

Swire Properties (1972 HK)

Overweight

Target price (HKD)	28.70
Share price (HKD)	23.40
Forecast dividend yield (%)	2.8
Potential return (%)	25.4

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

Dec	2014 a	2015 e	2016 e
HSBC EPS	1.22	1.29	1.33
HSBC PE	19.1	18.2	17.6
Performance	1M	3M	12M
Absolute (%)	-7.3	2.2	15.8
Relative ^A (%)	-6.0	-3.5	0.3

Note: (V) = volatile (please see disclosure appendix)

22 March 2015

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OW: Steady as it goes

- ▶ **Solid operations in FY14 across divisions, including positive rental growth and strong residential sales**
- ▶ **Encouraging rental momentum in China helps partly offset slowing HK rental growth**
- ▶ **Reiterate OW with a revised TP of HKD28.7 (from HKD29.2)**

Solid operations; attractive stock valuation. Swire Properties (SPL) delivered a solid performance across divisions in FY14, including 1) continuing rental growth (+7% y-o-y); 2) improved HK office occupancy (+1ppt y-o-y to 97% as of end-2014); 3) strong residential sales in HK which help drive FY14-15e earnings; and 4) flat to positive retail sales growth at most malls (except Pacific Place). Among HK landlord stocks, we believe Swire Properties offers an attractive valuation, trading at a 43% NAV discount (vs. HK landlords' 36% on the current average).

Encouraging momentum in China contributes to overall rental growth. The slowing rental growth momentum in HK should be partly offset by China gross rental, which saw strong growth of 17% y-o-y and accounted for 18% of total in FY14, up from 17% in FY13. Retail malls in China also saw double-digit growth (+11-66% y-o-y) in retail sales in FY14, compared to -6% to +5% y-o-y retail sales growth in HK malls.

FY14 results in line. SPL reported FY14 underlying earnings of HKD7,152m, up 13% y-o-y on higher property sales and robust +8% y-o-y growth in net rental. Results came in largely in line with our and consensus estimates. SPL declared a second interim DPS of HKD0.44, bringing FY14 DPS to HKD0.66, up 10% y-o-y. FY14 DPS implies a 54% payout ratio, compared to FY13's 55%. Book NAV rose 3% h-o-h to HKD35.5 at end-2014.

Reiterate OW with a revised target price of HKD28.7. We revise up our FY15-16e earnings by 0-2%, reflecting faster-than-expected HK residential sales. Our FY15-17e earnings are 3-5% above Bloomberg consensus. Our revised target price of HKD28.7 (tweaked down 2%) is based on a 30% NAV discount (unchanged) to our revised forward NAV of HKD41 (-1% from HKD41.6 on higher net debt). Catalysts include improved performance at Pacific Place. Key downside risks include: 1) lower-than-expected rental achieved; and 2) rising US long-term bond yield trends which could lead to upward pressure on commercial cap rates in HK.

Index ^A	HANG SENG INDEX
Index level	24,469
RIC	1972.HK
Bloomberg	1972 HK

Source: HSBC

Enterprise value (HKDm)	154466
Free float (%)	2
Market cap (USDm)	17,642
Market cap (HKDm)	136,890

Source: HSBC

Financials & Valuation: Swire Properties

Overweight

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (HKDm)				
Property investment	10,320	10,850	11,275	11,720
Property development	3,842	2,899	2,588	2,771
Hotels & other business	1,225	1,303	1,369	1,437
Operating costs (ex. dep&amor).	(6,047)	(5,253)	(5,126)	(5,667)
EBITDA	9,340	9,800	10,105	10,261
Depreciation and amortization	(360)	(384)	(406)	(429)
Other gains	56	56	56	56
Non-operating profit/loss	2,912	72	72	72
Net interest expense	(1,227)	(1,437)	(1,490)	(1,515)
Share of profit from asso.	648	543	600	645
PBT	11,369	8,650	8,937	9,090
Taxation	(1,646)	(1,083)	(1,114)	(1,129)
Minority interests	(207)	(37)	(40)	(39)
Net profit	9,516	7,530	7,783	7,922
Net impact of ppty rev reserve	(2,364)	0	0	0
Core profit	7,152	7,530	7,783	7,922

