

Hang Lung Properties (0101.HK)

1H18 Earnings Review: Above expectations on property sales; More openings in 2019E

Neutral

0101.HK | 12m Price Target: **HK\$20.00** | Price: **HK\$16.58** | Upside: **20.6%**

1H18 results highlights

Hang Lung Properties (HLP) reported above-expectation 1H18 results due to higher property sales profit, while rental contribution was in line.

- 1H18 underlying profit was HK\$2,319mn, down 23.7% yoy on lower development profit contribution, but was 9% higher than our forecasts mainly on earlier-than-expected property sales profit recognition.
- Overall rental revenue was up 7.4% yoy (slightly ahead of our forecasts), with HK up 3.2% yoy and China up 11.4% yoy. However, if we were to exclude the RMB FX impact, 1H China rental revenue was up 2.4% yoy on RMB terms.
- Interim DPS was flat yoy at HK¢17, in line with our forecasts.
- Positive revaluation of HK\$2.2bn for IPs in HK and HK\$0.2bn for those in China, with BVPS up 1.1% hoh to HK\$30.6.

Key takeaways from analyst briefing

- **Update on China operations:**
 - The China retail portfolio saw 2% yoy growth in rental revenue to RMB1,367mn. Plaza 66 in Shanghai continued its solid growth in revenue to 7% in to RMB763mn, while Grand Gateway revenue was down 9.1% yoy (with occupancy down 13pp yoy) due to major AEs, with 32% of the leasable area closed by end of June 2018 for renovation.
 - Outside of Shanghai, only one of the six malls (Shenyang Forum 66) recorded a decline in revenue yoy, while the rest saw positive growth of 0-18% yoy in RMB terms.

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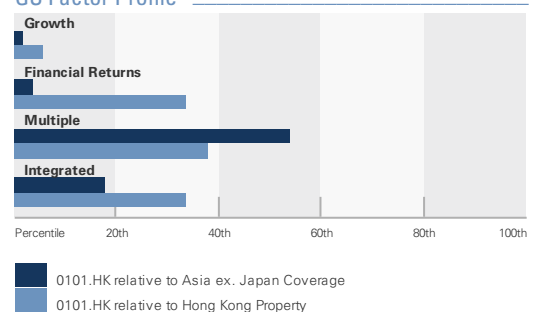
Key Data

Market cap: HK\$74.4bn / \$9.5bn
Enterprise value: HK\$91.6bn / \$11.7bn
3m ADTV: HK\$76.4mn / \$9.7mn
Hong Kong
Hong Kong Property
M&A Rank: 3

GS Forecast

	12/17	12/18E	12/19E	12/20E
Revenue (HK\$ mn) New	11,199.0	10,157.7	10,193.6	9,555.7
Revenue (HK\$ mn) Old	11,199.0	9,370.3	9,839.1	9,497.9
EBITDA (HK\$ mn)	7,462.0	6,732.4	6,911.7	6,634.8
EPS (HK\$) New	1.81	1.06	1.01	0.95
EPS (HK\$) Old	1.81	1.02	1.01	0.95
P/E (X)	10.6	15.7	16.3	17.4
P/B (X)	0.6	0.5	0.5	0.5
Dividend yield (%)	3.9	4.5	4.6	4.6
FCF yield (%)	5.0	(0.8)	(1.6)	6.5
	12/17	6/18	12/18E	--
EPS (HK\$)	0.95	1.04	0.02	--

GS Factor Profile



Source: Company data, Goldman Sachs Research estimates. See disclosures for details.

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Neutral

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Rating since Feb 9, 2017

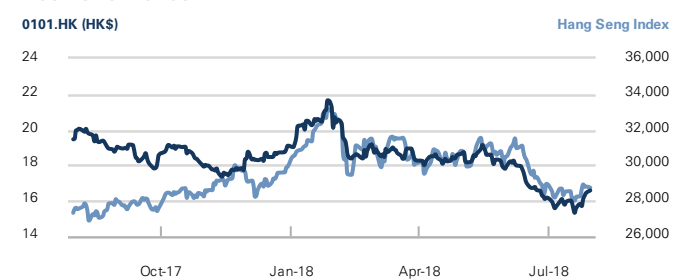
Ratios & Valuation

	12/17	12/18E	12/19E	12/20E
P/E (X)	10.6	15.7	16.3	17.4
P/B (X)	0.6	0.5	0.5	0.5
FCF yield (%)	5.0	(0.8)	(1.6)	6.5
EV/EBITDA (X)	13.2	13.6	14.0	14.4
CROCI (%)	2.3	4.7	4.2	3.3
ROE (%)	6.2	3.5	3.3	3.1
Net debt/equity (%)	4.5	7.2	10.4	9.0
Interest cover (X)	6.2	6.3	6.7	7.2
Days inventory outst, sales	64.6	57.9	57.7	61.6
Receivable days	97.4	69.6	66.7	70.6
Days payable outstanding	721.7	809.6	899.3	1,093.9
DuPont ROE (%)	5.7	3.3	3.1	2.9
Turnover (X)	0.1	0.1	0.1	0.1
Leverage (X)	1.3	1.3	1.3	1.2

