

JPM-pp1

Asia Pacific Equity Research

16 March 2015

# The Wharf (Holdings) Limited (4 HK)

Neutral

Price: HK\$52.50

13 Mar 2015

Price Target: HK\$60.00

PT End Date: 31 Dec 2015

## Disappointing FY14 results on China DP

Wharf reported lower-than-expected FY14 core profit of HK\$10.5 bn, down 7% Y/Y compared with consensus estimate of HK\$11.7 bn and our estimate of HK\$11.6 bn. Earnings drop was mainly attributable to decline in profit from China development property ("DP"). Operating profit margin of China DP compressed to 11% in FY14 (FY13: 22%) and a provision of HK\$1.8 bn was recorded against China DP. On HK investment properties ("IP"), though retail sales of Harbour City ("HC") and Times Square ("TS") outperformed the market in 2014, the growth is weakening. We expect the share price to react negatively to the results.

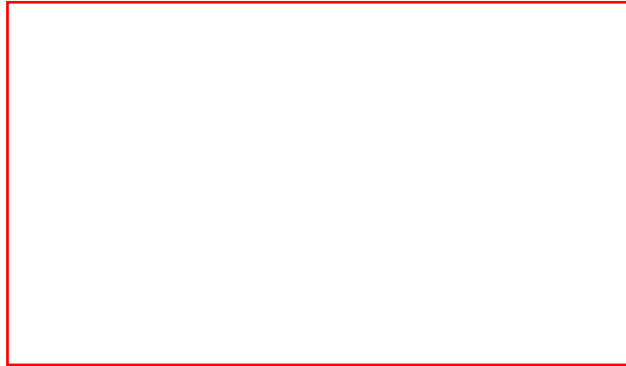
- IP growth insufficient to offset weakness in China DP:** Overall IP operating profit went up 17.6% Y/Y on increasing contribution from HC and TS in HK as well as contribution from Chengdu IFS after the mall opened in January 2014 (revenue of Rmb483 mn in FY14). However, IP income growth is insufficient to offset the disappointing China DP performance. Operating profit margin further contracted to 11% for full year FY14 from 16% in 1H14, implying a single digit margin in 2H14. In addition, a provision of HK\$1,812 mn was made for certain China DP projects (HK\$543 mn for Changzhou Marco Polo Hotel made in FY13). Including the provision and exceptional items but excluding revaluation IP gain, profit for FY14 was HK\$8,247 mn, a drop of 32%. Despite earnings decline, full year DPS increased 6.5% to HK\$1.81.

Figure 1: China DP operating margin

Figure 2: China DP contracted sales



Source: Company, J.P. Morgan estimates.



Source: Company.

- Deploying capital to a weakening business:** Since December 2014, Wharf has re-entered into the China residential market and acquired sites in Hangzhou and Beijing. The declining profit margin and provision indicated that China DP operating environment is still challenging. We expect margin for this year will still be under pressure given there is still unrecognized contracted sales of Rmb22 bn at end of 2014. Also, contracted sales are unlikely to have meaningful growth this year. If Wharf acquires the 50% stake of Greentown China (3900 HK) in Sunac-Greentown JV as mentioned by Bloomberg earlier, the risk will be further increased.

- Turnover rent marginally corrected in 2014:** HC and TS delivered revenue growth of 14% and 21% respectively in 2014, to HK\$8.1 bn and HK\$2.5 bn respectively. TS has stronger growth mainly due to major renovation completed in 2H13. Retail sales of HC and TS went up 3.4% and 11% respectively in 2014, outperforming the overall market contraction of 0.2%. However, retail sales growth of the two malls slowed down in the last few months of 2014. Turnover rent, which depends on tenants sales, has marginally corrected by 1.6% Y/Y to HK\$2,036 mn. Given the change in mainland shoppers spending pattern and the weakening currencies in areas like Europe, Japan and Korea, we expect the performance of the two malls to weaken this year and there are also downside risks in turnover rent portion.

Figure 3: Harbour City and Times Square - YTD retail sales growth slowing down



Source: Company.

Figure 4: Turnover rent as % of HK retail rental



Source: Company, J.P. Morgan estimates.

Table 1: Wharf FY14 results summary

HK\$ million, year-end December								
HK\$million, year-end December	FY13	1H14	2H14	FY14	Y/Y Chg (%)	H/H Chg (%)	FY14E	Var (%)
Property Development	2,633	933	829	1,762	(33)	(11)	2,513	(30)
Property Rental	9,268	5,322	5,574	10,896	18	5	10,411	5
Hotel Management	404	189	198	387	(4)	5	573	(33)
Logistics	974	517	534	1,051	8	3	1,090	(4)
i-CABLE	(88)	(19)	(121)	(140)	59	537	(145)	(3)
Telecom	300	162	189	351	17	17	227	55
Investment and others	723	380	334	714	(1)	(12)	713	0
Unallocated expenses	(934)	(360)	(378)	(738)	(21)	5	(981)	(25)
Other income	277	(148)	(1,595)	(1,743)	(729)	978	-	n/m
Total EBIT	13,557	6,976	5,564	12,540	(8)	(20)	14,401	(13)
Interest expenses	(552)	(1,076)	(854)	(1,930)	250	(21)	(1,974)	(2)
Total Operating Profit	13,005	5,900	4,710	10,610	(18)	(20)	12,427	(15)
Associates / JCEs	2,716	514	737	1,251	(54)	43	2,161	(42)
Profit before tax	15,721	6,414	5,447	11,861	(25)	(15)	14,588	(19)
Tax expenses	(2,763)	(1,397)	(1,723)	(3,120)	13	23	(2,386)	31
Minority Interests	(752)	(208)	(286)	(494)	(34)	38	(592)	(17)
Underlying profit	12,206	4,809	3,438	8,247	(32)	(29)	11,610	(29)
Exceptional Items	908	(210)	(2,017)	(2,227)	(345)	860		
Underlying Net Profit ex Prop reval and one-off items	11,298	5,019	5,455	10,474	(7)	9	11,610	(10)
Revaluation of Investment properties	17,174	6,892	20,791	27,683	61	202		
Reported net profit	29,380	11,701	24,229	35,930	22	107		
DPS (HK\$)	1.70	0.55	1.26	1.81			1.80	1
EPS ex reval and exceptional (HK\$)	3.73	1.66	1.80	3.46			3.83	(10)
EPS ex reval (HK\$)	4.03	1.59	1.13	2.72			3.83	(29)

