

Last Closing: HK\$ 79.65

Upside: -8.60%

Target Price: HK\$ 72.80↑

Hong Kong Property Sector

Wharf (4 HK)

1H17 results review: front-running expectation

UP

MP

OP

Financial Highlights

Y/E 31 Dec	2015	2016	2017E	2018E	2019E
Total operating revenue (HK\$m)	40,875	46,627	41,089	45,916	42,393
Growth (%)	7.2	14.1	(11.9)	11.7	(7.7)
Core profit (HK\$m)	10,969	13,754	13,532	13,747	13,432
Core EPS (HK\$)	3.62	4.54	4.46	4.53	4.43
Core EPS growth (%)	4.7	25.2	(1.7)	1.6	(2.3)
Core profit vs consensus (+/-%)	-	-	(4.7)	(7.2)	(14.1)
Core P/E (X)	22.0	17.6	17.9	17.6	18.0
DPS (HK\$)	1.900	2.150	2.250	2.350	2.450
Yield (%)	2.39	2.70	2.82	2.95	3.08

Source: Company, BOCOM Int'l estimates

- Gradual rental recovery.** Reported 1H17 core profit rose 22% YoY to HK\$7.3bn, or +6% YoY to ~HK\$6.8bn if adjusted for one-off gains, in our estimate. 1H17 adjusted profit accounted for 53% and 48% of our and consensus FY17E forecast, respectively. Therefore, we believe the overall results are in line. HK net rental income grew 5% YoY, led by the rental recovery at Harbour City (+5% YoY), although Times Square still lagged behind at -1.4% YoY. Similar trend was seen in 1H17 retail sales growth, with Harbour City retail sales +2.8% YoY, outperforming overall HK retail sales (-0.6% YoY), versus -4.3% YoY at Times Square. On the other hand, Mainland rental income rose 11% YoY in RMB terms. CDIFS mall remained the top performer, with 15% YoY growth in rental income, well supported by its 30% YoY retail sales growth, in our view. However, with the increased interest rate and RMB translation loss, overall core profit from recurrent rental income rose only 3% YoY. Earnings growth was once again led by property profit, mainly from the booking of Mount Nicholson in HK, as well as the major margin recovery in Mainland (1H17: 22.8% vs. 1H16: 14.6%), adding a total of HK\$380m to core profit, in our estimate. Jun 2017 BVPS was HK\$106.9, +2.4% HoH. Net gearing further improved to 6.6% (Dec 2016: 7.5%). 1H17 DPS rose 10% YoY to HK\$0.64. The company also declared distribution of its shares in i-CABLE (1097 HK) in specie, equivalent to HK\$0.17 per Wharf share.

- Potential earnings gap.** We are concerned the earnings boost from Mainland property sales may slow down, especially when the company continued to deleverage and paid down another HK\$10bn debt during 1H17, rather than landbanking (only added 1 site in 1H17). The 27% YoY decline in 1H17 contracted sales was also due to a lack of sellable resources. As of June 2017, Mainland landbank decreased to only 3.4m sq m. Even together with the Rmb30bn unbooked revenue, we estimate there to be only 3 years of booking, and there could be an earnings gap beyond 2019E, before new rental projects fully ramp up, in our view. In addition, while Harbour City continues to show signs of retail sales recovery, we expect rental reversion to stay low at mid-low single digits, considering the high rental base during 2014-15. Therefore, we only revise up our 17E-18E earnings by 3%-6%, mainly to reflect the higher development margin, rather than any significant rental growth.



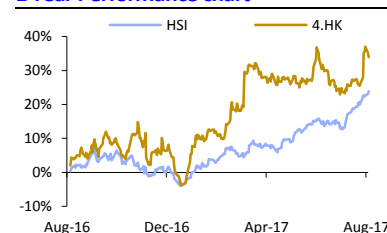
- 1H17 core profit rose 22% to HK\$7.3bn, or +6% YoY on an adjusted basis.
- Retail sales showed signs of recovery, but retail rent may lag behind, given the high base.
- Potential earnings gap after mainland landbank runs out in 3 years
- Share price has built in the excitement towards potential spin-off, but we expect little value enhancement at current valuation.