Cash flow summary (HKDm)

Cash flow from operations	10,750	11,213	11,077	11,708
Capex	(4,951)	(5,841)	(6,647)	(4,889)
Other investments activities	(1,343)	89	86	86
Dividends paid	(3,627)	(4,456)	(3,828)	(3,926)
Others fin. Activities	(445)	(1,203)	(432)	(2,493)
Net change in cash	384	(198)	255	485
Cash at beginning	2,521	2,874	2,676	2,930
Cash at end	2,874	2,676	2,930	3,416

Balance sheet summary (HKDm)

Shareholders' funds	207,691	211,456	215,348	219,309
Long-term liabilities	32,744	33,503	35,024	34,758
Minority interests	856	893	932	971
Deferred tax & Others	6,670	6,670	6,670	6,670
Total capital employed	247,961	252,522	257,974	261,708
Fixed assets	226,658	234,645	243,456	250,520
Other assets	19,938	18,504	16,975	15,362
Current assets	13,759	12,410	12,608	13,236
Total assets	260,355	265,559	273,039	279,117

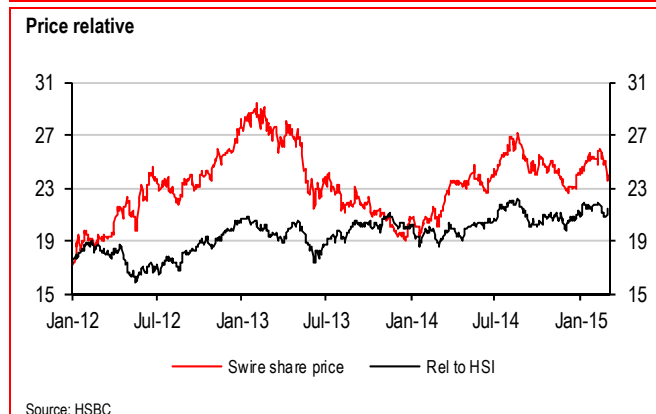
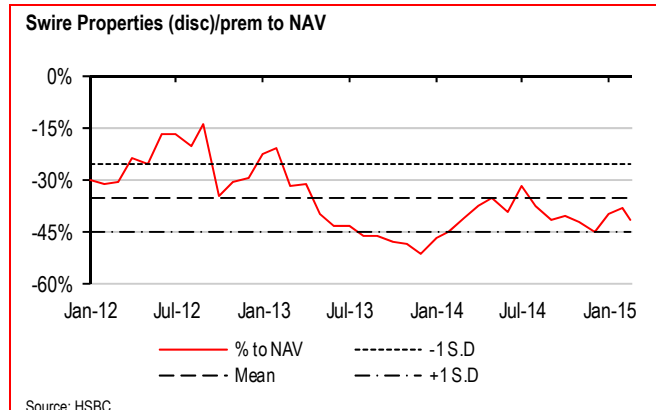
Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Y-o-y % change				
Revenue	19%	-2%	1%	5%
Operating profit	9%	5%	3%	1%
PBT	-19%	-24%	3%	2%
Reported EPS	-24%	-21%	3%	2%
HSBC EPS	13%	5%	3%	2%
Ratios (%)				
ROIC ex-exceptionals	4%	4%	4%	4%
ROAE ex-exceptionals	3%	4%	4%	4%
ROAA ex-exceptionals	3%	3%	3%	3%
Operating margin	58%	63%	64%	62%
Core profit margin	46%	50%	51%	50%
Interest cover ex-exceptional (x)	7.1	6.4	6.4	6.4
Net debt/equity	16%	17%	17%	16%
Per share data (HKD)				
Reported EPS (diluted)	1.63	1.29	1.33	1.35
HSBC EPS (diluted)	1.22	1.29	1.33	1.35
DPS	0.66	0.64	0.67	0.68

Swire Properties: NAV breakdown

Particulars	(HKDm)	HKD/Share	% of GAV
Investment properties-HK	188,383	32.2	69%
Office	125,353	21.4	46%
Retail	46,644	8.0	17%
Residential	9,162	1.6	3%
Hotel	7,225	1.2	3%
HK-Development properties	12,399	2.1	5%
China-Investment properties-	54,693	9.3	20%
Office (completed)	30,590	5.2	11%
Retail (completed)	11,091	1.9	4%
Under developments	11,062	1.9	4%
China Res and hotels	1,950	0.3	1%
Others (US Prop and HK other props)	16,998	2.9	6%
China-Development properties	0	0.0	0%
GAV	272,473	46.6	100%
Net debt	-34,071	-5.8	
Net asset value	238,402	41.0	

Source: HSBC estimates



Note: Priced at close of 20 March 2015.

