

# Wharf Holdings

## 4 HK

 Target (HKD): **78.40 → 78.40**

 Upside: **54.5%**

 16 Mar price (HKD): **50.75**

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

## Weak sentiment an opportunity

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- Rental income and other businesses have held up well
- Property sales profit could have seen its worst
- Book value of Harbour City alone is HKD55.5/share; Buy (1) rating reaffirmed

### ■ What's new

Wharf's underlying net profit for 2014 fell 7% YoY to HKD10,474m, or 25% YoY to HKD8,476m if a HKD2bn provision on China property assets is included. Despite the decline in earnings, Wharf's DPS is up 6.5% YoY to HKD1.81. We continue to view Wharf as a solid asset play, with various businesses showing promise.

### ■ What's the impact

*Likely hit to sentiment in near term.* Investor sentiment on Wharf is likely to be affected by the 55% YoY drop in its China property sales profit as a result of margin contraction (from 23% in 2013 to 11% in 2014) and the surprise HKD2bn provision. Factoring in slower and smaller profit contributions from China property sales, we revise down 2015-16 EPS by 8.7-13.5%.

### *Other businesses held up well.*

Wharf's gross rental income rose by 20% YoY (16% YoY from Hong Kong and 58% YoY from China). After

several years of profit declines, the port business looks to have turned the corner, with 7.9% YoY growth in operating profit to HKD1,051m.

*Hong Kong retail environment is a challenge, but China rental income should be taking off.* Gross rental income from Harbour City and Times Square rose by 16% YoY and 21% YoY, respectively, but occupancy costs at both malls don't seem stretched, at 16.2% and 17.9%, respectively. Meanwhile, we believe the group should soon enter the harvesting period for its investment properties (IP) projects in China.

Despite the challenges faced by shopping malls in China, Wharf's Chengdu IDS has been ramping up fast, with its retail sales at end-2014 being 4x greater than at the start of the year. The addition of new IPs in China, together with continued rises in achieved rents for its offices (helped by the migration of office space into retail or semi-retail usage), should underpin sustained growth in Wharf's IP businesses, in our view.

*Property development could be past its worst.* Some 30% of Wharf's 2014 recognised GFA came from projects in Changzhou, which has been a particularly tough market for property sales. However, we believe Wharf should start seeing Hong Kong property sales profits again from 2015 onward (from Mount Nicholson and redevelopment projects in East Kowloon, etc).

### ■ What we recommend

Wharf's BVPS reached HKD100.80 at end-2014, with the book value of Harbour City (including hotels) alone totalling HKD168bn, or HKD55.5/share. As such, we would see any post-results pullback in the

share price as a sound opportunity to accumulate the shares. We affirm our Buy (1) call and 12-month target price of HKD78.40, based on a 30% discount applied to our end-2015E NAV of HKD112/share. The main risk: major deterioration in the Hong Kong and Chinese economies.

### ■ How we differ

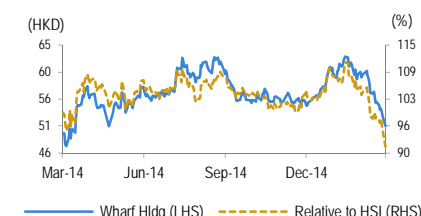
Unlike some in the market, we believe Wharf's other businesses have shown signs of improvement and we think 2014 could have marked the worst for its China property sales.

### Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
Revenue change	(0.3)	(0.9)	n.a.
Net profit change	(8.7)	(13.5)	n.a.
Core EPS (FD) change	(8.7)	(13.5)	n.a.