Growth & Margins (%)

	12/17	12/18E	12/19E	12/20E
Total revenue growth	(14.2)	(9.3)	0.4	(6.3)
EBITDA growth	(10.8)	(9.8)	2.7	(4.0)
EPS growth	31.1	(41.4)	(4.2)	(5.9)
DPS growth	(0.0)	0.0	2.7	0.0
EBIT margin	66.2	65.9	67.4	69.0
EBITDA margin	66.6	66.3	67.8	69.4
Net income margin	72.5	46.9	44.8	44.9

Price Performance



	3m	6m	12m
Absolute	(11.1)%	(17.5)%	(15.1)%
Rel. to the Hang Seng Index	(4.6)%	(6.4)%	(20.3)%

Source: FactSet. Price as of 30 Jul 2018 close.

Income Statement (HK\$ mn)

	12/17	12/18E	12/19E	12/20E
Total revenue	11,199.0	10,157.7	10,193.6	9,555.7
Cost of goods sold	(3,200.0)	(2,923.9)	(2,763.9)	(2,385.7)
SG&A	(580.0)	(597.4)	(615.3)	(633.8)
R&D	-	-	-	-
Other operating inc./exp.)	43.0	96.0	97.3	98.6
ESO expense	-	-	-	-
EBITDA	7,462.0	6,732.4	6,911.7	6,634.8
Depreciation & amortization	(43.0)	(43.0)	(44.3)	(45.6)
EBIT	7,419.0	6,689.4	6,867.5	6,589.2
Net interest inc./exp.)	(654.0)	(642.0)	(742.3)	(731.9)
Income/(loss) from associates	78.0	79.4	80.4	81.7
Pre-tax profit	9,902.0	6,344.8	6,205.6	5,939.0
Provision for taxes	(1,352.0)	(1,088.5)	(1,102.5)	(1,025.0)
Minority interest	(426.0)	(492.6)	(540.4)	(622.6)
Preferred dividends	-	-	-	-
Net inc. (pre-exceptionals)	8,124.0	4,763.7	4,562.7	4,291.4
Post-tax exceptionals	-	-	-	-
Net inc. (post-exceptionals)	8,124.0	4,763.7	4,562.7	4,291.4
EPS (basic, pre-exception) (HK\$)	1.81	1.06	1.01	0.95
EPS (diluted, pre-exception) (HK\$)	1.81	1.06	1.01	0.95
EPS (basic, post-exception) (HK\$)	1.81	1.06	1.01	0.95
EPS (diluted, post-exception) (HK\$)	1.81	1.06	1.01	0.95
EPS (diluted, excl. ESO) (HK\$)	--	--	--	--
DPS (HK\$)	0.75	0.75	0.77	0.77

Balance Sheet (HK\$ mn)

	12/17	12/18E	12/19E	12/20E
Cash & cash equivalents	18,401.0	14,406.6	8,129.7	5,935.8
Accounts receivable	2,036.0	1,836.9	1,885.9	1,810.3
Inventory	1,612.0	1,612.0	1,612.0	1,612.0
Other current assets	-	-	-	-
Total current assets	22,263.0	18,069.5	11,841.6	9,572.1
Net PP&E	156,256.0	162,794.0	169,330.7	169,285.1
Net intangibles	-	-	-	-
Total investments	1,362.0	1,441.4	1,521.9	1,603.6
Other long-term assets	3,705.0	3,705.0	3,705.0	3,705.0
Total assets	183,586.0	186,010.0	186,399.2	184,165.8
Accounts payable	6,327.0	6,643.4	6,975.5	7,324.3
Short-term debt	2,112.0	1,947.3	7,184.3	2,883.3
Other current liabilities	483.0	707.5	595.3	651.4
Total current liabilities	8,922.0	9,298.2	14,755.1	10,859.0
Long-term debt	22,708.0	22,872.7	16,165.0	16,376.8
Other long-term liabilities	9,025.0	9,025.0	9,025.0	9,025.0
Total long-term liabilities	31,733.0	31,897.7	25,190.0	25,401.8
Total liabilities	40,655.0	41,195.9	39,945.1	36,260.8
Preferred shares	--	--	--	--
Total common equity	136,844.0	138,234.5	139,334.1	140,162.3
Minority interest	6,087.0	6,579.6	7,120.0	7,742.6
Total liabilities & equity	183,586.0	186,010.0	186,399.2	184,165.8
Net debt, adjusted	6,419.0	10,413.4	15,219.6	13,324.4
Average capital employed	142,126.0	152,288.7	158,450.6	161,451.5
RNAV	162,434.7	160,335.4	164,478.0	-
BVPS (HK\$)	30.43	30.74	30.98	31.16

