGS | (114) | (107) | (107) | (133) | (140) | (141) | (143) | (152) |
| SG&A | (953) | (1,013) | (1,102) | (1,208) | (1,413) | (2,219) | (2,308) | (2,397) |
| Other op.expenses | (554) | (373) | (403) | (482) | (620) | (918) | (938) | (955) |
| Operating profit | 5,859 | 5,542 | 5,954 | 6,032 | 5,038 | 6,374 | 6,803 | 7,076 |
| Net-interest inc./(exp.) | 0 | 0 | 0 | 0 | (55) | (250) | (275) | (296) |
| Assoc/forex/extraord./others | 69 | 0 | 0 | 0 | (138) | 0 | 0 | 0 |
| Pre-tax profit | 5,928 | 5,542 | 5,954 | 6,032 | 4,845 | 6,124 | 6,528 | 6,780 |
| Tax | (800) | (838) | (917) | (939) | (761) | (929) | (1,006) | (1,040) |
| Min. int./pref. div./others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net profit (reported) | 5,129 | 4,704 | 5,037 | 5,093 | 4,084 | 5,195 | 5,522 | 5,740 |
| Net profit (adjusted) | 5,129 | 4,704 | 5,037 | 5,093 | 4,084 | 5,195 | 5,522 | 5,740 |
| EPS (reported)(HKD) | 4.783 | 4.372 | 4.681 | 4.720 | 3.768 | 4.518 | 4.803 | 4.992 |
| EPS (adjusted)(HKD) | 4.783 | 4.372 | 4.681 | 4.720 | 3.768 | 4.518 | 4.803 | 4.992 |
| EPS (adjusted fully-diluted)(HKD) | 4.755 | 4.372 | 4.681 | 4.720 | 3.768 | 4.518 | 4.803 | 4.992 |
| DPS (HKD) | 4.290 | 3.930 | 4.213 | 4.248 | 3.391 | 4.066 | 4.322 | 4.493 |
| EBIT | 5,859 | 5,542 | 5,954 | 6,032 | 5,038 | 6,374 | 6,803 | 7,076 |
| EBITDA | 5,969 | 5,643 | 6,064 | 6,122 | 5,196 | 6,884 | 7,331 | 7,610 |

## ■ Cash flow (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 5,928 | 5,542 | 5,954 | 6,032 | 4,845 | 6,124 | 6,528 | 6,780 |
| Depreciation and amortisation | 109 | 101 | 110 | 90 | 158 | 380 | 398 | 404 |
| Tax paid | (1,361) | (845) | (945) | (980) | (761) | (929) | (1,006) | (1,040) |
| Change in working capital | 330 | (796) | 514 | (87) | 780 | 110 | 120 | 130 |
| Other operational CF items | 42 | 45 | 50 | 54 | 111 | 308 | 335 | 358 |
| Cash flow from operations | 5,049 | 4,047 | 5,683 | 5,109 | 5,133 | 5,993 | 6,375 | 6,632 |
| Capex | (221) | (90) | (691) | (456) | (13,819) | (1,986) | (1,228) | (1,120) |
| Net (acquisitions)/disposals | 2 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other investing CF items | 1,428 | 18 | 23 | 0 | 0 | 0 | 0 | 0 |
| Cash flow from investing | 1,210 | (72) | (668) | (456) | (13,819) | (1,986) | (1,228) | (1,120) |
| Change in debt | 0 | 0 | 0 | 0 | 3,900 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 34 | 0 | 0 | 0 | 7,709 | 0 | 0 | 0 |
| Dividends paid | (6,282) | (3,917) | (4,842) | (4,606) | (3,949) | (4,057) | (4,387) | (4,661) |
| Other financing CF items | 0 | 5 | (3,048) | 348 | 6 | 0 | 0 | 0 |
| Cash flow from financing | (6,248) | (3,912) | (7,890) | (4,258) | 7,666 | (4,057) | (4,387) | (4,661) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 11 | 64 | (2,875) | 395 | (1,020) | (50) | 760 | 851 |
| Free cash flow | 4,827 | 3,958 | 4,992 | 4,653 | (8,686) | 4,007 | 5,147 | 5,512 |

*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 | 4,756 | 4,820 | 1,945 | 2,340 | 4,035 | 3,985 | 4,745 | 5,596 |
| Inventory | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Accounts receivable | 8,894 | 11,334 | 9,203 | 7,210 | 13,696 | 13,860 | 13,910 | 13,980 |
| Other current assets | 48,748 | 28,760 | 34,386 | 42,898 | 42,598 | 43,318 | 45,218 | 45,789 |
| Total current assets | 62,398 | 44,914 | 45,534 | 52,448 | 60,329 | 61,163 | 63,873 | 65,365 |
| Fixed assets | 311 | 303 | 295 | 948 | 1,675 | 1,749 | 1,479 | 1,151 |
| Goodwill & intangibles | 0 | 0 | 0 | 0 | 18,183 | 18,053 | 17,923 | 17,793 |
| Other non-current assets | 115 | 115 | 2,055 | 632 | 650 | 670 | 690 | 698 |
| Total assets | 62,824 | 45,332 | 47,884 | 54,028 | 80,837 | 81,635 | 83,965 | 85,007 |
| Short-term debt | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Accounts payable | 0 | 11,827 | 9,946 | 8,456 | 15,838 | 15,980 | 16,020 | 16,046 |
| Other current liabilities | 55,200 | 25,158 | 29,214 | 36,353 | 40,555 | 40,685 | 42,419 | 42,860 |
| Total current liabilities | 55,200 | 36,985 | 39,160 | 44,809 | 56,393 | 56,665 | 58,439 | 58,906 |
| Long-term debt | 0 | 0 | 0 | 0 | 6,615 | 6,615 | 6,615 | 6,615 |
| Other non-current liabilities | 328 | 320 | 47 | 60 | 65 | 71 | 75 | 76 |
| Total liabilities | 55,529 | 37,305 | 39,207 | 44,869 | 63,073 | 63,351 | 65,129 | 65,597 |
| Share capital | 1,075 | 1,076 | 1,078 | 1,080 | 1,150 | 1,150 | 1,150 | 1,150 |
| Reserves/R.E./others | 6,220 | 6,951 | 7,599 | 8,079 | 16,614 | 17,134 | 17,686 | 18,260 |
| Shareholders' equity | 7,295 | 8,027 | 8,677 | 9,159 | 17,764 | 18,284 | 18,836 | 19,410 |
| Minority interests | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total equity & liabilities | 62,824 | 45,332 | 47,884 | 54,028 | 80,837 | 81,635 | 83,965 | 85,007 |
| EV | 147,818 | 147,753 | 150,628 | 150,233 | 155,153 | 155,203 | 154,443 | 153,592 |
| Net debt/(cash) | (4,756) | (4,820) | (1,945) | (2,340) | 2,580 | 2,630 | 1,870 | 1,019 |
| BVPS (HKD) | 6.793 | 7.460 | 8.064 | 8.488 | 16.463 | 15.902 | 16.382 | 16.881 |

## Key ratios (%)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | (9.3) | (1.0) | 10.6 | 3.7 | (12.4) | 37.1 | 5.8 | 3.7 |
| EBITDA (YoY) | (15.4) | (5.5) | 7.5 | 1.0 | (15.1) | 32.5 | 6.5 | 3.8 |
| Operating profit (YoY) | (16.0) | (5.4) | 7.4 | 1.3 | (16.5) | 26.5 | 6.7 | 4.0 |
| Net profit (YoY) | (16.9) | (8.3) | 7.1 | 1.1 | (19.8) | 27.2 | 6.3 | 3.9 |
| Core EPS (fully-diluted) (YoY) | (16.8) | (8.1) | 7.1 | 0.8 | (20.2) | 19.9 | 6.3 | 3.9 |
| Gross-profit margin | 98.2 | 98.3 | 98.5 | 98.2 | 97.8 | 98.4 | 98.5 | 98.4 |
| EBITDA margin | 92.1 | 88.0 | 85.5 | 83.2 | 80.6 | 77.9 | 78.4 | 78.5 |
| Operating-profit margin | 90.4 | 86.4 | 83.9 | 82.0 | 78.2 | 72.1 | 72.8 | 73.0 |
| Net profit margin | 79.1 | 73.3 | 71.0 | 69.2 | 63.4 | 58.8 | 59.1 | 59.2 |
| ROAE | 65.5 | 61.4 | 60.3 | 57.1 | 30.3 | 28.8 | 29.8 | 30.0 |
| ROAA | 6.8 | 8.7 | 10.8 | 10.0 | 6.1 | 6.4 | 6.7 | 6.8 |
| ROCE | 74.8 | 72.3 | 71.3 | 67.6 | 30.0 | 25.9 | 27.0 | 27.5 |
| ROIC | 164.3 | 163.7 | 101.4 | 75.2 | 31.3 | 26.2 | 27.7 | 29.1 |
| Net debt to equity | net cash | net cash | net cash | net cash | 14.5 | 14.4 | 9.9 | 5.3 |
| Effective tax rate | 13.5 | 15.1 | 15.4 | 15.6 | 15.7 | 15.2 | 15.4 | 15.3 |
| Accounts receivable (days) | 250.4 | 575.6 | 528.3 | 407.1 | 592.0 | 569.1 | 542.2 | 525.3 |
| Current ratio (x) | 1.1 | 1.2 | 1.2 | 1.2 | 1.1 | 1.1 | 1.1 | 1.1 |
| Net interest cover (x) | n.a. | n.a. | n.a. | n.a. | 91.6 | 25.5 | 24.7 | 23.9 |
| Net dividend payout | 89.7 | 89.9 | 90.0 | 90.0 | 90.0 | 90.0 | 90.0 | 90.0 |
| Free cash flow yield | 3.2 | 2.6 | 3.3 | 3.0 | n.a. | 2.6 | 3.4 | 3.6 |

*Source: FactSet, Daiwa forecasts*

## Company profile

HK Exchanges & Clearing (HKEx) owns and operates the only stock exchange and futures exchange in Hong Kong and the related clearing houses. The company was formed in 2000 as a result of a merger between the Stock Exchange of Hong Kong and the Hong Kong Futures Exchange. After the merger, the company was listed on the Hong Kong Stock Exchange in June 2000.

Daiwa Capital Markets

Company

Financials / Hong Kong
22 March 2013

The 10-second briefing

## Hysan Development
14 HK

Target (HKD): **48.16 → 48.16**
Upside: **29.1%**
19 Mar price (HKD): **37.30**

# Riding the Causeway Bay tide

- The Causeway Bay area is very well-positioned in the Hong Kong commercial property sector
- Hysan Place completion opens up a new chapter for Hysan, and we look for positive spillover effects on the rest of its portfolio
- Looks well-positioned to deliver sustained growth in earnings and dividend over the next few years; Buy rating reaffirmed

1 Buy (unchanged)
2 Outperform
3 Hold
4 Underperform
5 Sell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### ■ What's new

We see Hysan Development as a company sitting on arguably one of the most prime commercial property portfolios in Hong Kong, and believe it is still far from having realised the full potential of its portfolio.

### ■ What's the impact

*Will Causeway Bay resemble London's West End over time?* In our view, the current stock of prime retail properties in Hong Kong is too small relative to the scale of retail spending in the territory. This situation is favourable for the three established retail locations in Hong Kong, namely, Causeway Bay, Tsimshatsui and Mongkok.

Amongst these areas, we are most optimistic about southern Causeway Bay, which is an integrated area where the major landlords seem committed to upgrade the area, with many developments continuing to come to market. Our view is that Causeway Bay is on track to become an even more important area in Hong Kong's commercial property landscape. Hysan, as the largest commercial property landlord in the area, is well-placed to benefit, in our view.

*We see the completion of Hysan Place as the beginning of the next chapter*. While the novelty factor related to Hysan Place has dissipated, we believe the importance of Hysan Place's completion is more to do with Causeway Bay as an area, and the overall position and prospects of Hysan's entire portfolio.

In our view, Hysan Place has started to have a positive spillover effect on the rest of the company's portfolio, and we think the group's decision to redevelop Sunning Court and Sunning Plaza is a positive move (see our 7 March report: *Lee Gardens Three in-the-making?*)

### ■ What we recommend

We reiterate our Buy (1) rating and target price of HKD48.16, based on an unchanged 30% discount to our end-2013E NAV of HKD68.80. Risks to our call include a plunge in retail spending in Hong Kong.

### ■ How we differ

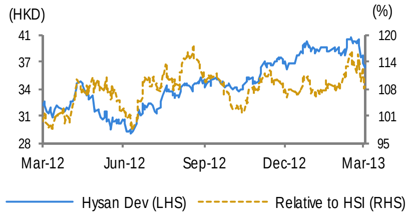
Unlike some in the market, we still see room for Hysan to realise the full potential of its portfolio.

**Forecast revisions (%)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 29.05-40.20 |
| Market cap (USDbn) | 5.08 |
| 3m avg daily turnover (USDm) | 8.17 |
| Shares outstanding (m) | 1,056 |
| Major shareholder | Lee Hysan Estate Company (40.9%) |

**Financial summary (HKD)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 2,823 | 3,130 | 3,444 |
| Operating profit (m) | 2,247 | 2,524 | 2,784 |
| Net profit (m) | 1,910 | 2,160 | 2,404 |
| Core EPS (fully-diluted) | 1.809 | 2.045 | 2.277 |
| EPS change (%) | 17.8 | 13.1 | 11.3 |
| Daiwa vs Cons. EPS (%) | (1.2) | 3.5 | 9.4 |
| PER (x) | 20.6 | 18.2 | 16.4 |
| Dividend yield (%) | 3.1 | 3.2 | 3.5 |
| DPS | 1.150 | 1.200 | 1.300 |
| PBR (x) | 0.7 | 0.7 | 0.6 |
| EV/EBITDA (x) | 18.2 | 16.1 | 14.5 |
| ROE (%) | 3.3 | 3.6 | 4.0 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## Key assumptions

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Completed investment properties (m sq ft) | 3.7 | 3.7 | 3.7 | 3.7 | 4.4 | 4.4 | 4.4 | 4.4 |
| Blended average office rent (on GFA) (HKD/sq ft) | 29.2 | 30.3 | 31.3 | 34.6 | 35.7 | 39.0 | 42.4 | 47.7 |
| Blended average retail rent (on GFA) (HKD/sq ft) | 59.2 | 61.2 | 66.2 | 66.0 | 81.2 | 91.5 | 103.4 | 112.3 |
| Blended average residential rent (on GFA) (HKD/sq ft) | 30.8 | 30.1 | 31.1 | 32.3 | 37.6 | 37.6 | 40.0 | 42.6 |

## Profit and loss (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Property rental - office | 720 | 747 | 770 | 820 | 908 | 1,081 | 1,175 | 1,323 |
| Property rental - retail | 626 | 648 | 700 | 789 | 1,250 | 1,414 | 1,605 | 1,746 |
| Other Revenue | 292 | 285 | 294 | 313 | 328 | 328 | 350 | 375 |
| Total Revenue | 1,638 | 1,680 | 1,764 | 1,922 | 2,486 | 2,823 | 3,130 | 3,444 |
| Other income | 63 | 38 | 49 | 90 | 73 | 56 | 59 | 62 |
| COGS | (217) | (235) | (250) | (262) | (423) | (438) | (463) | (510) |
| SG&A | (134) | (133) | (140) | (173) | (179) | (186) | (194) | (204) |
| Other op.expenses | (2) | (7) | (8) | (8) | (8) | (8) | (8) | (8) |
| Operating profit | 1,348 | 1,343 | 1,415 | 1,569 | 1,949 | 2,247 | 2,524 | 2,784 |
| Net-interest inc./(exp.) | (155) | (131) | (117) | (122) | (156) | (154) | (153) | (151) |
| Assoc/forex/extraord./others | 326 | 161 | 133 | 170 | 211 | 226 | 240 | 262 |
| Pre-tax profit | 1,519 | 1,373 | 1,431 | 1,617 | 2,004 | 2,319 | 2,611 | 2,895 |
| Tax | (264) | (189) | (201) | (226) | (288) | (314) | (353) | (392) |
| Min. int./pref. div./others | (54) | (71) | (82) | (81) | (94) | (95) | (98) | (99) |
| Net profit (reported) | 1,201 | 1,113 | 1,148 | 1,310 | 1,622 | 1,910 | 2,160 | 2,404 |
| Net profit (adjusted) | 1,201 | 1,113 | 1,148 | 1,310 | 1,622 | 1,910 | 2,160 | 2,404 |
| EPS (reported)(HKD) | 1.156 | 1.064 | 1.091 | 1.240 | 1.536 | 1.809 | 2.045 | 2.277 |
| EPS (adjusted)(HKD) | 1.156 | 1.064 | 1.091 | 1.240 | 1.536 | 1.809 | 2.045 | 2.277 |
| EPS (adjusted fully-diluted)(HKD) | 1.156 | 1.064 | 1.091 | 1.240 | 1.536 | 1.809 | 2.045 | 2.277 |
| DPS (HKD) | 0.680 | 0.680 | 0.740 | 0.800 | 0.950 | 1.150 | 1.200 | 1.300 |
| EBIT | 1,348 | 1,343 | 1,415 | 1,569 | 1,949 | 2,247 | 2,524 | 2,784 |
| EBITDA | 1,350 | 1,350 | 1,423 | 1,577 | 1,957 | 2,255 | 2,532 | 2,792 |

## Cash flow (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 1,519 | 1,373 | 1,431 | 1,617 | 2,004 | 2,319 | 2,611 | 2,895 |
| Depreciation and amortisation | 2 | 7 | 8 | 8 | 8 | 8 | 8 | 8 |
| Tax paid | (183) | (469) | (161) | (181) | (204) | (251) | (282) | (314) |
| Change in working capital | 64 | 24 | 72 | 5 | 109 | 70 | 44 | 45 |
| Other operational CF items | (223) | (55) | (51) | (82) | (63) | (80) | (95) | (119) |
| Cash flow from operations | 1,179 | 880 | 1,299 | 1,367 | 1,854 | 2,066 | 2,286 | 2,515 |
| Capex | 0 | (242) | (871) | (980) | (802) | (450) | (600) | (950) |
| Net (acquisitions)/disposals | (759) | 959 | (274) | (551) | 0 | 0 | 0 | 0 |
| Other investing CF items | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Cash flow from investing | (759) | 717 | (1,145) | (1,531) | (802) | (450) | (600) | (950) |
| Change in debt | 765 | 179 | 632 | 0 | 0 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 2 | 1 | 1 | 0 | 0 | 0 | 0 | 0 |
| Dividends paid | (641) | (642) | (733) | (790) | (845) | (1,162) | (1,267) | (1,193) |
| Other financing CF items | (140) | (127) | (109) | (154) | (135) | (132) | (138) | (140) |
| Cash flow from financing | (14) | (589) | (209) | (944) | (980) | (1,294) | (1,405) | (1,333) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 406 | 1,008 | (55) | (1,108) | 72 | 322 | 281 | 232 |
| Free cash flow | 1,179 | 638 | 428 | 387 | 1,052 | 1,616 | 1,686 | 1,565 |

*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 | 1,015 | 1,984 | 1,993 | 2,961 | 2,311 | 2,633 | 2,914 | 3,146 |
| Inventory | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Accounts receivable | 94 | 83 | 98 | 134 | 158 | 165 | 170 | 175 |
| Other current assets | 1,331 | 489 | 320 | 507 | 605 | 610 | 615 | 620 |
| Total current assets | 2,440 | 2,556 | 2,411 | 3,602 | 3,074 | 3,408 | 3,699 | 3,941 |
| Fixed assets | 203 | 396 | 429 | 530 | 580 | 590 | 620 | 636 |
| Goodwill & intangibles | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other non-current assets | 38,893 | 41,090 | 45,714 | 55,236 | 64,769 | 65,475 | 66,225 | 67,200 |
| Total assets | 41,536 | 44,042 | 48,554 | 59,368 | 68,423 | 69,473 | 70,544 | 71,777 |
| Short-term debt | 550 | 400 | 650 | 1,507 | 699 | 699 | 699 | 699 |
| Accounts payable | 320 | 314 | 433 | 532 | 469 | 565 | 610 | 635 |
| Other current liabilities | 836 | 499 | 552 | 589 | 599 | 612 | 635 | 650 |
| Total current liabilities | 1,706 | 1,213 | 1,635 | 2,628 | 1,767 | 1,876 | 1,944 | 1,984 |
| Long-term debt | 3,201 | 3,491 | 3,937 | 5,156 | 5,242 | 5,242 | 5,242 | 5,242 |
| Other non-current liabilities | 3,919 | 606 | 665 | 840 | 967 | 985 | 1,003 | 1,029 |
| Total liabilities | 8,826 | 5,310 | 6,237 | 8,624 | 7,976 | 8,103 | 8,189 | 8,255 |
| Share capital | 5,206 | 5,253 | 5,267 | 5,299 | 5,315 | 5,315 | 5,315 | 5,315 |
| Reserves/R.E./others | 26,263 | 31,963 | 35,410 | 43,454 | 52,808 | 53,715 | 54,660 | 55,797 |
| Shareholders' equity | 31,469 | 37,216 | 40,677 | 48,753 | 58,123 | 59,030 | 59,975 | 61,112 |
| Minority interests | 1,241 | 1,516 | 1,640 | 1,991 | 2,324 | 2,340 | 2,380 | 2,410 |
| Total equity & liabilities | 41,536 | 44,042 | 48,554 | 59,368 | 68,423 | 69,473 | 70,544 | 71,777 |
| EV | 41,616 | 40,295 | 40,609 | 41,659 | 41,584 | 41,087 | 40,736 | 40,434 |
| Net debt/(cash) | 2,736 | 1,907 | 2,594 | 3,702 | 3,630 | 3,308 | 3,027 | 2,795 |
| BVPS (HKD) | 30.278 | 35.571 | 38.674 | 46.168 | 55.041 | 55.899 | 56.795 | 57.871 |

## Key ratios (%)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | 19.7 | 2.6 | 5.0 | 9.0 | 29.3 | 13.6 | 10.9 | 10.0 |
| EBITDA (YoY) | 17.2 | 0.0 | 5.4 | 10.8 | 24.1 | 15.2 | 12.3 | 10.3 |
| Operating profit (YoY) | 17.4 | (0.4) | 5.4 | 10.9 | 24.2 | 15.3 | 12.3 | 10.3 |
| Net profit (YoY) | 3.7 | (7.3) | 3.1 | 14.1 | 23.9 | 17.8 | 13.1 | 11.3 |
| Core EPS (fully-diluted) (YoY) | 5.0 | (7.9) | 2.6 | 13.6 | 23.9 | 17.8 | 13.1 | 11.3 |
| Gross-profit margin | 86.8 | 86.0 | 85.8 | 86.4 | 83.0 | 84.5 | 85.2 | 85.2 |
| EBITDA margin | 82.4 | 80.4 | 80.7 | 82.0 | 78.7 | 79.9 | 80.9 | 81.1 |
| Operating-profit margin | 82.3 | 79.9 | 80.2 | 81.6 | 78.4 | 79.6 | 80.6 | 80.8 |
| Net profit margin | 73.3 | 66.3 | 65.1 | 68.1 | 65.2 | 67.7 | 69.0 | 69.8 |
| ROAE | 3.8 | 3.2 | 2.9 | 2.9 | 3.0 | 3.3 | 3.6 | 4.0 |
| ROAA | 2.9 | 2.6 | 2.5 | 2.4 | 2.5 | 2.8 | 3.1 | 3.4 |
| ROCE | 3.7 | 3.4 | 3.2 | 3.0 | 3.1 | 3.4 | 3.7 | 4.0 |
| ROIC | 3.2 | 3.0 | 2.8 | 2.7 | 2.8 | 3.0 | 3.4 | 3.7 |
| Net debt to equity | 8.7 | 5.1 | 6.4 | 7.6 | 6.2 | 5.6 | 5.0 | 4.6 |
| Effective tax rate | 17.4 | 13.8 | 14.0 | 14.0 | 14.4 | 13.5 | 13.5 | 13.5 |
| Accounts receivable (days) | 17.8 | 19.2 | 18.7 | 22.0 | 21.4 | 20.9 | 19.5 | 18.3 |
| Current ratio (x) | 1.4 | 2.1 | 1.5 | 1.4 | 1.7 | 1.8 | 1.9 | 2.0 |
| Net interest cover (x) | 8.7 | 10.3 | 12.1 | 12.9 | 12.5 | 14.6 | 16.5 | 18.4 |
| Net dividend payout | 58.8 | 63.9 | 67.8 | 64.5 | 61.8 | 63.6 | 58.7 | 57.1 |
| Free cash flow yield | 3.0 | 1.6 | 1.1 | 1.0 | 2.7 | 4.1 | 4.3 | 4.0 |

*Source: FactSet, Daiwa forecasts*

## Company profile

Hysan Development (Hysan) was founded by the Lee family in 1970 to redevelop the Lee family's properties and was listed on the Hong Kong Stock Exchange in 1981. Hysan currently owns an investment-property portfolio in Hong Kong comprising 4.4m sq ft (4.2m sq ft on an attributable basis), of which 3.7m sq ft is at Causeway Bay. In addition, the group owns 0.69m sq ft of luxury residential properties in Hong Kong's Mid-level area and has a 24.7% stake in Grand Gateway 66, one of the largest and most prominent mixed commercial-property complexes in Shanghai.

The 10-second briefing

# Midland

1200 HK

Target (HKD): **4.10 → 4.10**
Upside: **22.0%**
19 Mar price (HKD): **3.36**

## Offers long-term franchise value

- Primary residential market commissions are on the rise, which should mitigate the impact of a decline in transaction volume
- Midland has a strong ability to sustain its DPS, in our view
- Duopoly market structure should give the company long-term franchise value; reaffirm Buy rating

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

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### What's new

Recent reports in the local media that developers are raising agency commission rates to facilitate project sales should help to underpin Midland's business.

### What's the impact

**Has evolved into a company mainly serving the primary market.** We expect the primary market to become Midland's largest revenue source from 2013 onwards. Primary market commission rates are on the rise, which should help to mitigate the impact of a slowdown in its transaction volume.

**We advise investors not to overlook the primary market,** which is less competitive than the secondary market. With commission rates in the primary market on the increase, many recent projects have been offering a commission rate of well over 3%. Given that transacted value in the secondary market for 2012 (HKD323bn) was 2.4x that of the primary market (HKD132bn), we see considerable scope for the primary segment to gain market share from the secondary one. Provided that Midland adjusts its cost base over time, we believe its property agency business is still a viable one in Hong Kong.

**Midland was able to adjust its operating costs in the past.** Since its listing in 1995, Midland has not had net debt, and has not posted more than two consecutive half-yearly losses, suggesting to us that it can adjust its operating costs over time. We have lowered our assumptions for its transaction volume to take into account the latest market conditions, and thus reduce our 2013 EPS forecast by 4.7%.

### What we recommend

We believe Midland has a valuable franchise in a market that is effectively a duopoly. We think the company has the ability to sustain its annual DPS at HKD0.20 or above, which would translate into a 6% dividend yield for 2013E. We reiterate our Buy (1) rating with a six-month target price of HKD4.10, based on a 2013E PER of 10x, plus 40% of net cash which we value at HKD1.88/share as at end-2013E. The main risk to our call would be further government measures, which could affect transaction volume.

### How we differ

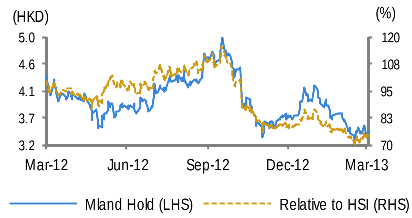
Unlike some in the market, we take into account the long-term franchise value we see for the company.

**Forecast revisions (%)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | 2.2 | 2.2 | n.a. |
| Net profit change | (4.7) | - | n.a. |
| Core EPS (FD) change | (4.7) | - | n.a. |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 3.28-5.00 |
| Market cap (USDbn) | 0.31 |
| 3m avg daily turnover (USDm) | 1.88 |
| Shares outstanding (m) | 722 |
| Major shareholder | Freddie Wong (10.0%) |

**Financial summary (HKD)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 3,730 | 4,085 | 4,542 |
| Operating profit (m) | 323 | 396 | 456 |
| Net profit (m) | 242 | 298 | 346 |
| Core EPS (fully-diluted) | 0.335 | 0.413 | 0.479 |
| EPS change (%) | (3.1) | 23.1 | 16.1 |
| Daiwa vs Cons. EPS (%) | 20.1 | 3.7 | 5.7 |
| PER (x) | 10.0 | 8.1 | 7.0 |
| Dividend yield (%) | 6.0 | 6.0 | 6.0 |
| DPS | 0.200 | 0.200 | 0.200 |
| PBR (x) | 1.4 | 1.3 | 1.2 |
| EV/EBITDA (x) | 3.1 | 2.5 | 2.1 |
| ROE (%) | 14.6 | 16.7 | 17.6 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## ■ Key assumptions

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Transaction volume - primary | 8,863 | 15,272 | 12,917 | 10,854 | 12,961 | 12,442 | 13,000 | 14,000 |
| Avg price per unit - primary (HKDm) | 7.7 | 7.5 | 10.0 | 12.1 | 10.2 | 8.5 | 9.0 | 9.5 |
| Transacted value - primary (HKDm) | 68,339 | 114,524 | 128,853 | 130,990 | 132,200 | 105,780 | 117,000 | 133,000 |
| Transaction volume - secondary | 87,993 | 107,588 | 123,995 | 75,195 | 70,183 | 54,000 | 60,000 | 65,000 |
| Avg price per unit - secondary (HKDm) | 3.1 | 3.1 | 3.4 | 4.1 | 4.6 | 4.6 | 4.6 | 4.8 |
| Transacted value - secondary (HKDm) | 276,128 | 329,200 | 427,432 | 311,839 | 323,000 | 248,400 | 276,000 | 312,000 |

## ■ Profit and loss (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Primary market commission | 573 | 931 | 1,093 | 1,104 | 1,116 | 1,237 | 1,369 | 1,556 |
| Secondary market commission | 962 | 1,380 | 1,215 | 1,114 | 1,200 | 932 | 1,035 | 1,217 |
| Other Revenue | 721 | 1,094 | 1,429 | 1,180 | 1,595 | 1,561 | 1,681 | 1,769 |
| Total Revenue | 2,255 | 3,405 | 3,737 | 3,398 | 3,911 | 3,730 | 4,085 | 4,542 |
| Other income | 14 | 28 | 29 | 7 | 23 | 32 | 33 | 34 |
| COGS | (649) | (1,119) | (1,224) | (1,126) | (1,305) | (1,213) | (1,411) | (1,616) |
| SG&A | (1,289) | (1,090) | (1,368) | (1,666) | (1,986) | (1,914) | (1,989) | (2,172) |
| Other op.expenses | (378) | (411) | (515) | (430) | (304) | (312) | (322) | (332) |
| Operating profit | (48) | 813 | 659 | 183 | 339 | 323 | 396 | 456 |
| Net-interest inc./(exp.) | 17 | 2 | 3 | 4 | 12 | 14 | 14 | 15 |
| Assoc/forex/extraord./others | 14 | 18 | 25 | 25 | 7 | 7 | 7 | 7 |
| Pre-tax profit | (17) | 832 | 687 | 212 | 358 | 344 | 417 | 478 |
| Tax | (24) | (118) | (119) | (53) | (60) | (57) | (71) | (79) |
| Min. int./pref. div./others | 1 | (23) | (35) | (25) | (48) | (45) | (48) | (53) |
| Net profit (reported) | (41) | 691 | 533 | 134 | 250 | 242 | 298 | 346 |
| Net profit (adjusted) | (41) | 666 | 533 | 134 | 250 | 242 | 298 | 346 |
| EPS (reported)(HKD) | (0.056) | 0.954 | 0.736 | 0.185 | 0.346 | 0.335 | 0.413 | 0.479 |
| EPS (adjusted)(HKD) | (0.056) | 0.920 | 0.736 | 0.185 | 0.346 | 0.335 | 0.413 | 0.479 |
| EPS (adjusted fully-diluted)(HKD) | (0.056) | 0.920 | 0.736 | 0.185 | 0.346 | 0.335 | 0.413 | 0.479 |
| DPS (HKD) | 0.075 | 0.814 | 0.590 | 0.307 | 0.200 | 0.200 | 0.200 | 0.200 |
| EBIT | (48) | 788 | 659 | 183 | 339 | 323 | 396 | 456 |
| EBITDA | (4) | 848 | 745 | 227 | 385 | 372 | 447 | 508 |

## ■ Cash flow (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | (17) | 832 | 687 | 212 | 358 | 344 | 417 | 478 |
| Depreciation and amortisation | 44 | 60 | 87 | 44 | 46 | 49 | 51 | 52 |
| Tax paid | (42) | (45) | (52) | (55) | (58) | (59) | (60) | (59) |
| Change in working capital | (50) | (83) | 127 | 120 | (34) | 20 | (20) | (68) |
| Other operational CF items | 33 | 194 | 0 | 9 | 25 | 24 | 25 | 24 |
| Cash flow from operations | (32) | 958 | 848 | 330 | 337 | 378 | 413 | 427 |
| Capex | (52) | (58) | (165) | (175) | (50) | (62) | (132) | (140) |
| Net (acquisitions)/disposals | 114 | (67) | (15) | (62) | (65) | (68) | (70) | (72) |
| Other investing CF items | (13) | (17) | (18) | (45) | (20) | (20) | (22) | (23) |
| Cash flow from investing | 49 | (142) | (198) | (282) | (135) | (150) | (224) | (235) |
| Change in debt | 0 | (5) | 0 | 0 | 0 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends paid | (274) | (280) | (511) | (393) | (152) | (145) | (145) | (145) |
| Other financing CF items | 0 | (4) | (5) | (7) | (8) | (8) | (8) | (7) |
| Cash flow from financing | (274) | (289) | (516) | (400) | (160) | (153) | (153) | (152) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | (257) | 527 | 134 | (352) | 42 | 75 | 36 | 40 |
| Free cash flow | (84) | 900 | 683 | 155 | 287 | 316 | 281 | 287 |

*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 | 942 | 1,477 | 1,602 | 1,249 | 1,290 | 1,354 | 1,390 | 1,430 |
| Inventory | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Accounts receivable | 698 | 1,114 | 1,259 | 1,168 | 1,823 | 1,991 | 2,050 | 2,134 |
| Other current assets | 68 | 13 | 0 | 19 | 0 | 23 | 24 | 25 |
| Total current assets | 1,708 | 2,605 | 2,861 | 2,436 | 3,113 | 3,368 | 3,464 | 3,589 |
| Fixed assets | 243 | 233 | 240 | 242 | 281 | 366 | 437 | 495 |
| Goodwill & intangibles | 12 | 12 | 12 | 12 | 0 | 12 | 13 | 14 |
| Other non-current assets | 44 | 59 | 79 | 87 | 95 | 202 | 218 | 226 |
| Total assets | 2,007 | 2,908 | 3,192 | 2,777 | 3,489 | 3,948 | 4,132 | 4,324 |
| Short-term debt | 2 | 2 | 13 | 12 | 11 | 0 | 0 | 0 |
| Accounts payable | 603 | 1,008 | 1,257 | 1,121 | 1,659 | 2,012 | 2,037 | 2,024 |
| Other current liabilities | 9 | 63 | 38 | 0 | 22 | 72 | 75 | 76 |
| Total current liabilities | 613 | 1,073 | 1,308 | 1,133 | 1,692 | 2,084 | 2,112 | 2,100 |
| Long-term debt | 17 | 21 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other non-current liabilities | 1 | 1 | 2 | 3 | 2 | 2 | 2 | 2 |
| Total liabilities | 632 | 1,094 | 1,310 | 1,136 | 1,694 | 2,086 | 2,114 | 2,102 |
| Share capital | 72 | 72 | 72 | 72 | 72 | 72 | 72 | 72 |
| Reserves/R.E./others | 1,250 | 1,667 | 1,700 | 1,433 | 1,539 | 1,637 | 1,790 | 1,992 |
| Shareholders' equity | 1,322 | 1,739 | 1,772 | 1,505 | 1,611 | 1,709 | 1,862 | 2,064 |
| Minority interests | 53 | 75 | 110 | 136 | 184 | 153 | 156 | 158 |
| Total equity & liabilities | 2,007 | 2,909 | 3,192 | 2,777 | 3,489 | 3,948 | 4,132 | 4,324 |
| EV | 1,526 | 999 | 896 | 1,268 | 1,278 | 1,166 | 1,131 | 1,090 |
| Net debt/(cash) | (923) | (1,455) | (1,589) | (1,237) | (1,279) | (1,354) | (1,390) | (1,430) |
| BVPS (HKD) | 1.826 | 2.401 | 2.447 | 2.079 | 2.231 | 2.365 | 2.578 | 2.857 |

## Key ratios (%)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | (41.7) | 51.0 | 9.8 | (9.1) | 15.1 | (4.6) | 9.5 | 11.2 |
| EBITDA (YoY) | n.a. | n.a. | (12.1) | (69.5) | 69.5 | (3.3) | 20.2 | 13.6 |
| Operating profit (YoY) | n.a. | n.a. | (16.4) | (72.2) | 85.1 | (4.6) | 22.6 | 15.2 |
| Net profit (YoY) | n.a. | n.a. | (20.0) | (74.8) | 86.3 | (3.1) | 23.1 | 16.1 |
| Core EPS (fully-diluted) (YoY) | n.a. | n.a. | (20.0) | (74.8) | 86.8 | (3.1) | 23.1 | 16.1 |
| Gross-profit margin | 71.2 | 67.1 | 67.2 | 66.9 | 66.6 | 67.5 | 65.5 | 64.4 |
| EBITDA margin | n.a. | 24.9 | 19.9 | 6.7 | 9.8 | 10.0 | 10.9 | 11.2 |
| Operating-profit margin | n.a. | 23.1 | 17.6 | 5.4 | 8.7 | 8.7 | 9.7 | 10.0 |
| Net profit margin | (1.8) | 19.6 | 14.3 | 3.9 | 6.4 | 6.5 | 7.3 | 7.6 |
| ROAE | n.a. | 43.5 | 30.3 | 8.2 | 16.0 | 14.6 | 16.7 | 17.6 |
| ROAA | n.a. | 27.1 | 17.5 | 4.5 | 8.0 | 6.5 | 7.4 | 8.2 |
| ROCE | n.a. | 48.8 | 35.3 | 10.3 | 19.6 | 17.6 | 20.4 | 21.5 |
| ROIC | (8.3) | 171.9 | 166.8 | 39.3 | 61.2 | 52.6 | 57.9 | 53.6 |
| Net debt to equity | net cash | net cash | net cash | net cash | net cash | net cash | net cash | net cash |
| Effective tax rate | n.a. | 14.2 | 17.3 | 25.0 | 16.8 | 16.6 | 17.0 | 16.5 |
| Accounts receivable (days) | 56.5 | 97.2 | 115.9 | 130.3 | 139.6 | 186.6 | 180.5 | 168.1 |
| Current ratio (x) | 2.8 | 2.4 | 2.2 | 2.2 | 1.8 | 1.6 | 1.6 | 1.7 |
| Net interest cover (x) | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Net dividend payout | n.a. | 85.3 | 80.2 | 165.7 | 57.9 | 59.7 | 48.5 | 41.8 |
| Free cash flow yield | n.a. | 37.1 | 28.2 | 6.4 | 11.8 | 13.0 | 11.6 | 11.8 |

*Source: FactSet, Daiwa forecasts*

## Company profile

Midland Holdings is engaged principally in the provision of brokerage services for residential, industrial and commercial properties in Hong Kong and the Mainland. It is currently one of the two largest companies in the residential property-agency industry in Hong Kong, which is effectively a duopoly, with Midland and Centaline Property accounting for about a 66% share of the market.

