

# Swire Properties (1972.HK)

## Stakes at Cityplaza Three and Four to be sold for HK\$15bn

Buy

1972.HK 12m Price Target: **HK\$33.10** Price: **HK\$32.50** Upside: **1.8%**

### Cityplaza Three and Four HK\$15bn sale announced, 73% higher than GS FY19E NAV

On June 15 after market close, Swire Properties announced that it has entered into a sale and purchase agreement to dispose of its entire interest at Cityplaza Three and Four -

- Total consideration for this 770k sq ft LFA office project stake to be HK\$15bn, implying -
  - c.HK\$19,500 per sq ft LFA, or;
  - c.3.1% estimated gross rental yield (based on GS est. 2018E spot rent of HK\$50 per sq ft LFA), or;
  - c.2.3% net rental income yield (CY2017 at HK\$343mn per announcement).
- Buyer and payment terms -
  - The purchaser is Henglilong Investments Limited.
  - The HK\$1.48bn deposit has been received already; another HK\$1.48bn and HK\$0.78bn is to be paid by Nov 2018 and Jan 2019, while the remaining HK\$11.3bn will be paid upon completion.
  - Completion of the disposal to take place no later than 11 April 2019.
- According to the announcement, the statutory disposal gain and underlying profit to be recognised upon completion will be HK\$509mn and HK\$14bn, respectively. The former being the gain based on comparing the sales consideration and most recent project company valuation (HK\$14.5bn as of April 2018), and the latter based on comparing the sales consideration and historical costs for this 24-year-old project.

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#### Key Data

Market cap: HK\$190.1bn / \$24.2bn  
Enterprise value: HK\$226.7bn / \$28.9bn  
3m ADTV: HK\$66.4mn / \$8.5mn  
Hong Kong  
Hong Kong Property  
M&A Rank: 3

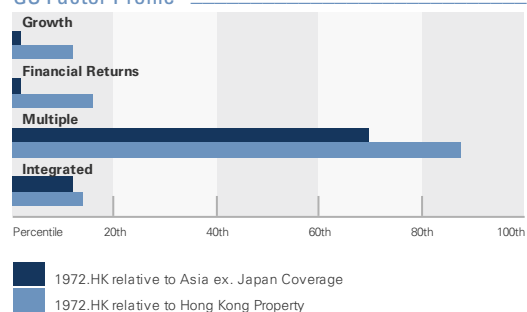
#### GS Forecast

	12/17	12/18E	12/19E	12/20E
Revenue (HK\$ mn)	18,558.0	20,191.0	16,413.5	14,796.4
EBITDA (HK\$ mn)	9,893.0	10,121.3	10,229.1	9,850.4
EPS (HK\$)	5.80	1.35	1.37	1.33
P/E (X)	4.4	24.1	23.7	24.4
P/B (X)	0.6	0.7	0.7	0.7
Dividend yield (%)	3.0	2.4	2.4	2.4
Net debt/EBITDA (X)	3.6	3.4	3.1	3.1
FCF yield (%)	4.2	2.8	3.7	3.2

	6/17	12/17	6/18E	12/18E
EPS (HK\$)	0.79	3.28	0.67	0.68

#### GS Factor Profile



Source: Company data, Goldman Sachs Research estimates.  
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Buy

## Swire Properties (1972.HK)

Rating since May 9, 2012

## Ratios &amp; Valuation

	12/17	12/18E	12/19E	12/20E
P/E (X)	4.4	24.1	23.7	24.4
P/B (X)	0.6	0.7	0.7	0.7
FCF yield (%)	4.2	2.8	3.7	3.2
EV/EBITDA (X)	18.8	22.4	21.9	22.6
CROCI (%)	3.1	2.7	2.7	2.5
ROE (%)	14.1	3.0	3.0	2.9
Net debt/equity (%)	13.6	13.2	12.1	11.3
Interest cover (X)	9.6	9.8	8.9	8.3
Days inventory outst, sales	79.9	40.2	43.6	52.5
Receivable days	119.5	172.9	226.5	265.1
Days payable outstanding	399.8	323.8	554.1	795.7
DuPont ROE (%)	13.1	3.0	3.0	2.9
Turnover (X)	0.1	0.1	0.1	0.0
Leverage (X)	1.2	1.2	1.2	1.2

