

# Wharf (Holdings) (4 HK)

## Overweight

Target price (HKD)	64.50
Share price (HKD)	52.50
Forecast dividend yield (%)	3.4
Potential return (%)	26.3

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Dec	2014a	2015e	2016e
HSBC EPS	3.46	3.99	4.42
HSBC PE	15.2	13.2	11.9
Performance	1M	3M	12M
Absolute (%)	-12.4	-4.9	5.3
Relative* (%)	-9.2	-8.1	-4.8

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## OW: Cautious guidance for 2015

- **2014 results slightly below our forecast**
- **We lower our earnings forecasts amid cautious company guidance and expect flat retail rents in 2015**
- **Cut TP to HKD64.5 (from HKD68.5) but reiterate Overweight, as stock is trading at almost 40% discount to NAV**

**2014 results slightly below forecast.** Reported net profit of HKD35.9bn (up 22% versus 2013) was mainly due to investment property revaluation gains. Recurring net profit came in at HKD10.5bn, down 3%, 6% below our forecast and 10% below consensus. Hong Kong investment property profits were higher than we expected although this was more than offset by weak China development property profits. Other divisions had smaller profit contributions, with China investment properties lower than our forecast while Logistics was better than we expected. DPS was at HKD1.81, up 6% on a higher payout ratio.

**Cautious guidance.** Management believes that China development properties will continue to face headwinds and that margins will stay weak in the medium term, with 2015e contract sales similar to 2014 levels. Wharf's three Hong Kong malls – Harbour City (HC), Times Square (TS), and Plaza Hollywood – had a 6% retail sales y-o-y decline in January (with HC and TS registering 5% and 10% y-o-y declines respectively) and 3% retail sales y-o-y growth in February. Management appears cautiously optimistic in its guidance of single-digit retail sales growth and 30-50% rental reversion in 2015 due to promotional efforts and tenant mix management. Management indicated that there is still strong interest from potential tenants for Hong Kong retail mall space, which should support rents.

**Lower assumptions and earnings.** We cut our Hong Kong retail rent assumptions, and now project flat retail rents for HC and TS in 2015, which implicitly assumes a 5% retail sales decline and 30% rental reversion. We also lower our China investment properties and development properties earnings forecasts on the worse than expected results. We lower 2015e/2016e recurring earnings by 8%/10% and introduce 2017e earnings.

**Reiterate OW.** We use a SoTP valuation and lower our NAV to HKD86 (from HKD91.4) to reflect the weaker results and cautious guidance. We continue to apply a 25% NAV discount to arrive at our TP of HKD64.5 (from HKD68.5). The stock is trading at almost a 40% discount to NAV, with a 26% potential return, including 2015e dividends. The key **downside risks** to our view are (i) higher USD interest rates; and (ii) a drastic slowdown in Eastern and Western China property markets, where Wharf's assets are located.

*Index	Hang Seng Index
Index level	23,823
RIC	0004.HK
Bloomberg	4 HK

Source: HSBC

Enterprise value (HKDm)	162,116
Free float (%)	45
Market cap (USDm)	20,481
Market cap (HKDm)	159,129

Source: HSBC

## Financials & valuation

### Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
<b>Profit &amp; loss summary (HKDm)</b>				
Revenue	38,136	40,811	43,513	48,891
EBITDA	15,356	16,239	17,211	18,892
Depreciation & amortisation	-1,787	-1,828	-1,871	-1,914
Operating profit/EBIT	13,569	14,410	15,340	16,978
Net interest	-986	-1,308	-1,169	-1,162
PBT	40,154	15,989	17,645	20,033
HSBC PBT	13,834	15,989	17,645	20,033
Taxation	-3,730	-3,209	-3,530	-4,006
Net profit	35,930	12,094	13,379	15,232
HSBC net profit	10,474	12,094	13,379	15,232

### Cash flow summary (HKDm)

Cash flow from operations	11,393	11,850	12,672	13,962
Capex	-43,454	16,772	-1,399	-1,403
Cash flow from investment	-47,444	17,559	-5,467	-5,689
Dividends	5,301	5,631	5,635	6,299
Change in net debt	1,187	-19,731	-1,033	2,336
FCF equity	-32,814	28,494	11,112	12,320

### Balance sheet summary (HKDm)

Intangible fixed assets	305	305	305	305
Tangible fixed assets	326,917	308,317	307,845	307,335
Current assets	70,450	96,233	98,619	87,577
Cash & others	18,725	38,456	39,489	37,153
Total assets	444,658	453,940	463,396	460,346
Operating liabilities	40,752	38,963	39,940	27,162
Gross debt	77,984	77,984	77,984	77,984
Net debt	59,259	39,528	38,495	40,831
Shareholders' funds	305,495	315,808	323,552	332,486
Invested capital	338,195	327,435	327,340	330,902

### Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
<b>Y-o-y % change</b>				
Revenue	19.6	7.0	6.6	12.4
EBITDA	8.5	5.7	6.0	9.8
Operating profit	8.3	6.2	6.5	10.7
PBT	22.3	-60.2	10.4	13.5
HSBC EPS	-2.5	15.5	10.6	13.9

### Ratios (%)

Revenue/IC (x)	0.1	0.1	0.1	0.1
ROIC	3.8	3.5	3.7	4.1
ROE	3.6	3.9	4.2	4.6
ROA	8.7	3.1	3.3	3.7
EBITDA margin	40.3	39.8	39.6	38.6
Operating profit margin	35.6	35.3	35.3	34.7
EBITDA/net interest (x)	15.6	12.4	14.7	16.3
Net debt/equity	18.9	12.2	11.5	11.9
Net debt/EBITDA (x)	3.9	2.4	2.2	2.2
CF from operations/net debt	19.2	30.0	32.9	34.2

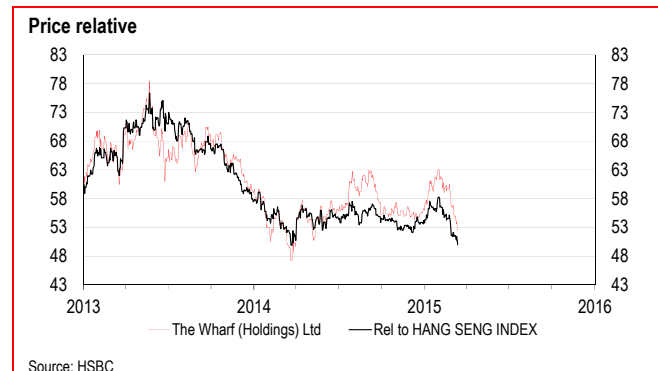
### Per share data (HKD)

EPS reported (diluted)	11.86	3.99	4.42	5.03
HSBC EPS (diluted)	3.46	3.99	4.42	5.03
DPS	1.81	1.80	1.99	2.26
Book value	100.84	104.25	106.80	109.75

### Valuation data

Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	5.1	4.0	3.5	3.0
EV/EBITDA	12.8	10.0	9.0	7.9
EV/IC	0.6	0.5	0.5	0.4
PE*	16.2	13.2	11.9	10.4
PB	0.5	0.5	0.5	0.5
FCF yield (%)	16.9	0.5	4.2	0.0
Dividend yield (%)	3.4	3.4	3.8	4.3

\*Based on HSBC EPS (diluted)



Note: Priced at close of 13 March 2015

With this report, we introduce our 12/2017 forecasts

## 2014 results slightly missed our forecast

### 1. Wharf 2014 results versus 2013

HKDm	2014	2013	Change	HSBC 2014e	Diff	HSBC comments
HK Inv Prop	9,905	8,507	16%	9,605	3%	
HK Dev Prop	93	68	37%	94	na	
Hotels	387	377	3%	390	-1%	
China Inv Prop	991	761	30%	1,084	-9%	Higher contribution especially from Chengdu IFS and Wheelock Square
China Dev Prop	1,669	2,565	-35%	2,301	-27%	Revenue increased, but margins fell from 22% in 2013 to 11% in 2014
<b>Property EBIT</b>	<b>13,045</b>	<b>12,278</b>	<b>6%</b>	<b>13,475</b>	<b>-3%</b>	
Logistics	1,051	974	8%	1,000	5%	
CME/others	-527	-722	-27%	-643	-18%	Improved CME earnings and lower corporate expenses
<b>EBIT</b>	<b>13,569</b>	<b>12,531</b>	<b>8%</b>	<b>13,832</b>	<b>-2%</b>	
<b>EBIT ex prop dev</b>	<b>11,807</b>	<b>9,898</b>	<b>19%</b>	<b>11,437</b>	<b>3%</b>	
Net finance costs	-986	-1,058	-7%	-1,329	-26%	
<b>Associates/JCE</b>						
Properties	866	2,343	-63%	2,023	-57%	Delayed timing of recognition and weak market conditions
Logistics	385	373	3%	331	16%	
<b>Associates/JCE</b>	<b>1,251</b>	<b>2,716</b>	<b>-54%</b>	<b>2,354</b>	<b>-47%</b>	
Property revaluation	28,293	17,105	65%	6800	na	
Other exceptionals	-1,973	1,533	na	-337	na	Mainly provision of China Development Properties in 2014
<b>Pretax profit</b>	<b>40,154</b>	<b>32,827</b>	<b>22%</b>	<b>21,320</b>	<b>88%</b>	
<b>Pretax recurring</b>	<b>13,834</b>	<b>14,189</b>	<b>-3%</b>	<b>14,857</b>	<b>-7%</b>	
Tax	-3,730	-2,694	38%	-3,017	24%	
MI	-494	-752	-34%	-606	-19%	
<b>Net profit</b>	<b>35,930</b>	<b>29,381</b>	<b>22%</b>	<b>17,697</b>	<b>103%</b>	
<b>Recurring net profit</b>	<b>10,474</b>	<b>10,743*</b>	<b>-3%</b>	<b>11,157</b>	<b>-6%</b>	
EPS (HKD)	11.86	9.70	22%	5.84	103%	
Recurring EPS (HKD)	3.46	3.55*	-3%	3.68	-6%	
DPS (HKD)	1.81	1.70	6%	1.66	9%	Payout ratio raised from 48% in 2013 to 52% in 2014