The 10-second briefing

# MTR Corporation

66 HK

Target (HKD): **33.40 → 33.40**
Upside: **8.1%**
19 Mar price (HKD): **30.90**

# Franchise value waiting to be unlocked

- The group's rail businesses could see a breakthrough in 2014-15 in terms of coverage and scope
- MTR is already a major foreign investor in China and could become much more prominent over time
- Facing near-term uncertainties, but structural trends look favourable; maintain Outperform

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

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## ■ What's new

MTRC's well-demonstrated expertise in building reliable subway systems puts it in a favourable position to take up the opportunities presented by China's rail sector.

## ■ What's the impact

**2014 and 2015 look set to be milestone years for the Hong Kong rail sector**. Many rail lines are due for completion in 2014-15, chief of which should be the Expressrail Link which will link up Hong Kong's rail system with China's high-speed rail network, and significantly improve the inter-accessibility of Hong Kong and China.

**China's rail and property sectors also present opportunities.** Many Chinese cities lack an efficient and reliable subway system, and we believe MTRC's well-demonstrated expertise in this area put it in a favourable position to seize opportunities on this front. It is already the largest foreign rail operator in China and we expect its market share to continue to expand in the years to come.

More importantly, MTRC has already obtained property development rights in Shenzhen. Given the group's track record in co-ordinating the development of the West Kowloon area, we would not be surprised if it eventually finds ways to expand its presence further in China's property sector. We believe this would be welcomed by the stock market, which we do not think has priced in the group's potential in this area yet.

## ■ What we recommend

While issues related to the renewal of the fare-adjustment mechanism are a near-term overhang, we think MTRC faces favourable structural trends and offers strong cash flow and solid asset backing. We maintain our Outperform (2) rating, with a six-month target price of HKD33.40 based on a 27% discount (in line with average since its IPO in 2010) to our end-2013E SOTP valuation of HKD45.80. The key risk to our call would be unfavourable regulatory developments.

## ■ How we differ

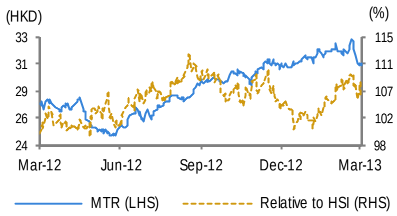
We believe MTRC sits on many valuable assets and franchises – not least of which are its rail expertise, Tseung Kwan O landbank, and retail property portfolio, but that this has yet to be fully recognised by the market.

### Forecast revisions (%)

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

*Source: Daiwa forecasts*

### Share price performance




| | |
|---|---|
| 12-month range | 24.80-32.75 |
| Market cap (USDbn) | 22.75 |
| 3m avg daily turnover (USDm) | 10.02 |
| Shares outstanding (m) | 5,713 |
| Major shareholder | HKSAR Government (76.4%) |

### Financial summary (HKD)

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 38,456 | 40,747 | 43,196 |
| Operating profit (m) | 10,216 | 10,787 | 11,376 |
| Net profit (m) | 9,040 | 13,010 | 14,355 |
| Core EPS (fully-diluted) | 1.582 | 2.277 | 2.513 |
| EPS change (%) | (7.5) | 43.9 | 10.3 |
| Daiwa vs Cons. EPS (%) | 12.1 | 21.4 | 16.9 |
| PER (x) | 19.5 | 13.6 | 12.3 |
| Dividend yield (%) | 2.7 | 3.1 | 3.2 |
| DPS | 0.820 | 0.950 | 1.000 |
| PBR (x) | 1.2 | 1.1 | 1.1 |
| EV/EBITDA (x) | 13.8 | 13.3 | 12.8 |
| ROE (%) | 6.2 | 8.5 | 8.9 |

*Source: FactSet, Daiwa forecasts*

## Financial summary

### Key assumptions

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| No of passenger travelled (Mils) | 1,205 | 1,219 | 1,261 | 1,367 | 1,553 | 1,606 | 1,661 | 1,717 |
| Rental EBIT (HKDm) | 2,712 | 2,928 | 3,045 | 3,167 | 3,401 | 3,571 | 3,750 | 3,937 |
| Property sales profit (HKDm) | 4,670 | 3,554 | 3,785 | 4,934 | 3,238 | 1,085 | 5,205 | 6,206 |

### Profit and loss (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Railway | 11,467 | 12,541 | 22,603 | 26,383 | 28,417 | 30,841 | 32,828 | 35,277 |
| Station Commercial | 3,449 | 3,328 | 3,715 | 3,873 | 4,028 | 4,190 | 4,357 | 4,357 |
| Other Revenue | 2,712 | 2,928 | 3,200 | 3,167 | 3,294 | 3,425 | 3,562 | 3,562 |
| Total Revenue | 17,628 | 18,797 | 29,518 | 33,423 | 35,739 | 38,456 | 40,747 | 43,196 |
| Other income | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| COGS | (4,207) | (5,165) | (14,353) | (17,621) | (17,929) | (19,183) | (20,591) | (22,128) |
| SG&A | (3,687) | (3,732) | (3,834) | (3,896) | (4,279) | (4,454) | (4,636) | (4,826) |
| Other op.expenses | (3,339) | (3,377) | (3,534) | (3,635) | (4,539) | (4,603) | (4,732) | (4,865) |
| Operating profit | 6,395 | 6,523 | 7,797 | 8,271 | 8,992 | 10,216 | 10,787 | 11,376 |
| Net-interest inc./(exp.) | (1,998) | (1,504) | (1,237) | (921) | (879) | (843) | (893) | (947) |
| Assoc/forex/extraord./others | 4,776 | 3,702 | 4,173 | 5,231 | 3,694 | 1,614 | 5,849 | 6,927 |
| Pre-tax profit | 9,173 | 8,721 | 10,733 | 12,581 | 11,807 | 10,987 | 15,743 | 17,357 |
| Tax | (992) | (1,418) | (2,076) | (2,113) | (1,893) | (1,807) | (2,592) | (2,858) |
| Min. int./pref. div./others | 4 | 0 | 0 | 0 | (139) | (140) | (142) | (144) |
| Net profit (reported) | 8,185 | 7,303 | 8,657 | 10,468 | 9,775 | 9,040 | 13,010 | 14,355 |
| Net profit (adjusted) | 8,185 | 7,303 | 8,657 | 10,468 | 9,775 | 9,040 | 13,010 | 14,355 |
| EPS (reported)(HKD) | 1.453 | 1.278 | 1.515 | 1.832 | 1.711 | 1.582 | 2.277 | 2.513 |
| EPS (adjusted)(HKD) | 1.453 | 1.278 | 1.515 | 1.832 | 1.711 | 1.582 | 2.277 | 2.513 |
| EPS (adjusted fully-diluted)(HKD) | 1.452 | 1.278 | 1.515 | 1.832 | 1.711 | 1.582 | 2.277 | 2.513 |
| DPS (HKD) | 0.480 | 0.520 | 0.590 | 0.760 | 0.790 | 0.820 | 0.950 | 1.000 |
| EBIT | 6,395 | 6,523 | 7,797 | 8,271 | 8,992 | 10,216 | 10,787 | 11,376 |
| EBITDA | 9,325 | 9,502 | 10,917 | 11,477 | 12,200 | 13,426 | 14,062 | 14,716 |

### Cash flow (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 9,173 | 8,721 | 10,733 | 12,581 | 11,807 | 10,987 | 15,743 | 17,357 |
| Depreciation and amortisation | 2,930 | 2,979 | 3,120 | 3,250 | 3,208 | 3,210 | 3,274 | 3,340 |
| Tax paid | (577) | (1,372) | (1,011) | (1,600) | (1,799) | (1,626) | (2,332) | (2,572) |
| Change in working capital | 42 | 10,401 | 65 | 680 | 654 | 325 | 330 | 345 |
| Other operational CF items | 1,167 | 13,034 | 16,678 | 5,216 | 6,737 | 3,570 | 3,372 | 3,245 |
| Cash flow from operations | 12,735 | 33,763 | 29,585 | 20,127 | 20,607 | 16,466 | 20,387 | 21,714 |
| Capex | (4,927) | (5,391) | (12,336) | (18,462) | (11,125) | (13,860) | (14,560) | (15,230) |
| Net (acquisitions)/disposals | 400 | 326 | 166 | 353 | 367 | 380 | 390 | 400 |
| Other investing CF items | (45) | 225 | (1,923) | 243 | 253 | 258 | 265 | 280 |
| Cash flow from investing | (4,572) | (4,840) | (14,093) | (17,866) | (10,505) | (13,222) | (13,905) | (14,550) |
| Change in debt | (3,538) | (7,421) | 0 | 0 | 0 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 45 | 16 | 18 | 19 | 20 | 0 | 0 | 0 |
| Dividends paid | (1,265) | (1,362) | (1,872) | (2,148) | (4,519) | (4,881) | (5,271) | (5,693) |
| Other financing CF items | (3,965) | (13,834) | (980) | (3,104) | (3,450) | (2,574) | (2,810) | (2,910) |
| Cash flow from financing | (8,723) | (22,601) | (2,834) | (5,233) | (7,949) | (7,455) | (8,081) | (8,603) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | (560) | 6,322 | 12,658 | (2,972) | 2,153 | (4,211) | (1,599) | (1,438) |
| Free cash flow | 7,808 | 28,372 | 17,249 | 1,665 | 9,482 | 2,606 | 5,827 | 6,484 |

*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 | 793 | 7,115 | 16,961 | 16,100 | 18,664 | 14,098 | 12,499 | 11,061 |
| Inventory | 2,228 | 3,783 | 1,936 | 3,757 | 3,016 | 320 | 1,650 | 2,120 |
| Accounts receivable | 7,190 | 2,428 | 3,057 | 3,964 | 4,474 | 3,125 | 3,260 | 3,350 |
| Other current assets | 426 | 5,646 | 5,632 | 6,613 | 6,723 | 9,288 | 9,420 | 9,580 |
| Total current assets | 10,637 | 18,972 | 27,586 | 30,434 | 32,877 | 26,831 | 26,829 | 26,111 |
| Fixed assets | 129,694 | 137,634 | 144,057 | 152,068 | 155,894 | 169,828 | 178,647 | 188,880 |
| Goodwill & intangibles | 539 | 382 | 384 | 344 | 256 | 430 | 440 | 450 |
| Other non-current assets | 18,468 | 19,506 | 9,638 | 15,027 | 17,888 | 18,250 | 18,680 | 18,930 |
| Total assets | 159,338 | 176,494 | 181,665 | 197,873 | 206,915 | 215,339 | 224,596 | 234,371 |
| Short-term debt | 1,705 | 46 | 316 | 0 | 355 | 0 | 0 | 0 |
| Accounts payable | 4,666 | 20,497 | 15,491 | 16,402 | 15,119 | 16,120 | 16,850 | 17,230 |
| Other current liabilities | 2,224 | 1,707 | 3,221 | 2,721 | 2,415 | 2,750 | 2,820 | 2,850 |
| Total current liabilities | 8,595 | 22,250 | 19,028 | 19,123 | 17,889 | 18,870 | 19,670 | 20,080 |
| Long-term debt | 29,584 | 23,822 | 20,741 | 23,168 | 23,222 | 23,222 | 23,222 | 23,222 |
| Other non-current liabilities | 23,337 | 23,969 | 24,603 | 26,537 | 21,324 | 24,233 | 24,473 | 24,610 |
| Total liabilities | 61,516 | 70,041 | 64,372 | 68,828 | 62,435 | 66,325 | 67,365 | 67,912 |
| Share capital | 41,119 | 42,497 | 43,734 | 44,062 | 44,281 | 44,281 | 44,281 | 44,281 |
| Reserves/R.E./others | 56,682 | 63,890 | 73,416 | 84,797 | 99,992 | 104,519 | 112,730 | 121,943 |
| Shareholders' equity | 97,801 | 106,387 | 117,150 | 128,859 | 144,273 | 148,800 | 157,011 | 166,224 |
| Minority interests | 21 | 66 | 143 | 186 | 207 | 214 | 220 | 235 |
| Total equity & liabilities | 159,338 | 176,494 | 181,665 | 197,873 | 206,915 | 215,339 | 224,596 | 234,371 |
| EV | 207,049 | 193,351 | 180,771 | 183,786 | 181,652 | 185,870 | 187,475 | 188,928 |
| Net debt/(cash) | 30,496 | 16,753 | 4,096 | 7,068 | 4,913 | 9,124 | 10,723 | 12,161 |
| BVPS (HKD) | 17.276 | 18.622 | 20.506 | 22.555 | 25.253 | 26.046 | 27.483 | 29.096 |

## ■ Key ratios (%)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | 64.9 | 6.6 | 57.0 | 13.2 | 6.9 | 7.6 | 6.0 | 6.0 |
| EBITDA (YoY) | 57.7 | 1.9 | 14.9 | 5.1 | 6.3 | 10.1 | 4.7 | 4.7 |
| Operating profit (YoY) | 101.5 | 2.0 | 19.5 | 6.1 | 8.7 | 13.6 | 5.6 | 5.5 |
| Net profit (YoY) | (4.5) | (10.8) | 18.5 | 20.9 | (6.6) | (7.5) | 43.9 | 10.3 |
| Core EPS (fully-diluted) (YoY) | (5.5) | (12.0) | 18.5 | 20.9 | (6.6) | (7.5) | 43.9 | 10.3 |
| Gross-profit margin | 76.1 | 72.5 | 51.4 | 47.3 | 49.8 | 50.1 | 49.5 | 48.8 |
| EBITDA margin | 52.9 | 50.5 | 37.0 | 34.3 | 34.1 | 34.9 | 34.5 | 34.1 |
| Operating-profit margin | 36.3 | 34.7 | 26.4 | 24.7 | 25.2 | 26.6 | 26.5 | 26.3 |
| Net profit margin | 46.4 | 38.8 | 29.3 | 31.3 | 27.4 | 23.5 | 31.9 | 33.2 |
| ROAE | 8.7 | 7.2 | 7.7 | 8.5 | 7.2 | 6.2 | 8.5 | 8.9 |
| ROAA | 5.2 | 4.3 | 4.8 | 5.5 | 4.8 | 4.3 | 5.9 | 6.3 |
| ROCE | 5.0 | 5.0 | 5.8 | 5.7 | 5.6 | 6.0 | 6.1 | 6.1 |
| ROIC | 4.5 | 4.3 | 5.1 | 5.3 | 5.3 | 5.6 | 5.5 | 5.5 |
| Net debt to equity | 31.2 | 15.7 | 3.5 | 5.5 | 3.4 | 6.1 | 6.8 | 7.3 |
| Effective tax rate | 10.8 | 16.3 | 19.3 | 16.8 | 16.0 | 16.4 | 16.5 | 16.5 |
| Accounts receivable (days) | 127.9 | 93.4 | 33.9 | 38.3 | 43.1 | 36.1 | 28.6 | 27.9 |
| Current ratio (x) | 1.2 | 0.9 | 1.4 | 1.6 | 1.8 | 1.4 | 1.4 | 1.3 |
| Net interest cover (x) | 3.2 | 4.3 | 6.3 | 9.0 | 10.2 | 12.1 | 12.1 | 12.0 |
| Net dividend payout | 33.0 | 40.7 | 38.9 | 41.5 | 46.2 | 51.8 | 41.7 | 39.8 |
| Free cash flow yield | 4.4 | 16.1 | 9.8 | 0.9 | 5.4 | 1.5 | 3.3 | 3.7 |

*Source: FactSet, Daiwa forecasts*

## ■ Company profile

MTRC is the only rail company in Hong Kong. In December 2007, it merged with the KCRC and now operates a rail network that encompasses the whole of Hong Kong. The company's traditional business model is characterised as "rail and property", which allows it to award property development rights to developers to raise funds to finance the construction of new subway lines.

Daiwa Capital Markets

Company

Industrials / Hong Kong
22 March 2013

The 10-second briefing

## Orient Overseas International
316 HK

Target (HKD): **73.00 → 73.00**
Upside: **41.2%**
19 Mar price (HKD): **51.70**

# Improving outlook for 2013

- Capacity discipline likely to continue, leading to an ongoing improvement in freight rates in 2013
- OOIL should benefit the most from the coming recovery in 2013, given its large transpacific and intra-Asia exposure
- Our top transportation pick for 2013; reiterate Buy

1 Buy (unchanged)
2 Outperform
3 Hold
4 Underperform
5 Sell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### ■ What's new
We expect high capacity discipline to continue in 2013 in the industry, and a gradual recovery in demand to help maintain overall YoY growth in freight rates over 2013.

### ■ What's the impact
For 2013, we forecast global container capacity to rise by 7% YoY (net of scrapping and idling), which is close to our demand-growth forecast of 6% YoY. Industry consultants Alphaliner and Drewry recently lowered their 2013 capacity growth forecasts to 6-7% YoY (from around 10% YoY), which is in line with our view that the overcapacity situation is not as bad as the market expected.

On the demand side, we forecast intra-Asia trade to be robust, increasing by 8% YoY this year amid growing consumption power in Asia. Also, with the recent positive US ISM manufacturing index in February (57.8%) and consistent improvements in new housing starts in the US, we forecast transpacific trade to increase by 4% YoY for 2013.

The recent freight rate hike for Asia-Europe routes on 15 March seems to be successful so far. We expect the freight rate to start an upward trend from 2Q13. The next round of freight-rate hikes is set for 1 April (transpacific routes) and 15 April (Asia-Europe routes).

### ■ What we recommend
We expect more good news in the form of strong macro data, rising freight rates, and a pick-up in volume due to improving consumer sentiment.

Our six-month target price of HKD73 is based on PBR of 1.2x on 2013E BVPS. This multiple was the industry average for 2010, and reflects our expectation that the industry will see a recovery in demand in 2013.

Risks to our view would include a worse-than-expected uplift in freight volume and freight rates, as well as a higher-than-expected fuel-price rise.

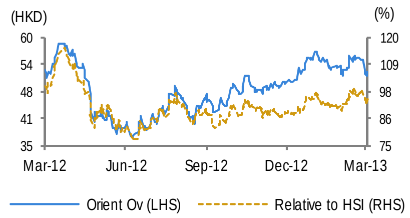
### ■ How we differ
Our 2013-14E EPS are 19-28% higher than those of the Bloomberg consensus, reflecting our expectation of a demand recovery and less concern about overcapacity in 2013.

**Forecast revisions (%)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | (0.2) | (0.3) | n.a. |
| Net profit change | 0.1 | 1.0 | n.a. |
| Core EPS (FD) change | 0.1 | 1.0 | n.a. |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 36.70-58.75 |
| Market cap (USDbn) | 4.17 |
| 3m avg daily turnover (USDm) | 4.87 |
| Shares outstanding (m) | 626 |
| Major shareholder | Tung Group (68.7%) |

**Financial summary (USD)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 6,873 | 7,419 | 7,927 |
| Operating profit (m) | 465 | 673 | 782 |
| Net profit (m) | 430 | 631 | 734 |
| Core EPS (fully-diluted) | 0.687 | 1.008 | 1.173 |
| EPS change (%) | 45.1 | 46.8 | 16.3 |
| Daiwa vs Cons. EPS (%) | 27.5 | 19.3 | 8.9 |
| PER (x) | 9.7 | 6.6 | 5.7 |
| Dividend yield (%) | 3.3 | 4.5 | 5.1 |
| DPS | 0.219 | 0.299 | 0.340 |
| PBR (x) | 0.9 | 0.8 | 0.7 |
| EV/EBITDA (x) | 7.4 | 5.7 | 4.8 |
| ROE (%) | 9.2 | 12.5 | 13.2 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## Key assumptions

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Avg freight rate (USD/TEU) | 1,227.0 | 924.0 | 1,178.0 | 1,098.6 | 1,130.6 | 1,171.3 | 1,219.0 | 1,255.5 |
| Lifting volume ('000 TEU) | 4,834.7 | 4,158.5 | 4,767.7 | 5,033.1 | 5,217.2 | 5,375.6 | 5,594.4 | 5,818.2 |
| Bunker price (USD/ton) | 511.0 | 375.0 | 458.0 | 624.0 | 664.0 | 655.0 | 655.0 | 700.0 |
| Avg freight rate growth (%) | 9.6 | (24.7) | 27.5 | (6.7) | 2.9 | 3.6 | 4.1 | 3.0 |
| Lifting volume growth (%) | 5.1 | (14.0) | 14.6 | 5.6 | 3.7 | 3.0 | 4.1 | 4.0 |
| Bunker price growth (%) | 45.4 | (32.0) | 29.7 | 36.2 | 6.4 | (1.4) | 0.0 | 6.9 |
| Vessel capacity growth (%) | 5.7 | (16.1) | 22.6 | 8.3 | 8.8 | 7.8 | 9.0 | 3.3 |

## Profit and loss (USDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Container transportation and logistics I | 6,503 | 4,326 | 6,009 | 5,987 | 6,433 | 6,847 | 7,392 | 7,901 |
| Rental income and others | 28 | 24 | 25 | 25 | 26 | 26 | 26 | 26 |
| Other Revenue | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Revenue | 6,531 | 4,350 | 6,033 | 6,012 | 6,459 | 6,873 | 7,419 | 7,927 |
| Other income | 32 | 9 | 45 | 64 | 118 | 109 | 109 | 109 |
| COGS | (5,469) | (4,060) | (4,405) | (5,228) | (5,571) | (5,756) | (6,027) | (6,367) |
| SG&A | (471) | (405) | (485) | (402) | (432) | (460) | (496) | (530) |
| Other op.expenses | (226) | (227) | (269) | (271) | (245) | (301) | (330) | (356) |
| Operating profit | 398 | (332) | 919 | 175 | 329 | 465 | 673 | 782 |
| Net-interest inc./(exp.) | (81) | (35) | (29) | (26) | (33) | (30) | (27) | (28) |
| Assoc/forex/extraord./others | 6 | 6 | 9 | 14 | 15 | 15 | 15 | 15 |
| Pre-tax profit | 323 | (362) | 899 | 162 | 311 | 451 | 661 | 769 |
| Tax | (25) | (14) | (29) | (23) | (14) | (20) | (29) | (34) |
| Min. int./pref. div./others | (25) | (26) | 997 | 42 | (1) | (1) | (2) | (2) |
| Net profit (reported) | 272 | (402) | 1,867 | 182 | 296 | 430 | 631 | 734 |
| Net profit (adjusted) | 294 | (378) | 862 | 139 | 296 | 430 | 631 | 734 |
| EPS (reported)(USD) | 0.435 | (0.643) | 2.983 | 0.290 | 0.474 | 0.687 | 1.008 | 1.173 |
| EPS (adjusted)(USD) | 0.470 | (0.604) | 1.378 | 0.222 | 0.474 | 0.687 | 1.008 | 1.173 |
| EPS (adjusted fully-diluted)(USD) | 0.470 | (0.604) | 1.378 | 0.222 | 0.474 | 0.687 | 1.008 | 1.173 |
| DPS (USD) | 0.110 | 0.000 | 2.838 | 0.070 | 0.118 | 0.219 | 0.299 | 0.340 |
| EBIT | 398 | (332) | 919 | 175 | 329 | 465 | 673 | 782 |
| EBITDA | 543 | (127) | 1,166 | 409 | 543 | 739 | 977 | 1,111 |

## Cash flow (USDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 323 | (362) | 899 | 162 | 311 | 451 | 661 | 769 |
| Depreciation and amortisation | 189 | 214 | 266 | 256 | 235 | 295 | 325 | 350 |
| Tax paid | (16) | (8) | (8) | (33) | (18) | (22) | (32) | (36) |
| Change in working capital | (217) | (205) | (2) | (195) | (121) | (153) | (156) | (151) |
| Other operational CF items | 69 | 9 | 20 | 55 | 18 | 15 | 12 | 12 |
| Cash flow from operations | 348 | (352) | 1,175 | 246 | 425 | 586 | 811 | 944 |
| Capex | (409) | (376) | (218) | (744) | (737) | (1,010) | (810) | (610) |
| Net (acquisitions)/disposals | 15 | (50) | 2,108 | 72 | (30) | 4 | 4 | 4 |
| Other investing CF items | 149 | 97 | (2,587) | 2,614 | (107) | 20 | (10) | (15) |
| Cash flow from investing | (245) | (329) | (698) | 1,942 | (875) | (986) | (816) | (621) |
| Change in debt | 504 | 525 | 584 | 282 | 627 | 300 | 300 | 300 |
| Net share issues/(repurchases) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends paid | (126) | (29) | (325) | (1,500) | (30) | (75) | (138) | (188) |
| Other financing CF items | (551) | (249) | (612) | (274) | (459) | (556) | (307) | (265) |
| Cash flow from financing | (172) | 247 | (353) | (1,492) | 138 | (331) | (145) | (153) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | (68) | (435) | 124 | 695 | (312) | (731) | (150) | 171 |
| Free cash flow | (60) | (728) | 956 | (498) | (313) | (424) | 1 | 335 |

*Source: FactSet, Daiwa forecasts*

# Financial summary continued …

## Balance sheet (USDm)

| As at 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Cash & short-term investment | 1,805 | 1,225 | 3,852 | 2,099 | 1,862 | 1,212 | 1,143 | 1,396 |
| Inventory | 90 | 84 | 96 | 150 | 154 | 158 | 164 | 170 |
| Accounts receivable | 336 | 275 | 358 | 356 | 426 | 447 | 476 | 502 |
| Other current assets | 1,020 | 1,422 | 250 | 235 | 324 | 324 | 354 | 389 |
| Total current assets | 3,250 | 3,006 | 4,556 | 2,839 | 2,765 | 2,142 | 2,137 | 2,457 |
| Fixed assets | 3,781 | 3,798 | 3,860 | 4,205 | 4,665 | 5,181 | 5,518 | 5,679 |
| Goodwill & intangibles | 47 | 53 | 47 | 40 | 39 | 38 | 37 | 36 |
| Other non-current assets | 623 | 473 | 612 | 649 | 796 | 965 | 1,137 | 1,259 |
| Total assets | 7,702 | 7,330 | 9,075 | 7,733 | 8,265 | 8,325 | 8,828 | 9,430 |
| Short-term debt | 143 | 432 | 248 | 439 | 556 | 307 | 265 | 266 |
| Accounts payable | 203 | 232 | 261 | 330 | 785 | 364 | 378 | 396 |
| Other current liabilities | 674 | 527 | 518 | 395 | 12 | 445 | 445 | 445 |
| Total current liabilities | 1,020 | 1,192 | 1,027 | 1,164 | 1,352 | 1,116 | 1,088 | 1,106 |
| Long-term debt | 2,183 | 2,136 | 2,416 | 2,233 | 2,326 | 2,324 | 2,359 | 2,393 |
| Other non-current liabilities | 77 | 34 | 77 | 79 | 72 | 72 | 72 | 72 |
| Total liabilities | 3,280 | 3,362 | 3,520 | 3,476 | 3,750 | 3,511 | 3,518 | 3,571 |
| Share capital | 63 | 63 | 63 | 63 | 63 | 63 | 63 | 63 |
| Reserves/R.E./others | 4,324 | 3,882 | 5,486 | 4,188 | 4,447 | 4,745 | 5,239 | 5,786 |
| Shareholders' equity | 4,387 | 3,945 | 5,548 | 4,251 | 4,509 | 4,807 | 5,302 | 5,849 |
| Minority interests | 34 | 24 | 7 | 7 | 6 | 7 | 8 | 10 |
| Total equity & liabilities | 7,702 | 7,330 | 9,075 | 7,733 | 8,265 | 8,325 | 8,828 | 9,430 |
| EV | 4,657 | 5,471 | 2,916 | 4,667 | 5,075 | 5,475 | 5,538 | 5,323 |
| Net debt/(cash) | 522 | 1,343 | (1,188) | 573 | 1,020 | 1,419 | 1,481 | 1,264 |
| BVPS (USD) | 7.010 | 6.303 | 8.866 | 6.793 | 7.206 | 7.682 | 8.472 | 9.346 |

## Key ratios (%)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | 15.6 | (33.4) | 38.7 | (0.4) | 7.4 | 6.4 | 7.9 | 6.9 |
| EBITDA (YoY) | (28.4) | n.a. | n.a. | (64.9) | 32.6 | 36.2 | 32.1 | 13.7 |
| Operating profit (YoY) | (42.1) | n.a. | n.a. | (81.0) | 88.2 | 41.6 | 44.7 | 16.1 |
| Net profit (YoY) | (46.7) | n.a. | n.a. | (83.9) | 113.8 | 45.1 | 46.8 | 16.3 |
| Core EPS (fully-diluted) (YoY) | (46.7) | n.a. | n.a. | (83.9) | 113.8 | 45.1 | 46.8 | 16.3 |
| Gross-profit margin | 16.3 | 6.7 | 27.0 | 13.0 | 13.7 | 16.3 | 18.8 | 19.7 |
| EBITDA margin | 8.3 | n.a. | 19.3 | 6.8 | 8.4 | 10.8 | 13.2 | 14.0 |
| Operating-profit margin | 6.1 | n.a. | 15.2 | 2.9 | 5.1 | 6.8 | 9.1 | 9.9 |
| Net profit margin | 4.5 | (8.7) | 14.3 | 2.3 | 4.6 | 6.3 | 8.5 | 9.3 |
| ROAE | 6.9 | n.a. | 18.2 | 2.8 | 6.8 | 9.2 | 12.5 | 13.2 |
| ROAA | 3.9 | n.a. | 10.5 | 1.6 | 3.7 | 5.2 | 7.4 | 8.0 |
| ROCE | 6.1 | n.a. | 12.5 | 2.3 | 4.6 | 6.3 | 8.8 | 9.5 |
| ROIC | 7.8 | (6.5) | 18.4 | 3.3 | 6.1 | 7.6 | 9.9 | 10.7 |
| Net debt to equity | 11.9 | 34.0 | net cash | 13.5 | 22.6 | 29.5 | 27.9 | 21.6 |
| Effective tax rate | 7.7 | n.a. | 3.2 | 14.2 | 4.4 | 4.4 | 4.4 | 4.4 |
| Accounts receivable (days) | 21.5 | 25.6 | 19.1 | 21.7 | 22.1 | 23.2 | 22.7 | 22.5 |
| Current ratio (x) | 3.2 | 2.5 | 4.4 | 2.4 | 2.0 | 1.9 | 2.0 | 2.2 |
| Net interest cover (x) | 4.9 | n.a. | 31.6 | 6.7 | 10.0 | 15.7 | 24.9 | 28.4 |
| Net dividend payout | 25.3 | n.a. | 95.1 | 24.1 | 25.0 | 31.8 | 29.6 | 29.0 |
| Free cash flow yield | n.a. | n.a. | 22.9 | n.a. | n.a. | n.a. | 0.0 | 8.0 |

*Source: FactSet, Daiwa forecasts*

## Company profile

OOIL is a Hong Kong-based container-shipping company with an operating capacity of 452,246 TEUs. In the past decade, the company entered the China property market, but announced on 18 January 2010 that it would exit the property-development business by disposing of this business.

Daiwa Capital Markets

Company

Financials / Hong Kong
22 March 2013

The 10-second briefing

# Regal REIT
1881 HK

Target (HKD): **2.60 → 2.60**
Upside: **16.1%**
19 Mar price (HKD): **2.24**

# Low-risk vehicle for exposure to HK hotel sector, in our view

- Good potential for sustained improvement in RevPAR, we believe
- Access to urban hotel sites; partnership with parent could be a win-win formula
- Maintain Outperform rating and target price of HKD2.60

1 Buy
2 Outperform (unchanged)
3 Hold
4 Underperform
5 Sell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## ■ What's new

We believe Regal REIT's business is well placed to benefit from a strong start to the year for Hong Kong's tourist inflow and hotel occupancy rates.

## ■ What's the impact

**Hotels in or close to urban areas look well-positioned.** We think more and more travellers are likely to find it hard to afford the room rates of premier hotels, and as such we believe the group's Regal Hotels are favourably positioned, as they are generally in convenient locations and three of the five initial hotels are in urban areas. While the group's RevPAR has already been catching up with the industry average, its average portfolio RevPAR is still 30-40% below the industry average, pointing to the possibility for a further improvement.

**Partnership with sponsor could be a win-win formula.** The Regal i-Club (a boutique hotel at Wanchai) acquired by Regal REIT from its parent company has been value-enhancing. The group was recently granted a call option to acquire two hotel sites in Sheung Wan and North Point now being developed by parent companies Paliburg Holdings and Regal Hotels, with the master lease guaranteeing a rental yield of 5-5.5%.