Source: Daiwa forecasts

### Share price performance

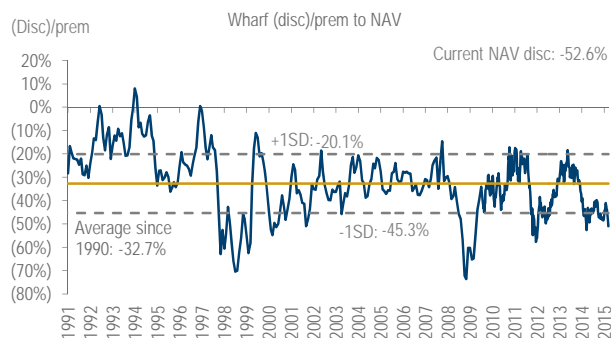


12-month range	47.20-63.00
Market cap (USDbn)	19.79
3m avg daily turnover (USDm)	29.56
Shares outstanding (m)	3,030
Major shareholder	Wheelock and Company (54.8%)

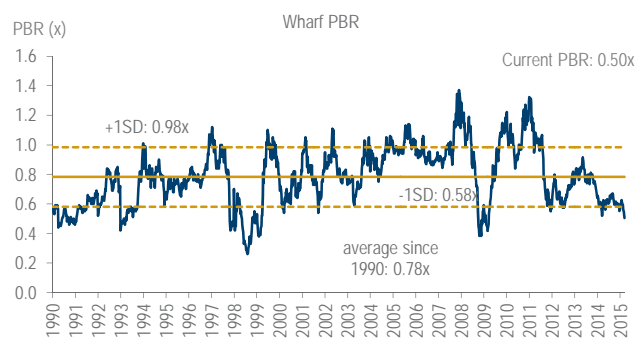
### Financial summary (HKD)

Year to 31 Dec	15E	16E	17E
Revenue (m)	38,652	41,331	46,855
Operating profit (m)	16,307	17,977	20,066
Net profit (m)	12,260	13,760	15,510
Core EPS (fully-diluted)	4.046	4.541	5.119
EPS change (%)	44.6	12.2	12.7
Daiwa vs Cons. EPS (%)	(4.6)	(3.7)	10.9
PER (x)	12.5	11.2	9.9
Dividend yield (%)	3.7	3.9	4.1
DPS	1.900	2.000	2.100
PBR (x)	0.5	0.5	0.5
EV/EBITDA (x)	9.8	8.6	7.3
ROE (%)	4.0	4.4	4.8

Source: FactSet, Daiwa forecasts

**■ Wharf: price-to-NAV multiple trend**


Source: Datastream, Daiwa estimates

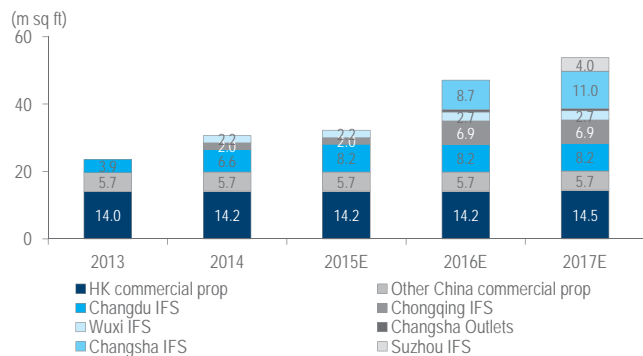
**■ Wharf: PBR trend**


Source: Datastream, Daiwa estimates

**■ Wharf: 2014 results highlights**

(HKDm)	2013	2014	YoY chg
<b>Turnover</b>	<b>31,887</b>	<b>38,136</b>	<b>19.6%</b>
<b>Operating profit</b>			
Rental income - HK	8,507	9,905	16.4%
Rental income - China	761	991	30.2%
Hotels	377	387	-4.2%
Property sales - HK	68	93	36.8%
Property sales - China	2,565	1,669	-34.9%
Logistic	974	1,051	7.9%
Communication, media & entertainment	212	211	-0.5%
Corporate overhead	(934)	(738)	-21.0%
Others	750	930	28.6%
	<b>13,280</b>	<b>14,499</b>	<b>9.2%</b>
Other gains/losses	0	(1,998)	nm
Interest expenses	(1,077)	(1,701)	57.9%
Share of profits from associates & joint cos.	2,716	1,251	-53.9%
<b>Profit before tax</b>	<b>14,919</b>	<b>12,051</b>	<b>-19.2%</b>
Tax (ex-deferred tax related to revaluation gain)	(2,869)	(3,081)	7.4%
Minority interests	(752)	(494)	-34.3%
<b>Underlying net profit</b>	<b>11,298</b>	<b>8,476</b>	<b>-25.0%</b>
DPS (HKD)	1.70	1.81	6.5%
<b>As of</b>	<b>31-Dec-13</b>	<b>31-Dec-14</b>	<b>YoY chg</b>
Net debt to total equity (%)	20.4%	18.9%	-1.5pp
Book value per share (HKD)	90.94	100.82	10.9%

