

Swire Properties

The benefits of diversification

Swire Properties' 2014 results came in slightly ahead of expectations. While earnings and DPS beat expectations, these positives were partly offset by negative revaluation in 2H 2014. At the operational level, there was also good and bad news. Positively, Swire's China retail properties are performing strongly with retail sales all rising double-digit. That said, the 6% retail sales decline at Pacific Place mall has continued into 2015 and looks likely to persist. We raise our price target by 2% to HK\$24.80. With potential upside of only 5%, we maintain our EW on Swire Properties.

Outlook: China retail doing well but Hong Kong still soft: Of Swire's various businesses, the outlook for its China retail operation was most positive. Retail sales at Swire's China shopping centres have all seen double-digit growth in 2015. The drag is coming from Hong Kong, where Pacific Place's -6% retail sales decline in 2014 appears to have carried over to 2015.

Earnings beat but revaluation turned negative in 2H: While Swire's underlying earnings and DPS beat our and consensus estimates by 3%, this was overshadowed by a HK\$401mn negative investment property revaluation in 2H. At the operational level, Swire's 9% EBIT growth was 1% ahead of our forecast.

Raising our NAV by 2%: We fine-tune our FY15E and FY16E earnings estimates to reflect the latest project completion schedule (FY15E +2%, FY16E -5%). We also raise our spot and forward NAV by 2% to reflect a lower net debt level. Keeping our target discount unchanged at 40%, we raise our price target by 2% to HK\$24.80 but maintain our EW rating.

Upside risks include: 1) earlier recovery of financial service sector, 2) pick-up in demand for luxury housing. **Downside risks include:** 1) spill-over of office rental weakness to decentralised areas and 2) more policy tightening.

1972.HK: Financial and Valuation Metrics EPS HKD

FY Dec	2013	2014	2015	2016	2017
EPS	1.09A	1.22A	1.24E	1.21E	1.34E
Previous EPS	1.09A	1.18E	1.22E	1.27E	N/A
Consensus EPS	1.09A	1.20E	1.22E	1.27E	N/A
P/E	21.7	19.3	18.9	19.5	17.5

Source: Barclays Research.

Consensus numbers are from Thomson Reuters

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PLEASE SEE ANALYST CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 7.

Stock Rating	EQUAL WEIGHT Unchanged
Industry View	NEUTRAL Unchanged
Price Target	HKD 24.80 raised 2% from HKD 24.20

Price (18-Mar-2015)	HKD 23.55
Potential	+5%
Upside/Downside	
Tickers	1972 HK / 1972.HK

Market Cap (USD mn)	17748
Shares Outstanding (mn)	5850.00
Free Float (%)	18.00
52 Wk Avg Daily Volume (mn)	2.1
52 Wk Avg Daily Value (USD mn)	6.65
Dividend Yield (%)	2.6
Return on Equity TTM (%)	5.96
Current BVPS (HKD)	35.21

Source: Thomson Reuters

Price Performance	Exchange-HKG
52 Week range	HKD 27.25-20.00



[Link to Barclays Live for interactive charting](#)

Asia ex-Japan Real Estate

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Asia ex-Japan Real Estate					Industry View: NEUTRAL
Swire Properties (1972.HK)					Stock Rating: EQUAL WEIGHT

Income statement (HKDmn)	2014A	2015E	2016E	2017E	CAGR
Revenue	15,387	15,826	16,646	17,158	3.7%
EBITDA	N/A	N/A	N/A	N/A	N/A
EBIT	8,980	9,154	9,209	10,033	3.8%
Pre-tax income	11,369	8,652	8,335	9,217	-6.8%
Net income	9,516	7,272	7,071	7,855	-6.2%
EPS (reported) (HKD)	1.63	1.24	1.21	1.34	-6.2%
Net income (adj)	7,152	7,272	7,071	7,855	3.2%
EPS (adj) (HKD)	1.22	1.24	1.21	1.34	3.2%
Diluted shares (mn)	5,850.0	5,850.0	5,850.0	5,850.0	0.0%
DPS (HKD)	0.66	0.66	0.66	0.66	0.0%
Profit growth (%)	12.7	1.7	-2.8	11.1	-4.4%