We think this partnership could be a win-win formula, as it enables the group's parents to cycle capital while Regal REIT can gain access to urban hotel properties which it would probably find hard to acquire. As Regal REIT is the foundation block of the entire Paliburg-Regal group, we think it is in its parents' interest to build up Regal REIT's investment and asset values.

## ■ What we recommend

Trading at a 2013E DPU yield of 6.5%, we believe Regal REIT is attractively valued and offers a low-risk way of investing in the prospects of the Hong Kong hotel sector, and maintain our Outperform (2) rating. We recently increased our DPU forecasts for 2013-14 and beyond, and raised our six-month target price to HKD2.60, based on our 10-year dividend discount model. Our target price implies a 2014E DPU yield of 5.5%. A sharp decline in tourists to Hong Kong would be a risk to our call.

## ■ How we differ

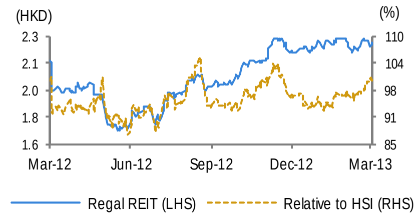
We believe our view of Regal REIT as a low-risk vehicle for exposure to Hong Kong's hotel sector has yet to be recognised by the market.

### 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 | 1.69-2.29 |
| Market cap (USDbn) | 0.94 |
| 3m avg daily turnover (USDm) | 0.42 |
| Shares outstanding (m) | 3,241 |
| Major shareholder | Regal Hotels (74.0%) |

### Financial summary (HKD)

| Year to 31 Dec | 12E | 13E | 14E |
|---|---|---|---|
| Revenue (m) | 742 | 810 | 876 |
| Net property income (m) | 711 | 776 | 839 |
| Distribution (m) | 419 | 474 | 526 |
| DPU | 0.129 | 0.146 | 0.162 |
| DPU change (%) | 7.2 | 13.0 | 11.0 |
| Daiwa vs Cons. EPS (%) | n.a. | n.a. | n.a. |
| DPU yield (%) | 5.8 | 6.5 | 7.2 |
| PER (x) | 17.7 | 15.4 | 13.7 |
| Core EPU (fully-diluted) | 0.127 | 0.145 | 0.163 |
| P/BV (x) | 0.6 | 0.6 | 0.6 |
| ROE (%) | 3.3 | 3.9 | 4.3 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## Key assumptions

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Interest cover ratio (x) | 4.0 | 3.4 | 3.8 | 4.5 | 3.2 | 3.3 | 3.6 | 4.0 |
| Interest service ratio (x) | 1.9 | 1.2 | 1.0 | 0.8 | 1.1 | 1.3 | 1.3 | 1.2 |
| Average portfolio cap rate (%) | 4.2 | 5.9 | 5.3 | 6.1 | 4.0 | 4.3 | 4.7 | 5.0 |
| Funds from operations (m) | 2,850 | (2,150) | 682 | 997 | 2,956 | 411 | 471 | 528 |
| Adj. funds from operations (m) | 2,837 | (2,225) | 610 | 886 | 2,876 | 331 | 400 | 458 |

## Profit and loss (HKDm)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Total revenue | 673 | 762 | 763 | 910 | 692 | 742 | 810 | 876 |
| Operating expenses | (7) | (12) | (9) | (11) | (29) | (31) | (34) | (36) |
| Net property income | 666 | 750 | 754 | 899 | 663 | 711 | 776 | 839 |
| Other income | 0 | 0 | 0 | 0 | 2 | 0 | 0 | 0 |
| Management fees | (54) | (67) | (71) | (75) | (76) | (74) | (77) | (79) |
| Other operating expenses | (6) | (13) | (10) | (14) | (7) | (10) | (10) | (10) |
| Depreciation and amortisation | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| EBIT | 606 | 671 | 673 | 810 | 583 | 627 | 690 | 751 |
| Net-int. income/(expenses) | (152) | (198) | (177) | (179) | (183) | (190) | (190) | (190) |
| Share of associates | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Revaluation gains/(loss) | 592 | (3,158) | 281 | 490 | 2,629 | 0 | 0 | 0 |
| Except./other inc./(exp.) | 2,044 | 0 | 10 | 0 | 0 | 0 | 0 | 0 |
| Profit before tax | 3,091 | (2,685) | 788 | 1,120 | 3,029 | 437 | 501 | 561 |
| Taxation | (241) | 535 | (107) | (103) | (73) | (26) | (30) | (33) |
| Min. int./pref. div./others | 0 | 0 | 1 | (20) | 0 | 0 | 0 | 0 |
| Net profit | 2,850 | (2,150) | 682 | 997 | 2,956 | 411 | 471 | 528 |
| Total return | 454 | 472 | 480 | 569 | 417 | 455 | 516 | 574 |
| Adjustments | (33) | 30 | 78 | 114 | (19) | 11 | 11 | 11 |
| Distributable income | 421 | 502 | 558 | 683 | 398 | 466 | 526 | 584 |
| Distribution rate | 1.00 | 1.00 | 0.95 | 0.90 | 0.98 | 0.90 | 0.90 | 0.90 |
| Distribution | 421 | 502 | 533 | 617 | 391 | 419 | 474 | 526 |
| EPU (HKD) | 0.145 | 0.151 | 0.151 | 0.177 | 0.116 | 0.127 | 0.145 | 0.163 |
| DPU (HKD) | 0.153 | 0.168 | 0.170 | 0.190 | 0.121 | 0.129 | 0.146 | 0.162 |

## Cash flow (HKDm)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 454 | 497 | 631 | 441 | 482 | 546 | 607 | 656 |
| Depreciation and amortisation | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net-interest expenses | 152 | 175 | 177 | 179 | 183 | 190 | 190 | 190 |
| Share of associate | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in working capital | (173) | 74 | (185) | (36) | 102 | 57 | 30 | 28 |
| Tax paid | 0 | (6) | (17) | (41) | (24) | (26) | (30) | (33) |
| Other operating CF items | 54 | 73 | 65 | 70 | 0 | 0 | 0 | 0 |
| Cash flow from operation | 486 | 812 | 670 | 613 | 742 | 766 | 796 | 841 |
| Capex | (13) | (76) | (72) | (111) | (80) | (80) | (70) | (70) |
| Net investment and sale of FA | (6,509) | 0 | (196) | 0 | 0 | 0 | 0 | 0 |
| Other investing CF items | (5) | 5 | (5) | 0 | 0 | 0 | 0 | 0 |
| Cash flow from investing | (6,528) | (71) | (273) | (111) | (80) | (80) | (70) | (70) |
| Change in debt | 4,308 | 8 | 297 | 73 | 79 | 0 | 0 | 0 |
| Equity raised/(repaid) | 2,201 | (21) | 0 | 0 | 0 | 0 | 0 | 0 |
| Distribution paid | (156) | (511) | (514) | (554) | (533) | (405) | (446) | (500) |
| Other financing CF items | (171) | (159) | (152) | (251) | (172) | (179) | (179) | (179) |
| Cash flow from financing | 6,182 | (684) | (369) | (733) | (626) | (584) | (625) | (679) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 140 | 58 | 28 | (230) | 37 | 103 | 101 | 92 |

*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 | 140 | 174 | 68 | 27 | 24 | 62 | 102 | 144 |
| Accounts receivable | 176 | 106 | 66 | 128 | 56 | 54 | 56 | 58 |
| Other current assets | 85 | 53 | 69 | 72 | 74 | 20 | 22 | 15 |
| Total current assets | 402 | 333 | 203 | 227 | 153 | 136 | 180 | 217 |
| Investment properties | 16,080 | 13,020 | 14,290 | 14,880 | 17,154 | 17,240 | 17,326 | 17,413 |
| Fixed assets | 430 | 447 | 0 | 0 | 615 | 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 | 22 | 116 | 2 | 0 | 0 | 0 | 0 | 0 |
| Total assets | 16,934 | 13,916 | 14,495 | 15,107 | 17,922 | 17,376 | 17,506 | 17,630 |
| Short-term debt | 0 | 0 | 5 | 75 | 4,563 | 0 | 0 | 0 |
| Accounts payable | 62 | 64 | 60 | 96 | 144 | 145 | 180 | 203 |
| Other current liabilities | 0 | 0 | 9 | 16 | 35 | 35 | 35 | 35 |
| Total current liabilities | 62 | 64 | 74 | 188 | 4,742 | 180 | 214 | 237 |
| Long-term debt | 4,314 | 4,322 | 4,614 | 4,617 | 209 | 4,741 | 4,741 | 4,741 |
| Other non-current liabilities | 1,642 | 1,373 | 457 | 383 | 320 | 283 | 283 | 283 |
| Total liabilities | 6,019 | 5,759 | 5,145 | 5,188 | 5,270 | 5,204 | 5,238 | 5,261 |
| Unitholders' funds | 10,915 | 8,157 | 9,329 | 9,920 | 12,652 | 12,172 | 12,268 | 12,369 |
| Minority interests | 0 | 0 | 22 | 0 | 0 | 0 | 0 | 0 |
| Total equity & liabilities | 16,934 | 13,916 | 14,495 | 15,107 | 17,922 | 17,376 | 17,506 | 17,630 |
| Book Value per unit | 3.503 | 2.596 | 2.912 | 3.061 | 3.904 | 3.756 | 3.785 | 3.816 |

### ■ Key ratios (%)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Total revenue (YoY) | n.a. | 13.3 | 0.1 | 19.2 | (24.0) | 7.2 | 9.2 | 8.1 |
| Net property income (YoY) | n.a. | 12.7 | 0.5 | 19.3 | (26.3) | 7.2 | 9.3 | 8.1 |
| Net profit (YoY) | n.a. | 3.8 | 1.7 | 18.6 | (34.0) | 9.4 | 14.6 | 12.2 |
| Distribution (YoY) | n.a. | 19.2 | 6.1 | 15.8 | (36.6) | 7.2 | 13.0 | 11.0 |
| EPU (YoY) | n.a. | 3.8 | 0.3 | 16.7 | (34.4) | 9.4 | 14.6 | 12.2 |
| DPU (YoY) | n.a. | 9.5 | 1.4 | 11.8 | (36.5) | 7.2 | 13.0 | 11.0 |
| ROE | 8.3 | 4.9 | 5.5 | 5.9 | 3.3 | 3.3 | 3.9 | 4.3 |
| ROA | 5.4 | 3.1 | 3.4 | 3.8 | 2.3 | 2.3 | 2.7 | 3.0 |
| ROCE | 8.0 | 4.8 | 5.1 | 5.7 | 3.6 | 3.7 | 4.1 | 4.4 |
| ROIC | 6.7 | 4.4 | 4.2 | 5.0 | 3.5 | 3.4 | 3.8 | 4.1 |
| Debt to asset | 24.6 | 29.8 | 31.4 | 30.9 | 26.5 | 26.9 | 26.5 | 26.1 |
| Net debt to equity | 38.2 | 50.9 | 48.7 | 47.0 | 37.5 | 38.4 | 37.8 | 37.2 |
| Effective tax rate | 7.8 | n.a. | 13.6 | 9.2 | 2.4 | 6.1 | 6.0 | 5.9 |

*Source: FactSet, Daiwa forecasts*

### ■ Company profile

Regal REIT is the only listed hotel REIT in Hong Kong. It was listed in 2007 after acquiring the hotel properties of Regal Hong Kong (Not rated) and leased back the properties to Regal Hong Kong, which operates the hotels.

The 10-second briefing

# SHK Properties
16 HK

Target (HKD): **136.50 → 136.50**
Upside: **28.4%**
19 Mar price (HKD): **106.30**

# A world-class company with world-class assets

- Trophy assets should command pricing power
- Development of additional trophy assets could drive upward NAV revisions
- China investments coming to fruition, and implied value of China assets still cheap; reiterate Buy

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

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## ■ What's new

We believe SHK Properties is well-positioned in the Hong Kong property sector given the size and quality of its property assets.

## ■ What's the impact

**Owns some of the most prime property assets in Hong Kong and Shanghai.** We believe one theme in the Hong Kong property sector is that the stock of top-end assets (residential, office or retail) is small relative to the future scale of the territory's economy. This should give owners of existing prime property assets in Hong Kong considerable pricing power. We see SHK Properties as a main beneficiary of this trend, as it owns some of the most prime property assets in Hong Kong and has been developing trophy property assets in Shanghai as well.

**Also developing many upcoming properties.** In terms of upside to NAV, the greatest potential probably lies with mid-tier properties that can be upgraded and marketed as credible alternatives to prime properties. We see SHK Properties' ICC project in West Kowloon as a classic example of this, and believe the group has many other assets that can be upgraded over the next few years – not least of which are Millenium City in East Kowloon, high-end residential apartments in the New Territories, and China assets. In addition, the group owns among the most prime suburban malls in Shatin, Tseung Kwan O and Sheung Shui, and is developing a number of promising malls in Yuen Long, Tuen Mun and other areas.

## ■ What we recommend

We think the group's assets are well-placed to achieve higher rents and capital values over the next few years. Thus, we reiterate our Buy (1) rating with a six-month target price of HKD136.50, based on a 35% discount applied to our end-2013E NAV of HKD210, which we believe takes into account the impact of court cases related to the Kwok brothers. Risks to our call would include major new negative developments in the court cases.

## ■ How we differ

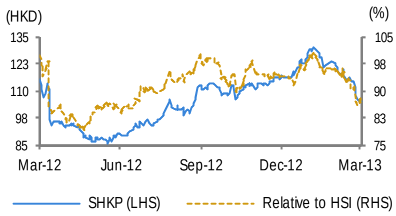
Unlike some in the market, we do not expect the impact of the court case on the group's share price to last indefinitely, and believe the quality of the group's assets should not be overlooked.

### Forecast revisions (%)

| Year to 30 Jun | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

*Source: Daiwa forecasts*

### Share price performance




| | |
|---|---|
| 12-month range | 86.00-130.50 |
| Market cap (USDbn) | 35.20 |
| 3m avg daily turnover (USDm) | 85.01 |
| Shares outstanding (m) | 2,570 |
| Major shareholder | Kwok family (42.9%) |

### Financial summary (HKD)

| Year to 30 Jun | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 67,650 | 70,250 | 74,932 |
| Operating profit (m) | 31,000 | 34,008 | 37,116 |
| Net profit (m) | 23,940 | 25,670 | 28,528 |
| Core EPS (fully-diluted) | 9.315 | 9.988 | 11.100 |
| EPS change (%) | 10.4 | 7.2 | 11.1 |
| Daiwa vs Cons. EPS (%) | 18.0 | 11.9 | 15.2 |
| PER (x) | 11.4 | 10.6 | 9.6 |
| Dividend yield (%) | 3.5 | 3.8 | 4.0 |
| DPS | 3.700 | 4.000 | 4.300 |
| PBR (x) | 0.8 | 0.7 | 0.7 |
| EV/EBITDA (x) | 8.9 | 8.0 | 7.2 |
| ROE (%) | 6.8 | 7.0 | 7.5 |

*Source: FactSet, Daiwa forecasts*

# *Financial summary*

## Key assumptions

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Rental EBIT (HKDm) | 5,992 | 7,271 | 8,314 | 9,511 | 11,069 | 11,538 | 12,291 | 12,773 |
| Property sales profit (HKDm) | 6,443 | 7,113 | 6,616 | 16,647 | 12,618 | 16,327 | 18,281 | 20,693 |
| Size of completed investment properties in HK (m sq.ft.) | 25.6 | 26.0 | 27.6 | 27.7 | 28.5 | 29.3 | 29.6 | 30.0 |
| Size of completed investment properties in China (m sq.ft.) | 3.0 | 3.0 | 5.5 | 7.5 | 9.4 | 9.7 | 10.9 | 12.5 |

## Profit and loss (HKDm)

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Property sales | 7,040 | 15,537 | 15,027 | 36,230 | 37,032 | 32,077 | 32,592 | 35,484 |
| Rental income | 6,927 | 8,133 | 11,082 | 12,609 | 14,444 | 15,082 | 15,962 | 16,588 |
| Other Revenue | 10,504 | 10,564 | 7,102 | 13,714 | 24,585 | 20,491 | 21,696 | 22,860 |
| Total Revenue | 24,471 | 34,234 | 33,211 | 62,553 | 76,061 | 67,650 | 70,250 | 74,932 |
| Other income | 3,057 | 1,394 | 663 | 574 | 532 | 610 | 635 | 660 |
| COGS | (11,118) | (17,428) | (14,328) | (31,367) | (43,894) | (34,054) | (33,540) | (34,945) |
| SG&A | (887) | (820) | (905) | (1,284) | (1,361) | (1,443) | (1,529) | (1,621) |
| Other op.expenses | (1,379) | (1,534) | (1,595) | (1,657) | (1,718) | (1,763) | (1,808) | (1,910) |
| Operating profit | 14,144 | 15,846 | 17,046 | 28,819 | 29,620 | 31,000 | 34,008 | 37,116 |
| Net-interest inc./(exp.) | (1,108) | (725) | (860) | (1,199) | (1,532) | (1,373) | (1,455) | (1,520) |
| Assoc/forex/extraord./others | 1,056 | 87 | 0 | 0 | 0 | 0 | 0 | 0 |
| Pre-tax profit | 14,092 | 15,208 | 16,186 | 27,620 | 28,088 | 29,627 | 32,553 | 35,596 |
| Tax | (1,553) | (2,586) | (2,005) | (5,831) | (5,896) | (5,339) | (6,515) | (6,685) |
| Min. int./pref. div./others | (353) | (207) | (300) | (310) | (514) | (348) | (368) | (383) |
| Net profit (reported) | 12,186 | 12,415 | 13,881 | 21,479 | 21,678 | 23,940 | 25,670 | 28,528 |
| Net profit (adjusted) | 12,186 | 12,415 | 13,881 | 21,479 | 21,678 | 23,940 | 25,670 | 28,528 |
| EPS (reported)(HKD) | 4.800 | 4.842 | 5.414 | 8.358 | 8.435 | 9.315 | 9.988 | 11.100 |
| EPS (adjusted)(HKD) | 4.800 | 4.842 | 5.414 | 8.358 | 8.435 | 9.315 | 9.988 | 11.100 |
| EPS (adjusted fully-diluted)(HKD) | 4.753 | 4.842 | 5.414 | 8.358 | 8.435 | 9.315 | 9.988 | 11.100 |
| DPS (HKD) | 2.500 | 2.500 | 2.700 | 3.350 | 3.350 | 3.700 | 4.000 | 4.300 |
| EBIT | 14,144 | 15,846 | 17,046 | 28,819 | 29,620 | 31,000 | 34,008 | 37,116 |
| EBITDA | 15,270 | 17,119 | 18,367 | 30,189 | 31,041 | 32,451 | 35,496 | 38,696 |

## Cash flow (HKDm)

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 14,092 | 15,208 | 16,186 | 27,620 | 28,088 | 29,627 | 32,553 | 35,596 |
| Depreciation and amortisation | 1,126 | 1,273 | 1,321 | 1,370 | 1,421 | 1,451 | 1,488 | 1,580 |
| Tax paid | (777) | (1,552) | (1,203) | (3,498) | (2,991) | (1,940) | (2,250) | (2,520) |
| Change in working capital | (2,865) | (2,869) | (2,949) | (2,797) | 3,406 | (2,950) | (3,120) | (3,340) |
| Other operational CF items | 495 | 990 | 1,259 | 1,589 | 1,889 | 1,727 | 1,795 | 1,960 |
| Cash flow from operations | 12,071 | 13,050 | 14,614 | 24,284 | 31,813 | 27,915 | 30,466 | 33,276 |
| Capex | (22,883) | (5,388) | (9,733) | (30,949) | (25,820) | (14,560) | (14,520) | (15,600) |
| Net (acquisitions)/disposals | 920 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other investing CF items | (352) | (385) | (392) | (414) | (425) | (430) | (450) | (460) |
| Cash flow from investing | (22,315) | (5,773) | (10,125) | (31,363) | (26,245) | (14,990) | (14,970) | (16,060) |
| Change in debt | 5,107 | 1,722 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 10,884 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends paid | (6,542) | (6,410) | (6,538) | (6,935) | (8,610) | (9,212) | (10,250) | (11,350) |
| Other financing CF items | (1,637) | (1,242) | (1,252) | (1,339) | (1,349) | (1,455) | (1,580) | (1,660) |
| Cash flow from financing | 7,812 | (5,930) | (7,790) | (8,274) | (9,959) | (10,667) | (11,830) | (13,010) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | (2,432) | 1,347 | (3,302) | (15,353) | (4,391) | 2,258 | 3,666 | 4,206 |
| Free cash flow | (10,812) | 7,662 | 4,881 | (6,665) | 5,993 | 13,355 | 15,946 | 17,676 |

*Source: FactSet, Daiwa forecasts*

## Financial summary continued ...

### Balance sheet (HKDm)

| As at 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Cash & short-term investment | 6,796 | 8,143 | 8,204 | 7,898 | 14,338 | 16,617 | 16,657 | 10,350 |
| Inventory | 5,986 | 9,238 | 9,685 | 9,935 | 10,452 | 10,825 | 10,960 | 11,320 |
| Accounts receivable | 11,552 | 15,611 | 16,060 | 23,932 | 24,159 | 24,680 | 24,860 | 25,120 |
| Other current assets | 60,148 | 59,711 | 76,088 | 90,052 | 107,840 | 102,520 | 102,650 | 102,860 |
| Total current assets | 84,482 | 92,703 | 110,037 | 131,817 | 156,789 | 154,642 | 155,127 | 149,650 |
| Fixed assets | 179,976 | 180,205 | 205,079 | 235,653 | 260,846 | 273,878 | 282,689 | 293,629 |
| Goodwill & intangibles | 0 | 35 | 42 | 47 | 48 | 51 | 53 | 55 |
| Other non-current assets | 37,057 | 36,872 | 36,443 | 45,680 | 49,887 | 48,785 | 50,030 | 50,805 |
| Total assets | 301,515 | 309,815 | 351,601 | 413,197 | 467,570 | 477,356 | 487,899 | 494,139 |
| Short-term debt | 2,051 | 2,644 | 11,262 | 9,682 | 9,801 | 9,850 | 9,920 | 9,970 |
| Accounts payable | 13,103 | 14,600 | 17,667 | 20,452 | 22,256 | 21,540 | 22,664 | 22,850 |
| Other current liabilities | 4,440 | 6,844 | 15,938 | 8,666 | 9,870 | 9,105 | 9,240 | 9,320 |
| Total current liabilities | 19,594 | 24,088 | 44,867 | 38,800 | 41,927 | 40,495 | 41,824 | 42,140 |
| Long-term debt | 38,252 | 39,381 | 34,126 | 50,753 | 61,465 | 61,437 | 57,741 | 47,178 |
| Other non-current liabilities | 19,612 | 19,426 | 22,744 | 11,449 | 13,219 | 11,775 | 11,830 | 11,990 |
| Total liabilities | 77,458 | 82,895 | 101,737 | 101,002 | 116,611 | 113,707 | 111,395 | 101,308 |
| Share capital | 1,282 | 1,282 | 1,285 | 1,285 | 1,308 | 1,308 | 1,308 | 1,308 |
| Reserves/R.E./others | 217,968 | 220,986 | 243,793 | 305,680 | 345,251 | 357,221 | 370,056 | 386,353 |
| Shareholders' equity | 219,250 | 222,268 | 245,078 | 306,965 | 346,559 | 358,529 | 371,364 | 387,661 |
| Minority interests | 4,807 | 4,652 | 4,786 | 5,230 | 4,400 | 5,120 | 5,140 | 5,170 |
| Total equity & liabilities | 301,515 | 309,815 | 351,601 | 413,197 | 467,570 | 477,356 | 487,899 | 494,139 |
| EV | 280,312 | 282,883 | 282,680 | 289,023 | 288,829 | 288,331 | 283,475 | 278,569 |
| Net debt/(cash) | 33,507 | 33,882 | 37,184 | 52,537 | 56,928 | 54,670 | 51,004 | 46,798 |
| BVPS (HKD) | 85.511 | 86.688 | 95.584 | 119.442 | 134.848 | 139.505 | 144.500 | 150.841 |

### Key ratios (%)

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | (21.0) | 39.9 | (3.0) | 88.4 | 21.6 | (11.1) | 3.8 | 6.7 |
| EBITDA (YoY) | 0.2 | 12.1 | 7.3 | 64.4 | 2.8 | 4.5 | 9.4 | 9.0 |
| Operating profit (YoY) | (0.2) | 12.0 | 7.6 | 69.1 | 2.8 | 4.7 | 9.7 | 9.1 |
| Net profit (YoY) | 6.0 | 1.9 | 11.8 | 54.7 | 0.9 | 10.4 | 7.2 | 11.1 |
| Core EPS (fully-diluted) (YoY) | 3.0 | 1.9 | 11.8 | 54.4 | 0.9 | 10.4 | 7.2 | 11.1 |
| Gross-profit margin | 54.6 | 49.1 | 56.9 | 49.9 | 42.3 | 49.7 | 52.3 | 53.4 |
| EBITDA margin | 62.4 | 50.0 | 55.3 | 48.3 | 40.8 | 48.0 | 50.5 | 51.6 |
| Operating-profit margin | 57.8 | 46.3 | 51.3 | 46.1 | 38.9 | 45.8 | 48.4 | 49.5 |
| Net profit margin | 49.8 | 36.3 | 41.8 | 34.3 | 28.5 | 35.4 | 36.5 | 38.1 |
| ROAE | 6.0 | 5.6 | 5.9 | 7.8 | 6.6 | 6.8 | 7.0 | 7.5 |
| ROAA | 4.4 | 4.1 | 4.2 | 5.6 | 4.9 | 5.1 | 5.3 | 5.8 |
| ROCE | 5.8 | 5.9 | 6.0 | 8.6 | 7.5 | 7.2 | 7.7 | 8.3 |
| ROIC | 5.3 | 5.1 | 5.5 | 7.0 | 6.1 | 6.2 | 6.4 | 7.0 |
| Net debt to equity | 15.3 | 15.2 | 15.2 | 17.1 | 16.4 | 15.2 | 13.7 | 12.1 |
| Effective tax rate | 11.0 | 17.0 | 12.4 | 21.1 | 21.0 | 18.0 | 20.0 | 18.8 |
| Accounts receivable (days) | 86.2 | 144.8 | 174.0 | 116.7 | 115.4 | 131.8 | 128.7 | 121.7 |
| Current ratio (x) | 4.3 | 3.8 | 2.5 | 3.4 | 3.7 | 3.8 | 3.7 | 3.6 |
| Net interest cover (x) | 12.8 | 21.9 | 19.8 | 24.0 | 19.3 | 22.6 | 23.4 | 24.4 |
| Net dividend payout | 52.1 | 51.6 | 49.9 | 40.1 | 39.7 | 39.7 | 40.0 | 38.7 |
| Free cash flow yield | n.a. | 2.8 | 1.8 | n.a. | 2.2 | 4.9 | 5.8 | 6.5 |

*Source: FactSet, Daiwa forecasts*

### Company profile

SHK Properties is currently one of the two largest property companies in Hong Kong, with substantial investments in the residential, office and retail property sectors of Hong Kong. It also has a total landbank of 46.7m sq ft in the territory. In recent years, it has been expanding into China, with major investments in the commercial property sector in Shanghai and a landbank of about 85.3m sq ft in the country.

The 10-second briefing

# Sino Land
83 HK

Target (HKD): **16.73 → 16.73**
Upside: **32.1%**
19 Mar price (HKD): **12.66**

## Deploying capital from property sales

- Sino Land has several prominent projects set to launch, including its joint-venture project in Wanchai in 2Q13
- Tuen Mun Town Plaza is riding on improved retail spending and the strong Mainland presence in the Tuen Mun area
- If competition heats up in the land sales market, Sino Land would likely retain an edge over new entrants; reiterating Buy

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

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### ■ What's new

We see opportunities ahead for Sino Land, which, along with the company's financial strength and product recognition, could lead to a rerating of the stock.

### ■ What's the impact

*One key for Sino is whether East New Territories can become a luxury residential district.* Some 2.4m sq ft (almost 60%) of Sino Land's current landbank is in Pak Shek Kok/Kau To in eastern New Territories. As such, we believe its NAV is highly sensitive to whether the area establishes itself as a luxury residential location in the New Territories. We see considerable room for NAV revisions if Sino can execute its projects well in this area.

*Wanchai project will be one of the company's most prominent new launches in 2013.* Many locations in Hong Kong are undergoing transformations, with one being Wanchai. We expect Sino's joint venture with Hopewell (Not rated) in Lee Tung Street to attract considerable market attention upon its launch in 2Q13.

*Its Tuen Mun Town Plaza is likely to remain the most prominent suburban mall in the area,* given that its size (1m sq ft in GFA) is far larger than that of any other mall in the area, and it is already popular among many Mainland consumers. Since Tuen Mun is close to Shenzhen, we see it as another area that could undergo a major transformation in the next few years.

### ■ What we recommend

We reckon some niche players have become more active in the land market in terms of buying land in recent months. That said, we believe Sino is still ahead in terms of financial strength and product recognition, and has continued to improve its product and competitive position in recent years. We reaffirm our Buy (1) rating on the stock and six-month target price of HKD16.73, based on a 30% discount to our end-2013E NAV estimate of HKD23.90. The key risk to our call would be further government measures to suppress high-grade demand.

### ■ How we differ

Unlike the consensus, we believe that Sino Land will still have an edge over medium-sized players in many respects although the land market will likely see more players bidding in the next few years.

**Forecast revisions (%)**

| Year to 30 Jun | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

*Source: Daiwa forecasts*

**Share price performance**


| | |
|---|---|
| 12-month range | 10.26-15.58 |
| Market cap (USDbn) | 9.64 |
| 3m avg daily turnover (USDm) | 13.86 |
| Shares outstanding (m) | 5,912 |
| Major shareholder | Tsimshatsui Properties (57.4%) |

**Financial summary (HKD)**

| Year to 30 Jun | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 8,445 | 12,308 | 19,535 |
| Operating profit (m) | 3,908 | 6,894 | 8,021 |
| Net profit (m) | 5,980 | 6,680 | 7,490 |
| Core EPS (fully-diluted) | 1.012 | 1.130 | 1.267 |
| EPS change (%) | 11.5 | 11.7 | 12.1 |
| Daiwa vs Cons. EPS (%) | (8.0) | 5.4 | 16.3 |
| PER (x) | 12.5 | 11.2 | 10.0 |
| Dividend yield (%) | 3.9 | 4.3 | 4.7 |
| DPS | 0.500 | 0.550 | 0.600 |
| PBR (x) | 0.8 | 0.8 | 0.7 |
| EV/EBITDA (x) | 14.9 | 8.9 | 8.3 |
| ROE (%) | 6.5 | 7.0 | 7.5 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## Key assumptions

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Rental EBIT (HKDm) | 1,601 | 1,942 | 2,053 | 2,254 | 2,558 | 2,739 | 2,903 | 3,077 |
| Property sales profit (HKDm) | 1,837 | 3,036 | 2,066 | 3,241 | 3,017 | 4,528 | 5,285 | 6,252 |
| Size of completed investment properties in HK (m sq.ft.) | 9.2 | 9.9 | 10.0 | 10.1 | 9.9 | 10.0 | 10.0 | 10.2 |

## Profit and loss (HKDm)

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Property sales | 1,438 | 6,808 | 4,567 | 2,149 | 4,279 | 3,952 | 7,403 | 14,344 |
| Rental income | 1,438 | 1,779 | 1,920 | 2,256 | 2,366 | 2,602 | 2,862 | 3,034 |
| Other Revenue | 3,376 | 1,107 | 1,211 | 1,539 | 1,751 | 1,891 | 2,043 | 2,157 |
| Total Revenue | 6,251 | 9,693 | 7,698 | 5,944 | 8,396 | 8,445 | 12,308 | 19,535 |
| Other income | 0 | 0 | 0 | 388 | 757 | 0 | 0 | 0 |
| COGS | (2,193) | (3,987) | (2,562) | (1,792) | (3,217) | (2,830) | (3,645) | (9,676) |
| SG&A | (685) | (724) | (606) | (794) | (793) | (849) | (908) | (972) |
| Other op.expenses | (311) | (877) | (791) | (824) | (841) | (858) | (861) | (866) |
| Operating profit | 3,062 | 4,104 | 3,739 | 2,922 | 4,302 | 3,908 | 6,894 | 8,021 |
| Net-interest inc./(exp.) | (48) | (128) | (21) | (7) | 117 | (50) | (56) | (65) |
| Assoc/forex/extraord./others | 868 | 215 | 386 | 2,489 | 1,977 | 3,365 | 1,217 | 1,304 |
| Pre-tax profit | 3,883 | 4,191 | 4,104 | 5,404 | 6,396 | 7,223 | 8,055 | 9,260 |
| Tax | (418) | (543) | (582) | (985) | (1,050) | (1,201) | (1,325) | (1,710) |
| Min. int./pref. div./others | (91) | (48) | (16) | (18) | (35) | (42) | (50) | (60) |
| Net profit (reported) | 3,374 | 3,601 | 3,506 | 4,401 | 5,311 | 5,980 | 6,680 | 7,490 |
| Net profit (adjusted) | 3,374 | 3,601 | 3,506 | 4,401 | 5,311 | 5,980 | 6,680 | 7,490 |
| EPS (reported)(HKD) | 0.704 | 0.744 | 0.661 | 0.809 | 0.907 | 1.012 | 1.130 | 1.267 |
| EPS (adjusted)(HKD) | 0.704 | 0.744 | 0.661 | 0.809 | 0.907 | 1.012 | 1.130 | 1.267 |
| EPS (adjusted fully-diluted)(HKD) | 0.704 | 0.744 | 0.661 | 0.809 | 0.907 | 1.012 | 1.130 | 1.267 |
| DPS (HKD) | 0.400 | 0.400 | 0.400 | 0.409 | 0.460 | 0.500 | 0.550 | 0.600 |
| EBIT | 3,062 | 4,104 | 3,739 | 2,922 | 4,302 | 3,908 | 6,894 | 8,021 |
| EBITDA | 3,096 | 4,141 | 3,778 | 2,964 | 4,346 | 3,954 | 6,940 | 8,069 |

## Cash flow (HKDm)

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 3,883 | 4,191 | 4,104 | 5,404 | 6,396 | 7,223 | 8,055 | 9,260 |
| Depreciation and amortisation | 34 | 37 | 39 | 42 | 44 | 46 | 46 | 48 |
| Tax paid | (824) | (403) | (427) | (453) | (480) | (512) | (525) | (540) |
| Change in working capital | 791 | 4,296 | 5,002 | 10,502 | 6,685 | 3,450 | 3,260 | 3,380 |
| Other operational CF items | (74) | (416) | (620) | (1,046) | (2,055) | (1,121) | 1,029 | (1,339) |
| Cash flow from operations | 3,809 | 7,705 | 8,098 | 14,449 | 10,590 | 9,086 | 11,865 | 10,809 |
| Capex | (6,745) | (3,426) | (11,250) | (9,482) | (6,709) | (12,520) | (14,510) | (14,560) |
| Net (acquisitions)/disposals | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other investing CF items | (132) | (145) | (185) | (210) | (221) | (230) | (235) | (240) |
| Cash flow from investing | (6,877) | (3,571) | (11,435) | (9,692) | (6,930) | (12,750) | (14,745) | (14,800) |
| Change in debt | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 4,264 | (695) | 0 | 4,050 | 0 | 0 | 0 | 0 |
| Dividends paid | (323) | (333) | (333) | (333) | (365) | (410) | (450) | (490) |
| Other financing CF items | (1,032) | (514) | (699) | (785) | (872) | (908) | (965) | (1,075) |
| Cash flow from financing | 2,909 | (1,542) | (1,032) | 2,932 | (1,237) | (1,318) | (1,415) | (1,565) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | (159) | 2,592 | (4,369) | 7,689 | 2,423 | (4,982) | (4,295) | (5,556) |
| Free cash flow | (2,936) | 4,279 | (3,152) | 4,967 | 3,881 | (3,434) | (2,645) | (3,751) |