Source: Company, Daiwa

**■ Wharf: commercial properties completion schedule (end-2014)**


Source: Company,

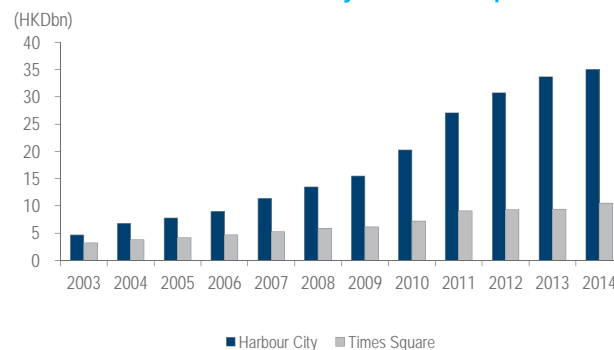
Note: E = company's estimate

**■ Wharf: YoY change in retail sales vs. HK retail sales**

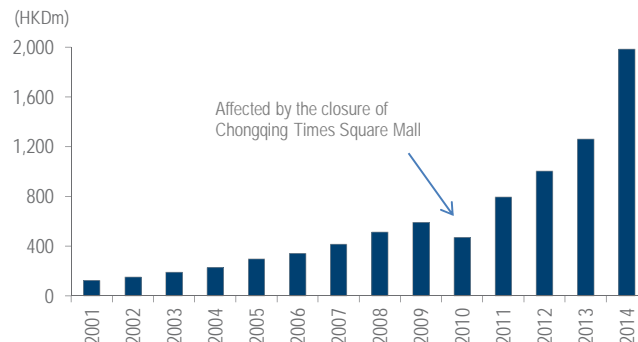
YoY chg	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	1H14
Harbour City	7.3%	8.3%	4.2%	6.5%	flat	1.6%	4.8%
Times Square	17.2%	20.9%	17.6%	17.2%	23.2%	14.5%	18.2%
HK retail sales	14.4%	-2.2%	-1.5%	-9.9%	-3.9%	-6.9%	-1.3%
YoY chg	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	2014
Harbour City	4.9%	6.7%	9.3%	0.1%	0.2%	nd	3.4%
Times Square	19.4%	20.1%	14.2%	2.7%	-5.7%	nd	11.1%
HK retail sales	-3.2%	3.5%	4.8%	1.4%	4.2%	-4.0%	-0.2%

Source: Company, Daiwa

Note: nd = not disclosed

**■ Wharf: retail sales in Harbour City and Times Square**


Source: Company, Daiwa

**■ Wharf: gross rental income from China**


Source: Company, Daiwa

## Financial summary

### ■ Key assumptions

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Gross rental income (HKDm)	7,513	9,941	9,880	11,133	13,397	14,384	15,163	16,492
Rental EBIT (HKDm)	6,214	7,320	8,187	9,268	10,896	11,960	12,706	13,791
China property sales profit (HKDm)	1,235	2,274	3,562	2,565	1,669	2,252	2,838	3,527
Size of completed investment properties in HK (m sq ft)	11.7	11.7	11.7	11.7	12.2	12.2	12.2	12.2

