BEA securities

EAST ASIA SECURITIES COMPANY LIMITED
6/F, 10 Des Voeux Road Central, Hong Kong.
Dealing: 2308 8200 Research: 3608 8096 Facsimile: 3608 6113

Analyst: Carmen Wong

HONG KONG RESEARCH
23rd March, 2015

SWIRE PACIFIC LIMITED (太古股份公司)

Sector	:	Conglomerates	Chairman	:	J.R. Slosar
HKSE Code	:	00019			
Market Price	:	HK$100.80 (23/03/2015) ('A' share)	Executive Director	:	Martin Cubbon
HSI	:	24,494.51 (23/03/2015)			
Shares Issued	:	905.6 million ('A' share)			
Market Cap	:	HK$91,373 million			
52-week Hi / Lo	:	HK$108.00/ HK$86.80			

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2014

Final Results Highlights

	2014 HK$ million	2013 HK$ million	*y-o-y Change*
• Turnover	61,301	51,437	*19.2%*
• Change in fair value of investment properties	1,896	5,845	*(67.6%)*
• Operating profit	13,697	16,686	*(17.9%)*
• Net finance charges	(2,025)	(1,999)	*1.3%*
• Share of results of jointly-controlled companies	2,253	1,682	*33.9%*
• Share of results of associated companies	1,678	1,521	*10.3%*
• Profit before tax	15,603	17,890	*(12.8%)*
• **Profit attributable to shareholders**	**11,069**	**13,291**	***(16.7%)***
• **Underlying profit attributable to shareholders**	**9,739**	**8,471**	***15.0%***
• Earnings per share – 'A' share	HK$7.36	HK$8.83	*(16.6%)*
• Final dividend per share – 'A' share	HK$2.50	HK$2.50	*Unchanged*
• Total dividend per share – 'A' share	HK$3.90	HK$3.50	*11.4%*

- Swire Pacific ("Swire" or the "Group") reported a net profit of HK$11.07 billion for the year ended 31st December 2014, a decrease of 16.7% year-on-year. Excluding the changes in the valuation of investment properties, underlying profit attributable to shareholders surged by 15.0% year-on-year to HK$9.74 billion, thanks to higher profitability from the Cathay Pacific Group, property, beverages and trading & industrial divisions. Yet, the overall results fell short of market consensus on the worse-than-expected performance of its marine service business.

- Turnover increased by 19.2% year-on-year to HK$61.30 billion, driven by solid growth in its property (+19.0% year-on-year) and aviation (+61.5% year-on-year) businesses.

- As at 31st December 2014, the Group's net gearing ratio lifted from 18.7% at the end of 2013 to 22.0%, with a 16.1% increase in net debt mainly for the investments in property projects, purchase of new vessels for Swire Pacific Offshore ("SPO") and the acquisition of TIMCO Aviation Services, Inc. ("TIMCO") by the Hong Kong Aircraft Engineering Company Limited ("HAECO").

- Earnings per share of Swire Pacific 'A' share fell 16.6% year-on-year to HK$7.36 per share. Yet, Swire declared a flat final dividend of HK$2.50 per share for 2014 (2013: HK$2.50 per share). Together with an interim dividend of HK$1.4 per share (1H13: HK$1.0 per share), its full-year dividend was up 11.4% year-on-year to HK$3.90 per share. Payout ratio improved from 39.6% in 2013 to 53.0% in 2014 accordingly.

- **Turnover breakdown by divisions**:

HK$ million	2014	%	2013	%	*y-o-y Change*
Property					
Property investment	10,366	16.9%	9,707	18.9%	*6.8%*
Property trading	3,842	6.3%	2,207	4.3%	*74.1%*
Hotels	1,089	1.8%	942	1.8%	*15.6%*
	15,297	25.0%	12,856	25.0%	*19.0%*
Aviation	11,927	19.5%	7,387	14.4%	*61.5%*
Beverages	16,382	26.7%	15,053	29.3%	*8.8%*
Marine Services	7,234	11.8%	6,292	12.2%	*15.0%*
Trading & Industrial	10,430	17.0%	9,836	19.1%	*6.0%*
Subtotal	61,270	100.0%	51,424	100.0%	*19.1%*
Head Office	31		13		*138.5%*
Total	**61,301**		**51,437**		*19.2%*