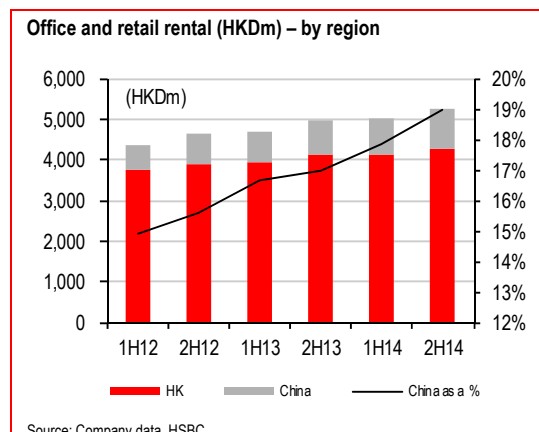
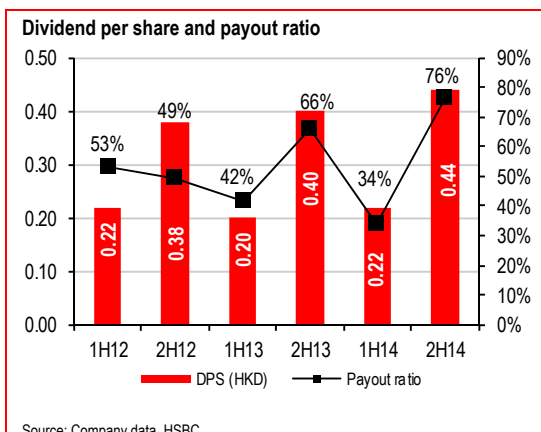
Solid FY14 results

FY14 results highlights

1. Swire Properties reported FY14 underlying earnings of HKD7,152m, up 13% y-o-y and largely in line with our and consensus estimates of HKD7,179m and HKD6,901m (before results), respectively.
2. The y-o-y increase in underlying earnings was driven by higher contributions from property trading, mainly from Mount Parker Residences (82 of 92 total units), Dunbar Place (52 of 53 total units) coupled with net rental growth of 8% y-o-y.
3. SPL declared final DPS of HKD0.44, bringing total DPS to HKD0.66, implying a payout ratio of 54%, which is largely similar to FY13's 55% and higher than our assumed 50%.
4. Gross rental grew 7% y-o-y and 5% h-o-h with stronger rental growth noted for retail (+8% y-o-y), followed by residential (+7% y-o-y) and office (+6% y-o-y).
5. China gross rental grew 17% y-o-y to HKD1,897m in FY14, with +15% y-o-y and +23% y-o-y growth noted for retail and office rental in China, respectively. China accounted for 18% of total gross rental in FY14, up from 17% in FY13.
6. Rental margin came in at 76%, lower than 78% in 1H14 and in line with 76% in FY13. The reported FY14 margin came in line with our assumed 76%.
7. Operating profits from property trading rose 14% y-o-y with sales recognized from more projects in HK (four in FY14 vs two in FY13). In FY14, property sales were recognized for Mount Parker Residences (82 of 92 total units), Dunbar Place (52 of 53 total units), ARGENTA (15 of 30 total units) and AZURA (3 of 126 total units). Development margin (consolidated) came in at 31%, compared to 1H14's 30% and FY13's 47% as well as our assumed 36%.
8. Operating loss from the hotel division narrowed to HKD22m in FY14 from HKD65m in FY13 reflecting improved performance of the hotel portfolio particularly in Hong Kong, the UK and reduced losses in China.
9. Book NAV rose 3% h-o-h to HKD35.5 as of end-2014 from HKD35.2 as of June 2014, although there appeared to be a slight revaluation loss (consolidated) of HKD400m, or -0.2% h-o-h in 2H14 on our estimates.
10. Gearing was flat h-o-h at 16.3% as of end-2014, compared to 16.4% as of June 2014 and 15.8% as of end-2013, with net debt up 1% h-o-h to HKD34.1bn from HKD33.9bn as of June 2014 and HKD32.0bn as of end-2013.