### ■ Profit and loss (HKDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Property sales	3,609	6,343	12,207	11,514	11,963	13,467	15,307	17,650
Rental income	7,513	6,552	7,229	11,133	9,941	9,880	11,133	12,467
Other Revenue	8,258	11,109	11,420	9,240	16,232	15,305	14,891	16,738
<b>Total Revenue</b>	<b>19,380</b>	<b>24,004</b>	<b>30,856</b>	<b>31,887</b>	<b>38,136</b>	<b>38,652</b>	<b>41,331</b>	<b>46,855</b>
Other income	188	288	134	358	250	265	275	280
COGS	(7,072)	(9,095)	(14,808)	(16,512)	(21,589)	(20,210)	(21,109)	(24,469)
SG&A	(1,796)	(2,414)	(550)	(934)	(738)	(790)	(850)	(890)
Other op. expenses	(1,328)	(1,395)	(1,462)	(1,520)	(1,560)	(1,610)	(1,670)	(1,710)
<b>Operating profit</b>	<b>9,372</b>	<b>11,388</b>	<b>14,170</b>	<b>13,279</b>	<b>14,499</b>	<b>16,307</b>	<b>17,977</b>	<b>20,066</b>
Net-interest inc./(exp.)	(996)	(1,211)	(939)	(1,077)	(1,701)	(1,596)	(1,533)	(1,470)
Assoc/forex/extraord./others	1,198	852	2,114	2,716	(747)	1,470	1,670	1,790
<b>Pre-tax profit</b>	<b>9,574</b>	<b>11,029</b>	<b>15,345</b>	<b>14,918</b>	<b>12,051</b>	<b>16,181</b>	<b>18,114</b>	<b>20,386</b>
Tax	(1,079)	(2,403)	(3,204)	(2,869)	(3,081)	(3,398)	(3,804)	(4,281)
Min. int./pref. div./others	(590)	(543)	(1,101)	(751)	(494)	(523)	(550)	(595)
<b>Net profit (reported)</b>	<b>7,905</b>	<b>8,083</b>	<b>11,040</b>	<b>11,298</b>	<b>8,476</b>	<b>12,260</b>	<b>13,760</b>	<b>15,510</b>
<b>Net profit (adjusted)</b>	<b>7,905</b>	<b>8,083</b>	<b>11,040</b>	<b>11,298</b>	<b>8,476</b>	<b>12,260</b>	<b>13,760</b>	<b>15,510</b>
<b>EPS (reported)(HKD)</b>	<b>2.870</b>	<b>2.718</b>	<b>3.645</b>	<b>3.730</b>	<b>2.798</b>	<b>4.046</b>	<b>4.541</b>	<b>5.119</b>
<b>EPS (adjusted)(HKD)</b>	<b>2.870</b>	<b>2.718</b>	<b>3.645</b>	<b>3.730</b>	<b>2.798</b>	<b>4.046</b>	<b>4.541</b>	<b>5.119</b>
<b>EPS (adjusted fully-diluted)(HKD)</b>	<b>2.870</b>	<b>2.669</b>	<b>3.645</b>	<b>3.730</b>	<b>2.798</b>	<b>4.046</b>	<b>4.541</b>	<b>5.119</b>
<b>DPS (HKD)</b>	<b>1.000</b>	<b>1.060</b>	<b>1.650</b>	<b>1.700</b>	<b>1.810</b>	<b>1.900</b>	<b>2.000</b>	<b>2.100</b>
<b>EBIT</b>	<b>9,372</b>	<b>11,388</b>	<b>14,170</b>	<b>13,279</b>	<b>14,499</b>	<b>16,307</b>	<b>17,977</b>	<b>20,066</b>
<b>EBITDA</b>	<b>10,700</b>	<b>12,783</b>	<b>15,632</b>	<b>14,799</b>	<b>16,059</b>	<b>17,917</b>	<b>19,647</b>	<b>21,776</b>