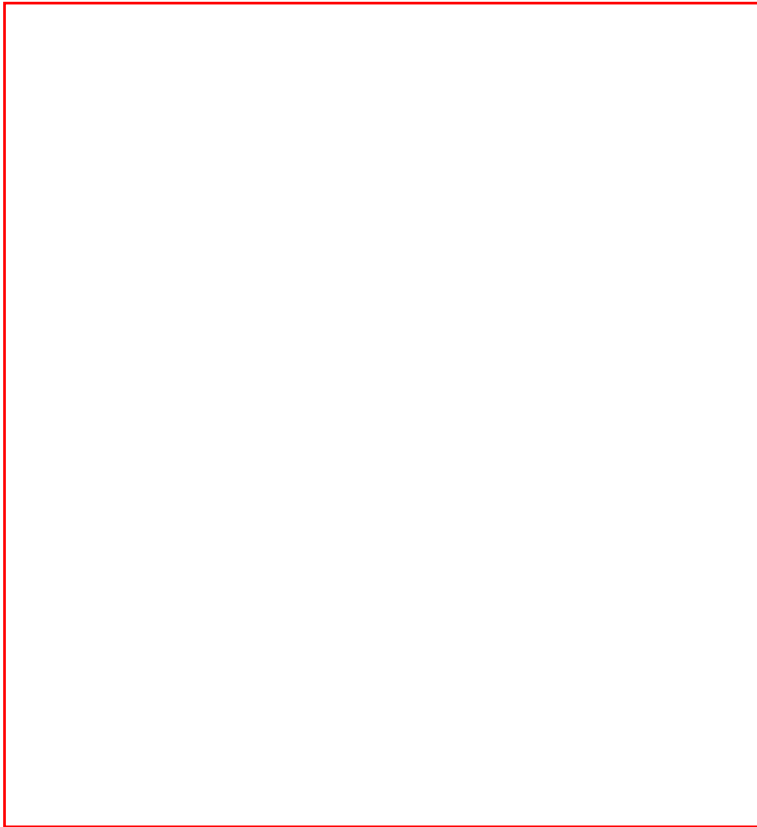
Source: Company data, J.P.I Morgan estimates.

Investment Thesis

Given the challenging operation environment of China development property (“DP”), Wharf plans to cease new investment in China DP and to shift focus to investment properties (IP). Given that HK turnover rent is at risk and the key China IP Chengdu IFS is already opened, we expect rental income growth to slow down in the next 2-3 years.

Valuation

Our Dec-15 price target of HK\$60 is based on a 37% discount, 0.5 SD below the long-term average, to our Dec-15 NAV estimate.



Source: J.P. Morgan estimates

### Risks to Rating and Price Target

Upside risks to our rating and price target include better-than-expected retail sales growth at Harbour City and Times Square as well as higher-than-expected China property development margin.

Downside risks include lower-than-expected rents and sales progress, delays in China properties completion and rise in interest rate.

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### Property

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
20-Mar-07	N	26.30	29.30
16-Aug-07	N	28.80	31.00
29-Nov-07	OW	37.12	49.00
26-Mar-08	N	37.75	39.16
28-Aug-08	UW	28.50	34.75
18-Nov-08	UW	16.30	19.00
15-Dec-08	UW	19.34	21.60
26-Mar-09	N	20.40	21.60
26-May-09	N	28.80	30.50
12-Aug-09	N	34.10	36.44
27-Aug-09	N	33.70	37.84
01-Dec-09	N	41.80	48.12
12-May-10	N	39.05	--
19-Nov-10	OW	54.80	65.50
24-Mar-11	OW	51.20	58.50
26-Aug-11	OW	48.10	56.60
07-Oct-11	N	36.25	33.20
16-Feb-12	N	47.60	43.50
05-Jun-12	OW	39.80	51.50
11-Jun-12	N	44.00	40.60
24-Aug-12	N	48.90	48.00
17-Jan-13	N	64.85	58.40
27-Mar-13	N	62.95	65.40
03-Jun-13	OW	68.90	80.00
22-Jul-13	OW	64.15	75.20
26-Nov-13	N	64.95	66.00
28-Mar-14	N	50.05	55.00
24-Jul-14	N	61.00	59.00
12-Aug-14	N	59.35	61.50
30-Oct-14	N	56.00	60.00

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