Cash Flow (HK\$ mn)

	12/17	12/18E	12/19E	12/20E
Net income	8,124.0	4,763.7	4,562.7	4,291.4
D&A add-back	43.0	43.0	44.3	45.6
Minority interest add-back	426.0	492.6	540.4	622.6
Net (inc)/dec working capital	2,643.0	515.4	283.2	424.3
Other operating cash flow	(6,426.0)	145.1	(192.7)	(25.6)
Cash flow from operations	4,810.0	5,959.8	5,237.9	5,358.3
Capital expenditures	(224.8)	(6,581.0)	(6,581.0)	-
Acquisitions	-	-	-	-
Divestitures	-	-	-	-
Others	-	-	-	-
Cash flow from investing	(224.8)	(6,581.0)	(6,581.0)	0.0
Dividends paid (common & pref)	(3,373.3)	(3,373.2)	(3,463.1)	(3,463.1)
Inc/(dec) in debt	(3,245.0)	0.0	(1,470.7)	(4,089.2)
Other financing cash flows	(3,890.9)	0.0	0.0	0.0
Cash flow from financing	(10,509.2)	(3,373.2)	(4,933.8)	(7,552.3)
Total cash flow	(5,924.0)	(3,994.4)	(6,276.9)	(2,194.0)
Free cash flow	4,585.2	(621.2)	(1,343.1)	5,358.3

Source: Company data, Goldman Sachs Research estimates.

Management said it was able to secure leadership positioning for three of the malls (Palace 66 in Shenyang, Parc 66 in Jinan and Center 66 in Wuxi, in their respective cities) after roughly 4-5 years of ramp-up.

- Management believes the 17% yoy revenue decline at Forum 66 Mall in Shenyang reflects the tough operating environment, but it is hopeful that the new management team can improve operations in the next 1-2 years.

■ **M&A:**

- As a recap, HLP acquired a 2.6mn sq ft GFA mixed-use site in Hangzhou in May 2018 for RMB10.7bn, which is scheduled for openings from 2024 onwards.
- With the aforesaid addition, management expects a new wave of completions to be scheduled from 2019 to 2024, at an average of 2.8mn sq ft GFA p.a., versus the 2010 to 2017 average of 2.5mn sq ft GFA.
- However, management said it would continue looking for new investment opportunities in China and is expecting more capex in the years ahead. At the moment, with all committed capex (c.HK\$48bn outstanding) and keeping other parameters constant, management guides for net debt gearing to increase to 23-25% by 2024.

■ **Dividend:**

- Management stated that in line with HLP's current objectives, the company will remain focused on rental profit. Without giving much colour on 2H18E DPS (remains flat yoy in our model), management is confident it will see noticeable growth into 2019, when new completions are scheduled to open (including Kunming's Spring City 66 shopping mall/office, and Shenyang's Forum 66 hotel portion, Wuxi's Center 66 office tower 2 and Wuhan's Heartland 66 shopping mall), which could lead to a potential dividend hike.

What to do with the stock

- We revise our 2018E/19E/20E EPS by 3.7%/0.2%/0.7%, mainly to factor in the pace of HK property inventory sales 2018 YTD and other rental segment assumptions, with our FY19E NAV revised up slightly by 0.3% to HK\$36.57 as a result.
- However, we lower our 12-month NAV-based target price by 8% to HK\$20.00 (from HK\$21.80), as we expand our target discount by 5pp to 45% versus the stock's NAV discount levels of 42% (post-QE average) and 53% (-1SD), due to increased macro uncertainties (e.g., RMB FX) and a likely smaller growth trajectory into 2H18 as we may see negative FX impact from the company's China rentals. Maintain Neutral.
- Looking ahead, though near-term positives in the retail market recovery are likely to continue to be partly offset by ongoing AElS (similar to what happened in FY2017), we continue to expect HLP to start to see noticeable rental profit growth into 2019 when new-completion projects are scheduled to be opened (including Kunming's Spring City 66 shopping mall/office, Shenyang's Forum 66 hotel portion, Wuxi's Center 66 office tower 2 and Wuhan's Heartland 66 shopping mall), which should provide additional support for a potential dividend hike.