### ■ Cash flow (HKDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	9,574	11,029	15,345	14,918	12,051	16,181	18,114	20,386
Depreciation and amortisation	1,328	1,395	1,462	1,520	1,560	1,610	1,670	1,710
Tax paid	(1,079)	(2,403)	(3,204)	(2,869)	(2,773)	(3,058)	(3,424)	(3,853)
Change in working capital	320	4,820	7,647	10,360	13,259	14,250	14,380	14,520
Other operational CF items	1,027	1,286	(640)	(1,039)	1,115	828	633	480
<b>Cash flow from operations</b>	<b>11,170</b>	<b>16,127</b>	<b>20,610</b>	<b>22,890</b>	<b>25,212</b>	<b>29,811</b>	<b>31,373</b>	<b>33,243</b>
Capex	(18,423)	(32,108)	(32,900)	(19,120)	(19,078)	(18,560)	(17,980)	(16,680)
Net (acquisitions)/disposals	267	249	5,262	302	285	290	298	298
Other investing CF items	(17)	(19)	(21)	(23)	(28)	(28)	(30)	(32)
<b>Cash flow from investing</b>	<b>(18,173)</b>	<b>(31,878)</b>	<b>(27,659)</b>	<b>(18,841)</b>	<b>(18,821)</b>	<b>(18,298)</b>	<b>(17,712)</b>	<b>(16,414)</b>
Change in debt	0	0	0	0	0	0	0	0
Net share issues/(repurchases)	0	10,052	0	0	0	0	0	0
Dividends paid	(3,274)	(3,450)	(3,938)	(5,149)	(5,452)	(5,755)	(6,058)	(6,361)
Other financing CF items	(980)	(1,627)	(1,174)	(1,346)	(2,126)	(1,995)	(1,916)	(1,838)
<b>Cash flow from financing</b>	<b>(4,254)</b>	<b>4,975</b>	<b>(5,111)</b>	<b>(6,496)</b>	<b>(7,578)</b>	<b>(7,750)</b>	<b>(7,974)</b>	<b>(8,198)</b>
Forex effect/others	0	0	0	0	0	0	0	0
<b>Change in cash</b>	<b>(11,257)</b>	<b>(10,776)</b>	<b>(12,160)</b>	<b>(2,447)</b>	<b>(1,187)</b>	<b>3,763</b>	<b>5,687</b>	<b>8,631</b>
Free cash flow	(7,253)	(15,981)	(12,290)	3,770	6,134	11,251	13,393	16,563