Margin and return data	Average				
EBITDA margin (%)	N/A	N/A	N/A	N/A	N/A
EBIT margin (%)	58.4	57.8	55.3	58.5	57.5
Pre-tax margin (%)	73.9	54.7	50.1	53.7	58.1
Net margin (%)	61.8	45.9	42.5	45.8	49.0
Net (adj) margin (%)	46.5	45.9	42.5	45.8	45.2
ROIC (%)	N/A	N/A	N/A	N/A	N/A
ROA (%)	2.8	2.8	2.7	3.0	2.8
ROE (%)	3.5	3.5	3.3	3.6	3.5

Balance sheet and cash flow (HKDmn)	CAGR				
Tangible fixed assets	227,578	230,687	233,796	236,905	1.3%
Intangible fixed assets	N/A	N/A	N/A	N/A	N/A
Cash and equivalents	2,874	2,500	2,500	2,501	-4.5%
Total assets	260,355	262,553	264,518	266,486	0.8%
Short and long-term debt	36,945	35,610	33,851	31,322	-5.4%
Net debt/(funds)	34,071	33,110	31,351	28,821	-5.4%
Other long-term liabilities	6,670	6,670	6,670	6,670	0.0%
Total liabilities	51,808	50,627	49,024	46,655	-3.4%
Shareholders' equity	207,691	211,102	214,312	218,306	1.7%
Change in working capital	-239	690	1,300	1,302	N/A
Cash flow from operations	10,724	10,235	10,900	11,726	3.0%
Capital expenditure	-4,989	-3,400	-3,400	-3,400	N/A
Free cash flow	5,735	6,835	7,500	8,326	13.2%
BVPS (HKD)	35.50	36.09	36.63	37.32	1.7%

Valuation and leverage metrics	Average				
P/E (reported) (x)	14.5	18.9	19.5	17.5	17.6
P/E (adj) (x)	19.3	18.9	19.5	17.5	18.8
NAV per share (HKD)	40.96	41.38	41.38	41.38	41.27
Premium/(discount) to NAV (%)	-40.5	-40.1	-40.1	-40.1	-40.2
P/BV (x)	0.7	0.7	0.6	0.6	0.6
Dividend yield (%)	2.8	2.8	2.8	2.8	2.8
Net debt/equity (%)	16.4	15.7	14.6	13.2	15.0
Net debt/EBITDA (x)	3.8	3.6	3.4	2.9	3.4
Total debt/capital (%)	15.1	14.4	13.6	12.5	13.9

Price (18-Mar-2015)	HKD 23.55
Price Target	HKD 24.80

Why Equal Weight? We expect Central rents to be steady in 2015. This, coupled with our expectation for 10 year UST yields to remain below 3.0%, should support capital values.

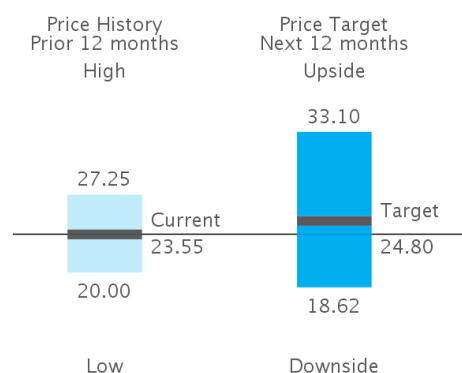
Upside case	HKD 33.10
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Lower for longer US interest rates may help sustain the current low property yields in HK. We assume the company trades at 20% discount to its NAV.

Downside case	HKD 18.62
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Correction of the residential market has a larger-than-expected knock-on effect on the broader economy. We assume the company's discount to NAV widens to 55%, which is close to Swire Property/Swire Pacific's mid-cycle discount minus 1.5x SD.

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Dec

The benefits of diversification

Earnings beat but negative revaluation in 2H

Swire Properties reported FY2014 earnings that were ahead of expectations. Underlying net profit rose 10% y/y to HK\$7,152mn and beat our and consensus forecasts by 3%. Similarly, full-year DPS of HK\$0.66/share was also up 10% y/y and 3% ahead of our forecast. At the segmental level, Swire's operations performed largely in line with our estimates, with lower interest and tax expenses making up most of the HK\$231mn positive earnings variance.