## Growth &amp; Margins (%)

	12/17	12/18E	12/19E	12/20E
Total revenue growth	10.5	8.8	(18.7)	(9.9)
EBITDA growth	6.7	2.3	1.1	(3.7)
EPS growth	125.6	(76.7)	1.3	(2.8)
DPS growth	8.5	0.0	0.0	0.0
EBIT margin	51.0	48.0	59.6	63.5
EBITDA margin	53.3	50.1	62.3	66.6
Net income margin	183.0	39.1	48.8	52.6

## Price Performance



Source: FactSet. Price as of 15 Jun 2018 close.

## Income Statement (HK\$ mn)

	12/17	12/18E	12/19E	12/20E
Total revenue	18,558.0	20,191.0	16,413.5	14,796.4
Cost of goods sold	(7,569.0)	(8,853.0)	(4,894.6)	(3,578.8)
SG&A	(1,170.0)	(1,216.8)	(1,289.8)	(1,367.2)
R&D	-	-	-	-
Other operating inc./exp.)	74.0	-	-	-
ESO expense	-	-	-	-
<b>EBITDA</b>	<b>9,893.0</b>	<b>10,121.3</b>	<b>10,229.1</b>	<b>9,850.4</b>
Depreciation & amortization	(426.0)	(434.5)	(443.2)	(460.9)
<b>EBIT</b>	<b>9,467.0</b>	<b>9,686.7</b>	<b>9,785.9</b>	<b>9,389.5</b>
Net interest inc./exp.)	(900.0)	(934.0)	(1,026.6)	(1,037.5)
Income/(loss) from associates	1,792.0	863.6	1,079.1	1,215.4
<b>Pre-tax profit</b>	<b>35,822.0</b>	<b>9,616.3</b>	<b>9,838.4</b>	<b>9,567.3</b>
Provision for taxes	(1,807.0)	(1,639.9)	(1,742.2)	(1,713.9)
Minority interest	(58.0)	(76.5)	(89.7)	(73.0)
Preferred dividends	-	-	-	-
<b>Net inc. (pre-exceptionals)</b>	<b>33,957.0</b>	<b>7,899.9</b>	<b>8,006.5</b>	<b>7,780.4</b>
Post-tax exceptionals	-	-	-	-
<b>Net inc. (post-exceptionals)</b>	<b>33,957.0</b>	<b>7,899.9</b>	<b>8,006.5</b>	<b>7,780.4</b>
<b>EPS (basic, pre-exception) (HK\$)</b>	<b>5.80</b>	<b>1.35</b>	<b>1.37</b>	<b>1.33</b>
<b>EPS (diluted, pre-exception) (HK\$)</b>	<b>5.80</b>	<b>1.35</b>	<b>1.37</b>	<b>1.33</b>
<b>EPS (basic, post-exception) (HK\$)</b>	<b>5.80</b>	<b>1.35</b>	<b>1.37</b>	<b>1.33</b>
<b>EPS (diluted, post-exception) (HK\$)</b>	<b>5.80</b>	<b>1.35</b>	<b>1.37</b>	<b>1.33</b>
<b>EPS (diluted, excl. ESO) (HK\$)</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>--</b>
DPS (HK\$)	0.77	0.77	0.77	0.77