Source: FactSet, Daiwa forecasts

## Financial summary continued ...

### ■ Balance sheet (HKDm)

As at 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	16,900	32,528	18,795	24,515	18,725	22,508	20,135	20,320
Inventory	113	130	45	47	48	51	53	60
Accounts receivable	3,518	3,420	4,796	4,456	3,851	4,230	4,650	4,920
Other current assets	29,896	47,736	49,354	54,083	47,826	48,342	51,232	53,250
<b>Total current assets</b>	<b>50,427</b>	<b>83,814</b>	<b>72,990</b>	<b>83,101</b>	<b>70,450</b>	<b>75,131</b>	<b>76,070</b>	<b>78,550</b>
Fixed assets	166,638	203,041	251,392	285,258	326,917	328,627	328,112	327,007
Goodwill & intangibles	297	297	297	297	305	305	305	305
Other non-current assets	24,863	30,821	44,319	46,396	46,986	48,165	49,136	50,490
<b>Total assets</b>	<b>242,225</b>	<b>317,973</b>	<b>368,998</b>	<b>415,052</b>	<b>444,658</b>	<b>452,228</b>	<b>453,623</b>	<b>456,352</b>
Short-term debt	7,829	8,903	5,330	9,502	8,653	9,840	9,910	9,960
Accounts payable	6,539	10,316	14,801	20,089	23,664	24,095	25,612	26,890
Other current liabilities	8,341	11,537	12,849	17,154	17,088	17,540	17,638	17,820
<b>Total current liabilities</b>	<b>22,709</b>	<b>30,756</b>	<b>32,980</b>	<b>46,745</b>	<b>49,405</b>	<b>51,475</b>	<b>53,160</b>	<b>54,670</b>
Long-term debt	41,760	67,090	69,090	73,085	69,331	68,165	60,035	51,539
Other non-current liabilities	7,107	9,253	10,022	10,967	11,811	11,950	12,120	12,425
<b>Total liabilities</b>	<b>71,576</b>	<b>107,099</b>	<b>112,092</b>	<b>130,797</b>	<b>130,547</b>	<b>131,590</b>	<b>125,315</b>	<b>118,634</b>
Share capital	2,754	3,029	3,029	3,030	29,376	29,376	29,376	29,376
Reserves/R.E./others	160,335	200,228	245,472	272,527	276,119	282,472	290,022	299,322
<b>Shareholders' equity</b>	<b>163,089</b>	<b>203,257</b>	<b>248,501</b>	<b>275,557</b>	<b>305,495</b>	<b>311,848</b>	<b>319,398</b>	<b>328,698</b>
Minority interests	7,560	7,617	8,405	8,698	8,616	8,790	8,910	9,020
<b>Total equity &amp; liabilities</b>	<b>242,225</b>	<b>317,973</b>	<b>368,998</b>	<b>415,052</b>	<b>444,658</b>	<b>452,228</b>	<b>453,623</b>	<b>456,352</b>
EV	173,705	177,723	181,600	181,753	180,169	175,735	169,243	159,412
<b>Net debt/(cash)</b>	<b>32,689</b>	<b>43,465</b>	<b>55,625</b>	<b>58,072</b>	<b>59,259</b>	<b>55,497</b>	<b>49,810</b>	<b>41,179</b>
<b>BVPS (HKD)</b>	<b>59.219</b>	<b>67.104</b>	<b>82.041</b>	<b>90.973</b>	<b>100.857</b>	<b>102.920</b>	<b>105.412</b>	<b>108.481</b>

### ■ Key ratios (%)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	10.4	23.9	28.5	3.3	19.6	1.4	6.9	13.4
EBITDA (YoY)	6.7	19.5	22.3	(5.3)	8.5	11.6	9.7	10.8
Operating profit (YoY)	7.4	21.5	24.4	(6.3)	9.2	12.5	10.2	11.6
Net profit (YoY)	23.1	2.3	36.6	2.3	(25.0)	44.6	12.2	12.7
Core EPS (fully-diluted) (YoY)	23.1	(7.0)	36.6	2.3	(25.0)	44.6	12.2	12.7
Gross-profit margin	63.5	62.1	52.0	48.2	43.4	47.7	48.9	47.8
EBITDA margin	55.2	53.3	50.7	46.4	42.1	46.4	47.5	46.5
Operating-profit margin	48.4	47.4	45.9	41.6	38.0	42.2	43.5	42.8
Net profit margin	40.8	33.7	35.8	35.4	22.2	31.7	33.3	33.1
ROAE	5.7	4.4	4.9	4.3	2.9	4.0	4.4	4.8
ROAA	3.7	2.9	3.2	2.9	2.0	2.7	3.0	3.4
ROCE	4.9	4.5	4.6	3.8	3.8	4.1	4.5	5.0
ROIC	4.8	3.9	4.0	3.3	3.0	3.4	3.8	4.2
Net debt to equity	20.0	21.4	22.4	21.1	19.4	17.8	15.6	12.5
Effective tax rate	11.3	21.8	20.9	19.2	25.6	21.0	21.0	21.0
Accounts receivable (days)	76.0	52.7	48.6	53.0	39.8	38.2	39.2	37.3
Current ratio (x)	2.2	2.7	2.2	1.8	1.4	1.5	1.4	1.4
Net interest cover (x)	9.4	9.4	15.1	12.3	8.5	10.2	11.7	13.7
Net dividend payout	34.8	39.0	45.3	45.6	64.7	47.0	44.0	41.0
Free cash flow yield	n.a.	n.a.	n.a.	2.5	4.0	7.3	8.7	10.8

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.

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