Risks:

NAV-accretive acquisitions or disposals; slower-than-expected recovery in China luxury retail market.

Exhibit 1: HLP's 1H18 rental segment was in line while HK development sales were better than our forecasts

HLP 1HFY18 results review

(HK\$mn)	1H17	2H17	1H18	YoY Chg	HoH Chg	Remarks (1HFY18)
Turnover						
Property leasing	3,835	3,944	4,118	7.4%	4.4%	China accounts for 53%/ 46% of rental turnover/ op. profit
Hong Kong	1,886	1,935	1,947	3.2%	0.6%	Property renovations at The Peak Galleria in HK caused a short-term disruption of rental income
- Retail	1,118	1,143	1,155	3.3%	1.0%	Hong Kong tenant sales +10% hoh
- Office	622	635	638	2.6%	0.5%	
- Others	146	157	154	5.5%	-1.9%	
China	1,949	2,009	2,171	11.4%	8.1%	Revenue of the mainland portfolio increased 11%, but was up 2.4% in RMB terms.
- Shanghai	1,313	1,332	1,444	9.9%	8.4%	
- Grand Gateway 66	510	509	505	-1.1%	-0.8%	32% of the leasable area has been closed for AEI; occupancy dropped 9 points to 868%
- Plaza 66 retail	463	495	571	23.4%	15.3%	Tenant sales increased by 15% mainly on the recovery of the luxury sector and completion of AEIs
- Plaza 66 office	340	328	368	8.1%	12.3%	Overall occu. +8pp yoy to 94%, AEIs for Office Tower Two were completed
- Shenyang	206	219	224	8.8%	2.4%	
- Palace 66	87	92	95	8.8%	3.3%	Tenant sales was down by 1% as a result of occu. -1% to 87% from tenant reshuffling
- Forum 66 Retail	66	62	59	-10.0%	-5.4%	Occu. was up by 10pp yoy to 87% and tenant sales -2%yoy
- Forum 66 Office	53	65	70	32.0%	8.7%	Occu. was up by 16pp yoy to 85%, six floors in the high zone ready for hand-over in phases from mid-2018
- Jinan Parc 66	150	162	174	15.3%	6.9%	Occu. was up by 2pp yoy to 94%, and tenant sales 20%yoy benefitting from ongoing tenant upgrading
- Wuxi Center 66	119	134	149	25.4%	11.2%	
- Center 66 Mall	77	87	98	28.0%	13.2%	Occu. Increased by 3pp yoy to 87% and tenant sales +15%yoy; 9% of the leasable area under AEIs
- Center 66 Office	42	47	50	20.6%	7.4%	
- Tianjin Riverside 66	102	107	111	8.8%	3.5%	Occu. Fell 1pp yoy to 86% and tenant sales -11%yoy amidst the changing tenant mix
- Dalian Olympia 66	59	55	70	19.3%	26.6%	Collected 10% more rents in 1H18 driven by 11pp yoy increase in occu. To 75%
Property sale	2,523	897	1,032	-59.1%	15.1%	The sales comprised 3 semi-detached houses at 23-39 Blue Pool Road (2017: 0)
Property sale margin (%)	65.1%	66.4%	54.7%	(10.3)pp	(11.7)pp	and five units of The Long Beach apartments (2017: 197 units).
Total revenue	6,358	4,841	5,150	-19.0%	6.4%	
Operating profit						
Property leasing	2,899	2,773	3,117	7.5%	12.4%	Overall rental margin was up 0.1pp yoy to 75.7%.
Hong Kong	1,625	1,593	1,670	2.8%	4.8%	
China	1,274	1,180	1,447	13.6%	22.6%	
<i>Rental margins: HK</i>	<i>86.2%</i>	<i>-1.9%</i>	<i>85.8%</i>	<i>(0.4)pp</i>	<i>87.7 pp</i>	
<i>Rental margins: China</i>	<i>65.4%</i>	<i>-3.4%</i>	<i>66.7%</i>	<i>1.3 pp</i>	<i>70.0 pp</i>	
Property sale	1,642	596	565	-65.6%	-5.2%	
Administrative exp. & others	(267)	(181)	(270)	1.1%	49.2%	
Depreciation	(26)	(17)	(22)	-15.4%	29.4%	
Net interest inc/(exp)	(237)	(417)	(286)	20.7%	-31.4%	Net debt of HK\$7,748mn vs. net debt of HK\$2,714 as of Dec-17
Operating profit	4,011	2,754	3,104	-22.6%	12.7%	Net-debt-to-equity ratio at 5.4% vs. 1.9% as of Dec 17
Gain on disposal of inv prop	2	462	45	2150.0%	-90.3%	
Gain on disposal of asset held for sale	-	-	25			
Remeasurement of financial instruments	-	-	-		NM	
Surplus arising from inv prop reval	737	1,862	2,456	233.2%	31.9%	
Associates	28	50	54	92.9%	8.0%	
Pretax profits	4,773	5,129	5,684	19.1%	10.8%	
Taxation	(734)	(618)	(736)	0.3%	19.1%	
Profit after taxation	4,039	4,511	4,948	22.5%	9.7%	
MI	(209)	(217)	(259)	23.9%	19.4%	
Net profit	3,830	4,294	4,689	22.4%	9.2%	
Underlying profit	3,040	2,490	2,319	-23.7%	-6.9%	
EPS, basic (HK\$)	0.85	0.95	1.04	22.4%	9.2%	
Underlying EPS, basic (HK\$)	0.68	0.55	0.52	-23.7%	-6.9%	
DPS (HK\$)	0.17	0.58	0.17	0.0%	NM	1H2018 DPS is flat at HK\$0.17 vs. HK\$0.17 in 1H2017
Investment properties	147,372	156,036	162,531	10.3%	4.2%	
Completed	128,954	134,444	136,433	5.8%	1.5%	
Under development	18,418	21,592	26,098	41.7%	20.9%	
Book Value	129,814	136,158	137,593	6.0%	1.1%	Overall revaluation gain of HK\$2456mn
BVPS (HK\$)	30.3	30.3	30.6	1.1%	1.1%	HK portfolio recorded a revaluation gain of HK\$2216 million
						China portfolio recorded a revaluation gain of HK\$240 million
Occupancy rates as at period end	Jun-17	Dec-17	Jun-18	YoY Chg	HoH Chg	
Hong Kong						
- Retail	93%	96%	97%	4 pp	1 pp	
- Office	95%	95%	94%	(1)pp	(1)pp	
- Residential	74%	80%	75%	1 pp	(5)pp	
China						
- Shanghai						
- Grand Gateway 66	81%	77%	68%	(13)pp	(9)pp	
- Plaza 66 retail	89%	96%	97%	8 pp	1 pp	
- Plaza 66 office	86%	89%	94%	8 pp	5 pp	
- Shenyang						
- Palace 66	88%	90%	87%	(1)pp	(3)pp	
- Forum 66 Retail	77%	83%	87%	10 pp	4 pp	
- Forum 66 Office	69%	80%	85%	16 pp	5 pp	
- Jinan Parc 66	92%	94%	94%	2 pp	-	
- Wuxi Center 66						
- Center 66 Mall	84%	87%	87%	3 pp	-	
- Center 66 Office	77%	87%	91%	14 pp	4 pp	
- Tianjin Riverside 66	87%	89%	86%	(1)pp	(3)pp	
- Dalian Olympia 66	64%	71%	75%	11 pp	4 pp	