FIGURE 1

Swire Properties results snapshot

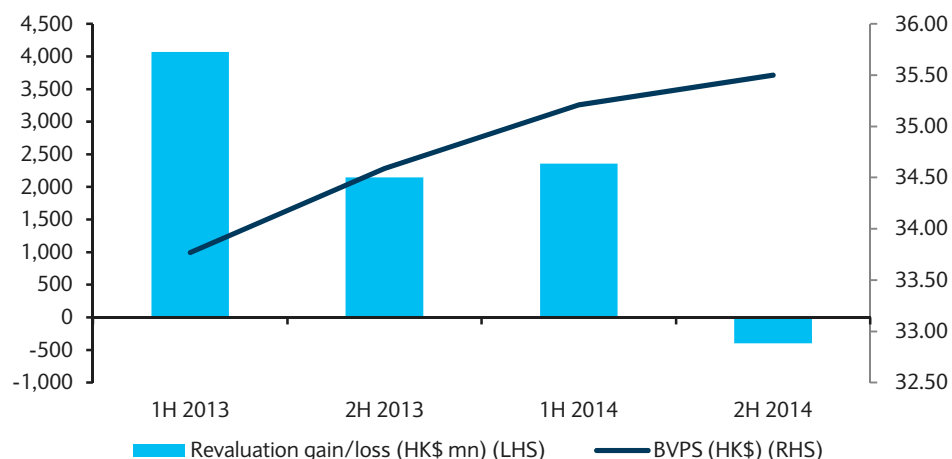
	FY 14E/A		% diff		
	Barclays	Consensus	Actual	to Barclays	Surprise
Underlying net profit (HK\$mn)	6,921	6,901	7,152	3%	Better
Underlying EPS (HK\$)	1.18	1.18	1.22	3%	Better
DPS (HK\$)	0.64	0.63	0.66	3%	Better

Source: Company data, Bloomberg consensus, Barclays Research

While we tend to focus on underlying earnings, it is notable that Swire's investment properties were revalued down by HK\$401mn in the 2H of 2014. We believe this likely reflects the downward rental pressure on Pacific Place office rents. This resulted in Swire Properties' BVPS being almost flat h/h, rising marginally from June 2014's HK\$35.21 to HK\$35.50 as of December 2014.

FIGURE 2

Swire Properties BVPS and revaluation gains/losses



Source: Company data, Barclays Research

Outlook: China retail picking up but Hong Kong retail still soft

One of the key takeaways from today's results briefing was the divergent performance between Hong Kong and China retail. Despite the macro slowdown, Swire's China shopping malls have all seen encouraging performance through the first two months of 2015. Taikoo Hui in Guangzhou has seen very strong retail sales growth of around 20% and the two shopping centres in Beijing have also seen double-digit growth. In Hong Kong, while Cityplaza has got off to a good start, the softness that The Mall at Pacific Place experienced in 2014 has continued and is likely to persist in 2015, in our view.

FIGURE 3

2014 retail sales growth (y/y)

Pacific Place, Hong Kong	-6.1%
Cityplaza, Hong Kong	-0.4%
Citygate Outlet, Hong Kong	4.6%
Taikoo Hui, Guangzhou	11.0%
Taikoo Sanlitun, Beijing	19.0%
Indigo, Beijing	66.0%

Source: Company data, Barclays Research

On the office side, the outlook is more guarded for both Hong Kong and China. Although Pacific Place only has about 10% of leases up for renewal in 2015, the high vacancy level at several buildings in Central is inevitably putting downward pressure on rents. In Guangzhou and Beijing, management expects office rents to be under pressure as substantial new supply comes on stream.