Stock data

52w High	80.15
52w Low	49.75
Market cap (HK\$ m)	241,747.89
Issued shares (m)	3,035.13
Avg daily vol (m)	3.33
1-mth change (%)	23.78
YTD change (%)	54.51
50d MA	67.30
200d MA	62.18
14-day RSI	83.1

Source: Company data, Bloomberg

1 Year Performance chart



Source: Company data, Bloomberg

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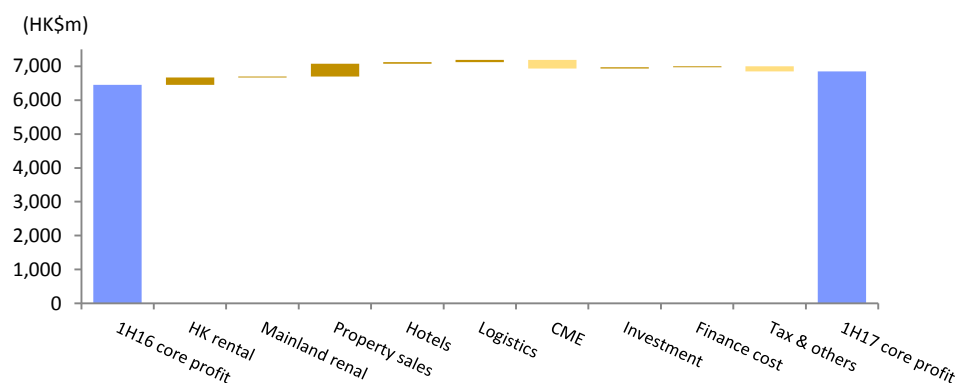
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- **Share prices front-running spin-off.** On top of the 1H17 results, we believe investors are most interested in the progress of the proposed spin-off of Wharf REIC, which will consist of six projects, including Harbour City, Times Square and Plaza Hollywood, with a total GFA of ~11m sq ft, asset value of >HK\$230bn and annual turnover of >HK\$13bn. While we estimate such asset value implies a very conservative cap rate of 5%-5.5%, and corresponding market value could easily be 30%-40% higher, this is common across HK developers/landlords and they are mostly trading at ~0.6-0.7x P/B. With Wharf's Jun 2017 P/B currently at 0.75x, we argue there is little value-add from the spin-off at current share price. Moreover, judging from the remaining assets, the post-spin-off Wharf might become a combination of a mid-sized HK developer with a Peak portfolio, a mid-sized Chinese developer/landlord and a local port operator, which we believe may cause risk of de-rating from current valuation, given the mixed and unclear positioning. Therefore, we maintain our view that there would be greater value to unlock by expanding the scope of strategic review to the group level, and removing the holding company discount at Wheelock (20 HK), especially when such review might have already been expanded to Harbour Centre Dev (51 HK, Wharf's 71%-owned subsidiary), which currently owns The Murray. We revise up our NAV to HK\$106.5 (from HK\$104.1), in reflecting the higher Mainland property prices. We also narrow the target discount on HK assets/established business to 30% (from 40%), in view of the proposed spin-off, while maintaining Mainland property target NAV discount at 40% (unchanged). As such, we raise our target price to HK\$72.80 (from HK\$67.70), but maintain **Neutral** on the counter, as we believe share price has already built in the excitement, trading at only 25% NAV discount. On the other hand, we believe Wheelock could be an even bigger beneficiary if Wharf expands the scope of restructuring, and at a more attractive valuation of 39% NAV discount. We currently have a **Buy** rating on Wheelock and target price of HK\$69.70, based on a 40% NAV discount.