12. **Management outlook** is as follows:

- ▶ SPL expects HK office demand, particularly from financial institutions, to remain subdued although occupancy of Pacific Place and rents at Taikoo Place and Cityplaza are expected to remain resilient. Management also expects demand for retail space in HK at prime locations and well-managed shopping malls to remain high.
- ▶ In China, SPL expects Guangzhou and Beijing office rents to come under pressure due to new supply. For retail, demand for mid-price products in Beijing and Guangzhou as well as the Chengdu retail market are expected to grow although demand for luxury goods has weakened and retailers are cautious about expanding.



Revisions to our earnings and NAV estimates

We revise our FY15-16e earnings and NAV estimates reflecting FY14 results. We have introduced our FY17 estimates.

- ▶ **FY15-16e earnings 0% to +2%:** Our higher earnings estimates mainly reflect revised property sales bookings as a result of faster-than-expected sales achieved. For example, we now assume 61% of AREZZO units to be sold by end-FY15 (vs. 25% previously).
- ▶ **FY15-16e DPS 0% to +2%:** Our revised FY15-16e DPS assumptions reflect our higher earnings estimates while keeping our payout ratio assumption at 50% in FY15-16e.
- ▶ **Forward NAV estimate -1% to HKD41.0 (from HKD41.6):** Our lower NAV estimate is driven by higher net debt based on FY14 results.

Summary of estimate changes

	FY15e	FY16e	FY17e	Fwd NAV (HKD)
Core profit (HKDm)				
Old estimate	7,359	7,761	n.a	41.6
New estimate	7,530	7,783	7,922	41.0
% change	2%	0%	n.a	-1%
Consensus – Bloomberg	7,158	7,519	7,684	
% difference	5%	4%	3%	
DPS (HKD)				
Old estimate	0.63	0.66	n.a	
New estimate	0.64	0.67	0.68	
% change	2%	0%	n.a	
Consensus – Bloomberg	0.65	0.68	0.70	
% difference	-1%	-2%	-3%	

Source: HSBC estimates, Bloomberg

Valuation and risks

We revise our target price to HKD28.7 (from HKD29.2), which is based on an unchanged 30% discount to our revised 12-month forward NAV of HKD41.0 (from HKD41.6). Our target discount is based on 0.5 standard deviations below the historical average discount, benchmarking against Hongkong Land's NAV discount history given the short trading history of Swire Properties stock.

Under our research model, the Neutral rating band for non-volatile Hong Kong equities equals the local hurdle of 8.5% plus or minus 5ppt. Our target price implies a potential return of 25.4% (including a forecast dividend yield of 2.8%), above the Neutral band of our model; therefore, we reiterate Overweight on Swire stock. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Key downside risks to our rating include: 1) lower-than-expected rental achieved by SPL's assets; and 2) higher-than-expected costs associated with the new projects.

Office occupancy and market rent by property

	Dec-14	Sep-14	Jun-14	Mar-14	4Q14 q-q pp	Market rent (HKDpsf)		
						Feb-15	Oct-14	July-14
HK properties								
Pacific Place	94.0%	95.0%	93.0%	91.0%	-1	90 to 110	90 to 110	90 to 110
Cityplaza	100.0%	99.0%	98.0%	98.0%	+1	Mid 40s - High 40s	Lows 40s - Mid 40s	Lows 40s - Mid 40s
Taikoo Place	98.0%	98.0%	99.0%	99.0%	0	Lows 40s - High 40s	Lows 40s - High 40s	Lows 40s - High 40s
One Island East	98.0%	98.0%	100.0%	99.0%	0	Mid 50s - High 60s	Mid 50s - High 60s	Mid 50s - High 60s
Techno Centres	100.0%	100.0%	97.0%	99.0%	0	Mid 20s	Mid 20s	Mid 20s
Overall HK office	97.0%	97.0%	97.0%	n.a.	0			
China properties								
						Market rent (RMBpsm)		
TaikooHui	100.0%	100.0%	99.0%	93.0%	0	Mid 100s - High 100s	Mid 100s - High 100s	Mid 100s - High 100s
ONE INDIGO	100.0%	100.0%	96.0%	96.0%	0	Mid 200s - High 200s	Mid 200s - High 200s	Mid 200s - High 200s