*Source: FactSet, Daiwa forecasts*

## Financial summary continued ...

### Balance sheet (HKDm)

| As at 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Cash & short-term investment | 3,913 | 8,163 | 4,867 | 8,194 | 5,722 | 6,020 | 6,320 | 6,580 |
| Inventory | 1,136 | 2,697 | 1,932 | 1,059 | 1,519 | 2,260 | 2,650 | 2,860 |
| Accounts receivable | 929 | 1,481 | 1,008 | 1,283 | 2,520 | 2,680 | 2,790 | 2,890 |
| Other current assets | 27,391 | 19,843 | 21,796 | 23,768 | 25,586 | 28,819 | 32,895 | 40,540 |
| Total current assets | 33,369 | 32,183 | 29,603 | 34,303 | 35,347 | 39,779 | 44,655 | 52,870 |
| Fixed assets | 34,416 | 39,018 | 44,089 | 50,843 | 54,873 | 56,468 | 59,178 | 60,014 |
| Goodwill & intangibles | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other non-current assets | 18,448 | 17,973 | 21,957 | 23,783 | 22,917 | 26,210 | 27,720 | 28,530 |
| Total assets | 86,233 | 89,174 | 95,650 | 108,929 | 113,137 | 122,457 | 131,553 | 141,414 |
| Short-term debt | 4,207 | 7,740 | 4,727 | 2,265 | 1,847 | 1,880 | 1,960 | 2,050 |
| Accounts payable | 4,067 | 4,554 | 3,501 | 3,471 | 3,492 | 3,650 | 3,850 | 3,930 |
| Other current liabilities | 2,146 | 1,430 | 1,532 | 2,413 | 1,973 | 2,030 | 2,160 | 2,250 |
| Total current liabilities | 10,420 | 13,724 | 9,760 | 8,149 | 7,312 | 7,560 | 7,970 | 8,230 |
| Long-term debt | 11,991 | 10,114 | 14,201 | 12,301 | 7,824 | 13,071 | 17,586 | 23,312 |
| Other non-current liabilities | 4,836 | 5,038 | 5,995 | 7,155 | 7,603 | 7,780 | 7,850 | 7,940 |
| Total liabilities | 27,246 | 28,876 | 29,956 | 27,605 | 22,739 | 28,411 | 33,406 | 39,482 |
| Share capital | 4,879 | 4,839 | 4,903 | 5,279 | 5,912 | 5,912 | 5,912 | 5,912 |
| Reserves/R.E./others | 53,845 | 55,163 | 60,412 | 75,386 | 83,800 | 87,399 | 91,465 | 95,240 |
| Shareholders' equity | 58,723 | 60,002 | 65,315 | 80,665 | 89,712 | 93,311 | 97,377 | 101,152 |
| Minority interests | 264 | 296 | 379 | 659 | 686 | 735 | 770 | 780 |
| Total equity & liabilities | 86,233 | 89,174 | 95,650 | 108,929 | 113,137 | 122,457 | 131,553 | 141,414 |
| EV | 70,557 | 67,861 | 68,428 | 59,179 | 57,344 | 59,049 | 61,859 | 66,595 |
| Net debt/(cash) | 12,285 | 9,691 | 14,061 | 6,372 | 3,949 | 8,931 | 13,226 | 18,782 |
| BVPS (HKD) | 12.037 | 12.398 | 12.309 | 14.475 | 15.323 | 15.784 | 16.472 | 17.110 |

### Key ratios (%)

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | (17.0) | 55.1 | (20.6) | (22.8) | 41.3 | 0.6 | 45.7 | 58.7 |
| EBITDA (YoY) | (16.5) | 33.8 | (8.8) | (21.5) | 46.6 | (9.0) | 75.5 | 16.3 |
| Operating profit (YoY) | (16.9) | 34.0 | (8.9) | (21.8) | 47.2 | (9.2) | 76.4 | 16.3 |
| Net profit (YoY) | (13.6) | 6.7 | (2.6) | 25.5 | 20.7 | 12.6 | 11.7 | 12.1 |
| Core EPS (fully-diluted) (YoY) | (17.1) | 5.6 | (11.2) | 22.5 | 12.1 | 11.5 | 11.7 | 12.1 |
| Gross-profit margin | 64.9 | 58.9 | 66.7 | 69.9 | 61.7 | 66.5 | 70.4 | 50.5 |
| EBITDA margin | 49.5 | 42.7 | 49.1 | 49.9 | 51.8 | 46.8 | 56.4 | 41.3 |
| Operating-profit margin | 49.0 | 42.3 | 48.6 | 49.2 | 51.2 | 46.3 | 56.0 | 41.1 |
| Net profit margin | 54.0 | 37.1 | 45.5 | 74.0 | 63.3 | 70.8 | 54.3 | 38.3 |
| ROAE | 6.3 | 6.1 | 5.6 | 6.0 | 6.2 | 6.5 | 7.0 | 7.5 |
| ROAA | 4.2 | 4.1 | 3.8 | 4.3 | 4.8 | 5.1 | 5.3 | 5.5 |
| ROCE | 4.4 | 5.4 | 4.6 | 3.2 | 4.4 | 3.7 | 6.1 | 6.5 |
| ROIC | 4.2 | 5.1 | 4.3 | 2.9 | 4.0 | 3.3 | 5.4 | 5.6 |
| Net debt to equity | 20.9 | 16.2 | 21.5 | 7.9 | 4.4 | 9.6 | 13.6 | 18.6 |
| Effective tax rate | 10.8 | 13.0 | 14.2 | 18.2 | 16.4 | 16.6 | 16.4 | 18.5 |
| Accounts receivable (days) | 144.1 | 45.4 | 59.0 | 70.3 | 82.7 | 112.4 | 81.1 | 53.1 |
| Current ratio (x) | 3.2 | 2.3 | 3.0 | 4.2 | 4.8 | 5.3 | 5.6 | 6.4 |
| Net interest cover (x) | 64.4 | 32.0 | 178.0 | 417.5 | n.a. | 78.2 | 123.1 | 123.4 |
| Net dividend payout | 56.8 | 53.8 | 60.5 | 50.6 | 50.7 | 49.4 | 48.7 | 47.4 |
| Free cash flow yield | n.a. | 5.7 | n.a. | 6.6 | 5.2 | n.a. | n.a. | n.a. |

*Source: FactSet, Daiwa forecasts*

### Company profile

Sino Land is one of the largest property companies in Hong Kong. It focuses mainly on the residential-property sector, and also has investments in the retail and office property sectors in Hong Kong. In addition, the company has hotel and commercial-property investments in Singapore and China.

Daiwa Capital Markets

Company

**Financials / Hong Kong**
22 March 2013

The 10-second briefing

# Soundwill
878 HK

Target (HKD): **28.40 → 28.40**
Upside: **42.9%**
19 Mar price (HKD): **19.88**

# Another Causeway Bay play

- Soundwill Plaza provides a solid anchor for the company's cash flow and value
- Riding on Causeway Bay's ongoing horizontal and vertical expansion
- Strong development pipeline and high earnings visibility

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


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### ■ What's new

Soundwill looks set to benefit in the years to come from the progression of Causeway Bay into an ever more important hub for retail properties.

### ■ What's the impact

**Soundwill Plaza is a solid anchor.** Soundwill is in an unusual position of having about a 30% share of the high-street shop-space market in Russell Street, one of the most expensive streets in the world. We estimate that its shops in Russell Street currently generate over HKD250m in annual cash flow and account for about HKD38.3/share of Soundwill's gross NAV.

**Riding on opportunities from the vertical and horizontal expansion of Causeway Bay.** This should augur well, especially for the current lower-tier streets and upper-floor space in Causeway Bay, where rents are much lower than for most prime space in the area. With Soundwill Plaza II-Midtown scheduled to be completed in 4Q13, Soundwill is well-placed to ride on this trend. As about 82% of Soundwill's GNAV comes from its Causeway Bay assets, we see it as another play on Causeway Bay after Hysan.

**Earnings likely to take off again in FY14.** We lower our FY13 earnings forecast by 51.2% as we now assume profits from Park Haven will be booked only in FY14 instead of being split between FY13 and FY14. However, we see this more as a natural consolidation as Soundwill's net profit grew by 230% YoY in FY12. Based on the company's existing completion schedule, earnings look set to take-off again in FY14.

### ■ What we recommend

While Soundwill's share price has rallied by 27% YTD, we think it still offers deep value, trading at a 72% discount to our end-2013E NAV of HKD71.20. We reiterate our Buy (1) rating with a six-month target price of HKD28.40, based on a 60% discount applied to our end-2013E NAV. A significant fall in retail rents in Causeway Bay would be a key risk.

### ■ How we differ

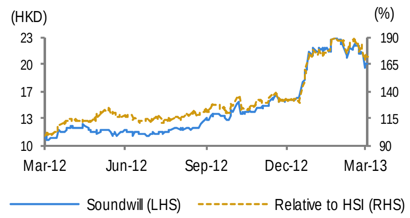
Unlike the market, we think Soundwill stands out from its peers in terms of asset quality, earnings visibility and management commitment, but believe this has yet to be widely recognised.

**Forecast revisions (%)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | (55.8) | (17.6) | n.a. |
| Net profit change | (51.2) | 3.8 | n.a. |
| Core EPS (FD) change | (51.2) | 3.8 | n.a. |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 10.68-23.00 |
| Market cap (USDbn) | 0.70 |
| 3m avg daily turnover (USDm) | 1.31 |
| Shares outstanding (m) | 275 |
| Major shareholder | Madam Foo and family (68.5%) |

**Financial summary (HKD)**

| Year to 31 Dec | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 1,420 | 2,890 | 3,020 |
| Operating profit (m) | 741 | 1,599 | 1,712 |
| Net profit (m) | 590 | 1,360 | 1,409 |
| Core EPS (fully-diluted) | 2.145 | 4.948 | 5.124 |
| EPS change (%) | (7.6) | 130.7 | 3.6 |
| Daiwa vs Cons. EPS (%) | (48.6) | 80.9 | n.a. |
| PER (x) | 9.3 | 4.0 | 3.9 |
| Dividend yield (%) | 1.1 | 1.3 | 1.4 |
| DPS | 0.220 | 0.250 | 0.280 |
| PBR (x) | 0.4 | 0.3 | 0.3 |
| EV/EBITDA (x) | 9.8 | 4.0 | 3.3 |
| ROE (%) | 4.2 | 9.0 | 8.5 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## ■ Key assumptions

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Property leasing revenues (HKDm) | 190 | 209 | 225 | 238 | 296 | 375 | 450 | 510 |
| Residential development sales revenues (HKDm) | 0 | 0 | 0 | 84 | 1,310 | 238 | 2,209 | 2,250 |
| Sales of assembled sites revenues (HKDm) | 85 | 423 | 591 | 483 | 100 | 498 | 80 | 92 |

## ■ Profit and loss (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Property leasing | 190 | 209 | 225 | 184 | 296 | 375 | 450 | 510 |
| Residential development sales | 0 | 0 | 0 | 0 | 1,310 | 238 | 2,209 | 2,250 |
| Other Revenue | 149 | 505 | 688 | 718 | 196 | 807 | 231 | 260 |
| Total Revenue | 339 | 714 | 914 | 902 | 1,802 | 1,420 | 2,890 | 3,020 |
| Other income | 4 | 7 | 7 | 17 | 19 | 20 | 21 | 23 |
| COGS | (72) | (343) | (446) | (581) | (859) | (401) | (1,001) | (1,010) |
| SG&A | (77) | (80) | (114) | (146) | (186) | (198) | (208) | (216) |
| Other op.expenses | (16) | (18) | (2) | (4) | (96) | (100) | (103) | (105) |
| Operating profit | 178 | 280 | 358 | 189 | 680 | 741 | 1,599 | 1,712 |
| Net-interest inc./(exp.) | (61) | (25) | (28) | (35) | (50) | (44) | (42) | (41) |
| Assoc/forex/extraord./others | 38 | 20 | 23 | 197 | 121 | 0 | 0 | 0 |
| Pre-tax profit | 155 | 274 | 353 | 351 | 751 | 697 | 1,557 | 1,671 |
| Tax | (25) | (29) | (51) | (64) | (104) | (98) | (187) | (251) |
| Min. int./pref. div./others | 2 | 4 | (13) | (8) | (9) | (9) | (10) | (11) |
| Net profit (reported) | 132 | 250 | 290 | 278 | 638 | 590 | 1,360 | 1,409 |
| Net profit (adjusted) | 132 | 250 | 290 | 278 | 638 | 590 | 1,360 | 1,409 |
| EPS (reported)(HKD) | 0.567 | 1.043 | 1.204 | 1.061 | 2.321 | 2.145 | 4.948 | 5.124 |
| EPS (adjusted)(HKD) | 0.567 | 1.043 | 1.204 | 1.061 | 2.321 | 2.145 | 4.948 | 5.124 |
| EPS (adjusted fully-diluted)(HKD) | 0.552 | 1.034 | 1.186 | 1.055 | 2.321 | 2.145 | 4.948 | 5.124 |
| DPS (HKD) | 0.070 | 0.100 | 0.100 | 0.130 | 0.200 | 0.220 | 0.250 | 0.280 |
| EBIT | 178 | 280 | 358 | 189 | 680 | 741 | 1,599 | 1,712 |
| EBITDA | 178 | 280 | 358 | 189 | 691 | 753 | 1,612 | 1,725 |

## ■ Cash flow (HKDm)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 155 | 274 | 353 | 351 | 751 | 697 | 1,557 | 1,671 |
| Depreciation and amortisation | 16 | 6 | 6 | 7 | 7 | 7 | 8 | 8 |
| Tax paid | (16) | (25) | (30) | (34) | (89) | (124) | (129) | (135) |
| Change in working capital | (448) | 224 | 226 | (631) | 1,005 | 450 | 580 | 610 |
| Other operational CF items | 32 | 21 | 14 | 39 | 53 | 44 | 42 | 41 |
| Cash flow from operations | (260) | 501 | 571 | (269) | 1,727 | 1,074 | 2,058 | 2,195 |
| Capex | (5) | (2) | (5) | (6) | (950) | (560) | (1,020) | (1,380) |
| Net (acquisitions)/disposals | (137) | (128) | (1,441) | (12) | 0 | 0 | 0 | 0 |
| Other investing CF items | (5) | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Cash flow from investing | (148) | (129) | (1,446) | (18) | (950) | (560) | (1,020) | (1,380) |
| Change in debt | 552 | (317) | 989 | 417 | 0 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 0 | 0 | 0 | 249 | 0 | 0 | 0 | 0 |
| Dividends paid | (16) | (17) | (24) | (36) | (49) | (55) | (55) | (69) |
| Other financing CF items | (62) | (26) | (14) | 9 | (50) | (55) | (51) | (47) |
| Cash flow from financing | 475 | (359) | 950 | 639 | (99) | (110) | (106) | (116) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 67 | 12 | 75 | 352 | 678 | 404 | 932 | 699 |
| Free cash flow | (265) | 499 | 566 | (275) | 777 | 514 | 1,038 | 815 |

*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 | 329 | 144 | 456 | 758 | 907 | 1,311 | 1,311 | 1,311 |
| Inventory | 33 | 37 | 37 | 43 | 42 | 79 | 82 | 90 |
| Accounts receivable | 71 | 71 | 163 | 122 | 191 | 436 | 447 | 458 |
| Other current assets | 602 | 635 | 828 | 2,481 | 3,235 | 2,687 | 2,930 | 3,134 |
| Total current assets | 1,034 | 887 | 1,484 | 3,404 | 4,375 | 4,513 | 4,771 | 4,993 |
| Fixed assets | 40 | 54 | 60 | 160 | 169 | 175 | 180 | 183 |
| Goodwill & intangibles | 7 | 7 | 7 | 6 | 6 | 6 | 6 | 6 |
| Other non-current assets | 6,238 | 7,250 | 10,153 | 11,130 | 13,350 | 14,019 | 14,290 | 14,893 |
| Total assets | 7,319 | 8,199 | 11,705 | 14,701 | 17,900 | 18,714 | 19,247 | 20,075 |
| Short-term debt | 707 | 2,104 | 3,092 | 3,509 | 2,994 | 2,994 | 2,063 | 1,363 |
| Accounts payable | 95 | 234 | 234 | 312 | 461 | 792 | 813 | 850 |
| Other current liabilities | 216 | 45 | 456 | 542 | 577 | 223 | 223 | 225 |
| Total current liabilities | 1,019 | 2,383 | 3,781 | 4,364 | 4,032 | 4,009 | 3,098 | 2,438 |
| Long-term debt | 1,713 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other non-current liabilities | 715 | 872 | 1,206 | 59 | 65 | 65 | 67 | 69 |
| Total liabilities | 3,446 | 3,255 | 4,988 | 4,423 | 4,097 | 4,074 | 3,165 | 2,507 |
| Share capital | 24 | 24 | 24 | 27 | 28 | 28 | 28 | 28 |
| Reserves/R.E./others | 3,816 | 4,863 | 6,602 | 10,151 | 13,519 | 14,347 | 15,777 | 17,257 |
| Shareholders' equity | 3,840 | 4,887 | 6,626 | 10,179 | 13,547 | 14,375 | 15,805 | 17,285 |
| Minority interests | 33 | 57 | 91 | 99 | 256 | 265 | 276 | 283 |
| Total equity & liabilities | 7,319 | 8,199 | 11,705 | 14,701 | 17,900 | 18,714 | 19,247 | 20,075 |
| EV | 7,565 | 7,438 | 8,148 | 8,270 | 7,779 | 7,382 | 6,460 | 5,767 |
| Net debt/(cash) | 2,091 | 1,960 | 2,637 | 2,752 | 2,087 | 1,683 | 752 | 52 |
| BVPS (HKD) | 16.053 | 20.360 | 27.440 | 37.028 | 49.282 | 52.293 | 57.496 | 62.854 |

## Key ratios (%)

| Year to 31 Dec | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | (27.0) | 110.5 | 28.0 | (1.3) | 99.8 | (21.2) | 103.5 | 4.5 |
| EBITDA (YoY) | (14.3) | 57.0 | 28.2 | (47.4) | 266.2 | 9.0 | 114.1 | 7.0 |
| Operating profit (YoY) | (14.3) | 57.0 | 28.2 | (47.4) | 260.4 | 9.0 | 115.8 | 7.1 |
| Net profit (YoY) | (18.3) | 89.3 | 15.9 | (3.9) | 129.2 | (7.6) | 130.7 | 3.6 |
| Core EPS (fully-diluted) (YoY) | (18.5) | 87.3 | 14.6 | (11.0) | 120.0 | (7.6) | 130.7 | 3.6 |
| Gross-profit margin | 78.7 | 51.9 | 51.1 | 35.6 | 52.3 | 71.8 | 65.4 | 66.6 |
| EBITDA margin | 52.5 | 39.2 | 39.2 | 20.9 | 38.3 | 53.0 | 55.8 | 57.1 |
| Operating-profit margin | 52.5 | 39.2 | 39.2 | 20.9 | 37.7 | 52.2 | 55.3 | 56.7 |
| Net profit margin | 38.9 | 35.0 | 31.7 | 30.9 | 35.4 | 41.5 | 47.1 | 46.7 |
| ROAE | 3.5 | 5.7 | 5.0 | 3.3 | 5.4 | 4.2 | 9.0 | 8.5 |
| ROAA | 1.9 | 3.2 | 2.9 | 2.1 | 3.9 | 3.2 | 7.2 | 7.2 |
| ROCE | 3.0 | 4.2 | 4.3 | 1.6 | 4.4 | 4.3 | 8.9 | 9.2 |
| ROIC | 2.6 | 3.9 | 3.8 | 1.4 | 4.1 | 4.0 | 8.5 | 8.4 |
| Net debt to equity | 54.5 | 40.1 | 39.8 | 27.0 | 15.4 | 11.7 | 4.8 | 0.3 |
| Effective tax rate | 16.1 | 10.4 | 14.4 | 18.4 | 13.8 | 14.1 | 12.0 | 15.0 |
| Accounts receivable (days) | 80.1 | 36.1 | 46.7 | 57.8 | 31.7 | 80.6 | 55.8 | 54.7 |
| Current ratio (x) | 1.0 | 0.4 | 0.4 | 0.8 | 1.1 | 1.1 | 1.5 | 2.0 |
| Net interest cover (x) | 2.9 | 11.0 | 12.8 | 5.4 | 13.6 | 16.7 | 38.1 | 41.8 |
| Net dividend payout | 12.3 | 9.6 | 8.3 | 12.3 | 8.6 | 10.3 | 5.1 | 5.5 |
| Free cash flow yield | n.a. | 9.1 | 10.4 | n.a. | 14.2 | 9.4 | 19.0 | 14.9 |

*Source: FactSet, Daiwa forecasts*

## Company profile

Soundwill Holdings is a niche player and veteran specialist in assembling old building sites with redevelopment potential. Its business of selling assembled sites accounts for over 60% of its total revenue, while its self-developed flagship investment property, Soundwill Plaza, contributed over 20% of its total revenue and over 40% of its assets in 2011. The company has also tapped into luxury residential property development, leveraging on the low cost advantage of its assembled sites. In addition, it derives a small portion of its revenue from urban infrastructure and China property development businesses in Mainland China.

Daiwa Capital Markets

Company

Financials / Hong Kong
22 March 2013

The 10-second briefing

## Sunlight REIT
435 HK

Target (HKD): **4.00 → 4.00**
Upside: **17.6%**
19 Mar price (HKD): **3.40**

# Riding on favourable trends

- Positive and robust rental reversion trend now under way in Sunlight REIT's portfolio
- Looks well-positioned to ride on structural trends, such as office decentralisation and the rise of suburban malls
- We reaffirm our Buy (1) call and target price 0f HKD4.00

1 Buy (unchanged)
2 Outperform
3 Hold
4 Underperform
5 Sell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### ■ What's new

We believe that Southern Wanchai and Tseung Kwan O are undergoing a transformation that will enhance rental outlook for Sunlight REIT.

### ■ What's the impact

**Robust rental reversion.** We saw a further acceleration in the rental-reversion trend in Sunlight REIT's portfolio in calendar 2H12, with the rental reversion for its offices rising to 23.7%, from 22.3% in 2H11. The rental reversion for its retail properties was even stronger, at 35.6% in 2H12, from 26.4% in 2H11.

**FY13 DPU affected by one-offs.** We view FY13 as a transitional year for Sunlight REIT, since its DPU has been affected by one-off items such as a rise in the effective tax rate, expiration of its low-interest loans, and a higher proportion of the management fee being paid in cash compared with prior years. We cut our FY13 DPU estimates as a result. But, from FY14 onward, we expect the DPU to show more clearly the improvement in Sunlight REIT's underlying operating performance.

**Beneficiary of transformation of Wanchai.** Sunlight REIT's largest property asset, Queen's Road East 248 (QRE 248), is in Southern Wanchai, where Swire Properties and Hopewell are embarking on major projects, which we think will help to upgrade the location and hence the rental potential of QRE 248. We also see upgrade potential in the group's several office buildings in Sheung Wan, which we think could be repositioned to appeal to higher-grade clients such as asset management and financial services companies.

**Broader environment favours the upgrading of Metro City I.** The retail environment in Tseung Kwan O has continued to improve, which should bode well for effectiveness of Sunlight REIT's Asset Enhancement Initiative for Metro City I.

### ■ What we recommend

We reaffirm our Buy (1) call and target price of HKD4.00, based on our 10-year DDM model. Risks include a new crisis in the global economy, which could curtail office demand.

### ■ How we differ

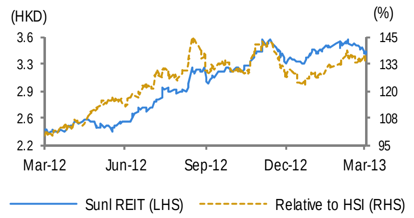
We believe that Sunlight stands to benefit from structural trends in the market to an extent that is not fully appreciated by the market.

**Forecast revisions (%)**

| Year to 30 Jun | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | (6.3) | - | - |
| Net-property-income chg | (6.3) | - | - |
| DPU change | (8.0) | - | - |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 2.36-3.57 |
| Market cap (USDbn) | 0.71 |
| 3m avg daily turnover (USDm) | 0.84 |
| Shares outstanding (m) | 1,624 |
| Major shareholder | Shau Kee Financial (23.9%) |

**Financial summary (HKD)**

| Year to 30 Jun | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 608 | 695 | 754 |
| Net property income (m) | 476 | 543 | 590 |
| Distribution (m) | 284 | 329 | 371 |
| DPU | 0.175 | 0.200 | 0.224 |
| DPU change (%) | 3.2 | 14.5 | 11.5 |
| Daiwa vs Cons. EPS (%) | 0.0 | 6.6 | 11.8 |
| DPU yield (%) | 5.1 | 5.9 | 6.6 |
| PER (x) | 21.9 | 18.6 | 16.3 |
| Core EPU (fully-diluted) | 0.155 | 0.183 | 0.209 |
| P/BV (x) | 0.6 | 0.6 | 0.6 |
| ROE (%) | 2.7 | 3.2 | 3.7 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## Key assumptions

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Interest cover ratio (x) | 1.5 | 1.6 | 1.3 | 2.3 | 3.4 | 3.7 | 4.2 | 4.7 |
| Interest service ratio (x) | 0.9 | 0.8 | 0.9 | 1.5 | 1.1 | 0.9 | 1.2 | 1.2 |
| Average portfolio cap rate (%) | 4.2 | 5.0 | 4.6 | 4.4 | 4.5 | 4.7 | 5.3 | 5.8 |
| Funds from operations (HKDm) | 729 | (491) | 1,389 | 1,655 | 1,027 | 251 | 299 | 345 |
| Adj. funds from operations (HKDm) | 727 | (508) | 1,375 | 1,642 | 1,014 | 238 | 286 | 332 |

## Profit and loss (HKDm)

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Total revenue | 431 | 472 | 489 | 532 | 582 | 608 | 695 | 754 |
| Operating expenses | (113) | (121) | (119) | (125) | (133) | (133) | (151) | (164) |
| Net property income | 319 | 351 | 370 | 407 | 449 | 476 | 543 | 590 |
| Other income | 0 | 0 | 0 | 0 | (8) | 0 | (9) | 0 |
| Management fees | (50) | (48) | (54) | (61) | (66) | (66) | (69) | (70) |
| Other operating expenses | (9) | (12) | (10) | (10) | (3) | (4) | (4) | (4) |
| Depreciation and amortisation | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| EBIT | 259 | 291 | 306 | 337 | 372 | 406 | 462 | 516 |
| Net-int. income/(expenses) | (174) | (179) | (234) | (145) | (110) | (111) | (111) | (111) |
| Share of associates | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Revaluation gains/(loss) | 590 | (803) | 1,344 | 1,494 | 808 | 0 | 0 | 0 |
| Except./other inc./(exp.) | 91 | 77 | 0 | 0 | 0 | 0 | 0 | 0 |
| Profit before tax | 766 | (614) | 1,417 | 1,685 | 1,070 | 295 | 352 | 405 |
| Taxation | (37) | 122 | (28) | (30) | (43) | (44) | (53) | (61) |
| Min. int./pref. div./others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net profit | 729 | (491) | 1,389 | 1,655 | 1,027 | 251 | 299 | 345 |
| Total return | 75 | 100 | 58 | 174 | 238 | 251 | 299 | 345 |
| Adjustments | 183 | 170 | 129 | 91 | 60 | 63 | 65 | 66 |
| Distributable income | 259 | 270 | 186 | 264 | 298 | 314 | 364 | 410 |
| Distribution rate | 1.00 | 1.00 | 1.00 | 0.91 | 0.91 | 0.91 | 0.91 | 0.91 |
| Distribution | 259 | 270 | 186 | 239 | 272 | 284 | 329 | 371 |
| EPU (HKD) | 0.050 | 0.065 | 0.037 | 0.110 | 0.149 | 0.155 | 0.183 | 0.209 |
| DPU (HKD) | 0.242 | 0.246 | 0.144 | 0.176 | 0.170 | 0.175 | 0.200 | 0.224 |

## Cash flow (HKDm)

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 86 | 112 | 72 | 191 | 262 | 295 | 352 | 405 |
| Depreciation and amortisation | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net-interest expenses | 174 | 179 | 234 | 145 | 110 | 111 | 111 | 111 |
| Share of associate | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in working capital | 23 | 39 | 33 | 121 | 7 | (86) | 14 | 10 |
| Tax paid | (19) | (41) | (16) | (18) | (23) | (44) | (53) | (61) |
| Other operating CF items | 50 | 48 | 27 | 61 | 46 | 47 | 48 | 49 |
| Cash flow from operation | 313 | 337 | 350 | 501 | 401 | 322 | 472 | 514 |
| Capex | (3) | (16) | (14) | (13) | (13) | (13) | (13) | (13) |
| Net investment and sale of FA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other investing CF items | 67 | 95 | 78 | 0 | 0 | 0 | 0 | 0 |
| Cash flow from investing | 64 | 79 | 64 | (13) | (13) | (13) | (13) | (13) |
| Change in debt | 4 | 4 | 1 | 0 | 0 | 0 | 0 | 0 |
| Equity raised/(repaid) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Distribution paid | (221) | (281) | (258) | (213) | (260) | (278) | (307) | (350) |
| Other financing CF items | (140) | (140) | (133) | (228) | (96) | (94) | (94) | (94) |
| Cash flow from financing | (357) | (417) | (389) | (441) | (357) | (372) | (401) | (444) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 21 | (1) | 25 | 48 | 32 | (63) | 58 | 57 |

*Source: FactSet, Daiwa forecasts*

## Financial summary continued …

### Balance sheet (HKDm)

| As at 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Cash & cash equivalent | 228 | 223 | 225 | 261 | 261 | 230 | 288 | 344 |
| Accounts receivable | 119 | 109 | 24 | 27 | 26 | 23 | 26 | 28 |
| Other current assets | 7 | 41 | 47 | 169 | 159 | 47 | 47 | 47 |
| Total current assets | 353 | 373 | 295 | 456 | 445 | 299 | 360 | 419 |
| Investment properties | 10,151 | 9,364 | 10,722 | 12,222 | 13,039 | 13,053 | 13,060 | 13,067 |
| 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 | 292 | 204 | 204 | 210 | 208 | 775 | 783 | 791 |
| Total assets | 10,796 | 9,941 | 11,221 | 12,888 | 13,692 | 14,127 | 14,203 | 14,277 |
| Short-term debt | 0 | 0 | 15 | 3,948 | 0 | 0 | 0 | 0 |
| Accounts payable | 53 | 86 | 99 | 223 | 211 | 122 | 139 | 151 |
| Other current liabilities | 119 | 130 | 203 | 158 | 222 | 299 | 377 | 459 |
| Total current liabilities | 172 | 216 | 316 | 4,329 | 433 | 420 | 516 | 610 |
| Long-term debt | 3,936 | 3,940 | 3,944 | 0 | 3,916 | 3,948 | 3,948 | 3,948 |
| Other non-current liabilities | 1,524 | 1,521 | 246 | 297 | 321 | 322 | 324 | 326 |
| Total liabilities | 5,631 | 5,678 | 4,507 | 4,626 | 4,670 | 4,690 | 4,788 | 4,884 |
| Unitholders' funds | 5,164 | 4,264 | 6,715 | 8,262 | 9,022 | 9,437 | 9,415 | 9,393 |
| Minority interests | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total equity & liabilities | 10,796 | 9,941 | 11,221 | 12,888 | 13,692 | 14,127 | 14,203 | 14,277 |
| Book Value per unit | 3.411 | 2.756 | 4.293 | 5.208 | 5.616 | 5.810 | 5.734 | 5.657 |

### Key ratios (%)

| Year to 30 Jun | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Total revenue (YoY) | n.a. | 9.4 | 3.6 | 9.0 | 9.2 | 4.6 | 14.2 | 8.5 |
| Net property income (YoY) | n.a. | 10.0 | 5.5 | 10.1 | 10.2 | 6.0 | 14.2 | 8.5 |
| Net profit (YoY) | n.a. | 32.4 | (41.9) | 199.7 | 37.3 | 5.2 | 19.2 | 15.2 |
| Distribution (YoY) | n.a. | 4.2 | (30.9) | 28.3 | 13.8 | 4.4 | 15.8 | 12.8 |
| EPU (YoY) | n.a. | 30.2 | (43.0) | 195.9 | 35.5 | 4.0 | 17.9 | 14.0 |
| DPU (YoY) | n.a. | 1.5 | (41.4) | 22.3 | (3.7) | 3.2 | 14.5 | 11.5 |
| ROE | 1.5 | 2.1 | 1.1 | 2.3 | 2.8 | 2.7 | 3.2 | 3.7 |
| ROA | 0.7 | 1.0 | 0.5 | 1.4 | 1.8 | 1.8 | 2.1 | 2.4 |
| ROCE | 2.8 | 3.4 | 3.2 | 2.9 | 3.0 | 3.1 | 3.5 | 3.9 |
| ROIC | 2.4 | 2.9 | 3.0 | 2.9 | 2.8 | 2.6 | 2.9 | 3.3 |
| Debt to asset | 34.3 | 37.4 | 33.3 | 28.6 | 26.7 | 26.3 | 25.8 | 25.2 |
| Net debt to equity | 71.8 | 87.2 | 55.6 | 44.6 | 40.5 | 39.4 | 38.9 | 38.4 |
| Effective tax rate | 4.8 | n.a. | 1.9 | 1.8 | 4.0 | 15.0 | 15.0 | 15.0 |

*Source: FactSet, Daiwa forecasts*

## Company profile

Sunlight REIT started out by acquiring 20 properties from Shau Kee Financial Enterprises and Henderson Land and became listed in 2006. Its current portfolio comprises a mixture of office and retail properties in Hong Kong Island, Kowloon, and the New Territories.

The 10-second briefing

# The Link REIT
823 HK

Target (HKD): **48.00 → 48.00**
Upside: **12.9%**
19 Mar price (HKD): **42.50**

# Riding on a virtuous cycle

- Starting to see the benefits of completed AEI on major malls; likely to take 2-3 leasing cycles for the full benefits to unfold
- AEI work on lower-tier assets another DPU growth driver
- Still in a growth phase; valuation looks reasonable if the REIT is seen as a premier global REIT; Outperform reiterated

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

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## ■ What's new

The number of malls on which The Link REIT has completed AEI work is starting to reach critical mass, which bodes well for its ability to attract tenants with stronger rent-paying capacity, in our view.

## ■ What's the impact

**A major beneficiary of the positive spill-over of rising rents in prime suburban malls.** While the most popular suburban malls are owned by the major property companies, we think The Link REIT will benefit from positive spill-over, as many tenants in these malls relocate to other malls as a result of rising rents.

**Rental reversions do not end with the completion of AEI.** In our opinion, properly done AEI work often gives a new lease of life to a retail-property asset, yet it can take 2-3 or more leasing cycles for the rejuvenated asset to reach its full potential in terms of rents and market position. As such, we are not too concerned that rental reversions for The Link REIT's portfolio will peak after it has completed AEI on most of its top-50 properties.

**Less prominent malls can be rejuvenated too.** We believe the group's less prominent malls, ranked 51-100 in market value, can also be rejuvenated through AEI, and our recent visit to its Fanling Wah Sum Shopping Centre (ranked 95 of the REIT's 182 properties) reinforced our view on this. We believe AEI on less prominent malls will open up other DPU-growth streams for the REIT.

## ■ What we recommend

While The Link REIT is trading at a premium to the other H-REITs, it is not more expensive than many of the premier REITs in developed markets globally (some of which are at a DPU yield of 3% or below), and therefore should hold stronger prospects for DPU growth. We think the REIT is still in a growth phase, and we maintain our Outperform (2) rating and six-month target price of HKD48.0, based on our 10-year dividend discount model. This translates into an FY14E DPU yield of 3.4%. The main risk to our call would be a sharp fall in retail spending in Hong Kong.