Source: Company data, Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

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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).

Financial Returns and Multiple use the Goldman Sachs analyst forecasts at the fiscal year-end at least three quarters in the future. Growth uses inputs for the fiscal year at least seven quarters in the future compared with the year at least three quarters in the future (on a per-share basis for all metrics).

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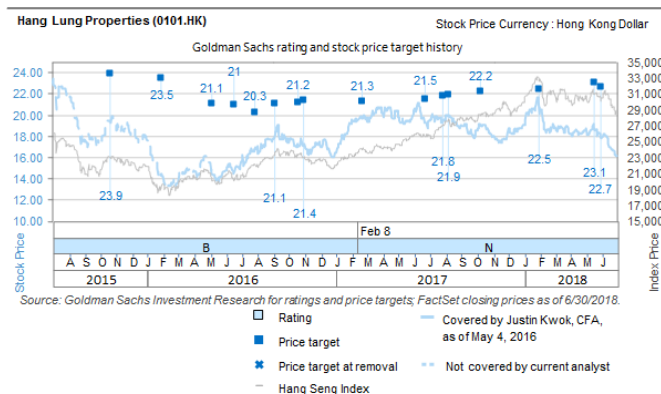
Goldman Sachs Investment Research global Equity coverage universe

	Rating Distribution			Investment Banking Relationships		
	Buy	Hold	Sell	Buy	Hold	Sell
Global	35%	53%	12%	63%	56%	51%

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