Source: Company data, HSBC

Retail occupancy and retail sales growth by property

	Dec-14	Sep-14	Jun-14	Mar-14	4Q14 q-q pp	Retail sales growth		
						12M14	9M14	6M14
HK properties								
Pacific Place Mall	100.0%	100.0%	100.0%	100.0%	0	-6.1%	-1.1%	0.8%
Cityplaza Mall	100.0%	100.0%	100.0%	100.0%	0	-0.4%*	-3.4%*	-5.6%*
Citigate Outlets	100.0%	100.0%	100.0%	100.0%	0	4.6%	6.0%	5.3%
China properties								
Taikoo Li Sanlitun	95.0%	97.0%	97.0%	94.0%	-2	18.8%	22.4%	22.8%
TaikooHui	99.0%	99.0%	99.0%	99.0%	0	11.0%	10.9%	13.0%
INDIGO	95.0%	95.0%	95.0%	94.0%	0	66.1%	78.4%	94.4%

* The renovation at Cityplaza was completed in December 2014 and no adjustment has been made to the retail sales figures to reflect sales lost as a result of shop closures during renovation.
Source: Company data, HSBC

Development pipeline and completion status

Principal Properties	GFA (100% basis)	Expected completion as of		
		Feb 15	Oct 14	July 14
Investment properties and hotels under dvpt				
Hong Kong (sqft)				
Taikoo Place Apartments	75,063	2014	2014	2014
Somerset House redevelopment	~1,020,000	2018	2018	2018
Tung Chung Town Lot No. 11	~460,000	2017	2017	2017
New Kowloon Inland Lot No. 6312	~555,000	2017	2017	2017
8 - 10 Wong Chuk Hang Road	~382,500	2018	2018	2018
Mainland China (sq m)				
Daci Temple Project, Chengdu	265,844	From 2014	From 2014	From 2014
Dazhongli Project, Shanghai	321,198	From 2016	From 2016	From 2016
Miami, Florida, USA (sq ft)				
Brickell Citi Centre (Phase I)	2,211,000	2015	From 2015	From 2015
Brickell CitiCentre (Phase II)	1,820,000	TBD	2019	2019
Trading properties				
Hong Kong (sqft)				
AREZZO (formerly 33 Seymour Road - Ph. I)	165,792	2015	2014	2014
100 Caine Road	195,533	2016	2016	2016
160 South Lantau Road, Cheung Sha	64,410	2015	2015	2015

Source: Company data, HSBC

Trading properties being sold or pre-sold (As at 17 Mar 2015)

	*Saleable area (100% basis)	Total Units	Unit sold/ Pre-sold as of Mar 15	ASP as of Mar 15** (HKDpsf)	Unit sold/ Pre-sold as of Feb 15	ASP as of Feb 15** (HKDpsf)
Hong Kong						
Azura	6,923	126	122	30,787	122	30,787
Argenta	7,921	30	27	32,470	27	32,470
Dunbar Place	1,830	53	52	22,231	52	22,231
Mount Parker Residences	9,612	92	86	24,831	84	24,011
Arezzo	61,303	127	79	27,360	78	27,297
Miami, Florida, USA						
				(USDpsf)		(USDpsf)
REACH, Brickell City Centre	168,365 [^]	390	304	634	299	634
RISE, Brickell City Centre	509,558 [^]	390	65	664	43	672

Note: *Represents the saleable area of the remaining unsold units, ** Excluding carpark, [^] saleable area as at 2 Feb 2015
Source: Company data, HSBC