## Balance Sheet (HK\$ mn)

	12/17	12/18E	12/19E	12/20E
Cash & cash equivalents	1,708.0	1,545.9	2,779.6	2,748.8
Accounts receivable	9,263.0	9,867.1	10,502.9	10,986.4
Inventory	2,380.0	2,063.3	1,858.3	2,397.7
Other current assets	-	-	-	-
<b>Total current assets</b>	<b>13,351.0</b>	<b>13,476.3</b>	<b>15,140.9</b>	<b>16,132.9</b>
Net PP&E	277,244.0	277,520.5	277,377.3	277,216.3
Net intangibles	178.0	178.0	178.0	178.0
Total investments	23,400.0	24,263.6	25,342.7	26,558.1
Other long-term assets	136.0	136.0	136.0	136.0
<b>Total assets</b>	<b>314,309.0</b>	<b>315,574.4</b>	<b>318,174.9</b>	<b>320,221.3</b>
Accounts payable	8,458.0	7,249.0	7,611.4	7,992.0
Short-term debt	8,337.0	5,023.0	5,715.0	8,175.0
Other current liabilities	-	-	-	-
<b>Total current liabilities</b>	<b>16,795.0</b>	<b>12,272.0</b>	<b>13,326.4</b>	<b>16,167.0</b>
Long-term debt	28,718.0	31,111.0	29,155.0	25,085.0
Other long-term liabilities	9,418.0	9,418.0	9,418.0	9,418.0
Total long-term liabilities	38,136.0	40,529.0	38,573.0	34,503.0
<b>Total liabilities</b>	<b>54,931.0</b>	<b>52,801.0</b>	<b>51,899.4</b>	<b>50,670.0</b>
<b>Preferred shares</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>--</b>
<b>Total common equity</b>	<b>257,381.0</b>	<b>260,776.4</b>	<b>264,278.5</b>	<b>267,554.4</b>
<b>Minority interest</b>	<b>1,997.0</b>	<b>1,997.0</b>	<b>1,997.0</b>	<b>1,997.0</b>
<b>Total liabilities &amp; equity</b>	<b>314,309.0</b>	<b>315,574.4</b>	<b>318,174.9</b>	<b>320,221.3</b>
<b>Net debt, adjusted</b>	<b>35,347.0</b>	<b>34,588.1</b>	<b>32,090.4</b>	<b>30,511.2</b>
Average capital employed	278,663.5	296,043.3	297,863.7	299,214.2
RNAV	228,361.7	234,523.5	241,774.5	-
BVPS (HK\$)	44.00	44.58	45.18	45.74

## Cash Flow (HK\$ mn)

	12/17	12/18E	12/19E	12/20E
Net income	33,957.0	7,899.9	8,006.5	7,780.4
D&A add-back	426.0	434.5	443.2	460.9
Minority interest add-back	58.0	76.5	89.7	73.0
Net (inc)/dec working capital	3,683.0	(1,496.5)	(68.4)	(642.3)
Other operating cash flow	(26,368.0)	(863.6)	(1,079.1)	(1,215.4)
<b>Cash flow from operations</b>	<b>11,756.0</b>	<b>6,050.9</b>	<b>7,392.0</b>	<b>6,456.7</b>
Capital expenditures	(5,417.0)	(711.0)	(300.0)	(300.0)
Acquisitions	-	-	-	-
Divestitures	-	-	-	-
Others	(1,470.0)	-	-	-
<b>Cash flow from investing</b>	<b>(6,887.0)</b>	<b>(711.0)</b>	<b>(300.0)</b>	<b>(300.0)</b>
Dividends paid (common & pref)	(4,271.0)	(4,504.5)	(4,504.5)	(4,504.5)
Inc/(dec) in debt	(440.0)	(921.0)	(1,264.0)	(1,610.0)
Other financing cash flows	(131.0)	(76.5)	(89.7)	(73.0)
<b>Cash flow from financing</b>	<b>(4,842.0)</b>	<b>(5,502.0)</b>	<b>(5,858.2)</b>	<b>(6,187.5)</b>
<b>Total cash flow</b>	<b>27.0</b>	<b>(162.1)</b>	<b>1,233.8</b>	<b>(30.8)</b>
Free cash flow	6,339.0	5,339.9	7,092.0	6,156.7

Source: Company data, Goldman Sachs Research estimates.