## ■ How we differ

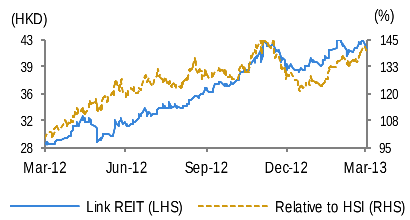
Unlike some in the market, we believe The Link REIT's less prominent malls can also be rejuvenated.

**Forecast revisions (%)**

| Year to 31 Mar | 13E | 14E | 15E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net-property-income chg | - | - | - |
| DPU change | - | - | - |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 28.40-43.00 |
| Market cap (USDbn) | 12.55 |
| 3m avg daily turnover (USDm) | 35.91 |
| Shares outstanding (m) | 2,292 |
| Major shareholder | Commonwealth Bank of AU (7.0%) |

**Financial summary (HKD)**

| Year to 31 Mar | 13E | 14E | 15E |
|---|---|---|---|
| Revenue (m) | 6,522 | 7,071 | 7,762 |
| Net property income (m) | 4,672 | 5,195 | 5,805 |
| Distribution (m) | 3,360 | 3,814 | 4,340 |
| DPU | 1.466 | 1.654 | 1.869 |
| DPU change (%) | 13.5 | 12.8 | 13.0 |
| Daiwa vs Cons. EPS (%) | 0.7 | 4.7 | 9.6 |
| DPU yield (%) | 3.4 | 3.9 | 4.4 |
| PER (x) | 29.0 | 25.7 | 22.7 |
| Core EPU (fully-diluted) | 1.466 | 1.653 | 1.869 |
| P/BV (x) | 1.6 | 1.6 | 1.6 |
| ROE (%) | 5.6 | 6.3 | 7.0 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## ■ Key assumptions

| Year to 31 Mar | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Interest cover ratio (x) | 4.7 | 5.7 | 5.6 | 7.0 | 8.7 | 8.8 | 10.2 | 11.2 |
| Interest service ratio (x) | 11.5 | 3.7 | 51.8 | 7.1 | 7.9 | 8.0 | 9.3 | 10.0 |
| Average portfolio cap rate (%) | 9.5 | 10.4 | 9.3 | 8.0 | 8.2 | 8.8 | 9.4 | 10.1 |
| Funds from operations (HKDm) | 5,153 | 638 | 12,209 | 15,288 | 2,939 | 3,380 | 3,835 | 4,362 |
| Adj. funds from operations (HKDm) | 4,658 | (211) | 11,453 | 14,547 | 989 | 2,600 | 3,044 | 3,526 |

## ■ Profit and loss (HKDm)

| Year to 31 Mar | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Total revenue | 4,199 | 4,503 | 4,990 | 5,353 | 5,915 | 6,522 | 7,071 | 7,762 |
| Operating expenses | (1,662) | (1,698) | (1,662) | (1,709) | (1,740) | (1,850) | (1,876) | (1,957) |
| Net property income | 2,537 | 2,805 | 3,328 | 3,644 | 4,176 | 4,672 | 5,195 | 5,805 |
| Other income | 14 | 16 | 17 | 0 | 0 | 0 | 0 | 0 |
| Management fees | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other operating expenses | (102) | (134) | (120) | (158) | (229) | (175) | (180) | (172) |
| Depreciation and amortisation | (14) | (16) | (17) | (18) | (19) | (20) | (21) | (22) |
| EBIT | 2,435 | 2,671 | 3,208 | 3,468 | 3,928 | 4,477 | 4,994 | 5,610 |
| Net-int. income/(expenses) | (526) | (474) | (577) | (497) | (455) | (509) | (489) | (503) |
| Share of associates | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Revaluation gains/(loss) | 3,537 | (1,197) | 9,809 | 12,812 | 0 | 0 | 0 | 0 |
| Except./other inc./(exp.) | (19) | 0 | 0 | (10) | 0 | 0 | 0 | 0 |
| Profit before tax | 5,427 | 1,000 | 12,440 | 15,773 | 3,473 | 3,968 | 4,505 | 5,107 |
| Taxation | (288) | (378) | (209) | (503) | (552) | (608) | (690) | (767) |
| Min. int./pref. div./others | 0 | 0 | (39) | 0 | 0 | 0 | 0 | 0 |
| Net profit | 5,139 | 622 | 12,192 | 15,270 | 2,920 | 3,360 | 3,814 | 4,340 |
| Total return | 1,602 | 1,819 | 2,134 | 2,475 | 2,920 | 3,360 | 3,814 | 4,340 |
| Adjustments | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Distributable income | 1,602 | 1,819 | 2,134 | 2,475 | 2,920 | 3,360 | 3,814 | 4,340 |
| Distribution rate | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Distribution | 1,602 | 1,819 | 2,134 | 2,475 | 2,920 | 3,360 | 3,814 | 4,340 |
| EPU (HKD) | 2.381 | 0.287 | 1.082 | 1.101 | 1.291 | 1.466 | 1.653 | 1.869 |
| DPU (HKD) | 0.744 | 0.840 | 0.969 | 1.105 | 1.291 | 1.466 | 1.654 | 1.869 |

## ■ Cash flow (HKDm)

| Year to 31 Mar | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 5,427 | 1,000 | 12,440 | 15,773 | 3,473 | 3,968 | 4,505 | 5,107 |
| Depreciation and amortisation | 14 | 16 | 17 | 18 | 19 | 20 | 21 | 22 |
| Net-interest expenses | 526 | 474 | 577 | 477 | 459 | 514 | 494 | 503 |
| Share of associate | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in working capital | 93 | 272 | 846 | 37 | 40 | 42 | 50 | 53 |
| Tax paid | (113) | (183) | (209) | (316) | (528) | (580) | (649) | (689) |
| Other operating CF items | 107 | 118 | (9,684) | (12,624) | 165 | 169 | 174 | 180 |
| Cash flow from operation | 6,054 | 1,697 | 3,987 | 3,365 | 3,628 | 4,133 | 4,595 | 5,176 |
| Capex | (495) | (849) | (756) | (741) | (1,950) | (780) | (791) | (836) |
| Net investment and sale of FA | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other investing CF items | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Cash flow from investing | (495) | (849) | (756) | (741) | (1,950) | (780) | (791) | (836) |
| Change in debt | 0 | (654) | 8,407 | (548) | 900 | (250) | 0 | 0 |
| Equity raised/(repaid) | 0 | 0 | 0 | 680 | 680 | 250 | 200 | 200 |
| Distribution paid | (1,154) | (1,570) | (1,990) | (2,251) | (2,731) | (3,117) | (3,566) | (4,078) |
| Other financing CF items | (534) | (468) | (963) | (587) | (378) | (509) | (489) | (513) |
| Cash flow from financing | (1,688) | (2,692) | 5,454 | (2,706) | (1,528) | (3,626) | (3,856) | (4,391) |
| Forex effect/others | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 3,871 | (1,844) | 8,685 | (82) | 150 | (273) | (51) | (50) |

*Source: FactSet, Daiwa forecasts*

## *Financial summary continued …*

### Balance sheet (HKDm)

| As at 31 Mar | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Cash & cash equivalent | 1,870 | 1,230 | 876 | 854 | 2,140 | 2,117 | 2,066 | 2,016 |
| Accounts receivable | 112 | 121 | 130 | 159 | 162 | 166 | 172 | 185 |
| Other current assets | 25 | 21 | 70 | 32 | 34 | 36 | 38 | 40 |
| Total current assets | 2,007 | 1,372 | 1,076 | 1,045 | 2,336 | 2,319 | 2,276 | 2,241 |
| Investment properties | 44,307 | 43,255 | 53,781 | 67,318 | 72,340 | 73,787 | 75,002 | 76,623 |
| Fixed assets | 46 | 65 | 367 | 391 | 542 | 560 | 580 | 576 |
| Associates | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Goodwill and intangible assets | 3,988 | 3,988 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other long-term assets | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total assets | 50,348 | 48,680 | 55,224 | 68,754 | 75,218 | 76,666 | 77,858 | 79,440 |
| Short-term debt | 2,199 | 0 | 39 | 2,636 | 1,750 | 1,750 | 1,750 | 1,750 |
| Accounts payable | 858 | 1,125 | 1,235 | 1,026 | 1,034 | 1,105 | 1,205 | 1,360 |
| Other current liabilities | 424 | 564 | 533 | 915 | 920 | 925 | 1,030 | 1,220 |
| Total current liabilities | 3,481 | 1,689 | 1,807 | 4,577 | 3,704 | 3,780 | 3,985 | 4,330 |
| Long-term debt | 9,986 | 11,538 | 10,867 | 7,782 | 10,704 | 10,704 | 10,704 | 10,704 |
| Other non-current liabilities | 6,323 | 6,252 | 1,405 | 1,420 | 1,459 | 1,519 | 1,839 | 2,026 |
| Total liabilities | 19,790 | 19,479 | 14,079 | 13,779 | 15,867 | 16,003 | 16,528 | 17,060 |
| Unitholders' funds | 30,558 | 29,201 | 41,145 | 54,975 | 59,351 | 60,663 | 61,332 | 62,380 |
| Minority interests | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total equity & liabilities | 50,348 | 48,680 | 55,224 | 68,754 | 75,218 | 76,666 | 77,860 | 79,440 |
| Book Value per unit | 14.156 | 13.475 | 18.685 | 24.627 | 26.235 | 26.464 | 26.585 | 26.865 |

### Key ratios (%)

| Year to 31 Mar | 2008 | 2009 | 2010 | 2011 | 2012 | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|
| Total revenue (YoY) | 6.2 | 7.2 | 10.8 | 7.3 | 10.5 | 10.3 | 8.4 | 9.8 |
| Net property income (YoY) | 7.5 | 10.6 | 18.6 | 9.5 | 14.6 | 11.9 | 11.2 | 11.7 |
| Net profit (YoY) | 18.0 | (87.9) | 283.1 | 3.1 | 18.8 | 15.0 | 13.5 | 13.8 |
| Distribution (YoY) | 11.2 | 13.5 | 17.3 | 16.0 | 18.0 | 15.0 | 13.5 | 13.8 |
| EPU (YoY) | 16.8 | (87.9) | 277.0 | 1.7 | 17.2 | 13.5 | 12.8 | 13.1 |
| DPU (YoY) | 10.3 | 12.9 | 15.4 | 14.0 | 16.9 | 13.5 | 12.8 | 13.0 |
| ROE | 17.9 | 2.1 | 6.8 | 5.1 | 5.1 | 5.6 | 6.3 | 7.0 |
| ROA | 10.8 | 1.3 | 4.6 | 4.0 | 4.1 | 4.4 | 4.9 | 5.5 |
| ROCE | 6.0 | 6.4 | 6.9 | 5.9 | 5.7 | 6.2 | 6.8 | 7.6 |
| ROIC | 5.1 | 3.6 | 6.4 | 5.7 | 4.8 | 5.3 | 5.8 | 6.4 |
| Debt to asset | 20.5 | 21.2 | 18.2 | 13.9 | 13.7 | 13.5 | 13.3 | 13.1 |
| Net debt to equity | 33.8 | 35.3 | 24.4 | 17.4 | 17.4 | 17.0 | 16.9 | 16.7 |
| Effective tax rate | 5.3 | 37.8 | 1.7 | 3.2 | 15.9 | 15.3 | 15.3 | 15.0 |

*Source: FactSet, Daiwa forecasts*

## Company profile

The Link REIT was the first REIT listed in Hong Kong, and is by far the largest in terms of portfolio size. Its portfolio comprises 182 properties and car parks, two standalone retail facilities, and 29 standalone car parks. All are located near the homes of some 40% of Hong Kong's population. Currently, it has a retail portfolio with an internal floor area of 11.1m sq ft and a gross floor area of 19.1m sq ft. In addition, it has about 80,000 car-parking spaces.

The 10-second briefing

# Wharf Holdings

4 HK

Target (HKD): **72.40 → 72.40**
Upside: **17.7%**
19 Mar price (HKD): **61.50**

## Harvesting investments in China

- Its strong asset backing in Hong Kong is likely to be helped by the kicking-in of property sales profits
- China businesses progressing well and Chengdu IFS (opening 1Q14) could drive a rerating of its China business
- Still room for NAV revision or reduction in NAV discount; reaffirm Buy (1) rating

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

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### ■ What's new

We see upside for Wharf's NAV and room for a narrowing of its NAV discount, given the promising prospects for its China businesses and strong cash flow of its Hong Kong assets.

### ■ What's the impact

*Strong cash flow and asset backing for Hong Kong properties.* We believe the group's two prime malls in Hong Kong will remain strong cash cows, underpinned by continuous upgrading work. Meanwhile, Wharf's offices in Times Square and Gateway Towers are well-positioned in the current office cycle, in our view. On top of this, the company is set to receive supplementary earnings from development properties, ports and the sale of non-core assets.

*China investments entering a harvesting period.* Wharf's residential property business in China has been making continuous progress in terms of profits, and looks poised to enter the next stage after the company's acquisition of a stake in Greentown (Not rated). We also expect its investment property businesses in China to enter a new phase from 2013, as Wharf is due to complete Chengdu IFS in 4Q13 and has a stream of IFS buildings to be completed over the next few years. Over 80% of the Chengdu IFS mall has been pre-leased at premium rents, and we expect the project to boost investor confidence in the group's China businesses and its retail management expertise, which we think has yet to be fully priced in.

### ■ What we recommend

While Wharf's shares performed well in 2012, we see room for further upside to the company's NAV as well as a narrowing of its NAV discount, given the promising prospects for its China businesses. We reiterate our Buy rating and six-month target price of HKD72.40 based on a 20% discount to our end-2013E NAV of HKD90.50 (note that its NAV discount narrowed to 15.2% in 1991-94 when the stock was rerated as an actively managed conglomerate). A sharp downturn in China property sales would be a key risk to our view.

### ■ How we differ

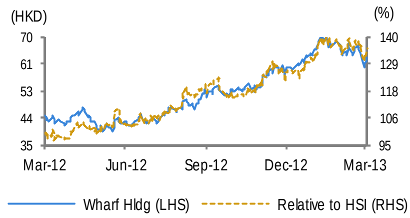
We think Wharf's retail management expertise and bright prospects for its China businesses have yet to be fully priced in.

**Forecast revisions (%)**

| Year to 31 Dec | 12E | 13E | 14E |
|---|---|---|---|
| Revenue change | - | - | - |
| Net profit change | - | - | - |
| Core EPS (FD) change | - | - | - |

*Source: Daiwa forecasts*

**Share price performance**




| | |
|---|---|
| 12-month range | 39.20-69.90 |
| Market cap (USDbn) | 24.00 |
| 3m avg daily turnover (USDm) | 38.26 |
| Shares outstanding (m) | 3,029 |
| Major shareholder | Wheelock and Company (50.0%) |

**Financial summary (HKD)**

| Year to 31 Dec | 12E | 13E | 14E |
|---|---|---|---|
| Revenue (m) | 29,715 | 33,512 | 36,335 |
| Operating profit (m) | 14,623 | 15,583 | 17,275 |
| Net profit (m) | 10,060 | 11,320 | 12,840 |
| Core EPS (fully-diluted) | 3.321 | 3.737 | 4.239 |
| EPS change (%) | 24.5 | 12.5 | 13.4 |
| Daiwa vs Cons. EPS (%) | (5.1) | (0.7) | (3.2) |
| PER (x) | 18.5 | 16.5 | 14.5 |
| Dividend yield (%) | 1.9 | 2.0 | 2.2 |
| DPS | 1.150 | 1.250 | 1.350 |
| PBR (x) | 0.8 | 0.8 | 0.7 |
| EV/EBITDA (x) | 13.4 | 12.7 | 11.5 |
| ROE (%) | 4.6 | 4.7 | 5.2 |

*Source: FactSet, Daiwa forecasts*

# Financial summary

## Key assumptions

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Gross rental income (HKDm) | 5,567 | 6,552 | 7,229 | 7,513 | 9,941 | 10,736 | 11,595 | 12,523 |
| Rental EBIT (HKDm) | 4,348 | 5,243 | 5,949 | 6,214 | 7,320 | 8,198 | 8,557 | 8,890 |
| Property sales profit (HKDm) | 1,026 | 84 | 1,012 | 1,235 | 2,274 | 3,771 | 4,619 | 5,090 |
| Size of completed investment properties in HK (m sq ft) | 11.7 | 11.7 | 11.7 | 11.7 | 11.7 | 11.7 | 11.7 | 11.7 |

## Profit and loss (HKDm)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Property sales | 2,336 | 710 | 3,065 | 3,609 | 6,343 | 9,469 | 13,197 | 14,543 |
| Rental income | 5,567 | 6,552 | 7,229 | 7,513 | 9,941 | 10,736 | 11,595 | 12,523 |
| Other Revenue | 8,305 | 8,678 | 7,259 | 8,258 | 7,720 | 9,510 | 8,720 | 9,269 |
| Total Revenue | 16,208 | 15,940 | 17,553 | 19,380 | 24,004 | 29,715 | 33,512 | 36,335 |
| Other income | 1,684 | 137 | 152 | 188 | 288 | 458 | 593 | 682 |
| COGS | (5,610) | (5,400) | (6,069) | (7,072) | (9,095) | (11,576) | (14,422) | (15,562) |
| SG&A | (1,644) | (1,646) | (1,606) | (1,796) | (2,414) | (2,512) | (2,580) | (2,620) |
| Other op.expenses | (1,273) | (1,392) | (1,301) | (1,328) | (1,395) | (1,462) | (1,520) | (1,560) |
| Operating profit | 9,365 | 7,639 | 8,729 | 9,372 | 11,388 | 14,623 | 15,583 | 17,275 |
| Net-interest inc./(exp.) | (1,142) | (909) | (338) | (996) | (1,211) | (1,304) | (1,482) | (1,505) |
| Assoc/forex/extraord./others | 533 | (616) | 1,749 | 1,198 | 852 | 940 | 1,677 | 1,848 |
| Pre-tax profit | 8,756 | 6,114 | 10,140 | 9,574 | 11,029 | 14,259 | 15,778 | 17,618 |
| Tax | (2,091) | (1,159) | (1,524) | (1,079) | (2,403) | (3,565) | (3,779) | (4,051) |
| Min. int./pref. div./others | (773) | (761) | (799) | (590) | (543) | (634) | (679) | (727) |
| Net profit (reported) | 5,892 | 4,194 | 7,817 | 7,905 | 8,083 | 10,060 | 11,320 | 12,840 |
| Net profit (adjusted) | 5,892 | 4,194 | 6,424 | 7,905 | 8,083 | 10,060 | 11,320 | 12,840 |
| EPS (reported)(HKD) | 2.317 | 1.528 | 2.838 | 2.870 | 2.718 | 3.321 | 3.737 | 4.239 |
| EPS (adjusted)(HKD) | 2.317 | 1.528 | 2.333 | 2.870 | 2.718 | 3.321 | 3.737 | 4.239 |
| EPS (adjusted fully-diluted)(HKD) | 2.317 | 1.528 | 2.333 | 2.870 | 2.669 | 3.321 | 3.737 | 4.239 |
| DPS (HKD) | 0.800 | 0.800 | 1.000 | 1.000 | 1.060 | 1.150 | 1.250 | 1.350 |
| EBIT | 9,365 | 7,639 | 8,729 | 9,372 | 11,388 | 14,623 | 15,583 | 17,275 |
| EBITDA | 10,638 | 9,031 | 10,030 | 10,700 | 12,783 | 16,085 | 17,103 | 18,835 |

## Cash flow (HKDm)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Profit before tax | 8,756 | 6,114 | 10,140 | 9,574 | 11,029 | 14,259 | 15,778 | 17,618 |
| Depreciation and amortisation | 1,273 | 1,392 | 1,301 | 1,328 | 1,395 | 1,462 | 1,520 | 1,560 |
| Tax paid | (958) | (1,628) | (2,247) | (1,079) | (2,403) | (3,565) | (3,779) | (4,051) |
| Change in working capital | 256 | (1,868) | 963 | 320 | 4,820 | 8,231 | 10,360 | 13,259 |
| Other operational CF items | 493 | 1,740 | (590) | 1,027 | 1,286 | 899 | 405 | 322 |
| Cash flow from operations | 9,820 | 5,750 | 9,567 | 11,170 | 16,127 | 21,286 | 24,284 | 28,708 |
| Capex | (15,895) | (9,541) | (8,520) | (18,423) | (32,108) | (32,900) | (20,120) | (21,650) |
| Net (acquisitions)/disposals | 2,722 | 234 | 3,324 | 267 | 249 | 5,262 | 270 | 285 |
| Other investing CF items | (12) | (14) | (16) | (17) | (19) | (21) | (23) | (26) |
| Cash flow from investing | (13,185) | (9,321) | (5,212) | (18,173) | (31,878) | (27,659) | (19,873) | (21,391) |
| Change in debt | 10,612 | 6,727 | 1,835 | 0 | 0 | 0 | 0 | 0 |
| Net share issues/(repurchases) | 0 | 9,620 | 0 | 0 | 10,052 | 0 | 0 | 0 |
| Dividends paid | (2,735) | (2,748) | (2,759) | (3,274) | (3,450) | (3,938) | (4,544) | (4,998) |
| Other financing CF items | (605) | (1,958) | (905) | (980) | (1,627) | (1,630) | (1,853) | (1,881) |
| Cash flow from financing | 7,272 | 11,641 | (1,829) | (4,254) | 4,975 | (5,568) | (6,396) | (6,879) |
| Forex effect/others | 41 | 99 | 0 | 0 | 0 | 0 | 0 | 0 |
| Change in cash | 3,948 | 8,169 | 2,526 | (11,257) | (10,776) | (11,941) | (1,985) | 438 |
| Free cash flow | (6,075) | (3,791) | 1,047 | (7,253) | (15,981) | (11,614) | 4,164 | 7,058 |

*Source: FactSet, Daiwa forecasts*

# Financial summary continued ...

## Balance sheet (HKDm)

| As at 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Cash & short-term investment | 7,717 | 15,886 | 18,412 | 16,900 | 32,528 | 20,587 | 18,602 | 19,040 |
| Inventory | 97 | 112 | 107 | 113 | 130 | 140 | 152 | 156 |
| Accounts receivable | 1,396 | 1,727 | 4,554 | 3,518 | 3,420 | 4,560 | 5,340 | 5,680 |
| Other current assets | 9,289 | 17,280 | 18,784 | 29,896 | 47,736 | 49,280 | 51,789 | 53,902 |
| Total current assets | 18,499 | 35,005 | 41,857 | 50,427 | 83,814 | 74,567 | 75,883 | 78,778 |
| Fixed assets | 114,613 | 119,593 | 134,002 | 166,638 | 203,041 | 235,881 | 246,660 | 255,494 |
| Goodwill & intangibles | 302 | 297 | 297 | 297 | 297 | 297 | 297 | 297 |
| Other non-current assets | 12,757 | 13,659 | 14,305 | 24,863 | 30,821 | 37,783 | 38,628 | 39,691 |
| Total assets | 146,171 | 168,554 | 190,461 | 242,225 | 317,973 | 348,528 | 361,468 | 374,260 |
| Short-term debt | 6,720 | 4,443 | 8,328 | 7,829 | 8,903 | 8,903 | 8,903 | 8,903 |
| Accounts payable | 5,678 | 6,924 | 8,240 | 6,539 | 10,316 | 6,620 | 10,749 | 13,468 |
| Other current liabilities | 1,527 | 1,425 | 1,681 | 8,341 | 11,537 | 12,450 | 13,280 | 14,318 |
| Total current liabilities | 13,925 | 12,792 | 18,249 | 22,709 | 30,756 | 27,973 | 32,932 | 36,689 |
| Long-term debt | 24,562 | 33,566 | 31,516 | 41,760 | 67,090 | 67,090 | 67,090 | 67,090 |
| Other non-current liabilities | 15,682 | 16,339 | 18,532 | 7,107 | 9,253 | 9,360 | 9,820 | 9,935 |
| Total liabilities | 54,169 | 62,697 | 68,297 | 71,576 | 107,099 | 104,423 | 109,842 | 113,714 |
| Share capital | 2,448 | 2,754 | 2,754 | 2,754 | 3,029 | 3,029 | 3,029 | 3,029 |
| Reserves/R.E./others | 83,916 | 96,740 | 112,456 | 160,335 | 200,228 | 233,116 | 240,347 | 249,097 |
| Shareholders' equity | 86,364 | 99,494 | 115,210 | 163,089 | 203,257 | 236,145 | 243,376 | 252,126 |
| Minority interests | 5,638 | 6,363 | 6,954 | 7,560 | 7,617 | 7,960 | 8,250 | 8,420 |
| Total equity & liabilities | 146,171 | 168,554 | 190,461 | 242,225 | 317,973 | 348,528 | 361,468 | 374,260 |
| EV | 206,750 | 202,772 | 202,881 | 206,216 | 210,234 | 215,589 | 217,144 | 215,898 |
| Net debt/(cash) | 23,565 | 22,123 | 21,432 | 32,689 | 43,465 | 55,406 | 57,391 | 56,953 |
| BVPS (HKD) | 35.279 | 36.127 | 41.834 | 59.219 | 67.104 | 77.961 | 80.348 | 83.238 |

## Key ratios (%)

| Year to 31 Dec | 2007 | 2008 | 2009 | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|---|---|---|
| Sales (YoY) | 21.3 | (1.7) | 10.1 | 10.4 | 23.9 | 23.8 | 12.8 | 8.4 |
| EBITDA (YoY) | 37.5 | (15.1) | 11.1 | 6.7 | 19.5 | 25.8 | 6.3 | 10.1 |
| Operating profit (YoY) | 44.7 | (18.4) | 14.3 | 7.4 | 21.5 | 28.4 | 6.6 | 10.9 |
| Net profit (YoY) | 37.5 | (28.8) | 53.2 | 23.1 | 2.3 | 24.5 | 12.5 | 13.4 |
| Core EPS (fully-diluted) (YoY) | 32.3 | (34.1) | 52.7 | 23.1 | (7.0) | 24.5 | 12.5 | 13.4 |
| Gross-profit margin | 65.4 | 66.1 | 65.4 | 63.5 | 62.1 | 61.0 | 57.0 | 57.2 |
| EBITDA margin | 65.6 | 56.7 | 57.1 | 55.2 | 53.3 | 54.1 | 51.0 | 51.8 |
| Operating-profit margin | 57.8 | 47.9 | 49.7 | 48.4 | 47.4 | 49.2 | 46.5 | 47.5 |
| Net profit margin | 36.4 | 26.3 | 36.6 | 40.8 | 33.7 | 33.9 | 33.8 | 35.3 |
| ROAE | 7.3 | 4.5 | 6.0 | 5.7 | 4.4 | 4.6 | 4.7 | 5.2 |
| ROAA | 4.4 | 2.7 | 3.6 | 3.7 | 2.9 | 3.0 | 3.2 | 3.5 |
| ROCE | 8.4 | 5.7 | 5.7 | 4.9 | 4.5 | 4.8 | 4.8 | 5.2 |
| ROIC | 6.7 | 5.1 | 5.5 | 4.8 | 3.9 | 4.0 | 3.9 | 4.2 |
| Net debt to equity | 27.3 | 22.2 | 18.6 | 20.0 | 21.4 | 23.5 | 23.6 | 22.6 |
| Effective tax rate | 23.9 | 19.0 | 15.0 | 11.3 | 21.8 | 25.0 | 24.0 | 23.0 |
| Accounts receivable (days) | 38.0 | 35.8 | 65.3 | 76.0 | 52.7 | 49.0 | 53.9 | 55.4 |
| Current ratio (x) | 1.3 | 2.7 | 2.3 | 2.2 | 2.7 | 2.7 | 2.3 | 2.1 |
| Net interest cover (x) | 8.2 | 8.4 | 25.8 | 9.4 | 9.4 | 11.2 | 10.5 | 11.5 |
| Net dividend payout | 34.5 | 52.4 | 35.2 | 34.8 | 39.0 | 34.6 | 33.4 | 31.8 |
| Free cash flow yield | n.a. | n.a. | 0.6 | n.a. | n.a. | n.a. | 2.2 | 3.8 |

*Source: FactSet, Daiwa forecasts*

## Company profile

Wharf is one of the largest property investors in Hong Kong, with its two key properties, Harbour City and Times Square, accounting for more than 60% of its assets and operating profit. In addition to its investment-property portfolio, the company has investments in ports, as well as the media and telecom sectors. In recent years, it has been expanding its investments in China and has a long-term target of having about half of its assets in Hong Kong and half in the Mainland.

Daiwa Capital Markets

Company

Financials / Hong Kong
22 March 2013

The 10-second briefing

# CSI Properties
497 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **0.34**

## A real-estate opportunity fund

- CSI Properties has a proven track record of identifying real-estate opportunities and executing them
- Past record suggests that it has financial discipline
- Improved financial resources

■ Not Rated

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### ■ Background

Since Mr. Mico Chung took over the management of CSI Properties in 2004, the company has focused on a special niche: that of repositioning property assets and then realising their value by exiting them at higher prices vs. the purchase prices. Through active trading of property assets over the past eight years, the company has increased its equity base tenfold; it also became a constituent stock of the MSCI Hong Kong Small Cap Index in May 2011.

### ■ Highlights

**Record of identifying and executing real estate opportunities.** Looking at its investment track record since 2004, it would seem that CSI Properties has often been early to identify ‘mispricing’ opportunities and emerging trends in the property sector, such as: 1) food and beverage tenants in Tsimshatsui moving out of ground-floor units, 2) increasing unit rents for furnished serviced apartments in city areas, and 3) the increasing scarcity value of grade-A office buildings with Victoria Harbour sea views. Most recently, the company has invested in designer apartments or houses – hence its acquisitions of the Kau To site and projects at the Peak and Jardine Lookout in 2012.

**Past expansion funded more by profits from asset sales.** CSI Properties’ total assets expanded from HKD906m in 2004 to HKD9,094m in 2012, but the total equity it has raised since 2004 is HKD1.7bn, based on our estimate, suggesting that it has not made excessive use of equity capital to fund its growth. Nor has it been highly leveraged – its total debt has not exceeded HKD4bn between the peak level reached during 2004 and now.

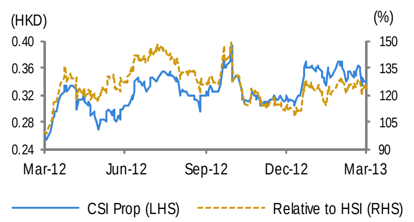
CSI Properties’ active realisation and deployment of profits from sales of properties (we estimate that total realised profits since 2003 have exceeded HKD4.5bn in gross terms, as detailed on pg. 2) has been the main driver for growth. In this light, the company’s NAV would appear more realisable than many others as it is more likely to dispose of its properties in the open market.

**Starting to have greater financial flexibility.** The company raised about HKD400m from its share placement in October 2012, and has since raised an additional USD150m from a five-year bond, which is the first time it has been able to access the bond market. These developments have strengthened its financial resources.

### ■ Valuation

The CSI Properties stock trades currently at a PBR of 0.55x based on its reported November 2012 BVPS of HKD0.62, at a 66% discount to its pro-forma NAV of HKD0.99 based on the valuations of independent assessors at November 2012, and at a dividend yield of 7.1% based on its FY12 DPS. The company has declared a DPS of HKD0.024 for FY12, which translates into a payout ratio of 11.3%.

**Share price performance**




| | |
|---|---|
| 12-month range | 0.25-0.39 |
| Market cap (USDbn) | 0.42 |
| 3m avg daily turnover (USDm) | 1.28 |

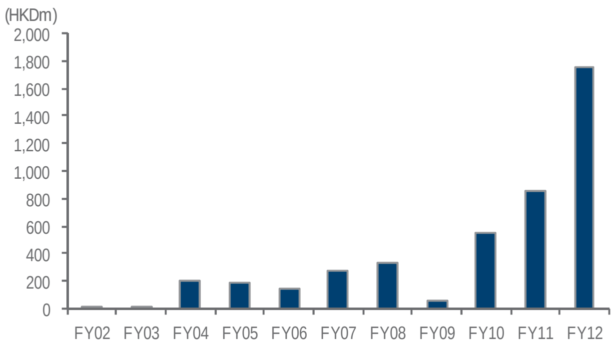
*Source: FactSet, Daiwa*

### CSI Properties: track record of projects and achieved returns

| Year | Property/Project | Location | Usage | Date of purchase | Date of disposal | Months of holding | Cost (HKDm) | Selling price (HKDm) | Gross profit (HKDm) | Achieved return (profit/ cost) | Achieved margin (profit/ revenue) % |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2003 | No. 88 Gloucester Road | Wanchai | Grade-A office | Jun-03 | Sep-07 | 51 | 196 | 783 | 587 | 299% | 75.0% |
| 2004 | Leighton Road | Causeway Bay | Development site | Feb-04 | Mar-04 | 2 | 70 | 108 | 38 | 54% | 35.1% |
| | Fullcorp Centre | Tsimsahtsui | Retail / office | May-04 | Dec-04 | 7 | 223 | 296 | 73 | 33% | 24.7% |
| 2005 | Yiu Wa Street | Causeway Bay | Development site | Apr-05 | Jun-06 | 15 | 240 | 337 | 97 | 40% | 28.8% |
| 2006 | Paul Y. Centre | Kwun Tong | Industrial /office | Jan-06 | Jun-07 | 17 | 780 | 1,150 | 370 | 47% | 32.2% |
| | International Capital Plaza | Shanghai | Retail / office | Apr-06 | Dec-10 | 56 | 834 | 1,346 | 512 | 61% | 38.0% |
| | AXA Tower (10 floors) | Wanchai | Grade A office | Aug-06 | Nov-10 | 51 | 768 | 1,560 | 792 | 103% | 50.8% |
| | House A, Tai Tam Road | Island South | Luxury residential | Dec-06 | Feb-08 | 14 | 83 | 147 | 64 | 77% | 43.4% |
| | House B, Tai Tam Road | Island South | Luxury residential | Dec-06 | May-09 | 26 | 86 | 110 | 24 | 28% | 21.6% |
| | House C, Tai Tam Road | Island South | Luxury residential | Dec-06 | Mar-08 | 15 | 76 | 138 | 62 | 81% | 44.7% |
| | House D, Tai Tam Road | Island South | Luxury residential | Dec-06 | Jul-08 | 18 | 85 | 161 | 76 | 89% | 47.1% |
| 2007 | No. 14-16 Hankow Road | Tsimsahtsui | Retail / residential | Apr-07 | Aug-11 | 52 | 605 | 1,380 | 775 | 128% | 56.2% |
| | Novel Plaza | Shanghai | Office | Oct-07 | Sep-08 | 12 | 819 | 1,209 | 390 | 48% | 32.3% |
| 2008 | The Hampton (8 apartments) | Happy Valley | Luxury residential | May-08 | Mar-12 | 46 | 335 | 807 | 472 | 141% | 58.5% |
| | | | | | | | 5,200 | 9,531 | 4,331 | 83% | 45.4% |

*Source: Company*

### CSI Properties: net profit record



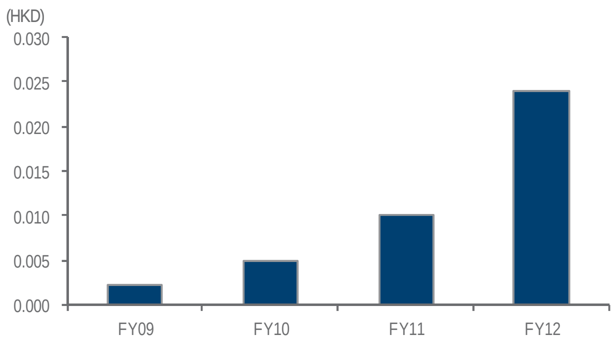

*Source: Company*

### CSI Properties: investment performance record

| | |
|---|---|
| Major property assets acquired since 2003 | HKD17bn |
| Equity raised since 2003 | HKD1.2bn |
| Shareholders' funds at the end of FY04 | HKD712m |
| Realised gross profit from major properties sold | HKD9.5bn |
| Maximum net debt | HKD4bn |

*Source: Daiwa estimates compiled from company data*

### CSI Properties: DPS record




*Source: Company*

### CSI Properties: financial summary

| HKDm | FY04 | FY05 | FY06 | FY07 | FY08 | FY09 | FY10 | FY11 | FY12 |
|---|---|---|---|---|---|---|---|---|---|
| Turnover | | | | | | | | | |
| 1H | 35 | 20 | 287 | 293 | 57 | 596 | 541 | 158 | 2,511 |
| 2H | 380 | 349 | 85 | 262 | 346 | 73 | 907 | 2,587 | 707 |
| Total | 415 | 369 | 372 | 555 | 403 | 669 | 1,448 | 2,745 | 3,218 |
| Net profit | | | | | | | | | |
| 1H | 17 | 42 | 10 | 107 | 217 | 103 | 397 | 111 | 1,312# |
| 2H | 14 | 30 | 130 | 170 | 108 | (41) | 149 | 747 | 442 |
| Total | 31 | 72 | 140 | 277 | 325 | 62 | 546 | 858 | 1,754 |
| Total assets | 906 | 1,514 | 1,621 | 3,601 | 5,164 | 6,060 | 7,790 | 7,685 | 9,049 |
| Shareholder funds | 712 | 858 | 1,211 | 2,102 | 2,478 | 2,470 | 3,413 | 4,238 | 5,959 |
| Properties & related assets* | 525 | 1045 | 764 | 2525 | 3228 | 4,330 | 4,724 | 5,207 | 5,877 |
| Cash on hand | 139 | 216 | 381 | 608 | 1063 | 1,206 | 617 | 1,860 | 2,445 |
| Bank loans | 131 | 376 | 155 | 40 | 120 | 1,973 | 2,842 | 1,936 | 2,296 |
| Convertible bonds | - | - | - | 211 | 489 | 506 | 169 | 166 | 9 |

*Source: Company Note: *based on cost # boosted by the sale of No.14-16 Hankow Road, which raised about HKD0.8bn in profit.*

*** High volatility in HoH earnings change, but full-year profit has been rising since FY04 (with the exception of FY09, which was affected by the global financial crisis).*

The 10-second briefing

## Great Eagle
41 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **31.85**

# Champion REIT plus a growing hotel portfolio

■ Not Rated

- Spin-off of Champion REIT and sale of Langham Place to Champion
- Over HKD10bn invested in hotel businesses; seeking to unlock value in hotels in coming years
- Intends to spin off Hong Kong hotels

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### ■ Background

Great Eagle has been involved in the Hong Kong property market since the 1960s. Since the 1980s, it has committed to two large-scale commercial property projects — Citibank Plaza and Langham Place — which have stretched its balance sheet. In 2007, it spun off Champion REIT as the holding company of Citibank Plaza and subsequently injected into it the retail and office portion of Langham Place. As a result, Great Eagle's major assets are its 58% stake in Champion REIT (2778 HK, HKD3.98, Hold [3]), plus hotel assets in Hong Kong and overseas.