Swire Properties FY14 comparison table

Year to December (HKDm)	FY13	FY14	y-o-y	FY14e	Diff (%)
Profit & loss					
Revenue					
Office	5,386	5,707	6%	5,540	3%
Retail	3,961	4,260	8%	4,335	-2%
Residential	329	353	7%	351	1%
Gross rental income	9,676	10,320	7%	10,225	1%
Property trading	2,207	3,842	74%	4,077	-6%
Hotel	942	1,089	16%	1,030	6%
Other property income	110	136	24%	116	18%
Total revenue	12,935	15,387	19%	15,448	0%
Total operating costs	(4,691)	(6,407)	37%	(6,244)	3%
EBITDA	8,635	9,340	8%	9,618	-3%
Depreciation and amortisation	(391)	(360)	-8%	(414)	-13%
Operating profits					
Property investment	7,317	7,878	8%	7,732	2%
Property trading	1,035	1,180	14%	1,456	-19%
Hotels	(65)	(22)	-66%	61	-136%
Other operating profits	(43)	(56)	30%	(45)	24%
Total operating profits	8,244	8,980	9%	9,204	-2%
Total non-recurring items	6,933	2,968	-57%	72	n.a
Net finance charges	(1,447)	(1,227)	-15%	(1,466)	-16%
Total share of JCE/associates	269	648	141%	551	18%
Pre-tax profits	13,999	11,369	-19%	8,360	36%
Total tax	(1,344)	(1,646)	22%	(1,003)	64%
After-tax profits	12,655	9,723	-23%	7,358	32%
Minority interests	(130)	(207)	59%	(179)	16%
Net profit to shareholders	12,525	9,516	-24%	7,179	33%
Non-recurring items					
Revaluation	(7,017)	(3,148)			n.a
Deferred tax	573	710			n.a
Other adjustment	267	74			n.a
Underlying Net Profit	6,348	7,152	13%	7,179	0%
Per share calculations					
Weighted avg shares (m)	5,850	5,850		5,850	
EPS	2.14	1.63	-24%	1.23	33%
Underlying EPS	1.09	1.22	13%	1.23	0%
DPS	0.60	0.66	10%	0.61	8%
Dividend payout (based on underlying EPS)	55%	54%		50%	

Source: Company data, HSBC

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Perveen Wong and Derek Kwong

Important disclosures

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This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

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Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

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 price target). 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.

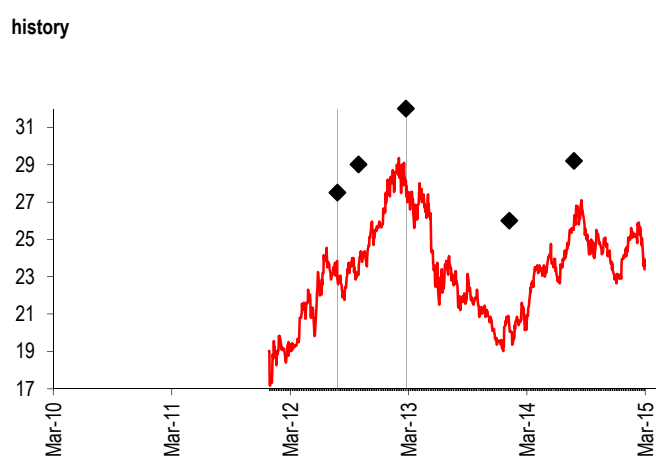
Rating distribution for long-term investment opportunities

As of 22 March 2015, the distribution of all ratings published is as follows:

Overweight (Buy)	41%	(30% of these provided with Investment Banking Services)
Neutral (Hold)	39%	(28% of these provided with Investment Banking Services)
Underweight (Sell)	20%	(20% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Swire Properties (1972.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Overweight (V)	14 August 2012
Overweight (V)	Overweight	14 March 2013
Target Price	Value	Date
Price 1	27.50	14 August 2012
Price 2	29.00	19 October 2012
Price 3	32.00	14 March 2013
Price 4	26.00	27 January 2014
Price 5	29.20	14 August 2014

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
SWIRE PROPERTIES	1972.HK	23.40	20-Mar-2015	4, 5, 6, 7

Source: HSBC

- 1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
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