- **Attributable profit by divisions:**

HK$ million	2014	%	2013	%	*y-o-y Change*
Property	7,786	70.3%	10,207	76.8%	*(23.7%)*
Aviation	1,822	16.5%	1,627	12.2%	*12.0%*
Beverages	854	7.7%	802	6.0%	*6.5%*
Marine Services	1,072	9.7%	1,307	9.8%	*(18.0%)*
Trading & Industrial	423	3.8%	237	1.8%	*78.5%*
Head Office	(888)	-8.0%	(889)	-6.7%	*(0.1%)*
Total	**11,069**	**100.0%**	**13,291**	**100.0%**	*(16.7%)*

- **Property Division**: Attributable profit tumbled by 23.7% year-on-year to HK$7,786 million. Stripping out revaluation gains on investment properties, underlying profit soared 14.7% year-on-year to HK$5,841 million on higher profitability of property development and property investment businesses.

- Revenue from property trading jumped 74.1% year-on-year to HK$3,842 million in 2014, thanks to resilient property sales during the period. Major bookings of development projects included i) AZURA in Mid-Levels, ii) ARGENTA in Mid-Levels, iii) DUNBAR PLACE in Ho Man Tin, and iv) MOUNT PARKER RESIDENCES in Quarry Bay.

- Gross rental income of the property division climbed 6.7% year-on-year to HK$10,320 million, on the back of positive rental reversions of its Hong Kong office and retail portfolio, Taikoo Hui in Guangzhou and Taikoo Li Sanlitun in Beijing.

- In Hong Kong, growth in rental income on the office front continued (+5.0% year-on-year to HK$5,355 million) on the back of positive rental reversions. Occupancy rate of its office portfolio remained stable at 97% as at 31st December 2014 (as at 30th June 2014: 97%). On the other hand, rental income of its retail portfolio grew modestly by 3.5% year-on-year to HK$2,705 million, with 100% occupancy rate at the end of December 2014 (as at 30th June 2014: 100%). Retail sales at Citygate in Tung Chung rose steadily by 4.6% year-on-year. Yet, retail sales at Pacific Place in Admiralty slipped 6.1% year-on-year as a result of less spending by Mainland tourists, whereas the retail sales at Cityplaza Mall in Tai Koo Shing fell 0.4% year-on-year due to renovation works which was completed in December 2014.

- In China, the total gross rental income posted solid growth of 16.9% from a year earlier. For retail properties, gross rental income grew 15.4% year-on-year. As at 31st December 2014, the occupancy rates of the malls at Taikoo Hui in Guangzhou and INDIGO in Beijing stood at 99% and 95%, against 99% and 96% at the end of 2013, respectively. Additionally, retail sales growth at Taikoo Li Sanlitun in Beijing leaped 19% year-on-year in 2014, with the overall occupancy rate up from 94% at the end of 2013 to 95% at the end of 2014. For office properties, rental performance was satisfactory, with gross rental income increasing 22.6% from a year ago. Occupancy rates of the office space in Taikoo Hui and ONE INDIGO were both fully let, compared to 89% and 97% at the end of 2013, respectively.

- **Aviation Division**: Attributable profit of the **Cathay Pacific Group** surged by 20.3% from the previous year. Passenger revenue was HK$75,734 million, an increase of 5.4% year-on-year. Yet, passenger yield was down 1.8% to HK67.3 cents, adversely impacted by intense competition. Business in the air cargo market started to recover in 2014, with revenue up 7.3% from a year ago. Cargo yield fell 5.6% year-on-year to HK$2.19. Yet, its improved business performance was partly offset by fuel hedging losses as a result of lower fuel costs in the final 3 months of the year. Separately, attributable profit of the **HAECO Group** dropped 8.3% year-on-year to HK$430 million in 2014, owing to losses from the newly acquired HAECO Americas (formerly known as HAECO USA or TIMCO Aviation Services) and reduced earnings in its engine servicing units in Hong Kong and Singapore. Its bottom line was also dragged by higher tax expenses in HAECO Xiamen on reduced deferred tax benefit.

- **Beverage Division:** The beverage division reported an attributable profit of HK$854 million in 2014, an increase of 6.5% year-on-year. Excluding non-recurring gains on disposal of available-for-sale investments in 2014 and on remeasurement of an associate in 2013, adjusted attributable profit was HK$776 million (+6% year-on-year). The steady growth of profit was mainly attributable to its improved performance in China as well as lower raw material costs. Overall sales volume grew 3% year-on-year to 1,044 million unit cases in 2014, accelerated from a 2% yearly growth in 2013.