### ■ Highlights

**Balance sheet.** Great Eagle is generally viewed as a savvy investor, but its equity base has seemed modest relative to the scale of the property projects it has taken on. The group's restructuring initiatives in recent years may have been an attempt to address this balance-sheet issue. Great Eagle's net gearing ratio was 1% as at end-December 2012, down from 3% at end-December 2011.

**Asset backing; identity as investment vehicle.** We estimate the group's stake in Champion REIT is worth HKD18.40/share assuming a conservative unit price for the latter of HKD3.80. If we value Great Eagle's Champion stake at its underlying book NAV, we estimate it is worth HKD38.20/share.

While the group has solid asset backing, the question may be whether, after putting its two key assets under Champion REIT, it can establish a new identity for itself as an investment vehicle.

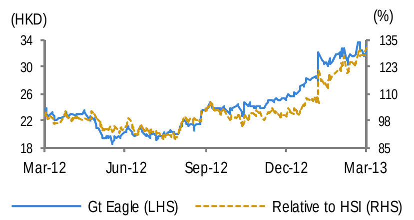
**Hotel investments.** Great Eagle has been investing in establishing an international hotel business, encompassing hotel ownership and management, for nearly two decades. It has made considerable progress, though it may still be some way from achieving its ultimate goal.

**Intention to spin off Hong Kong hotels.** Such a move might be Great Eagle's first step toward realising the value of its hotel assets. The group's hotel assets are currently carried at cost (minus depreciation) of HKD10.1bn; we estimate their market value to be HKD19.2bn. Based on its announcement and media reports, Great Eagle's plan is to first spin off its three hotels located in Hong Kong. They are The Langham HK, Langham Place Hotel and Eaton Smart, which have a total of 1,610 rooms. The bulk of the hotel assets, however, is held in its overseas portfolio, which has a total of over 4,000 rooms.

### ■ Valuation

Great Eagle trades at a PBR of 0.54x, based on its reported December 2012 BVPS of HKD58.50, compared with an average multiple of 0.38x since 1995. We estimate its current NAV at HKD57.5/share.

**Share price performance**




| | |
|---|---|
| 12-month range | 18.60-33.20 |
| Market cap (USDbn) | 2.59 |
| 3m avg daily turnover (USDm) | 2.89 |

*Source: FactSet, Daiwa*

### ■ Great Eagle: NAV breakdown (Champion REIT stake valued at its latest unit price)

| | HKDm | HKD/share |
|---|---|---|
| Investment properties in Hong Kong | 6,343 | 10.0 |
| Investment properties in overseas | 2,180 | 3.5 |
| Hotel assets in Hong Kong | 6,963 | 11.0 |
| Hotel assets in overseas | 11,026 | 17.5 |
| Hotel and other property assets in China | 1,184 | 1.9 |
| Champion REIT stake based on unit price* | 11,644 | 18.4 |
| Gross NAV | 39,340 | 62.3 |
| Net debt | (3,017) | (4.8) |
| NAV | 36,323 | 57.5 |

*Source: Company, Daiwa estimates*

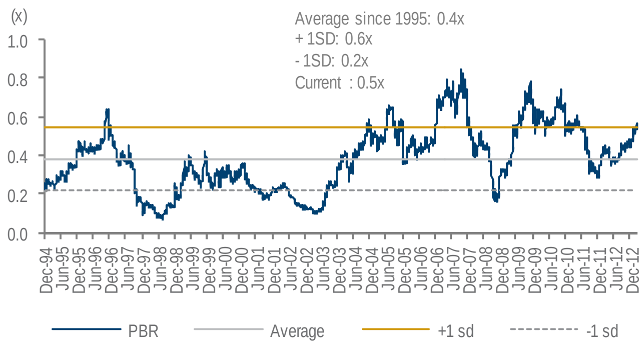
*Note: NAV estimated as at February 2013 * based on HKD3.80/unit*

### ■ Great Eagle: NAV breakdown (Champion REIT stake valued at its asset value)

| | HKDm | HKD/share |
|---|---|---|
| Investment properties in Hong Kong | 6,343 | 10.0 |
| Investment properties in overseas | 2,180 | 3.5 |
| Hotel assets in Hong Kong | 6,963 | 11.0 |
| Hotel assets in 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*

### ■ Great Eagle: PBR




*Source: Company, Daiwa*

### ■ Great Eagle: hotel portfolio

| | City | Stake % | No. of rooms |
|---|---|---|---|
| Hong Kong | | | |
| The Langham HK | Hong Kong | 100% | 495 |
| Langham Place Hotel | Hong Kong | 100% | 654 |
| Eaton Smart | Hong Kong | 100% | 461 |
| | | | 1,610 |
| China | | | |
| Langham Xintiandi | Shanghai | 33.30% | 358 |
| Lanham Dalian | Dalian | 50% | 350 |
| | | | 708 |
| Overseas | | | |
| Langham London | London | 100% | 378 |
| Langham Boston | Boston | 100% | 318 |
| Langham Huntington Pasadena | Los Angeles | 100% | 380 |
| Fifth Avenue Hotel | New York | 100% | 220 |
| Langham Chicago | Chicago | 100% | 330 |
| Delta Chelsea Toronto | Toronto | 100% | 1,590 |
| Langham Melbourne | Melbourne | 100% | 372 |
| Observatory Hotel Sydney | Sydney | 100% | 96 |
| Langham Auckland | Auckland | 100% | 411 |
| | | | 4,095 |

*Source: Company*

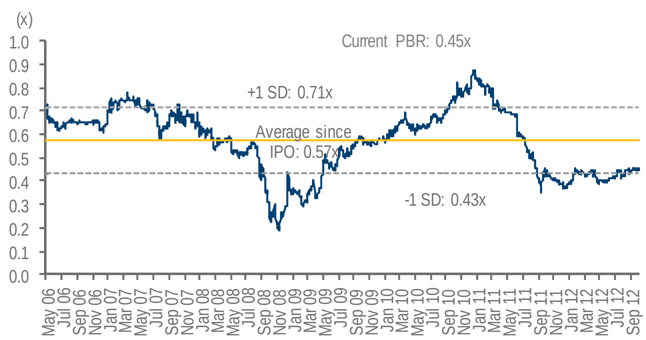
### ■ Ownership structure of Champion REIT units and CBs (before the exercise of CBs)

| | No. of units | Aggregate principal amount (HKDm) |
|---|---|---|
| Great Eagle | 2,578,702 | 2,340 |
| Public bondholders/ unitholders | 2,394,573 | 2,265 |
| | 4,973,275 | 4,605 |
| | | |
| Great Eagle | 51.9% | 50.8% |
| Public bondholders/ unitholders | 48.1% | 49.2% |
| | 100.0% | 100.0% |

*Source: Company, Daiwa*

*Note: the CBs (convertible bonds) arose because of Champion REIT's acquisition of the Langham Place mall and office from Great Eagle in 2008. Great Eagle currently owns 50.8% of Champion's 2013 CBs.*

### ■ Champion REIT: PBR trend




*Source: Bloomberg, Company, Daiwa*

The 10-second briefing

## Guotai Junan International
1788 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **3.57**

# Benefitting from China's retail investors going abroad

■ Not Rated

- Owned by one of the largest securities houses in China
- Has an established online trading platform and appears well-positioned to tap into China's retail-investor market
- A pioneer in the business of converting B shares into H shares

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### ■ Background

Guotai Junan Securities is one of the largest securities houses in China, owns a 71.3% stake in Guotai Junan International (Guotai Junan). Guotai Junan Securities is 46.7% owned by Shanghai International Group, the investment vehicle of the Shanghai Municipal Government, while Shenzhen Investment Holdings, the investment vehicle of the Shenzhen Municipal Government, holds a 10.6% stake.

### ■ Highlights

*A long-established player in Hong Kong, focused on online trading.* Guotai Junan started operating in Hong Kong in 1995. The company's chairman and CEO is Yim Fung who joined the Guotai Junan Group in 1992 and has 20 years' experience in the securities industry. Unlike many others, Guotai Junan focuses on online trading. It launched its online trading platform for Hong Kong securities in April 2011. For 2012, internet trading accounted for more than 75% of its trading volume.

*Opportunities to tap into China's retail-investor market.* Guotai Junan Securities is one of the largest securities houses in China with more than 1m clients, while Guotai Junan's total active clients in 2012 numbered 16,000. Currently, Guotai Junan shares less than 2% of its parent company's client base, but the company believes that there should be considerable scope for this ratio to increase over time, especially if high net-worth individuals in China are allowed to start investing outside the country.

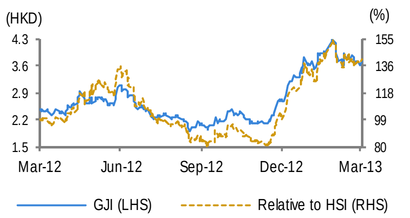
*A beneficiary of inflows of China investment capital into Hong Kong.* We believe that allowing more investment capital from China to flow into Hong Kong is essential to speed up Hong Kong's development as an offshore Renminbi centre. Given that many investors in China are individuals, the company believes that it is well-positioned to capitalise on such an initiative given its established online trading platform. Meanwhile, the company has been a pioneer in the business of converting B-share companies into H-share companies, and believes it is be well-positioned to benefit from any related opportunities.

*Loans and financing the largest source of revenue.* As at December 2012, Guotai Junan-had HKD2.9bn in loans and advances to customers. Loans and financing was the largest source of revenue (35%) for 2012. This was followed by broking and dealing, which accounted for 34% of 2012 revenue. As at December 2012, the company had shareholders' funds of HKD3.3bn and bank borrowings amounted to HKD650m.

### ■ Valuation

The stock is trading currently at a PBR of 1.8x based on its reported BVPS of HKD1.99 as at December 2012.

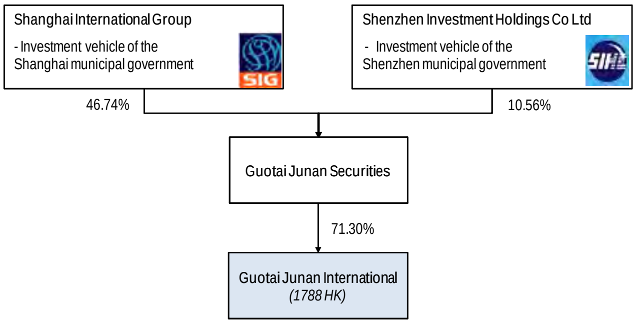
**Share price performance**




| | |
|---|---|
| 12-month range | 1.89-4.25 |
| Market cap (USDbn) | 0.79 |
| 3m avg daily turnover (USDm) | 4.27 |

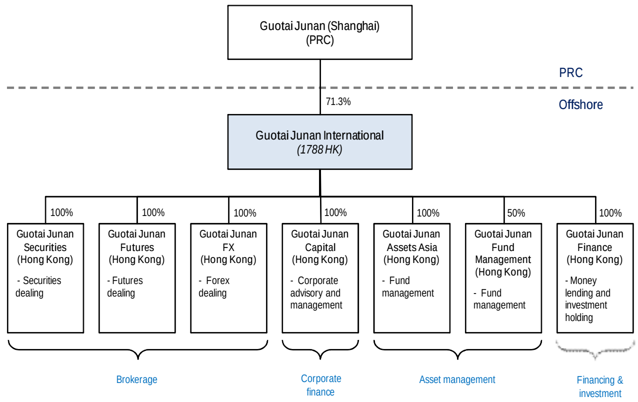
*Source: FactSet, Daiwa*

## ■ Guotai Junan: corporate structure



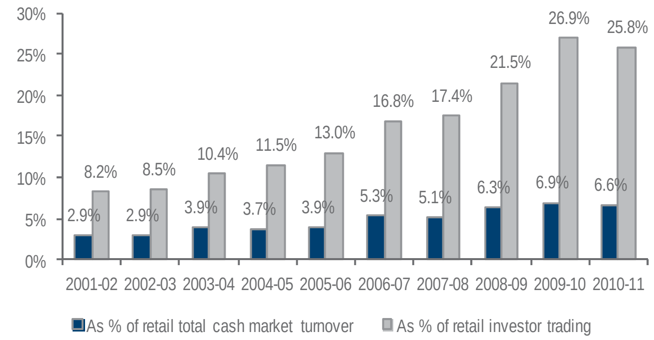

*Source: Company, Daiwa*

## ■ Guotai Junan: main business lines



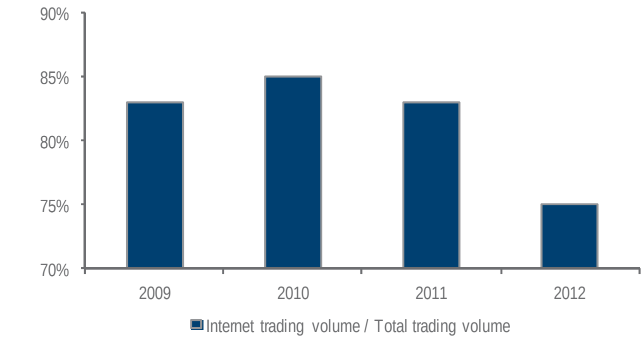

*Source: Company*

## ■ Hong Kong: online trading



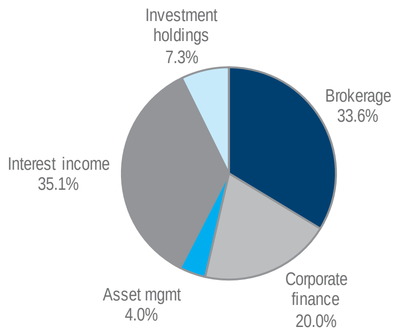

*Source: Company*

## ■ Guotai Junan: Internet trading/total trading volume



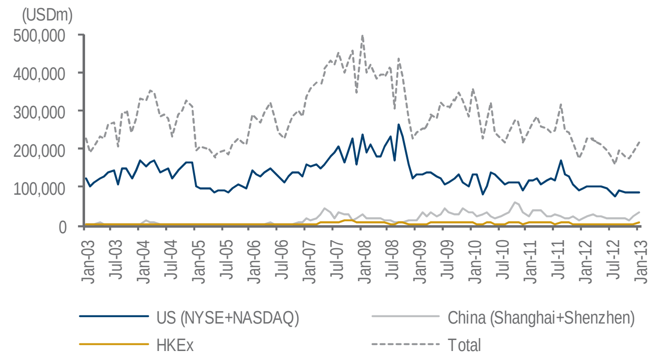

*Source: Company*

## ■ Guotai Junan: 2012 revenue mix




*Source: Company*

## ■ Average daily turnover: Hong Kong vs. Shenzhen and Shanghai




*Source: WFE, Daiwa*

The 10-second briefing

# Hongkong Land
HKL SP

Target (SGD): **n.a.**
Up/downside: -
19 Mar price (SGD): **7.00**

## Anchored in Central, growing within the region

■ Not Rated

- Hongkong Land looks so far to have defended its position in Central well
- We believe the Central office market has passed its worst; Central is also becoming a stronger retail location
- After years of investment within the region, Hongkong Land is starting to attain scale in some Asian cities

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### ■ Background
Part of the Jardine Group, Hongkong Land was once Hong Kong's largest property group by asset value. Hit hard by the city's property market downturn in the early 1980s, the company subsequently adopted a more cautious strategy. After completing its Exchange Square project in Central in the late 1980s, it opted not to take on large-scale investment projects in Hong Kong, instead pursuing less capital-intensive, lower-risk property projects in various cities in Asia (Singapore, Vietnam, Indonesia, Bangkok, Macau, Mainland China)

### ■ Highlights
*Solid position in the Central office market.* Hongkong Land's Central portfolio has not grown in size since the 1990s. Still, over the years, the company has continuously upgraded its office portfolio and built a more stable, defensive tenant profile. Hongkong Land's office portfolio is arguably more stable and less exposed to the volatile finance industry than is generally believed. We reiterate our view that the worst is probably over for the Central office market in terms of rentals.

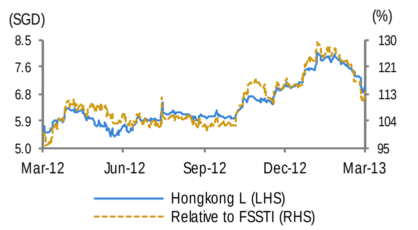
*Central has been gaining strength as a retail location.* While Central used to be seen mainly as an office location, it has become a much more prominent retail story in recent years, with Queen's Road Central being transformed into a major location for premier brands, and the Soho and fringe Central areas increasingly being considered part of Greater Central. We believe that Hongkong Land stands to benefit from Central's continued evolution into a vibrant area for retailing.

*Presence in some cities in Asia starting to attain scale.* The group has pursued a strategy of deploying surplus cash from its Hong Kong portfolio to build its presence in other key cities in the region. Its presence in Singapore now extends to some 1.8m sq ft (net floor area) of prime commercial properties, together with a 100% stake in Singapore-based MCL Land, which we estimate has a residential development land bank in Singapore totalling more than 3m sq ft.

*Deepening its investments in China.* The group started investing in China in the early 2000s, and initially focused on developing residential properties for sale. In recent years, it has scaled up its investments in Mainland China, embarking on two commercial property projects in Beijing and expanding its residential development land bank in cities such as Chongqing, Chengdu and Shenyang.

### ■ Valuation
Hongkong Land is trading at a PBR of 0.63x on its reported Dec 2012 BVPS of USD11.11, compared with an average PBR multiple for the stock of 0.7x since 1995. We estimate its current NAV at USD11.37/share, of which some 70% is from Hong Kong and 9% from Mainland China.

**Share price performance**




| | |
|---|---|
| 12-month range | 5.41-8.08 |
| Market cap (USDbn) | 13.16 |
| 3m avg daily turnover (USDm) | 15.40 |

*Source: FactSet, Daiwa*

## Hongkong Land: commercial property portfolio

| | Office (m sq ft*) | Retail (m sq ft*) | Hotel (m sq ft*) | Total (m sq ft*) |
|---|---|---|---|---|
| Hong Kong | 4.11 | 0.59 | 0.14 | 4.84 |
| Macau | - | 0.09 | 0.15 | 0.25 |
| Singapore | 1.64 | 0.13 | - | 1.77 |
| Jakarta | 0.35 | 0.06 | - | 0.41 |
| Hanoi | 0.11 | 0.01 | - | 0.12 |
| Bangkok | 0.03 | 0.06 | - | 0.09 |
| Others | 0.07 | - | 0.31 | 0.38 |
| Total: | 6.30 | 0.95 | 0.61 | 7.86 |
| | | | | |
| Under development | | | | |
| | | | | |
| Hong Kong | 0.04 | - | - | 0.04 |
| Jakarta | 0.31 | 0.02 | - | 0.33 |
| Total: | 6.65 | 0.98 | 0.61 | 8.23 |

*Source: Company, Daiwa. Note:*net floor area*

## Hongkong Land's commercial property portfolio in Singapore

| | Office (m sq ft*) | Retail (m sq ft*) | Hotel (m sq ft*) | Total (m sq ft*) |
|---|---|---|---|---|
| One Raffles Link | 0.24 | 0.07 | - | 0.31 |
| One Raffles Quay | 0.44 | 0.00 | - | 0.45 |
| Marina Bay Financial Centre | | | | - |
| - Tower 1 | 0.21 | 0.01 | - | 0.21 |
| - Tower 2 | 0.34 | 0.03 | - | 0.37 |
| - Tower 3 | 0.41 | 0.03 | - | 0.44 |
| Total: | 1.6 | 0.1 | - | 1.8 |

*Source: Company, Daiwa. Note:*net floor area*

## Hongkong Land: commercial property portfolio in Hong Kong

| | Stake % | Office (m sq ft*) | Retail (m sq ft*) | Hotel (m sq ft*) | Total (m sq ft*) |
|---|---|---|---|---|---|
| Alexandra House | 100% | 0.32 | 0.05 | - | 0.38 |
| Chater House | 100% | 0.42 | 0.04 | - | 0.46 |
| Exchange Square | 100% | | | | |
| - One Exchange Square | 100% | 0.57 | - | - | 0.57 |
| - Two Exchange Square | 100% | 0.51 | | - | 0.51 |
| - Three Exchange Square | 100% | 0.32 | | - | 0.32 |
| - Podium | 100% | - | 0.05 | - | 0.05 |
| - The Forum* | 100% | 0.04 | - | - | 0.04 |
| Jardine House | 100% | 0.64 | 0.04 | - | 0.68 |
| The Landmark | 100% | | | | |
| - Gloucester Tower | 100% | 0.47 | - | - | 0.47 |
| - Atrium | 100% | - | 0.26 | - | 0.26 |
| - Edinburg Tower | 100% | 0.34 | - | - | 0.34 |
| - York House | 100% | 0.11 | - | - | 0.11 |
| - Landmark Mandarin | 100% | - | - | 0.14 | 0.14 |
| Prince's Building | 100% | 0.41 | 0.14 | - | 0.55 |
| Total: | | 4.16 | 0.59 | 0.14 | 4.89 |
| | | | | | |
| Alexandra House | 100% | 0.32 | 0.05 | - | 0.38 |
| Chater House | 100% | 0.42 | 0.04 | - | 0.46 |
| Exchange Square | 100% | 1.44 | 0.05 | - | 1.50 |
| Jardine House | 100% | 0.64 | 0.04 | - | 0.68 |
| The Landmark | 100% | 0.93 | 0.26 | 0.14 | 1.33 |
| Prince's Building | 100% | 0.41 | 0.14 | - | 0.55 |
| Total: | | 4.16 | 0.59 | 0.14 | 4.89 |

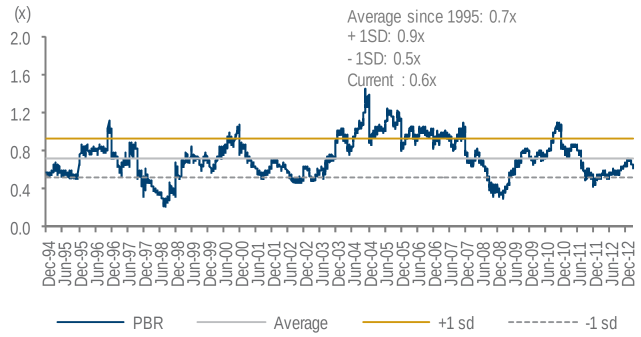
*Source: Company, Daiwa. Note:*net floor area*

## Hongkong Land: commercial property portfolio in other cities in the region

| | | Office (m sq ft*) | Retail (m sq ft*) | Hotel (m sq ft*) | Total (m sq ft*) |
|---|---|---|---|---|---|
| Jakarta | | | | | |
| Wisma Metropolitan I | 50% | 0.08 | 0.01 | - | 0.09 |
| Wisma Metropolitan II | 50% | 0.08 | 0.01 | - | 0.09 |
| World Trade Centre | 50% | 0.19 | 0.03 | - | 0.22 |
| Completed properties | | 0.35 | 0.06 | - | 0.41 |
| | | | | | |
| Under construction | | | | | |
| World Trade Centre II | 50% | 0.31 | 0.02 | - | 0.33 |
| | | 0.31 | 0.02 | - | 0.33 |
| Total: | | 0.66 | 0.08 | - | 0.73 |
| | | | | | |
| Hanoi, Vietnam | | | | | |
| Central Building | 71.0% | 0.03 | - | - | 0.03 |
| 63 Ly Thai To | 73.9% | 0.05 | 0.01 | - | 0.03 |
| Total: | | 0.08 | 0.01 | - | 0.06 |
| | | | | | |
| Bangkok, Thailand | | | | | |
| Gayson Plaza | 49% | 0.026 | 0.063 | - | 0.090 |
| Total: | | 0.026 | 0.063 | - | 0.090 |

*Source: Company, Daiwa. Note:*net floor area*

## Hongkong Land: PBR




*Source: Bloomberg, Daiwa*

## Hongkong Land: NAV breakdown

| | USDm | USD/share |
|---|---|---|
| Office properties in Hong Kong | 16,323 | 6.95 |
| Retail and hotel properties in Hong Kong | 6,251 | 2.66 |
| Commercial properties in Singapore | 3,404 | 1.45 |
| Commercial properties in other countries | 312 | 0.13 |
| Property assets in China | 2,575 | 1.10 |
| Development properties in Singapore and others | 974 | 0.42 |
| Gross NAV | 29,839 | 12.7 |
| Net debt | (3,148) | (1.34) |
| NAV | 26,691 | 11.37 |

*Source: Company, Daiwa estimates. Note: NAV estimated as at March 2013*

Daiwa Capital Markets

Company

Industrials / Hong Kong
22 March 2013

The 10-second briefing

# Hopewell Holdings
54 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **32.15**

# A play on the transformation of Wanchai

■ Not Rated

- Company offers probably the greatest exposure to property assets in Wanchai
- Planned spin-off of Hong Kong property assets may be the prelude to more active investment in the city
- Currently trading at a 0.67x PBR compared with an average of 0.6x since 2005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## ■ Background

Hopewell Holdings (Hopewell) is a well-established property firm in Hong Kong. Since the late 1980s, it has diversified into infrastructure investments in China and Asia. Hopewell was affected by the Asia financial crisis in 1997, but the subsequent sale of non-core assets and listing of Hopewell Highway Infrastructure in 2003 helped it to rebuild its balance sheet and it has been in a net cash position for the past few years until it settled the land premium for Hopewell Centre II in 1H FY13.

The company owns sizeable property assets in Wanchai. In 2012, it settled the land premium related to the redevelopment of Hopewell Centre II. In 2010, it entered into a 50-50 joint-venture with Sino Land (83 HK, HKD12.66, Buy [1]) to win the Lee Tung Street redevelopment project by the Urban Renewal Authority in Wanchai. In February 2013, it announced a plan to spin off its Hong Kong property assets under Hopewell Hong Kong Properties.

## ■ Highlights

**A play on the transformation of the Wanchai area.** Owning some 1m sq ft of completed rental properties in Wanchai and with 1.5m sq ft GFA under development in the area (of which, 0.4m sq ft is for sale and 1.1m sq ft is to be kept for rental), Hopewell offers among the strongest exposure to Wanchai property among the HK-listed companies.

**Also a play on the Pearl River Delta area.** Almost all of Hopewell's assets are highways, power plants, or properties in Hong Kong and Guangdong, making it a company with focused exposure to the Pearl River Delta area.

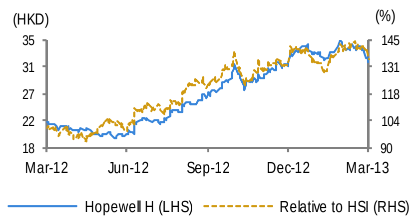
**Spin-off may be a prelude to more active investment in Hong Kong.** Apart from funding the construction of Hopewell Centre II, the proceeds that the new listed vehicle raised from the IPO may also be used to finance new investments in Hong Kong. Kowloon East could be one area it considers given that the group's Kowloon Bay International Trade and Exhibition Centre is a major property asset there.

**The sale of the Lee Tung Street project is likely to be a major event in the coming months**, as it is in the heart of Wanchai and is one of the few large-scale projects to become available on Hong Kong Island in the coming years.

## ■ Valuation

The stock is trading currently at 0.67x on its end-December 2012 BVPS of HKD47.69 compared with an average of 0.6x since 2005. The planned spin-off of its Hong Kong property vehicle could boost market interest in the company, although Hopewell's future valuations may reflect a holding company discount after the spin-off of its key assets. We estimate the Hong Kong assets to be held by Hopewell Hong Kong Property have a market value of about HKD41bn.

### Share price performance




| | |
|---|---|
| 12-month range | 19.50-34.95 |
| Market cap (USDbn) | 3.62 |
| 3m avg daily turnover (USDm) | 6.45 |

*Source: FactSet, Daiwa*

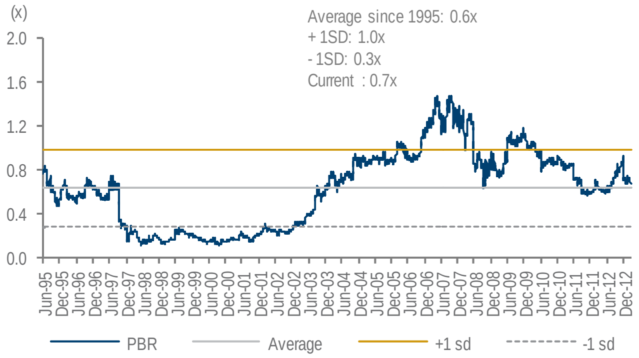
### ■ Hopewell Hong Kong Property: major assets

| | GFA (m sq ft) | HKDm |
|---|---|---|
| Hopewell Centre | 0.84 | 11,424 |
| QRE Plaza | 0.08 | 719 |
| Wu Chung House | 0.02 | 151 |
| GardenEast | 0.10 | 901 |
| Kowloon Bay International Trade & Exhibition Centre | 1.78 | 8,993 |
| Panda Place | 0.23 | 1,832 |
| Hopewell Centre II | 1.10 | 8,800 |
| Lee Tung Street redevelopment* | 0.41 | 5,556 |
| Broadwood Twelve** | 0.03 | 358 |
| | 4.57 | 38,733 |
| Panda Hotel | | 2,278 |
| Total | | 41,010 |

** Attributable floor area; **saleable area of unsold units as of 7 February 2013*

*Source: Company, Daiwa*

### ■ Hopewell: PBR

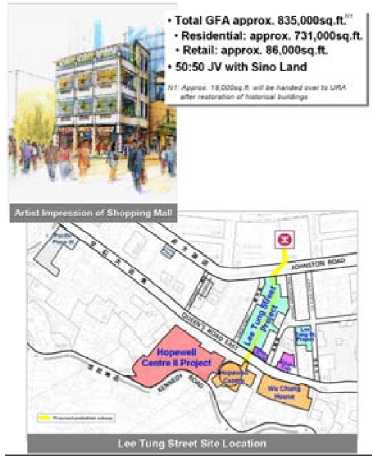



*Source: Bloomberg, Daiwa*

### ■ Hopewell Centre II and Lee Tung Street redevelopment project

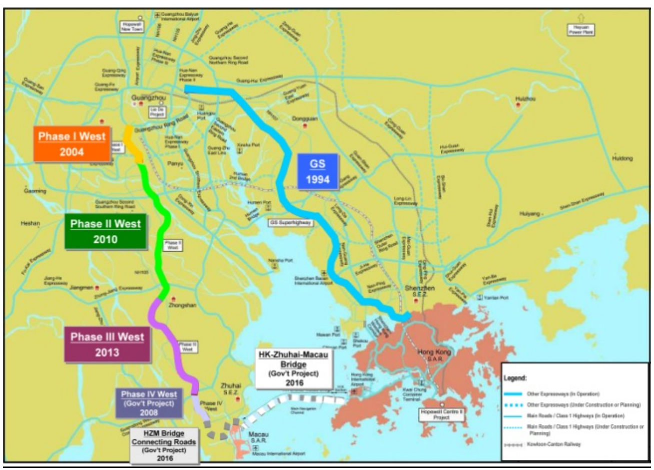

*Source: Company*

### ■ Hopewell: major developments in the Wanchai area




*Source: Company*

### ■ Pearl River Delta area: transport network




*Source: Company*
*Note: The coloured highways are operated by Hopewell Highway Infrastructure*

### ■ Hopewell: commercial properties on Hong Kong Island


*Source: Company, **the most updated figure is 1.9m sq. ft.*

Company

Industrials / Hong Kong
22 March 2013

The 10-second briefing

# Hutchison Whampoa
13 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **80.10**

## A veteran business builder

- Has a strong track record in terms of business building and investing
- The 3 Group has been EBIT positive since 2010
- Has a strong and growing cash-flow profile and had a 2011 consolidated EBITDA of HKD80.4bn

■ Not Rated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### ■ Background

Hutchison Whampoa (Hutchison) is one of Hong Kong's oldest and largest conglomerates. It was acquired in 1979 by Cheung Kong (Holdings) (1 HK, HKD111.70, Buy [1]), which has been using it as a vehicle to build its presence in six core areas (ports, property, retail, energy, infrastructure, and telecoms), first in Hong Kong, and subsequently to many other parts of the world. Hutchison now operates in 53 countries and is one of the world's largest players in terms of ports, retail, and infrastructure investments.

### ■ Highlights

**Hutchison's history: one of business building and investing.** Hutchison appears to have always focused on businesses that offer sustainable long-term earnings growth and where there are not many major players. We believe the company's strategy has always been to become one of Hong Kong's and the world's main players in these industries.

**A telecoms bonanza in the late 1990s.** Most of the company's businesses have expanded continuously, but in the late 1990s, its telecoms businesses, which was once considered by the market to be a burden, was recognised as having valuable assets by industry participants such as Vodafone and Deutsche Telekom. The company subsequently monetised their value, raising about USD20.4bn in cash through the sale of Orange and US company VoiceStream (against an equity investment of not more than USD2bn, we estimate), making it one of the world's largest winners in the 2G days of mobile telephony.

**Embarking on an 'asset swap'.** The company made a strategic decision to stay in the telecoms business and reinvest itself across an expanded market. We estimate the company has invested about USD35bn in its mobile businesses, and that this was almost fully funded by the sale of its telecoms assets.

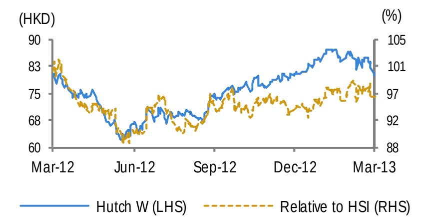
**Has it turned the corner?** The results of the 3 Group over the past 10 years (see the next page) suggest to us that it passed the start-up period in 2010 (it has been EBITDA positive since 2009 and EBIT positive since 2010, although it still needs sustained revenue market-share expansion to enable the business to generate a profit that is in line with its investments.