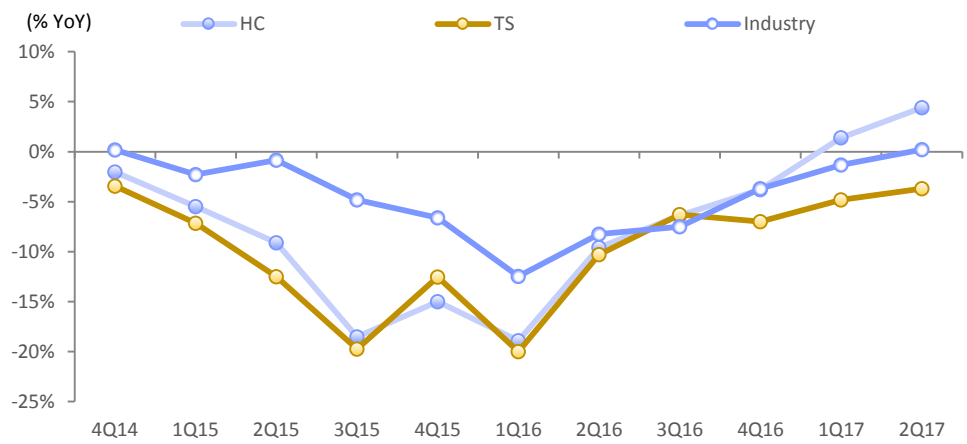
Figure 1: 1H17 results review

HK\$m	1H16	1H17	% YoY	Remarks
HK net rental income	5,688	5,942	+4.5	HC and TS rental income +4.8%/-1.4% YoY; Full six-month contribution of Wheelock House
Mainland net rental income	689	732	+6.2	Revenue/EBIT +9%/+11% YoY in RMB terms (FY16: +9%/+8%); CDIFS posted +21% in rental income (+15% YoY)
HK property profit	280	859	+206.8	HK\$3.1bn from Mount Nicholson (2 houses and 6 apartments)
Mainland property profit	1,900	2,070	+8.9	Booked revenue -30% YoY to HK\$9.1bn; Jun 2017 unbooked revenue Rmb30.2bn (Dec 2016: Rmb27.0bn)
Hotel	104	155	+49.0	
Logistics	422	506	+19.9	Helped by volume growth (HK TEU +17% YoY); stable market share
CME	78	(222)	-384.6	Absence of Wharf T&T contribution after disposal
Investment and others	208	248	+19.2	
Overhead	(296)	(390)	+31.8	
Operating profit	9,073	9,900	+9.1	
Finance cost	(674)	(639)	-5.2	Paid down HK\$16bn debt over the past 12 months, but interest rate +40bps to 3.3% after hedging
Tax	(1,717)	(2,081)	+21.2	
MI	(232)	(319)	+37.5	
Adjusted core profit	6,450	6,861	+6.4	
Net revaluation gain	525	1,171	+123.0	
Currency & interest rate swap	352	50	-85.8	
Other income	(478)	410	-185.8	Disposal gain
Others	(124)	(51)	-58.9	
Net profit	6,725	8,441	+25.5	
Core EPS (HK\$)	1.97	2.39	+21.5	
DPS (HK\$)	0.58	0.64	+10.3	
Payout (%)	29	27	-3ppt	
BVPS (HK\$)	101.29	106.94	+5.6	
Net gearing (%)	15.7	6.6	-9.1ppt	
HK net rental margin (%)	88.2	88.9	+0.7ppt	
Mainland net rental margin (%)	57.6	58.7	+1.2ppt	
HK property margin (%)	NA	27.7	NA	
Mainland property margin (%)	14.6	22.8	+8.2ppt	Subsid. Margin: 28.9% (1H16: 15.6%)

Source: Company data, BOCOM Int'l estimates

Figure 2: Movement in 1H17 core profit

Source: BOCOM Int'l estimates

Figure 3: Quarterly retail sales growth


Sources: Company, BOCOM Int'l

Figure 4: Proposed portfolio of Wharf REIC

	GFA (sqft)	Dec 2016 valuation (HK\$ m)	% (%)	FY16 revenue (HK\$ m)	% (%)
Harbour City (ex-hotel/club)	7.5	164,540	67	8,960	70
Times Square	2.0	54,510	22	2,838	22
Plaza Hollywood	0.6	9,551	4	546	4
Crawford House	0.2	5,790**	2	220***	2
Wheelock House	0.2	6,200**	3	220***	2
The Murray (Murray Building)*	0.3	4,400**	2		0
Total	~11m sqft	>HK\$230bn	100	>HK\$13bn	100

Source: Annual Report

* Owned by Harbour Centre Development (51 HK) at the moment

** Acquisition cost during 2014, 2016 and 2013, respectively

*** BOCOM Int'l estimates

Figure 5: NAV summary

Project	NAV (HK\$ m)	% of GAV (%)	NAV/share (HK\$)
Harbour City	164,540	41.1	54.3
Times Square	54,510	13.6	18.0
Other HK completed IP	40,948	10.2	13.5
China completed IP	37,315	9.3	12.3
China IP underdevelopment	13,090	3.3	4.3
Development properties	26,825	6.7	8.9
Hotels	17,932	4.5	5.9
Total property NAV	355,160	88.8	117.2
Modern Terminal (68%-owned)	7,793	1.9	2.6
CME	-	0.0	-
Other investment	7,886	2.0	2.6
Cash	29,131	7.3	9.6
GAV	399,970	100.0	132.0
Adjusted borrowings at Wharf	(50,423)		(16.6)
Other liabilities	(26,869)		(8.9)
NAV	322,679		106.50
NAV per share (HK\$)	106.50		
Target discount (%)	32.0	(30% discount for established business; 40% for Mainland property)	
Target price (HK\$)	72.80		

Source: BOCOM Int'l estimates

Figure 6: Earnings revision

	Old	New	% chg
17E Core profit (HK\$ m)	12,781	13,532	5.9
18E Core profit (HK\$ m)	13,304	13,747	3.3
19E Core profit (HK\$ m)	NA	13,432	NA
17E EPS (HK\$)	4.22	4.46	5.7
18E EPS (HK\$)	4.39	4.53	3.2
19E EPS (HK\$)	NA	4.43	NA
17E DPS (HK\$)	2.25	2.25	-
18E DPS (HK\$)	2.35	2.35	-
19E DPS (HK\$)	NA	2.45	NA

Source: BOCOM Int'l estimates

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Buy: Expect more than 20% upside in 12 months

LT Buy: Expect more than 20% upside but longer than 12 months

Neutral: Expect low volatility

Sell: Expect more than 20% downside in 12 months

Sector Rating

Outperform ("OP"): Expect more than 10% upside in 12 months

Market perform ("MP"): Expect low volatility

Underperform ("UP"): Expect more than 10% downside in 12 months

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