FIGURE 4

Hong Kong office portfolio performance

HK Office Properties	GFA (sf)	Occupancy (31 Dec 2014)	Area Let (sf)	Reversion	Attri. Interest
Pacific Place	2,186,433	94%	201,128	7%	100%
Cityplaza	1,632,930	100%	284,955	25%	100%
Taikoo Place office towers	3,136,541	98%	545,464	27%	50%/100%
One Island East	1,537,011	98%	171,117	14%	100%
Techno Centres	893,516	100%	61,061	12%	100%
Others	1,077,161	94%	N.A.	N.A.	Various
Total	10,463,592				

Note: Taikoo Place office towers include 50% owned PCCW Tower, managed by Swire Properties

Source: Company data, Barclays Research

Key aspects of the results

At the segmental level, Swire Properties performed largely in line with our forecast. Its EBIT rose 9% y/y to HK\$8,980mn and was 1% ahead of our HK\$8,890mn forecast.

- Gross and net rental incomes both rose by 7% to HK\$10,320mn and HK\$8,534mn and were 1% ahead of our forecasts. The net rental margin improved slightly from 82.5% to 82.7%.
- Development profits increased by 14% y/y to HK\$14,03mn but was slightly lower than our forecast of HK\$1,423mn. With more mass market projects booked, Swire's development margin for the period was 37% versus 56% in 2013.
- Net debt and interest charges – Swire's net debt increased slightly to HK\$34.1bn as of December 2014 from HK\$33.9bn as of June 2014. Interest expense, however, declined from HK\$1,525mn to HK\$1,324mn as the average cost of debt declined from 5.2% to 4.4%. Furthermore, with more projects ongoing, capitalised interest increased from HK\$327mn to HK\$413mn. Looking out to 2015 and 2016, Swire expects its capex to be lower than 2014's HK\$9bn.

FIGURE 5

Profile of capital commitment for investment properties and hotel

(HK\$ mn)	2014E	2015E	2016E	2017E	2018 & beyond
Hong Kong	4,657	1,564	4,122	4,030	7,781
Mainland China	2,272	1,955	1,620	244	827
USA	2,051	1,707	290	-	-
Total	8,980	5,226	6,032	4,274	8,608

Source: Company data, Barclays Research

Estimate changes

With the results largely in line with our estimates, the change to our FY15E and FY16E earnings mostly relate to project handover timing and lower interest expense due to higher capitalisation. Specifically, we have delayed the profit contribution from 100 Caine Road from 2016 to 2017. On the NAV front, we raise our spot and forward NAV by 2% each to HK\$40.54 and HK\$41.38 to reflect a lower level of net debt.

FIGURE 6

Estimate changes

	Net profit (HKD mn)			DPS (HKD)			NAV (HKD)	
	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	Current	Forward
Previous estimate	7,149	7,453	NA	0.64	0.64	NA	39.72	40.39
New estimate	7,272	7,071	7,855	0.66	0.66	0.66	40.54	41.38
Change	123	(382)	NA	0.02	0.02	NA	0.82	0.99
Change (%)	2%	-5%	NA	3%	3%	NA	2%	2%

Source: Company data, Barclays Research

Keeping our target discount unchanged at 40%, we increase our price target by 2% from HK\$24.20 to HK\$24.80. With potential upside of 5%, we continue to rate Swire Properties EW.

Key investment risks

Upside risks to our price target include: 1) an earlier recovery of the financial services sector could boost demand for decentralised office and 2) better-than-expected demand for luxury residential sales could benefit Swire's trading properties performance.

Downside risks include 1) if Central office demand turns weaker and also spills over to impact Swire's decentralised office portfolio. 2) Further policy tightening to curb Hong Kong's home prices could hurt higher end residential demand.