- **Marine Services Division**: Attributable profit of the division tumbled by 18.0% from a year earlier. Excluding non-recurring profits related to the profits on disposal of vessels, adjusted attributable profit of SPO fell 11% year-on-year. The drop in profit was dragged by lower utilization rate (-4.5 percentage points to 80.6%) as well as a smaller increase in charter hire rates for its specialist fleet, amid the significant decline in the oil price in 2H14.

- **Trading and Industrial Division**: Attributable profit of the division jumped 78.5% year-on-year, thanks to better results from Taikoo Motors (+2.7 times year-on-year to HK$213 million) as well as reduced losses from Campbell Swire (net loss of HK$14 million in 2014 vs. net loss of HK$125 million in 2013), which were partly offset by weaker results from the Swire Retail group and increased start-up costs from Swire Pacific Cold Storage.

Outlook & Prospect

- **Property Investment:** In Hong Kong, Management expected the rental performance of its office portfolio, particularly in the Central district, will be subdued in 2015 due to weak office demands. However, the office rents in Pacific Place should remain stable, given no major leases expiring this year. On the other hand, office rents at decentralized districts including Taikoo Place in Tai Koo Shing and Cityplaza in Tung Chung are expected to remain resilient owing to high occupancy. In respect of the retail segment, retail rental performance will be muted in 2015, amid weakening demand for luxury goods. Retail sales in Pacific Place continued to see yearly decline during the first 2 months of 2015, which has lifted its occupancy cost to sales to over 10%.

In China, although office rents in Beijing and Guangzhou are expected to be under pressure this year as a result of an increase in office supply, retail rental performance should remain resilient on the back of its organic and inorganic growth. For the first 2 months of 2015, retail sales growth at Taikoo Hui in Guangzhou grew 20% year-on-year, following the replacement of 45 weaker-performing tenants in 2014 and the introduction of new brands to consumers. INDIGO in Beijing also registered double-digit retail sales growth during the same period, whereas sales at Taikoo Li Sanlitun rose at a low-teens rate. In addition, the Group will benefit from the rental contribution from its new investment properties. The retail mall of Daci Temple project in Chengdu was opened in October 2014, with 83% of the retail space being committed as of March 2015. Separately, Dazhongli project in Shanghai will be opened in phases starting from 2016.

- **Property Trading:** Demand for luxury residential properties in Hong Kong will likely remain intact, amid limited impact from the recent mortgage tightening measures. Property trading profits in 2015 are expected to be recognised on sales of units at i) AREZZO in the Mid-Levels, ii) 160 South Lantau Road project in Lantau Island, and iii) Pinnacle One, the office tower of the Daco Temple project in Chengdu.

- **Aviation Division:** The outlook for Cathay Pacific will stay positive in 2015, given lower fuel costs, strong passenger demand as well as the continued recovery of its cargo business. Yet, yields will remain under pressure in the face of stiff market competition. For HAECO, its airframe services capacity is expected to increase with easing labour shortage. Yet, its engine overhaul business will likely be adversely affected by the retirement of older engine type.

- **Beverage:** The results from its beverage business are expected to be better in 2015 than those in 2014, thanks to the inclusion of full-year results from the franchised territories in the US in 2014. However, Management turned more cautious on its China business, amid rising labour costs which may put pressure on its profit margin.

- **Marine:** Soft oil price and the consequent pressure on the exploration and production activities of oil companies are expected to put downward pressure on its utilization rate of fleets as well as charter hire rates. Nevertheless, Swire continues to stick with its CAPEX (capital expenditure) plan, with six new vessels to be received in 2015.

- **Trading & Industrial:** The results of its trading & industrial division will likely to be lower in 2015 than those in 2014, primarily due to the absence of significant non-recurring profits from Taikoo Motors as well as lower sales of Taikoo Motors following its termination of dealership in Taiwan. Additionally, the division will be negatively affected by increased start-up cost for its new cold stores in China, including i) cold stores in Nanjing and Ningbo, both of which are expected to be completed in late 2015 and ii) a new cold store in Chengdu which is expected to start operation in 2016.

- **Valuation:** Swire Pacific shares are trading at 34.1% discount to 2015E NAV (vs. historical average of 26% NAV discount). The valuation is fair, taking into account of its holding company status following the listing of Swire Properties. Downside risks include global economic slowdown, weaker-than-expected rental performance and property sales as well as lower-than-expected demand for offshore exploration activities.

Recommendation: Hold

Important Disclosure / Analyst Certification / Disclaimer

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA).

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Information and opinions expressed herein reflect a judgment as at the date of this document and are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction, publication, availability or use would be contrary to law and regulation.