Meanwhile, the company's other businesses have been expanding (see page 2), despite its large investment in 3G.

### ■ Valuation

The stock is trading currently at a PBR of 0.93x on its reported BVPS of HKD86.2 as at 30 June 2012 (this compares with its average PBR of 1.52x since 1990). For 2011, its consolidated EBITDA was HKD80.4bn (HKD18.8/share).

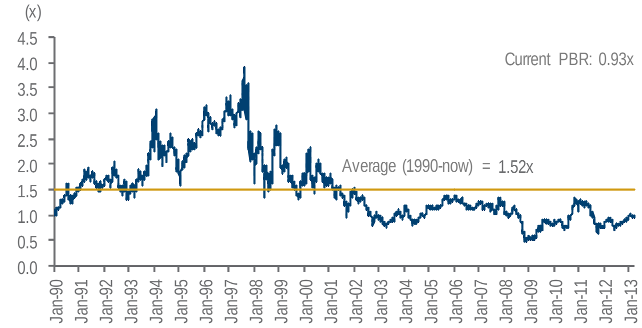
**Share price performance**




| | |
|---|---|
| 12-month range | 61.90-87.30 |
| Market cap (USDbn) | 44.00 |
| 3m avg daily turnover (USDm) | 69.91 |

*Source: FactSet, Daiwa*

## ■ Hutchison: PBR




*Source: Bloomberg, Daiwa*

## ■ Hutchison: key performance indicators

| | FY08 (HKDm) | FY09 (HKDm) | FY10 (HKDm) | FY11 (HKDm) | 1H12 (HKDm) |
|---|---|---|---|---|---|
| EBITDA - established businesses | 74,828 | 54,980 | 52,294 | 69,828 | 36,665 |
| EBITDA - 3 Group | (1,055) | 176 | 8,718 | 10,524 | 4,099 |
| Consolidated EBITDA | 73,773 | 55,156 | 61,012 | 80,352 | 40,764 |
| EBIT- established businesses | 55,364 | 37,870 | 35,717 | 49,889 | 24,596 |
| EBIT- 3 Group | (15,792) | (8,922) | 2,931 | 1,481 | 1,371 |
| Consolidated EBIT | 39,572 | 28,948 | 38,648 | 51,370 | 25,967 |
| Shareholder funds | 260,319 | 283,531 | 314,033 | 359,612 | 367,668 |
| Net debt | (183,413) | (157,630) | (148,512) | (138,278) | (134,707) |

*Source: Company*

## ■ Hutchison: 3G operating performance

| | FY02 (HKDm) | FY03 (HKDm) | FY04 (HKDm) | FY05 (HKDm) | FY06 (HKDm) | FY07 (HKDm) | FY08 (HKDm) | FY09 (HKDm) | FY10 (HKDm) | FY11 (HKDm) | 1H12* (HKDm) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Turnover | - | 2,023 | 15,742 | 37,502 | 50,668 | 59,909 | 60,372 | 57,590 | 64,205 | 74,288 | 27,990 |
| Operating cost | - | (13,594) | (28,630) | (35,677) | (37,445) | (43,401) | (43,980) | (40,108) | (37,580) | (39,004) | (13,675) |
| EBITDA/ (LBITDA)* | - | (11,571) | (12,888) | 1,825 | 13,223 | 16,508 | 16,392 | 17,482 | 26,625 | 35,284 | 14,315 |
| Support contributions from suppliers | - | - | 4,982 | - | - | - | - | - | - | - | - |
| Forex gains | | | | | | 1,898 | 2,945 | - | - | - | - |
| Exceptional gains - 3UK | | | | | | | | | 6,010 | - | - |
| Exceptional gains - 3 Italia | | | | | | | | | 1,489 | 457 | - |
| Restructuring loss - 3 UK | | | | | | | | | (3,742) | - | - |
| EBITDA/(LBITDA) before prepaid CAC | (1,839) | (11,571) | (7,906) | 1,825 | 13,223 | 18,406 | 19,337 | 17,482 | 30,382 | 35,741 | 14,315 |
| - Prepaid and other expensed CAC | - | (917) | (8,423) | (11,444) | (5,494) | (5,732) | (3,457) | (17,306) | (17,909) | (24,760) | (10,216) |
| EBITDA/(LBITDA) after expensed CAC | (1,839) | (12,488) | (16,329) | (9,619) | 7,729 | 12,674 | 15,880 | 176 | 12,473 | 10,524 | 4,099 |
| - Amortisation of post-paid CAC | - | (997) | (7,666) | (11,515) | (11,721) | (13,270) | (12,000) | - | - | - | - |
| - Depreciation | (231) | (4,015) | (8,399) | (9,086) | (9,501) | (11,199) | (9,237) | (7,759) | (8,221) | (8,238) | (3,075) |
| - Amortisation of licence fee | - | (2,185) | (6,055) | (6,060) | (6,503) | (6,143) | (5,500) | (1,339) | (1,323) | (1,262) | (100) |
| - Others | | | | | | | | | | | |
| EBIT | (2,070) | (19,685) | (38,449) | (36,280) | (19,996) | (17,938) | (10,857) | (8,922) | 2,929 | 1,024 | 1,371 |
| EBITDA margin (before forex gains, CAC and others) | | -572.0% | -81.9% | 4.9% | 26.1% | 27.6% | 27.2% | 30.4% | 41.5% | 47.5% | 51.1% |

*Source: Company*

*Note: *Excluding Hutchison Telecom (Australia) from 1H12. CAC = customer acquisition cost*

## ■ Hutchison: EBIT

| EBIT | FY01 (HKDm) | FY02 (HKDm) | FY03 (HKDm) | FY04 (HKDm) | FY05 (HKDm) | FY06 (HKDm) | FY07 (HKDm) | FY08 (HKDm) | FY09 (HKDm) | FY10 (HKDm) | FY11 (HKDm) | 1H12 (HKDm) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Ports | 5,791 | 6,626 | 7,597 | 8,956 | 10,219 | 11,395 | 12,849 | 13,236 | 10,406 | - | - | - |
| Ports- rest of the group | - | - | - | - | - | - | - | - | - | 5,877 | 6,937 | 3,283 |
| Ports- Hutchison Port Holdings | - | - | - | - | - | - | - | - | - | 1,330 | 1,289 | 419 |
| Property and hotels | 1,717 | 2,570 | 3,121 | 3,003 | 3,939 | 5,667 | 4,060 | 8,087 | 6,430 | 8,847 | 9,517 | 4,795 |
| Retail | 537 | 1,031 | 2,305 | 3,202 | 3,261 | 2,720 | 3,711 | 4,384 | 5,692 | 7,866 | 9,330 | 3,998 |
| CKI | 4,589 | 4,990 | 5,605 | 5,921 | 6,675 | 6,136 | 7,353 | 7,404 | 6,905 | 8,454 | 13,478 | 7,863 |
| Husky | 1,899 | 2,084 | 3,462 | 2,793 | 6,140 | 8,305 | 10,523 | 13,316 | 4,010 | 3,073 | 8,614 | 3,725 |
| Telecoms | 719 | 969 | 1,195 | 162 | 2,789 | 2,648 | 3,218 | 3,261 | 493 | (1,598) | 254 | (435) |
| Finance and investment | 6,457 | 6,200 | 6,250 | 8,989 | 5,491 | 6,920 | 13,851 | 6,467 | 4,079 | 810 | 470 | 948 |
| Others | | | | | | | | (791) | (145) | | | |
| Established businesses | 21,709 | 24,470 | 29,535 | 33,026 | 38,514 | 43,791 | 55,565 | 55,364 | 37,870 | 34,659 | 49,889 | 24,596 |
| 3 Group | - | (2,070) | (18,310) | (38,449) | (26,880) | (19,996) | (17,938) | (15,792) | (8,922) | 2,931 | 1,481 | 1,371 |
| Consolidated EBIT | 21,709 | 22,400 | 11,225 | -5,423 | 11,634 | 23,795 | 37,627 | 39,572 | 28,948 | 37,590 | 51,370 | 25,967 |
| Reconciliation items | - | - | - | - | - | - | - | - | - | 1,058 | - | - |
| Consolidated EBIT | 21,709 | 22,400 | 11,225 | -5,423 | 11,634 | 23,795 | 37,627 | 39,572 | 28,948 | 38,648 | 51,370 | 25,967 |

*Source: Company, Daiwa*

Daiwa Capital Markets

Company

Financials / Hong Kong
22 March 2013

The 10-second briefing

# Kerry Properties
683 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **34.70**

# Owning and building prime property assets

■ Not Rated

- Kerry Properties has prime property assets in Hong Kong, not least its luxury residential portfolio
- It has 5.3m sq ft of prime commercial property assets in major cities in Mainland China, and is building 20m sq ft more
- It is a major player in logistics in Greater China, with 5.8m sq ft of warehouse and logistics facilities in Hong Kong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## ■ Background

Kerry Properties is part of the Malaysia-based Kerry Group, which has diversified investments in such businesses as hotels, trading, sugar and logistics across Asia. In Hong Kong, the company has focused on investing in prime property assets and is now one of the largest owners of luxury residential property, with 0.7m sq ft of residential rental property, mainly in the Mid-Levels area.

Kerry Properties is also one of the largest foreign investors in Mainland China property, with property and land in China amounting to 45.3m sq ft. Of this, 5.3m sq ft is comprised of completed commercial properties for rental in major cities such as Beijing, Shanghai and Shenzhen.

## ■ Highlights

*Owns premier commercial property assets in Mainland China.* Kerry Group was one of the earliest investors in Mainland China, and now has 5.3m sq ft of rental properties there, mostly in major cities such as Beijing, Shanghai and Shenzhen. Moreover, Kerry Properties now has about 20m sq ft of rental properties under development, which should take its completed rental portfolio in Mainland China to 25m sq ft by 2018.

*Owns prime property assets in Hong Kong, some with redevelopment potential.* In recent years, the group has focused on investing and building prime property assets. It currently has one of the most prime luxury residential-property portfolios in Hong Kong, with a market value of HKD23bn (HKD16.0/share), on our estimates. The group also has some 2.2m sq ft of other rental properties, plus 5.8m sq ft of warehouses and logistics facilities in Hong Kong, some of which could have redevelopment potential, in our view.

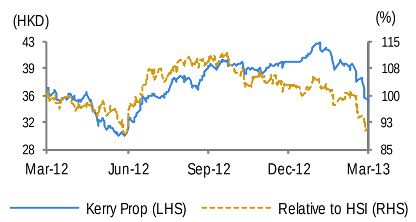
*Funding the accumulation of prime assets through property sales.* The group has a 2m sq ft residential land bank in Hong Kong, which we estimate could bring in more than HKD21bn in property sales proceeds. In addition, it has some 20m sq ft of residential landbank in China for sale.

*Major player in the logistics business in Greater China.* In addition to its Hong Kong/Mainland China portfolio, Kerry Properties is one of the largest players in logistics in Greater China, generating some HKD16bn in revenue in 2011. It also has investments in infrastructure and property assets in Hong Kong, Mainland China, Macau and the Philippines, some of which are non-core assets which could be disposed of when the opportunity arises.

## ■ Valuation

Kerry Properties is trading at a PBR of 0.71x based on its reported June BVPS of HKD49.19, compared with an average multiple for the stock of 0.76x since 1996. It is trading at a 48% discount to our estimated current NAV of HKD67.20/share.

**Share price performance**




| | |
|---|---|
| 12-month range | 29.85-42.85 |
| Market cap (USDbn) | 6.44 |
| 3m avg daily turnover (USDm) | 10.15 |

*Source: FactSet, Daiwa*

## Kerry: NAV breakdown

| | HKDm | HKD/share |
|---|---|---|
| Luxury residential properties in HK | 22,991 | 16.0 |
| Other HK investment properties | 12,103 | 8.4 |
| Overseas property assets | 3,723 | 2.6 |
| Warehouse and logistic properties in HK | 6,960 | 4.8 |
| Development properties in HK | 20,735 | 14.4 |
| Completed investment properties in China | 20,819 | 14.5 |
| Properties under development in China | 17,839 | 12.4 |
| Logistic businesses and other assets | 8,010 | 5.6 |
| Gross NAV | 113,181 | 78.7 |
| Net debt | (16,419) | (11.4) |
| NAV | 96,762 | 67.2 |

*Source: Company, Daiwa estimates. Note: NAV estimated as at 30 October 2012*

## Kerry: luxury residential property portfolio in Hong Kong

| | Area | GFA (sq ft) |
|---|---|---|
| Branksome Grande | Mid-level | 257,372 |
| Aigburth | Mid-level | 204,940 |
| Branksome Crest | Mid-level | 153,375 |
| Tavistock | Mid-level | 104,460 |
| Gladdon | Mid-level | 2,300 |
| | | 722,447 |

*Source: Company, Daiwa*

## Kerry: development landbank in Hong Kong and Macau

| | | Stake % | GFA (sq ft) |
|---|---|---|---|
| Hong Kong | | | |
| Soho 189 | R | 71% | 100,581 |
| Yuk Yat Street | R | 100% | 162,400 |
| Hing Hon Street | R | 71% | 126,568 |
| Kowloon Tong | R | 100% | 77,469 |
| Prince Edward Road West | R | 100% | 60,852 |
| Shan Kwong Bldg | R | 100% | 81,322 |
| Sha Tin Heights | R | 71% | 14,200 |
| Kau to Shan | R | 40% | 412,588 |
| So Kwun Wat | R | 100% | 939,600 |
| | | | 1,975,580 |
| Macau | | | |
| Nam Wan | R | 100% | 397,190 |
| | | | 397,190 |

*Source: Company, Daiwa*

## Kerry: investment properties in Hong Kong

| | | | GFA (sq ft) |
|---|---|---|---|
| Enterprise Square V | O | 100% | 519,316 |
| Enterprise Square | O | 100% | 59,413 |
| Kerry Centre | O | 40% | 193,252 |
| Hollywood Centre | O | 45% | 33,888 |
| Harbour Centre | O | 15% | 32,944 |
| | | | 838,813 |
| | | | |
| MegaBox | S | 100% | 1,145,537 |
| Enterprise Square III | S | 100% | 19,800 |
| Kerry Centre | S | 40% | 10,952 |
| Hollywood Centre | S | 45% | 10,151 |
| Harbour Centre | S | 15% | 6,135 |
| South Seas Centre | S | 100% | 6,341 |
| Wing On Plaza | S | 10% | 2,896 |
| Belair Monte | S | 8% | 3,820 |
| | | | 1,205,632 |
| | | | |
| Traders Hotel HK | H | 30% | 37,517 |

*Source: Company, Daiwa*

### Kerry: Mainland China landbank

| | | | Office (sq ft) | Retail (sq ft) | Residential (sq ft) | Hotel (sq ft) | Serviced apartments (sq ft) | Total (sq ft) |
|---|---|---|---|---|---|---|---|---|
| Completed rental properties | | | | | | | | |
| Beijing Kerry Centre | Beijing | 71.25% | 711,121 | 98,406 | 277,330 | - | - | 1,086,857 |
| Kerry Hotel Beijing | Beijing | 71.25% | - | - | - | 499,642 | - | 499,642 |
| Shenzhen Kerry Plaza I | Shenzhen | 100% | 804,709 | - | - | - | - | 804,709 |
| Fuzhou Central Residences | Fuzhou | 100% | - | 63,986 | - | - | - | 63,986 |
| Kerry Parkside Shanghai Pudong | Shanghai | 40.80% | 425,074 | 224,557 | 147,250 | - | - | 796,881 |
| Kerry Everbight City Phase I | Shanghai | 74.25% | 228,100 | 103,971 | 142,355 | - | - | 474,426 |
| Shanghai Kerry Centre | Shanghai | 74.25% | 308,584 | 103,971 | 142,355 | - | - | 554,910 |
| Shanghai Central Resid. Tower 1-3 | Shanghai | 100.00% | - | - | 478,286 | - | - | 478,286 |
| Shanghai Kerry Centre | Shanghai | 100% | 1,641 | 107,256 | - | - | - | 108,897 |
| Kerry Hotel Pudong | Shanghai | 40.80% | - | - | - | 336243 | - | 336,243 |
| | | | 2,479,229 | 702,147 | 1,187,576 | 835,885 | - | 5,204,837 |
| | | | | | | | | |
| Properties under development | | | | | | | | |
| Shenzhen Kerry Plaza II | Shenzhen | 100% | 784,685 | 66,844 | | | | 851,529 |
| Jiang An Kerry Centre | Shanghai | 51% | 624,386 | 364,891 | | 404,389 | | 1,393,666 |
| Kerry Everbright City Phase III | Shanghai | 74% | 477,011 | 81,485 | | | 246,641 | 805,137 |
| Tangshan Complex Development | Tangshan | 40% | - | 88,394 | 1,001,590 | 231,770 | | 1,321,754 |
| Tianjin Kerry Centre | Tianjin | 49% | 672,766 | 548,080 | 925,819 | 369,205 | 116,036 | 2,631,906 |
| Parkview Residence Phase 2 and 3 | Hangzhou | 100% | - | 69,962 | 1,843,238 | - | - | 1,913,200 |
| Nanjing Complex Development | Nanjing | 45% | | 4,219 | | 412,072 | | 416,291 |
| Manzhouli project phase 2 | Manzhouli | 100% | | 32,453 | 584,970 | | | 617,423 |
| Qinhuangdao | Qinhuangdao | 60% | | 207,960 | 2,647,944 | | | 2,855,904 |
| Hangzhou Kerry Centre | Hangzhou | 100% | 117,554 | 1,132,523 | | 490,020 | 361,369 | 2,101,466 |
| Ningbao project | Ningbao | 50% | | | 521,882 | | | 521,882 |
| The Metropolis Ph. 1 and 2 | Chengdu | 55% | | 161,006 | 2,138,092 | | - | 2,299,098 |
| The Metropolis Ph. 3 | Chengdu | 55% | | - | 1,161,827 | | 280,913 | 1,442,740 |
| Zhengzhou Complex Development | Zhengzhou | 55% | 213,127 | 172,592 | 581,624 | 325,611 | | 1,292,954 |
| Jinan Lixia Complex Development | Luoyuan | 55% | 201,287 | 60,800 | | 292,043 | | 554,130 |
| Changsha project | Changsha | 100% | | 52,746 | 2,918,669 | | 235,398 | 3,206,813 |
| Nanchang Complex Development | Nanchang | 80% | 533245 | 69,119 | 706,101 | 746930 | 0 | 2,055,395 |
| Yingkou Complex Development | Yingkou | 40% | | 62,431 | 1,496,196 | 221,652 | | 1,780,279 |
| Putian Complex Development | Putian | 60% | | 106,564 | 1,653,299 | 581,256 | | 2,341,119 |
| Shenyang Complex Development | Shenyang | 60% | 1264117 | 2,419,968 | 3,264,360 | 394,524 | 1,461,256 | 8,804,225 |
| | | | 4,888,178 | 5,702,037 | 21,445,611 | 4,469,472 | 2,701,613 | 39,206,911 |

*Source: Company, Daiwa*

The 10-second briefing

## Lai Sun Development
488 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **0.24**

# Attempting to revitalise a family property company

■ Not Rated

- Has started to emerge from a 15-year struggle to overcome the problems resulting from over-expansion in the 1990s
- Still has asset backing and has become financially sound, with over USD50m in rental income and 7% net gearing
- Could be the first Hong Kong family property company to try the model of 'family owned but with professional management'

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### ■ Background

Lai Sun Development (Lai Sun) started out as a garment manufacturer listed on the Hong Kong stock exchange in 1972. In the 1980s, it diversified into the property sector, establishing itself as a medium-sized developer with a portfolio of rental properties and a handful of residential development projects. It used the cash flow from the property business to diversify into other businesses, such as China property, hospitality, media, and entertainment.

The company encountered financial difficulties with the onset of the Asia financial crisis in late 1997. For the next 15 years it undertook a series of restructurings to rebuild its balance sheet and clean up the problems resulting from previous over-expansion. In June 2012, F.A. Chew, a veteran professional of the Hong Kong property market, was appointed deputy chairman, with a mandate to rejuvenate the company. It looks set to be one of the first family property companies to try the model of "family owned but run by professional managers".

### ■ Highlights

**The old assets it owns should limit share price downside.** While the company may face high execution risks, one factor limiting downside is that it still owns many old property assets. Lai Sun, for one, owns 1.2m sq ft of completed rental properties that are all in the urban area and have a market value of HKD14bn (HKD0.70/share).

**Also owns quality assets in the city centres of Shanghai and Guangzhou.** Similarly, the current associated company, Lai Fung Holdings (Not rated), owns some 2.4m sq ft of rental properties in the city areas of Shanghai and Guangzhou that we estimate have a market value of HKD10bn.

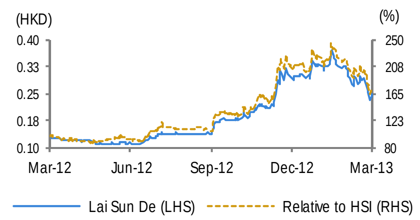
**Has been developing and completing new assets.** In addition, Lai Sun Development has been completing new assets, such as the CCB Building in Central. The company is scheduled to complete some 0.65m sq ft of properties in the coming 3-5 years. Meanwhile, Lai Fung Holdings is due to complete some 10m sq ft of residential property in the coming 3-5 years, as well as some 3.4m sq ft of commercial property.

**Balance sheet problem has been addressed.** As at July 2012, Lai Sun Development had net debt of HKD1.1bn compared with an equity base of HKD16.4bn (net gearing ratio of 7%). The combined gross rental income generated by the completed rental properties of Lai Sun Development and Lai Fung Holdings amounted to USD110m for FY12.

### ■ Valuation

The stock trades currently at a PBR of 0.29x on its reported book NAV of HKD0.815 as at July 2012. The market capitalisation is HKD4.9bn, while we estimate the value of its completed rental properties in Hong Kong at HKD14bn.

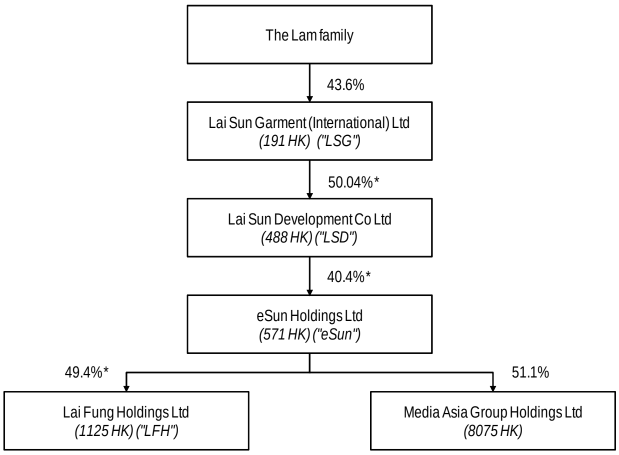
**Share price performance**




| | |
|---|---|
| 12-month range | 0.10-0.37 |
| Market cap (USDbn) | 0.63 |
| 3m avg daily turnover (USDm) | 3.79 |

*Source: FactSet, Daiwa*

## ■ Lai Sun group: structure




*Source: Company*

*Note: *Shareholding includes interests held by certain directors under the Takeovers Code. LSG's corporate interest in LSD is 49.97%; LSD's corporate interest in eSun is 39.93%; and eSun's corporate interest in LFH is 49.39%.*

## ■ Lai Sun group: development pipeline

| | % owned | Attributable GFA (sq ft, approx.) | Remarks |
|---|---|---|---|
| Lai Sun Development - HK | | | |
| Ocean One | 100% | 110,000 | Completed and sale in progress |
| 335-339 Tai Hang Rd | 100% | 30,000 | Expected to complete in 2013 |
| Lai Fung - PRC | | | |
| Shanghai May Flower Plaza | 95% | 480,000 | Completed and sale in progress, approx 344,000 sq ft of GFA remaining |
| Eastern Place V | 100% | 320,000 | Completion residential 2013/2014 |
| Dolce Vita I (JV with CapitaLand) | 47.5% | 526,000 | Phase I completion in 2H12, approx 2.7m sq ft of project GFA remaining |
| Palm Spring I | 100% | 969,000 | Phase I completion in 2H12, approx 4.5m sq ft of project GFA remaining |
| King's Park | 100% | 99,000 | Completion in 2013 |
| Guan Lu Road project | 100% | 144,000 | Completion in 2014 |
| | | 2,684,000 | |

*Source: Company*

## ■ Lai Sun group: properties in Hong Kong

| GFA by type (as at 31 Jul 2012) | Comm. / Retail (sq ft) | Office (sq ft) | Industrial (sq ft) | Residential (sq ft) | Total (sq ft) | Attri. no. of car parks |
|---|---|---|---|---|---|---|
| Lai Sun Garment | | | | | | |
| Investment properties | 98,000 | - | 174,000 | - | 272,000 | 39 |
| Lai Sun Development | | | | | | |
| Investment properties | 434,000 | 738,000 | 11,000 | - | 1,183,000 | 943 |
| Properties under development | 111,000 | 115,000 | - | 135,000 | 361,000 | 61 |
| Properties held for sale | 13,000 | - | - | 3,000 | 16,000 | 13 |
| | 558,000 | 853,000 | 11,000 | 138,000 | 1,560,000 | 1,017 |

*Source: Company*

*Note: this table excludes GFA held by Lai Fung Holdings Ltd*

## ■ Lai Sun group: properties in PRC

| GFA by type (as at 31 Jul 2012) | Comm. / retail (sq ft) | Office (sq ft) | Serviced apartments (sq ft) | Residential (sq ft) | Total (sq ft) | Attri. no. of Car parks |
|---|---|---|---|---|---|---|
| Lai Fung | | | | | | |
| Investment properties | 1,432,000 | 548,000 | 368,000 | 7,000 | 2,355,000 | 537 |
| Properties under development | 1,190,000 | 1,706,000 | 484,000 | 6,692,000 | 10,072,000 | 6,723 |
| Properties held for sale | 186,000 | 9,000 | 290,000 | 819,000 | 1,304,000 | 964 |
| | 2,808,000 | 2,263,000 | 1,142,000 | 7,518,000 | 13,731,000 | 8,224 |

*Source: Company*

## ■ Lai Sun Development: breakdown of rental turnover by major investment property

| Year to 31 July | 2011 (HKDm) | 2012 (HKDm) | Change (%) | Occupancy (%) |
|---|---|---|---|---|
| Cheung Sha Wan Plaza (including car parks) | 198.2 | 212.7 | 7.3 | 99.4 |
| Causeway Bay Plaza 2 (office, retail and car parks) | 113.9 | 120.8 | 6.1 | 95.4 |
| Lai Sun Commercial Centre (including car parks) | 42.4 | 48.0 | 13.2 | 98.2 |
| Other | 13.0 | 14.3 | 10.0 | n.a. |
| | 367.5 | 395.8 | 7.7 | |

*Source: Company*

## ■ Development landbank of the Lai Sun group

| GFA by type (as at 31 Jul 2012) | Comm. / Retail (m sq ft) | Office (m sq ft) | Serviced apartments (m sq ft) | Residential (m sq ft) | Total (m sq ft) | Attri. no. of car parks |
|---|---|---|---|---|---|---|
| Lai Sun Development | | | | | | |
| Properties under development | 0.11 | 0.12 | - | 0.42 | 0.65 | 61 |
| Completed properties held for sale / lease | 0.01 | - | - | 0.00 | 0.02 | 13 |
| | 0.12 | 0.12 | - | 0.42 | 0.66 | 74 |
| Lai Fung | | | | | | |
| Properties under development | 1.19 | 1.71 | 0.48 | 6.69 | 10.07 | 6,877 |
| Completed properties held for sale / lease | 0.19 | 0.01 | 0.29 | 0.82 | 1.30 | 1,691 |
| | 1.38 | 1.72 | 0.77 | 7.51 | 11.38 | 8,568 |

*Source: Company, Daiwa*

The 10-second briefing

# Lifestyle

1212 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **17.52**

# Expanding its Hong Kong retail franchise into Mainland China

■ Not Rated

- Proven record of managing retail property assets in Hong Kong and Mainland China
- Pipeline of retail property assets in Mainland China could make Lifestyle an important player in the field
- It could also be viewed as a retail property company

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## ■ Background

Lifestyle's origins go back to the Lau brothers' acquisition of the building and operations of Sogo HK in the early 2000s, when the Sogo group faced financial difficulties. The acquisition was done via a 50:50 joint venture between the Lau brothers and Y.T. Cheng of the New World Group.

We see the group's IPO in April 2004 as an attempt by its major shareholders to quickly recoup their investment and to build a platform upon which to establish a retail and property business in China. In hindsight, one could question whether Lifestyle has fully utilised the capital market, as Sogo HK has been a growing cash cow and the dividends paid out by Lifestyle since its IPO have exceeded the IPO's proceeds, on our estimates. Still, in terms of its business operation, we believe that Lifestyle has come a long way — from being essentially a single-store company to one with a sizeable retail property footprint in many cities in Mainland China.

## ■ Highlights

**One of the best-managed retail assets in Hong Kong.** We see Sogo HK as one of the best-managed retail property assets in Hong Kong, especially considering the physical limitations it faces on account of its location. We think that Sogo HK's partnership-style ties with retailers are conducive to the building up of retail sales and hence the property value of the store that it owns. This property management expertise could be seen as one of Lifestyle's key competitive advantages.

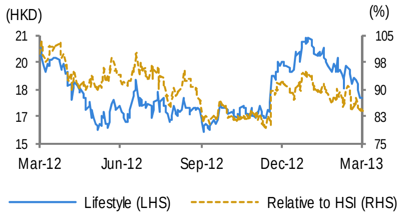
*Track record of building up retail property assets in China.* We estimate that Lifestyle's retail sales in Shanghai have expanded by more than 3x since 2005, the first full year of operation, to some CNY2.6bn in 2011. This looks to be a solid performance against a backdrop of abundant supply of retail property space. Meanwhile, the group's Suzhou store looks on track to achieve positive EBIT in 2013, five years after opening in 2009. In sum, the group appears to have a solid record of executing retail property projects in Mainland China.

*Sizeable retail property portfolio in China.* Lifestyle now has a pipeline of retail property assets in Mainland China. It appears to be on track to roll out some 0.13m sq m of retail property assets in Shenyang and 0.27m sq m in Shanghai, which would boost the size of its retail property portfolio in China to 0.75m sq m by 2016, we estimate.

## ■ Valuation

The stock is trading at a PBR of 2.8x on its reported December 2012 BVPS of HKD6.29, compared with an average PBR multiple of 4.5x since listing in 2004. We note that its BVPS reflects Sogo HK at less than HKD3bn (based on acquisition cost minus depreciation), while we estimate Sogo HK's market value is well over HKD25bn.

**Share price performance**




| | |
|---|---|
| 12-month range | 15.66-20.90 |
| Market cap (USDbn) | 3.76 |
| 3m avg daily turnover (USDm) | 2.66 |

*Source: FactSet, Daiwa*

## Lifestyle: EBITDA from Hong Kong and China stores

| | 2007 (HKDm) | 2008 (HKDm) | 2009 (HKDm) | 2010 (HKDm) | 2011 (HKDm) | 2012 (HKDm) |
|---|---|---|---|---|---|---|
| EBITDA | | | | | | |
| HK stores | 1,066 | 1,083 | 1,209 | 1,466 | 1,832 | 1,969 |
| Mainland stores | 136 | 199 | 265 | 326 | 430 | 474 |
| | 1,202 | 1,282 | 1,474 | 1,792 | 2,262 | 2,443 |
| | | | | | | |
| HK stores | 88.7% | 84.5% | 82.0% | 81.8% | 81.0% | 80.6% |
| Mainland stores | 11.3% | 15.5% | 18.0% | 18.2% | 19.0% | 19.4% |
| | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

*Source: Company*

## Lifestyle: retail portfolio in Hong Kong and China

| | GFA (sq m) | |
|---|---|---|
| Completed projects | | |
| Sogo CWB | 40,000 | 1985 |
| Sogo TST | 10,000 | 2005 |
| Shanghai Jiugunag | 90,000 | 2004 |
| Suzhou Jiuguang | 171,000 | 2009 |
| Dalian Jiuguang | 35,000 | 2009 |
| | 346,000 | |
| Under development | | |
| Shanghai Freshmart | 7,700 | 2013 |
| Shenyang Jiuguang | 132,000 | 2013 |
| Shanghai Zhabei | 270,000 | 2016 |
| | 755,700 | |

*Source: Company*

## Operating performance of Sogo CWB

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|
| Average daily traffic (persons) | 92,455 | 93,600 | 94700 | 92,500 | 90,900 | 92,900 | 92,500 | 90,600 |
| Stay and buy ratio (%) | 28.3% | 28.5% | 30.4% | 30.1% | 29.6% | 29.3% | 31.2% | 32.0% |
| No. of tickets | 26,165 | 26,676 | 28,789 | 27,843 | 26,906 | 27,220 | 28,860 | 28,992 |
| Average sales per ticket (HKD) | 396 | 436 | 483 | 530 | 565 | 636 | 743 | 790 |
| Sales per day (HKDm) | 10.4 | 11.6 | 13.9 | 14.8 | 15.2 | 17.3 | 21.4 | 22.9 |
| Total retail sales (HKDm) | 3,761 | 4,222 | 5,048 | 5,357 | 5,518 | 6,284 | 7,784 | 8,314 |
| Sales per sq ft (HKD/sq ft/mth) | 728 | 817 | 977 | 1,036 | 1,068 | 1,216 | 1,506 | 1,609 |
| Achieved commission rate (%) | | | | 23.1% | 22.9% | 22.9% | 22.6% | 22.7% |

*Source: Company*

## Operating performance of Shanghai Jiuguang

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|
| Average daily traffic (persons) | 32,496 | 39,600 | 45700 | 49,300 | 48,300 | 49,900 | 47,300 | 47,900 |
| Stay and buy ratio (%) | 34% | 34% | 36% | 38% | 41% | 43% | 43% | 42.0% |
| No. of tickets | 11,049 | 13,464 | 16,452 | 18,734 | 19,803 | 21,457 | 20,339 | 20,118 |
| Average sales per ticket (CNY) | 215 | 230 | 261 | 269 | 285 | 310 | 356 | 351 |
| Sales per day (CNYm) | 2.4 | 3.1 | 4.3 | 5.0 | 5.6 | 6.7 | 7.2 | 7.1 |
| No. of working days | 363 | 363 | 363 | 363 | 363 | 363 | 363 | 363 |
| Total retail sales (CNYm) | 862 | 1,124 | 1,559 | 1,829 | 2,049 | 2,415 | 2,628 | 2,563 |
| Achieved commission rate (%) | | | | 21.0% | 21.4% | 21.8% | 22.3% | 22.6% |

*Source: Company*

## Operating performance of Suzhou Jiuguang

| | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|
| Average daily traffic (persons) | 10,800 | 12,200 | 14,200 | 17,200 |
| Stay and buy ratio (%) | 33.0% | 39.0% | 42.0% | 41.0% |
| No. of tickets | 3,564 | 4,758 | 5,964 | 7,052 |
| Average sales per ticket (CNY) | 320 | 281 | 332 | 342 |
| Sales per day (CNYm) | 1.1 | 1.3 | 2.0 | 2.4 |
| No. of working days | 348 | 363 | 363 | 363 |
| Total retail sales (CNYm) | 397 | 485 | 719 | 875 |

*Source: Company*

## Operating performance of Dalian Jiuguang

| | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|
| Average daily traffic (persons) | 4,000 | 5,300 | 5,800 | 5,200 |
| Stay and buy ratio (%) | 21.0% | 33.0% | 32.0% | 31.0% |
| No. of tickets | 840 | 1,749 | 1,856 | 1,612 |
| Average sales per ticket (CNY) | 253 | 211 | 248 | 270 |
| Sales per day (CNYm) | 0.2 | 0.4 | 0.5 | 0.4 |
| No. of working days | 219 | 363 | 363 | 363 |
| Total retail sales (CNYm) | 47 | 134 | 167 | 158 |

*Source: Company*

# New World Development
17 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **13.04**

## Embarking on a comeback

- Present corporate structure is a result of previous focus on diversification
- Over the past few years, it has sought to refocus on Hong Kong property
- Sits on a considerable landbank and owns prime assets, as well as some 18.7m sq ft of agricultural land

■ Not Rated

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### ■ Background

Listed in 1972, New World Development (New World) is one of the most well-established property companies in Hong Kong. Compared with its peers, New World is more diversified and, over the years, has engaged in a wide range of businesses, including telecoms, infrastructure, department stores, and transportation.