\*In 2013, our recurring net profit estimate was HKD10.7bn (versus the HKD11.2bn stated by Wharf), as we believe there were some one-off accounting gains that Wharf treated as recurring  
Key: Inv Prop = Investment Properties, Dev Prop = Development Properties  
Source: Company data, HSBC estimates

## Earnings changes

We have lowered our Hong Kong investment properties earnings forecasts to reflect our more cautious retail rent assumptions and have lowered our margin projections for both China investment properties and China development properties in line with the higher-than-expected costs involved in both segments. This is partially negated by the better-than-expected Logistics results. We cut 2015e/2016e earnings by 8%/10% and introduce 2017 earnings forecasts in this note. We are 9%/10% below consensus for 2015e/2016e respectively potentially due to our peers' higher HK retail sales forecast at Wharf's malls and higher expectation of development property sales.

### 2. Changes to HSBC net profit forecasts

HKDm	New			Old			Change		
	2015e	2016e	2017e	2015e	2016e	2017e	2015e	2016e	2017e
HK Inv Prop	7,037	7,080	7,495	7,139	7,539	na	-1%	-6%	na
China Inv Prop	911	1,074	1,257	1,087	1,203	na	-16%	-11%	na
Hotels	289	303	320	293	309	na	-1%	-2%	na
China Dev Prop	3,483	4,267	5,424	4,258	5,258	na	-18%	-19%	na
<b>Property</b>	<b>11,719</b>	<b>12,723</b>	<b>14,496</b>	<b>12,777</b>	<b>14,310</b>	<b>na</b>	<b>-8%</b>	<b>-11%</b>	<b>na</b>
Logistics	691	738	774	639	680	na	8%	9%	na
Other	-317	-83	-38	-224	-123	na	na	na	na
<b>Recurring NP</b>	<b>12,094</b>	<b>13,379</b>	<b>15,232</b>	<b>13,192</b>	<b>14,867</b>	<b>na</b>	<b>-8%</b>	<b>-10%</b>	<b>na</b>

Key: Inv Prop = Investment Properties, Dev Prop = Development Properties  
Source: HSBC estimates

## Maintain Overweight; valuations attractive despite our lowered target price

We use a sum-of-the-parts valuation and lower our NAV estimate to HKD86 per share (from HKD91.4) mainly on our more cautious assumptions for Hong Kong Investment Properties, and we have cut our China investment and development property valuations given the lower-than-expected results in these segments. We continue to apply a 25% discount to our NAV to arrive at our new target price of HKD64.5 (old: HKD68.5). Under our research model, the Neutral band for non-volatile stocks equals a local market hurdle rate (8.5% for Hong Kong), plus or minus 5ppt. Our target price, including 2015e dividend yield, implies a 26% potential return, above the Neutral band; we therefore reiterate our Overweight rating on the shares. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

The key **downside risks** to our rating and estimates are (i) a rise in USD interest rates; (ii) a drastic slowdown in the Eastern and Western China development property markets, where Wharf's assets are located.