### Analysis - consideration in line with earlier news reports; next focus to be on use of proceeds

- We are not surprised by this announcement as the company had already made clear that a sale was in advanced discussions a month ago (Swire Prop: In discussions on potential disposal of CityPlaza Three and Four, dated May 13, 2018), while the announced consideration is at the higher end of the range cited in news report.
- Use of proceeds will now be the main investor focus, in our view. On the one hand, we believe Swire Prop has two key areas that would benefit from funding:
  - Debt management – Given our view that rates are likely to rise, a potential disposal could increase management's flexibility in proactively managing its borrowings (its net debt position went up from HK\$29bn in 2012 to HK\$35bn as of 2017), in line with recent moves by its peer Link REIT.
  - Dry powder for growth – There are a number of commercial sites potentially becoming available for public tender in the next 2-3 years (including Queensway Plaza, a 1mn sq ft GFA office/retail redevelopment project in Admiralty). We note Swire Prop is actively involved in the redevelopment of old buildings (e.g., it is currently involved in a compulsory resumption process on two old industrial buildings in Quarry Bay, which could potentially be redeveloped into two c.780 sq ft GFA office buildings).
- On the other hand, the group has previously used proceeds for special dividend payouts and for its own funding needs:
  - Precedent special distribution post a key disposal: in 2011, Swire Pacific (0019.HK, Neutral, last close HK\$83.2; covered by Simon Cheung), its parentco and predecessor before the spin-off, sold a key shopping mall, Festival Walk, for HK\$18.8bn, and paid a special distribution in the same year (at a c.50% payout rate, per Swire Prop's management).
  - On June 10, Swire Pacific announced a proposal to privatize its listed aircraft engineering subsidiary, HAECO (0044.HK, Not Covered) (Conglomerates team's write-up). Swire plans to fund the HK\$3.0bn proposed privatization offer to minority shareholders with cash on hand (Swire had HK\$3.3bn cash at the holdco level as of end-FY17). The privatization is pending approval from minority shareholders and regulatory authorities.

### Potentially NAV-accretive; estimates unchanged pending completion

- We believe this potential disposal could be c.2.6% NAV accretive vs. our base case FY2019E NAV estimates for the project of HK\$8.7bn (or vs the company's independent valuation of HK\$9.3bn, as of Dec 2017); our estimates are unchanged pending completion.
- The announced underlying disposal gain of HK\$14bn would be substantial if-and-when recognised upon completion, versus our base case 2018E/ 2019E underlying profit of HK\$7.9/ 8.0 bn, respectively.
- Our model does not currently bake in any special distribution and there is no further guidance from management on this. However, with its overall target of a c.50%

payout ratio to underlying earnings (which includes disposals) through the cycle (Swire Prop: Best of both worlds, published Oct 9, 2017), a potential special distribution, given the quantum of disposal proceeds (HK\$15bn, or HK\$2.6/share), if any, could be sizable vs our base case 2018E and 2019E DPS of HK\$0.77 per share.

- Fundamentally, we expect Swire Properties to continue to benefit from the structurally positive trends in the HK office market and from its active development pipeline. Stay Buy-rated. Our 12-month FY19E NAV-based target price remains HK\$33.10. Key risks: An abrupt economic slowdown dampening HK office demand; project delays.

# Disclosure Appendix

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**Growth** is based on a stock's forward-looking sales growth, EBITDA growth and EPS growth (for financial stocks, only EPS and sales growth), with a higher percentile indicating a higher growth company. **Financial Returns** is based on a stock's forward-looking ROE, ROCE and CROCI (for financial stocks, only ROE), with a higher percentile indicating a company with higher financial returns. **Multiple** is based on a stock's forward-looking P/E, P/B, price/dividend (P/D), EV/EBITDA, EV/FCF and EV/Debt Adjusted Cash Flow (DACF) (for financial stocks, only P/E, P/B and P/D), with a higher percentile indicating a stock trading at a higher multiple. The **Integrated** percentile is calculated as the average of the Growth percentile, Financial Returns percentile and (100% - Multiple percentile).

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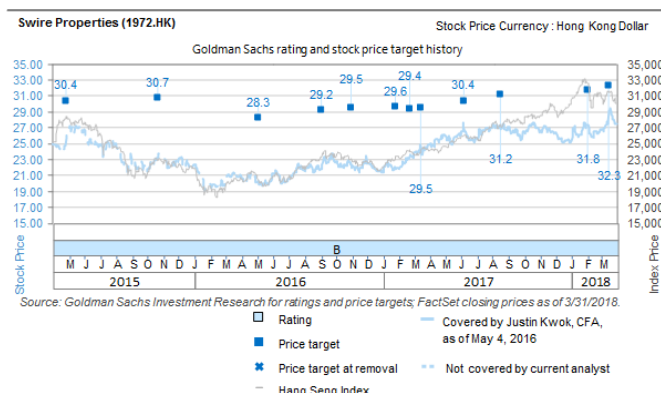
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