### ■ Highlights

*Diversification strategy has led to the present corporate structure.* Over the past two decades, New World has undergone significant restructuring and undertaken a number of spin-offs. Currently, the group comprises four main listed entities: New World Development, New World China Land (Not rated), NWS Holdings (Not rated), and New World Department Store China (Not rated). The three spun-off entities are engaged in different businesses.

*Refocusing on Hong Kong property.* We note that in recent years, the company has tried to become more focused, especially on rebuilding its presence in the Hong Kong property sector.

Although the company's market position has diminished compared with the past, we believe it is still a force to be reckoned with, if only because it owns some prime property assets in Hong Kong (its 3m-sq-ft New World Centre redevelopment project in Tsimshatsui is one of the largest integrated property projects in the urban area currently) and owns some 18.7m sq ft of agricultural land in Hong Kong.

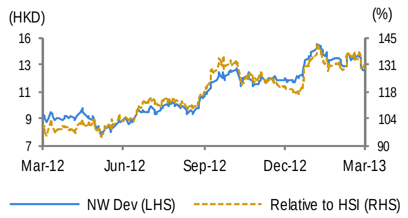
*Development landbank of 6.2m sq ft in Hong Kong.* New World has a development landbank in Hong Kong of about 6.2m sq ft, of which some 1.7m sq ft is in urban areas and the remainder in the New Territories. In addition, the company has secured a development landbank of 3.7m sq ft GFA as a result of converting agricultural land over 2007-11. Meanwhile, through New World China Land, the company also has a sizeable development landbank in China, which we estimate has an attributable GFA of 20.6m sq ft.

*Owns some 2m sq ft of completed rental properties and has 3.2m sq ft of rental properties under development,* of which some 3m sq ft is from its New World Centre redevelopment project in Tsimshatsui. In addition, the company has 16 hotels, with 7,235 rooms in Hong Kong, the Mainland, and Southeast Asia.

### ■ Valuation

The stock is trading currently at a PBR of 0.61x on its end-Dec 2012 book value of HKD21.49, compared with an average of 0.70x since 1990. Based on the current share prices of its listed companies, New World's listed assets have a market value of HKD59bn, which represents HKD9.4 in its share price.

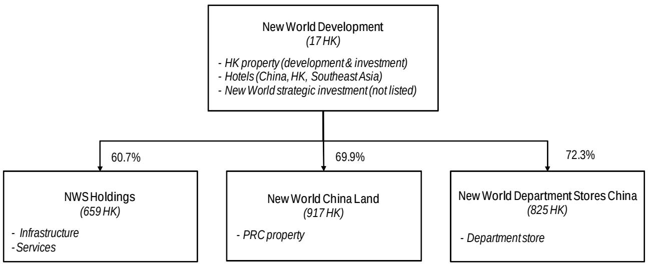
**Share price performance**




| | |
|---|---|
| 12-month range | 7.98-15.06 |
| Market cap (USDbn) | 10.52 |
| 3m avg daily turnover (USDm) | 37.63 |

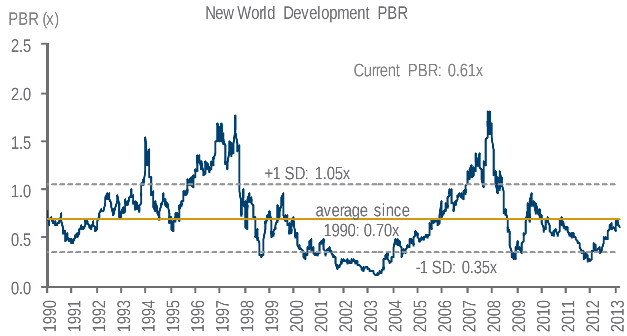
*Source: FactSet, Daiwa*

## New World group: corporate structure




Source: Company

## New World Development: PBR




Source: Datastream, Bloomberg, Daiwa

## New World: development landbank in Hong Kong

| | Attributable GFA (sq ft) |
|---|---|
| HK Island | |
| North Point | 229,320 |
| Tin Hau | 337,064 |
| happy Valley | 56,417 |
| Mid Levels | 26,334 |
| Western | 41,134 |
| | 690,269 |
| Kowloon | |
| West Kowloon | 641,083 |
| Yau Tong | 346,038 |
| Hunghom | 36,679 |
| | 1,023,800 |
| New Territories | |
| Yuen Long | 1,844,922 |
| Tuen Mun | 83,651 |
| Shatin | 966,520 |
| Ma On Shan | 944,211 |
| Sai Kung | 603,990 |
| | 4,443,294 |
| Total | 6,157,363 |

Source: Company, Daiwa

## New World: major investment properties

| | Location | Attributable GFA (sq ft) |
|---|---|---|
| Completed properties | | |
| New World Tower | Central | 640,135 |
| Manning House | Central | 110,040 |
| Pearl City | Causeway Bay | 46,158 |
| K11 | Tsimshatsui | 264,552 |
| Sogo | Tsimshatsui | 141,439 |
| Telford Plaza | Kowloon Bay | 335,960 |
| Discovery Park Shopping Centre | Tsuen Wan | 466,400 |
| The Edge | Tseung Kwan O | 16,974 |
| | | 2,021,658 |
| Under development | | |
| New World Centre redevelopment | Tsimshatsui | 2,951,285 |
| Pentahotel | San Po Kong | 285,601 |
| | | 3,236,886 |

Source: Company, Daiwa

## New World: distribution of agricultural land

| | Year of conversion | Attributable GFA (sq ft) |
|---|---|---|
| Tai Po Tsai project | 2011 | 1,078,553 |
| Hung Shui Kiu project | 2010 | 79,664 |
| Tai Tong Road project - The Reach | 2010 | 272,558 |
| Lok Wo Sha project - Double Cove | 2009 | 944,211 |
| Lung Tin Tsuen project - Park Signature | 2008 | 1,098,463 |
| Tai Tao Tsuen project - The Woodsville | 2007 | 228,993 |
| | | 3,702,442 |

Source: Company, Daiwa

## New World: record in agricultural land conversion

| Location | Attributable land area (sq ft) |
|---|---|
| Yuen Long | 12,913,500 |
| Fanling | 2,386,000 |
| Sha Tin/ Tai Po | 2,162,000 |
| Sai Kung | 1,100,000 |
| Tuen Mun | 120,000 |
| | 18,681,500 |

Source: Company, Daiwa

The 10-second briefing

## Swire Properties
1972 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **27.55**

# A premier asset manager

- Swire has a distinctive business model focused on nurturing property assets in what it sees as strategic locations
- The two locations on which it has focused – Admiralty and Island East – look well placed in the coming years
- Mainland China businesses are starting to bear fruit. Valuations appear reasonable relative to premier names in global property

■ Not Rated

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### ■ Background

Swire Properties (Swire) has a strategy of focusing its investments in key areas where it foresees long-term strategic value. Its intention is to transform these locations over time. Following its disposal of Festival Walk in 2011, Swire has focused on two key areas in Hong Kong in terms of commercial properties: Pacific Place in Admiralty, and Island East.

### ■ Highlights

*Pacific Place on track to become an integral part of the Greater Central area.* Our view is that the Central area will continue to expand, such that Pacific Place will no longer be considered as "fringe Central". Indeed, office rents at Pacific Place have already surpassed those for Citibank Plaza and many buildings in Central. Our view is that the position of Pacific Place will strengthen further in the coming years. First, Swire has been actively seeking to expand its Pacific Place portfolio into Southern Wanchai, and has a stream of new projects to be completed in the coming years. In our view, this process should be reinforced by several new developments in Wanchai, such as Hopewell Centre II and the Lee Tung Street redevelopment.

In addition, Admiralty is now planned to serve as the terminal station for both the Shatin-Central Link and the Southern Line extension, making it the intersection for four MTR lines. We believe this should underline the importance of Admiralty as an area for commercial properties. In our view, Greater Central could ultimately encompass parts of Southern Wanchai, with Pacific Place serving as an important component.

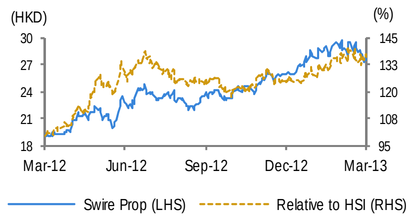
*Island East portfolio looks on track to become a major Grade-A office area for multinationals.* We believe the prime buildings in the four core office areas outside Central – Wanchai, Causeway Bay, Island East and Tsimshatsui – are very well-positioned in the coming years. We especially like Island East as an office location, and it will host more new office developments in the coming years, all from Swire.

*Mainland China investments bearing fruit.* Swire's investments in Mainland China have finally started to bear fruit, as evidenced by a surge in gross rental income from Beijing and Guangzhou. We expect the surge in its rental income to continue on positive rental reversion and estimate completion of 3.1m sq ft of new properties in Chengdu and Shanghai over 2014-18.

### ■ Valuation

Trading at a PBR of 0.84x (based on its reported December 2012 BVPS of HKD32.93) and a 23% discount to our estimated current NAV of HKD35.80, the stock is not very cheap as a property stock in Hong Kong. However, its asset quality is one of the best among peers and it is not uncommon for the world's premier property companies to trade at close to NAV or above it.

**Share price performance**




| | |
|---|---|
| 12-month range | 19.02-29.35 |
| Market cap (USDbn) | 20.77 |
| 3m avg daily turnover (USDm) | 12.42 |

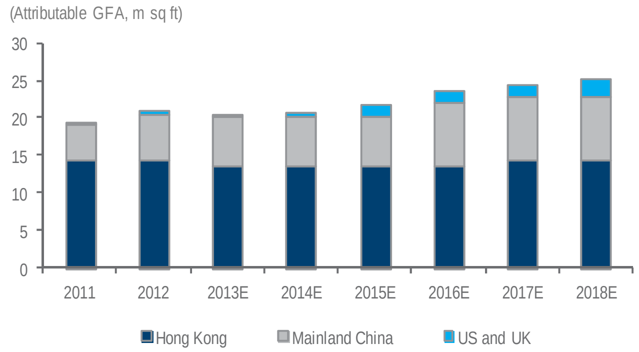
*Source: FactSet, Daiwa*

## ■ Swire Properties: investment-property portfolio (in m sq ft)

| (Attributable GFA) | Office | Retail | Hotel | Residential | Total |
|---|---|---|---|---|---|
| Completed investment properties | | | | | |
| Hong Kong | 10.6 | 2.4 | 0.7 | 0.6 | 14.3 |
| Mainland China | 2.0 | 3.0 | 0.9 | 0.1 | 6.0 |
| US and others | 0.0 | 0.0 | 0.5 | 0.0 | 0.5 |
| Sub-total | 12.6 | 5.4 | 2.1 | 0.7 | 20.8 |
| Investment properties under development | | | | | |
| Hong Kong | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 |
| Mainland China* | 0.9 | 1.1 | 0.4 | 0.0 | 2.4 |
| USA | 1.0 | 0.5 | 0.2 | 0.1 | 1.8 |
| Sub-total | 1.9 | 1.6 | 0.6 | 0.2 | 4.3 |
| | | | | | |
| Total | 14.5 | 7.0 | 2.7 | 0.9 | 25.1 |

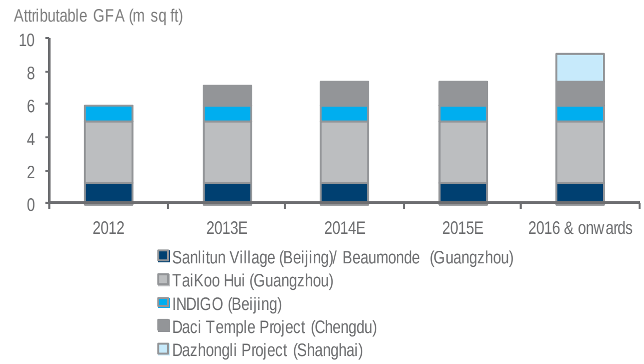
*Source: Company*
*Note: As at 31 December 2012*
*Note: Excluding GFA of car parks. *Excluding office floor space in Daci Temple project that is intended for trading purposes.*

## ■ Swire: expected attributable GFA of completed investment properties



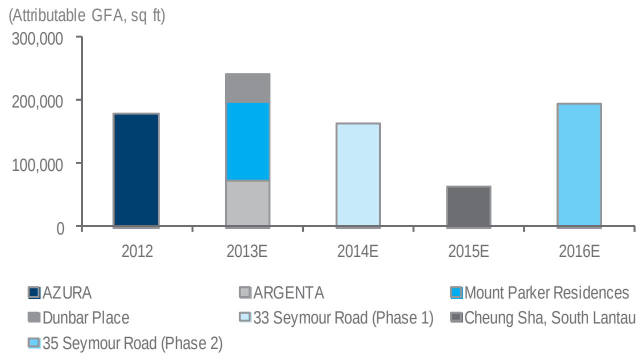

*Source: Company*
*Note: As at 31 December 2012*
*Note: E – Swire projection*

## ■ Swire: expected attributable GFA of completed property portfolio in China




*Source: Company*
*Note: As at 31 December 2012*
*E – Swire guidance*

## ■ Swire: expected residential GFA completions in Hong Kong from 2012-16




*Source: Company*
*Note: As at 31 December 2012*
*E – Swire guidance*

## ■ Swire: breakdown of gross rental income

| | 2011 (HKDm) | 2012 (HKDm) | YoY change |
|---|---|---|---|
| Gross rental income | | | |
| Office | 4,537 | 5,008 | 10.4% |
| Retail | 3,066 | 3,675 | 19.9% |
| Residential | 310 | 332 | 7.1% |
| Festival Walk | 644 | - | n.a. |
| Total | 8,557 | 9,015 | 5.4% |
| Gross rental income | | | |
| Hong Kong | 7,122 | 7,626 | 7.1% |
| China | 782 | 1,373 | 75.6% |
| Festival Walk | 644 | - | n.a. |
| Others | 9 | 16 | 77.8% |
| Total | 8,557 | 9,015 | 5.4% |

*Source: Company, Daiwa*

## ■ Swire: NAV breakdown

| | HKDm | HKD/share |
|---|---|---|
| Pacific Place and its Wanchai extension | | |
| - Office | 62,501 | 10.7 |
| - Retail | 18,779 | 3.2 |
| - Hotel | 2,352 | 0.4 |
| Island East | | - |
| - Office | 96,688 | 16.5 |
| - Retail | 14,148 | 2.4 |
| - Hotel | 1,380 | 0.2 |
| China property assets | 28,030 | 4.8 |
| Development properties in HK | 8,648 | 1.5 |
| Other property assets in HK and overseas | 7,424 | 1.3 |
| Gross NAV | 239,950 | 41.0 |
| Net debt | (30,535) | (5.2) |
| NAV | 209,415 | 35.8 |

*Source: Company, Daiwa estimates*
*Note: NAV estimated as at 30 October 2012*

The 10-second briefing

# Wheelock & Company
20 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **38.20**

## Up-and-coming developer

- Has tried various businesses, and appears to have settled on property as its key area of competence
- Its stake in Wharf alone has a market value of HKD45.1/share
- Planning major new launches, such as at Austin Station in West Kowloon, due to come to market in the next 6-18 months

■ Not Rated

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### ■ Background

Established in 1857, Wheelock & Company (Wheelock) is one of Hong Kong's oldest conglomerates. It was acquired in the 1980s by Y.K. Pao's family and became the holding company for The Wharf (Holdings) (Wharf) (4 HK, HKD61.5, Buy [1]) after several rounds of restructuring.

**A diversified conglomerate.** Since the late 1980s, Wharf has focused on becoming a more actively managed conglomerate as opposed to being a passive investment-holding company. Wheelock tried to move in a similar direction in the early 1990s, by investing in a range of businesses, including retailing, beverages, investment banking and property.

**Property business the most successful.** Most of its efforts did not yield the desired results. Wheelock did well with its property-development business in the 1990s, but the onset of the Asia financial crisis in 1997, followed by a six-year downturn in Hong Kong's residential-property market, led to the company focusing on rebuilding its balance sheet: it halted new investments and used the proceeds from property sales to retire debt. Wheelock has not pursued major investments independently since the late 1990s, after it sold its major property projects, such as the Sorrento and Bellagio.

### ■ Highlights

**Overseas progress**. Wheelock appears to have fared better outside its home market, with Wheelock Properties becoming a recognised niche player in Singapore's luxury residential-property segment. Wheelock owns 75.8% of Wheelock Properties (Singapore), its vehicle for expanding into Singapore and potentially other ASEAN countries.

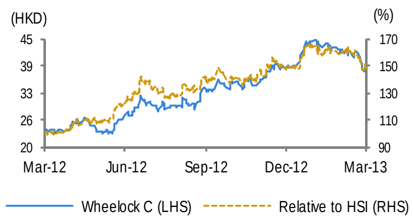
**Medium-sized developer in the making.** Wheelock has been building up its landbank for the past few years and now has more than 3.5m sq ft in attributable GFA, on top of 1.4m sq ft of attributable GFA as part of Wharf's Hong Kong landbank. With about 5m sq ft in attributable landbank, and 0.4m sq ft in rental property, Wheelock appears to be an up-and-coming medium-sized developer.

**New launches due in the next few months.** The company will launch some major new developments in the next 6-18 months (ie, a luxury residential project at Austin Station, West Kowloon).

### ■ Valuation

Based on Wharf's current share price of HKD61.5, Wheelock's 50% stake is worth HKD93.1bn, or HKD45.8/share – more than its current share price of HKD38.2. Wheelock is trading at a PBR of 0.57x on its June 2012 reported BVPS of HK67.12, compared with a past-12-year average PBR of 0.6x.

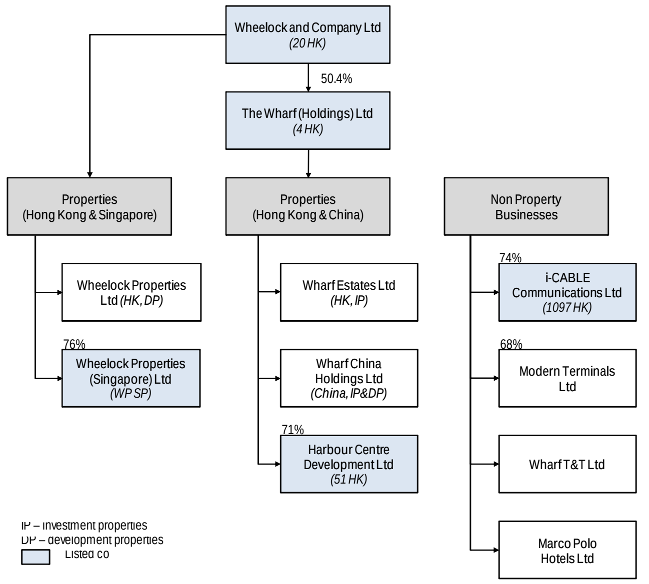
**Share price performance**




| | |
|---|---|
| 12-month range | 23.15-44.85 |
| Market cap (USDbn) | 10.00 |
| 3m avg daily turnover (USDm) | 9.25 |

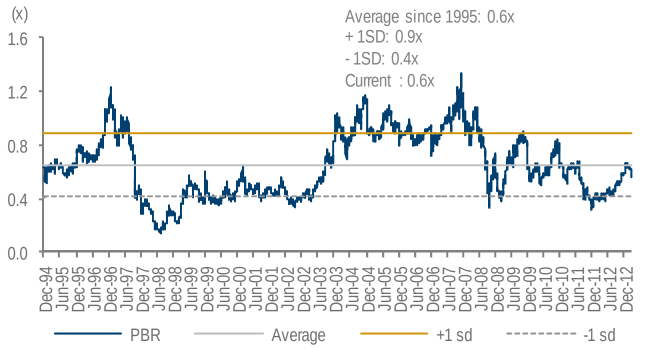
*Source: FactSet, Daiwa*

## ■ Wheelock: corporate structure




*Source: Company, Daiwa*

## ■ Wheelock: PBR




*Source: Datastream, Bloomberg, Daiwa*

## ■ Wheelock: development landbank

| | Area | Usage | Stake (%) | Attr. GFA (sq ft) |
|---|---|---|---|---|
| Development properties | | | | |
| Austin Station | West Kowloon | R | 50% | 641,000 |
| Kadoorie Hill | Ho Man Tin | R | 100% | 91,700 |
| Lexington Hill | Western | R | 100% | 103,000 |
| Junction of Wai Yip St & Hoi Bun Rd | Kwun Tong | O | 100% | 914,897 |
| Junction of Hung Luen Rd & Kin Wan St | Hung Hom | O | 100% | 589,996 |
| Tseung Kwan O Area 66B2 | Tseung Kwan O | R | 100% | 489,011 |
| Tseung Kwan O Area 68A1 | Tseung Kwan O | R | 100% | 429,731 |
| Junction of So Kwun Wat Road & Kwun Chui Rd | Tuen Mun | R | 100% | 376,891 |
| Others | | R | 100% | 158,000 |
| | | | | 3,794,226 |
| Investment properties | | | | |
| Wheelock House | Central | O | 100% | 199,300 |
| Crawford House | Central | O | 100% | 191,400 |
| One Island South | Island South | S | 100% | 90,500 |
| | | | | 481,200 |
| Total | | | | 4,275,426 |

*Source: Company, Daiwa*
*Note: O = offices, R = residential, S = shops*

## ■ Wheelock: land acquisitions in recent years

| | Area | Usage | Stake (%) | Attr. GFA (sq ft) | Land cost (HKDm) | Purchase date |
|---|---|---|---|---|---|---|
| Development properties | | | | | | |
| Austin Station | West Kowloon | R | 50% | 641,000 | 5,854 | Mar 10 |
| Kadoorie Hill | Ho Man Tin | R | 100% | 91,700 | 803 | May 11 |
| Lexington Hill | Western | R | 100% | 103,000 | 340 | May 11 |
| Junction of Wai Yip St & Hoi Bun Rd | Kwun Tong | O | 100% | 914,897 | 3,528 | 11 Jul 11 |
| Junction of Hung Luen Rd & Kin Wan St | Hung Hom | O | 100% | 589,996 | 4,028 | 4 Aug 11 |
| Tseung Kwan O Area 66B2 | Tseung Kwan O | R | 100% | 489,011 | 1,860 | 12 Jan 12 |
| Tseung Kwan O Area 68A1 | Tseung Kwan O | R | 100% | 429,731 | 1,968 | 13 Dec 12 |
| Junction of So Kwun Wat Road & Kwun Chui Rd | Tuen Mun | R | 100% | 376,891 | 1,388 | 30 Jan 13 |
| Others | | R | 100% | 158,000 | 858 | |
| | | | | 3,794,226 | 20,626 | |
| Investment properties | | | | | | |
| Wheelock House | Central | O | 100% | 199,300 | | |
| Crawford House | Central | O | 100% | 191,400 | | |
| One Island South | Island South | S | 100% | 90,500 | | |
| | | | | 481,200 | | |
| Total | | | | 4,275,426 | | |

*Source: Company, Daiwa*

## ■ Wheelock Properties (Singapore): landbank (as at March 2013)

| Projects | Usage | GFA ('000 sq ft) |
|---|---|---|
| Investment properties | | |
| Wheelock Place | O/S | 465 |
| Scotts Square | S | 131 |
| | | 596 |
| Development properties | | |
| Ardmore Three | R | 149 |
| Hangzhou Fuyang Shijiayuan | R | 3,853 |
| | | 4,002 |
| Total | | 4,598 |

*Source: Company, Daiwa*
*Note: O = offices, R = residential, S = shops*

## ■ Wheelock: NAV estimate (as at March 2013)

| | (HKDm) | (HKD/share) |
|---|---|---|
| 51% stake in Wharf | 97,415 | 47.9 |
| 75.8% stake in Wheelock Properties (Singapore) | 11,284 | 5.6 |
| Investment properties | 9,768 | 4.8 |
| Development properties | 26,671 | 13.1 |
| Other assets | - | - |
| Gross NAV | 145,137 | 71.4 |
| Net debt | (17,100) | (8.4) |
| NAV | 128,037 | 63.0 |

*Source: Daiwa*

The 10-second briefing

# Wing Tai Properties

369 HK

Target (HKD): **n.a.**
Up/downside: -
19 Mar price (HKD): **5.46**

# An emerging force in Hong Kong property

■ Not Rated

- Wing Tai has built up a development pipeline over many years
- Proceeds from property assets should help fund further landbanking
- Trading at a PBR of 0.54x based on its latest reported BVPS relative to the 17-year average of 0.5x

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## ■ Background

Wing Tai Properties (formerly USI Holdings), which has been listed on the Hong Kong Stock Exchange since November 1991, shifted its focus to the property business (from the garment industry) in the late 1990s. It is now 50.7%-owned by Wing Tai Holdings and the Cheng family in Singapore, while SHK Properties is its second-largest shareholder with a 13.7% stake.

At present, Wing Tai has three main divisions: property development, property investment and hospitality. Despite being a relative newcomer to the Hong Kong property industry, Wing Tai has entered into joint ventures with major property companies such as Nan Fung, Hongkong Land and Sino Land. We think it has acquired a reputation for the design of its projects, and has developed several well-regarded projects in Hong Kong, such as Forfar (Kowloon), The Giverny (Sai Kung), and Seymour (Midlevels).

## ■ Highlights

*Has finally built up a development pipeline.* Like most other niche developers, Wing Tai started out with one or two projects, but has now passed through this stage, having built up a development landbank in Hong Kong with a total GFA of 2.5m sq ft, of which 0.6m sq ft is attributable to it.

The company has a stream of projects due for completion in the next few years, including three in the Pak Shek Kok area (Shatin) in 2013-14, The Shanghai Luijiazui in 2013, The Warren (Causeway Bay) and The Pierre (Central) in 2014, and the Ko Shan Road and Kau To Shan sites (Hung Hom) in 2015-16. Proceeds from the sale of these projects should help the group to fund further land acquisitions.

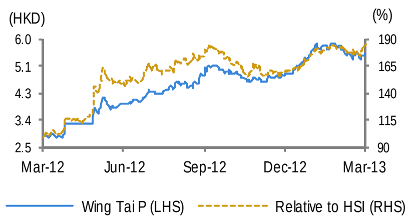
*Two major past deals have significantly strengthened its potential.* The first landmark deal for Wing Tai was its general offer for Winsor Properties shares in 2007 (funded by an offer of 2.825 new shares of USI for every Winsor share), which gave it instant access to Winsor's landbank and almost tripled the size of its balance sheet.

The second deal was the restructuring of Winsor Properties' assets in 2012, which gave it 100% ownership of many of Winsor's property assets, one of the most important of which was the Landmark East, a prime grade-A office building in Kowloon East.

## ■ Valuation

Wing Tai is trading currently at a PBR of 0.54x based on its latest reported BVPS of HKD10.1, versus its average PBR of 0.5x since 1995.

**Share price performance**




| | |
|---|---|
| 12-month range | 2.82-5.84 |
| Market cap (USDbn) | 0.94 |
| 3m avg daily turnover (USDm) | 0.12 |

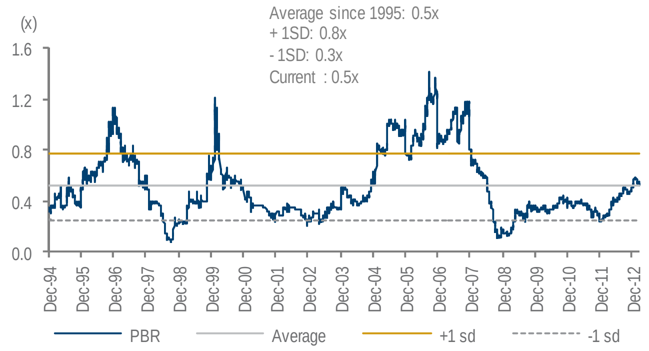
*Source: FactSet, Daiwa*

■ **Wing Tai Properties: financial summary**

| (HKDm) | 2007 | 2008 | 2009 | 2010 | 2011 | 1H11 | 1H12 |
|---|---|---|---|---|---|---|---|
| Revenue | 2,210 | 1,665 | 1,207 | 2,177 | 2,735 | 922 | 653 |
| Profit before taxation | 2,849 | 340 | 483 | 2,485 | 2,871 | 1,815 | 301 |
| Taxation | (94) | (45) | (57) | (48) | (135) | (56) | (48) |
| Discontinued operations | 0 | 0 | 0 | 0 | 0 | (25) | 253 |
| Non-controlling interests | (272) | (82) | (113) | (524) | (523) | (371) | (54) |
| Net profit | 2,483 | 213 | 313 | 1,913 | 2,240 | 1,363 | 452 |
| | | | | | | | |
| Change in fair value of investment properties | n.a | 542 | 364 | 1,895 | 2,108 | 1,491 | 60 |
| . | | | | | | | |
| Total assets | 14,835 | 15,796 | 16,985 | 18,866 | 21,837 | 21,296 | 22,752 |
| Total liabilities | (5,273) | (6,024) | (6,152) | (5,595) | (6,454) | (6,711) | (6,834) |
| Non-controlling interests | (1,639) | (1,711) | (1,828) | (2,343) | (2,435) | (2,324) | (2,483) |
| Shareholders' equity | 7,923 | 8,061 | 9,005 | 10,928 | 12,948 | 12,261 | 13,435 |

*Source: Company, Bloomberg*

■ **Wing Tai Properties: PBR trend**




*Source: Company, Bloomberg*

■ **Wing Tai Properties: corporate milestones**

| Date | Events | Remarks |
|---|---|---|
| Nov-91 | Listed on the Hong Kong Stock Exchange | |
| Mar-96 | Won the bid to develop the Waterfront at Kowloon Station | The first attempt to enter into the Hong Kong residential property industry |
| May-96 | Lanson Place Singapore and Kuala Lumpur commenced operations | Lanson Place started becoming a division within the group |
| Dec-03 | Acquired 133 Leighton Road and later renovated, refurbished and relaunched it as Lanson Place Hotel | Lanson Place began its business in Hong Kong |
| Oct-04 | Launched The Grandville for pre-sale in Hong Kong | Started the building of its brand name in luxury residential developments |
| Jul-05 | Acquired the site in 314-324 Hennessy Road | First attempt to upgrade commercial property projects and later market it as W Square |
| Oct-05 | Launched the first phase of The Giverny | Becoming a developer of high-end residential properties in Hong Kong |
| Apr-07 | Entered into JVs with Nan Fung, Sino Land and K Wah to develop 3 sites in the Pak Shek Kok area | Became a joint-venture partner of Nan Fung (Not listed) and other listed developers |
| | Proposed a general offer of Winsor Properties which has resulted in it becoming a subsidiary of Wing Tai (2.825 new shares of USI for every one Winsor share) | The transaction significantly strengthened the group's asset and recurrent income base |
| Oct-07 | Formed a 50/50 JV with Hong Kong Land to develop a comprehensive property project in Shenyang, China | Becoming a business partner of major property companies |
| Sep-008 | Completed the development of Landmark East | Landmark East is considered a landmark in Kowloon East. |
| Nov-09 | Launched the Seymour for pre-sale | The Seymour achieved premium pricing |
| Dec-09 | Raised HKD550m via a 1-for-3 rights issue (330m shares at HKD1.70/share) | Has been building up its equity and asset base. |
| Jun-10 | Changed its name to Wing Tai Properties Limited | Officially established itself as part of the Wing Tai Group, with the main focus being the property business |
| Dec-10 | Formed a JV with Nan Fung to acquire a residential site in Ko Shan Road, Hunghom via a land auction | Nan Fung became an important business partner for Wing Tai Properties |
| Apr-12 | Disposed of the entire equity interest in Gieves & Hawkes Group | Streamlined its operation significantly. |
| May-Jun 12 | Underwent series of transactions to bring Winsor's rental properties under its umbrella and to streamline its corporate structure | Arguably, the 'second chapter' of its acquisition of Winsor Properties. |

*Source: Company, compiled by Daiwa*

■ **Wing Tai Properties: landbank structure**

| | GFA (sq ft) | Stake (%) | Attr. GFA (m sq ft) | Office (m sq ft) | Retail (m sq ft) | Resid. (m sq ft) | Industrial (m sq ft) | Hotels/serviced apts. (m sq ft) | Total (m sq ft) |
|---|---|---|---|---|---|---|---|---|---|
| Hong Kong investment properties | | | | | | | | | |
| Landmark East | 1,335,823 | 100% | 1,335,823 | 1,335,823 | - | - | - | - | 1,335,823 |
| W Square | 128,658 | 100% | 128,658 | 98,658 | 30,000 | - | - | - | 128,658 |
| Shui Hing Centre | 186,827 | 100% | 186,827 | - | - | - | 186,827 | - | 186,827 |
| Winner Godown Building | 497,140 | 100% | 497,140 | - | - | - | 497,140 | - | 497,140 |
| Lanson Place, Causeway Bay | 114,097 | 100% | 114,097 | - | - | - | - | 114,097 | 114,097 |
| | | | | 1,434,481 | 30,000 | - | 683,967 | 114,097 | 2,262,545 |
| Hong Kong development properties | | | | | | | | | |
| Seymour Road project | 103,800 | 30% | 31,140 | | | 31,140 | | | 31,140 |
| No. 1 Coronation. The Pierre | 40,000 | 100% | 40,000 | | | 40,000 | | | 40,000 |
| The Warren | 73,000 | 100% | 73,000 | | | 73,000 | | | 73,000 |
| Tai Po Town Lot 186, Providence Peak | 714,000 | 15% | 107,100 | | | 107,100 | | | 107,100 |
| Tai Po Town Lot 187, The Graces | 345,000 | 15% | 51,750 | | | 51,750 | | | 51,750 |
| Tai Po Town Lot 188. Providence Bay | 750,000 | 15% | 112,500 | | | 112,500 | | | 112,500 |
| Ko Shan Road project | 160,000 | 50% | 80,000 | | | 80,000 | | | 80,000 |
| Kau To Shan project | 318,000 | 35% | 111,300 | | | 111,300 | | | 111,300 |
| | | | | | | 606,790 | | | 606,790 |
| China property assets | | | | | | | | | |
| Lanson Place Central Park Residences, Beijing | 66,352 | 100% | 66,352 | | | | | 66,352 | 66,352 |
| Lanson Place Jinlin Tiandi Residences, Shanghai | 37,651 | 100% | 37,651 | | | | | 55,648 | 55,648 |
| Lujiazui project, Shanghai | 204,592 | 50% | 102,296 | | | 102,296 | | | 102,296 |
| | | | | - | - | 102,296 | - | 122,000 | 224,296 |
| Property assets in Hong Kong and China | | | | 1,434,481 | 30,000 | 709,086 | 683,967 | 236,097 | 3,093,631 |

*Source: Company*

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"1": the security could outperform the local index by more than 15% over the next six months.
"2": the security is expected to outperform the local index by 5-15% over the next six months.
"3": the security is expected to perform within 5% of the local index (better or worse) over the next six months.
"4": the security is expected to underperform the local index by 5-15% over the next six months.
"5": the security could underperform the local index by more than 15% over the next six months.

**Additional information may be available upon request.**

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- In addition to the purchase price of a financial instrument, we will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction.
- In some cases, we may also charge a maximum of ¥ 2 million (including tax) per year as a standing proxy fee for our deposit of your securities, if you are a non-resident of Japan.
- For derivative and margin transactions etc., we may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by us.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.
  *The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with us.

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| | Financial instruments firm: chief of Kanto Local Finance Bureau (Kin-sho) No.108 |
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