### 3. HSBC appraised value

HKDm	EV	Net debt	Equity	HKD/ share	Equity portion	Pre-disc 2016 PE	Post-disc 2016 PE**	Assumptions
HK inv prop	200,015	-3,950	196,065	64.7	75%	26.6	19.9	Cap rate of 5% (net), OT at 21 year lease less land premium at 6.5% WACC
China inv prop	44,499	-17,841	26,658	8.8	10%	24.8	18.6	Cap rates of 7.5% (net)
<b>Total investment</b>	<b>244,514</b>	<b>-21,791</b>	<b>222,723</b>	<b>73.5</b>	<b>86%</b>	<b>26.3</b>	<b>19.8</b>	
Development prop*	38,105	-14,597	23,508	7.8	9%	6.2	4.6	DCF and cost
<b>Total property</b>	<b>282,619</b>	<b>-36,389</b>	<b>246,231</b>	<b>81.3</b>	<b>95%</b>	<b>20.1</b>	<b>15.0</b>	
MTL/logistics	13,235	-3,119	10,116	3.3	4%	13.7	10.3	EV/EBITDA of 9.5x
Equity stakes	5,874	0	5,874	1.9	2%	13.2	9.9	Greentown and Sino Ocean stakes at CMP
Other	-1,768	0	-1,768	-0.6	-1%	21.3	16.0	CME at 4x EV/EBITDA, HO cost at 10x PE
<b>Total</b>	<b>299,960</b>	<b>-39,508</b>	<b>260,453</b>	<b>86.0</b>	<b>100%</b>	<b>19.5</b>	<b>14.6</b>	

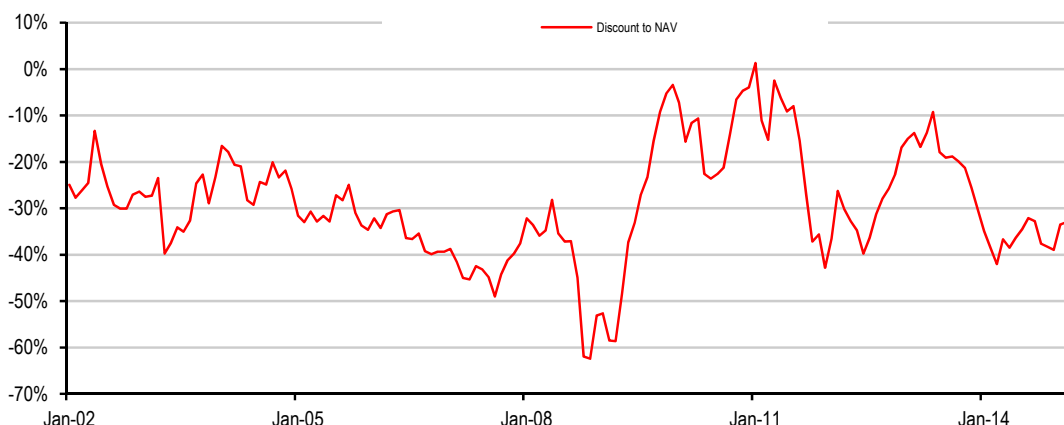
\*Includes Property Under Development

\*\*Given the vast majority of Wharf's value is from properties, it's arguably a pure-play company and we thus use post-discount PE in our analysis, in line with other property companies

Key: Inv = Investment, Prop = Property, MTL = Modern Terminals Limited

Source: HSBC estimates

### 4. Discount to NAV chart of Wharf



Source: Thomson Reuters Datastream, Company data, HSBC estimates

# Disclosure appendix

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Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in target price). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

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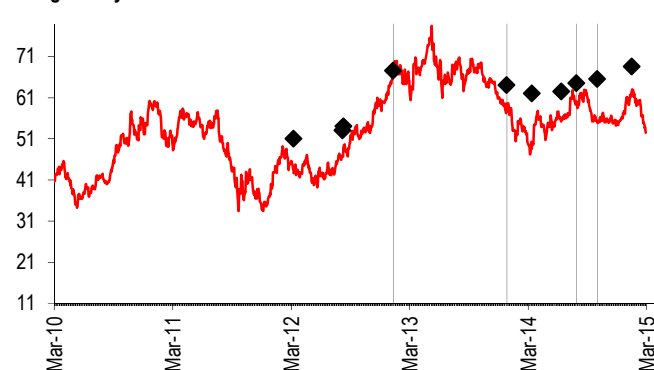
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Overweight (Buy)	41%	(30% of these provided with Investment Banking Services)
Neutral (Hold)	40%	(28% of these provided with Investment Banking Services)
Underweight (Sell)	19%	(20% of these provided with Investment Banking Services)

## Share price and rating changes for long-term investment opportunities

The Wharf (Holdings) Ltd (0004.HK) share price performance HKD vs HSBC rating history



Source: HSBC

Recommendation & target price history

From	To	Date
Overweight	Neutral	23 January 2013
Neutral	Overweight	8 January 2014
Overweight	Neutral	11 August 2014
Neutral	Overweight	14 October 2014
Target price	Value	Date
Price 1	51.00	22 March 2012
Price 2	53.00	20 August 2012
Price 3	54.00	23 August 2012
Price 4	67.50	23 January 2013
Price 5	64.00	8 January 2014
Price 6	62.00	27 March 2014
Price 7	62.50	26 June 2014
Price 8	64.50	11 August 2014
Price 9	65.50	14 October 2014
Price 10	68.50	29 January 2015

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

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Source: HSBC

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