FIGURE 7

Key aspect of Swire Properties' results

	Dec-14	Jun-14	h/h Change
BVPS (HK\$)	35.50	35.21	1%
Net debt (HK\$mn)	34,071	33,900	1%
Net-debt-to-shareholders' fund	16.4%	16.5%	-0.1%
	FY14	FY13	y/y Change
Underlying net profit (HK\$mn)	7,152	6,348	13%
Interim DPS (HK\$)	0.66	0.60	10%
Development margin (%)	36.5%	55.6%	-19.1%
Rental income (HK\$mn)	8,534	7,978	7%
Rental margin (%)	82.7%	82.5%	0.2%
Revaluation gain (HK\$mn)	1,956	6,211	-69%
...1H	2,357	4,068	
...2H	(401)	2,143	

Source: Company data, Barclays Research

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Primary Stocks (Ticker, Date, Price)

Swire Properties (1972.HK, 18-Mar-2015, HKD 23.55), Equal Weight/Neutral, J/K/M/N

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Overweight - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Equal Weight - The stock is expected to perform in line with the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

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CapitaCommercial Trust (CACT.SI)	CapitaLand (CATL.SI)	CapitaMall Trust (CMLT.SI)
Champion REIT (2778.HK)	China Overseas Grand Oceans Group (0081.HK)	China Overseas Land & Investment (0688.HK)
China Resources Land (1109.HK)	Chong Hong Construction Co. (5534.TW)	City Developments (CTDM.SI)
CKH Holdings (0001.HK)	Country Garden Holdings (2007.HK)	DLF Ltd. (DLF.NS)
Evergrande Real Estate Group (3333.HK)	Far Eastern New Century Corp. (1402.TW)	Farglory Land Development Co., Ltd. (5522.TW)
Fortune REIT (0778.HK)	Global Logistic Properties (GLPL.SI)	Godrej Properties Ltd. (GODR.NS)
Greentown China Holdings Ltd. (3900.HK)	Guangzhou R&F Properties Co., Ltd. (2777.HK)	Hang Lung Properties (0101.HK)
Henderson Land (0012.HK)	Hongkong Land (HKLD.SI)	Huaku Development Co., Ltd. (2548.TW)
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Keppel Land (KLAN.SI)	Keppel REIT (KASA.SI)	Kerry Properties (0683.HK)
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Midland Holdings (1200.HK)	New World Development (0017.HK)	Oberoi Realty Ltd. (OEBO.NS)
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IMPORTANT DISCLOSURES CONTINUED

Swire Properties (1972 HK / 1972.HK)

HKD 23.55 (18-Mar-2015)

Stock Rating

Industry View

EQUAL WEIGHT

NEUTRAL

Rating and Price Target Chart - HKD (as of 18-Mar-2015)

Currency=HKD



Date	Closing Price	Rating	Adjusted Price Target
30-Jan-2015	24.95	Equal Weight	24.20
03-Sep-2014	26.85		19.94
28-Oct-2013	21.20	Underweight	18.65

Source: Thomson Reuters, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

J: Barclays Bank PLC and/or an affiliate trades regularly in the securities of Swire Properties.

K: Barclays Bank PLC and/or an affiliate has received non-investment banking related compensation from Swire Properties within the past 12 months.

M: Swire Properties is, or during the past 12 months has been, a non-investment banking client (securities related services) of Barclays Bank PLC and/or an affiliate.

N: Swire Properties is, or during the past 12 months has been, a non-investment banking client (non-securities related services) of Barclays Bank PLC and/or an affiliate.

Valuation Methodology: Our 12-month price target for Swire Properties of HK\$24.80 is based on a 40% discount to our end-2015 NAV estimate. As Swire Properties has a short trading history since its January 2012 spinoff, we calculated that it should have an average discount of 28% with a one standard deviation swing of 13% since 1994 based on the historical NAV discount of HK Land and also Swire Pacific. Our 40% target discount is equal to 0.9SD below its average. Although interest rates remain low, given the weak economic growth and the knock-on effect on office demand, we believe Swire Properties should trade below its historical mid-cycle discounts.

Risks which May Impede the Achievement of the Barclays Research Price Target: Upside risks to our price target for Swire Properties include: 1) an earlier recovery of the financial services sector could boost demand for decentralised offices in terms of both occupancy and rental rates; and 2) better-than-expected demand in luxury residential sales that could benefit Swire Properties' trading properties' performance. Downside risks to our price target include: 1) if Central office demand turns weaker in the near term, there may be a spill-over effect to Swire Properties' decentralised office portfolio in rent rates; and 2) further tightening policies to curb demand in the residential market may hurt the upper-end segment that Swire Properties is focused on.

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