

Champion REIT (2778.HK)

Earnings Review: 1H18 DPU higher-than-expectations; more rental reversion upside in 2019E

Neutral

2778.HK	12m Price Target: HK\$6.39	Price: HK\$5.18	Upside: 23.4%
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Champion REIT reported higher-than-expected 1H18 results on better-than-expected retail contributions, and highlights include:

- DPU grew 7.0% yoy to HK\$ cents 12.53 (versus GS's HK\$ cents 11.71).
- Revenue grew by 10.1% yoy to HK\$1.3bn, of which rental income from Three Garden Road and Langham Place Mall grew by 12%/ 11% respectively.
- BVPS grew by 6.6% hoh to HK\$11.05/unit amid positive rental reversions while cap rates were unchanged (Three Garden Road/ Langham Place Mall/ Langham Place office at 3.60%/ 3.75%/ 4.00% respectively)

Key takeaways from analyst briefing:

- **Three Garden Road:**
 - Positive reversions (spot rentals reach HK\$130s psf p.m. LFA for small offerings, vs entire building's passing at HK\$96) plus higher occupancies into 2018 (up 4.6pp hoh to 98.8%).
 - New demand are mainly from Chinese financials and flexible workspace operators (account for 5% of their space now).
 - Minimal expiry in 2H2018E, but with 42% space up for re-pricing in 2019E (of which 20.2% is leases expiry and 22.4% is rent review), amid negative supply in Central (as Hutchison House will be redeveloped), which will give rise to more opportunity to potentially close their gap between passing rent and spot rent.
- **Langham Place Mall:**

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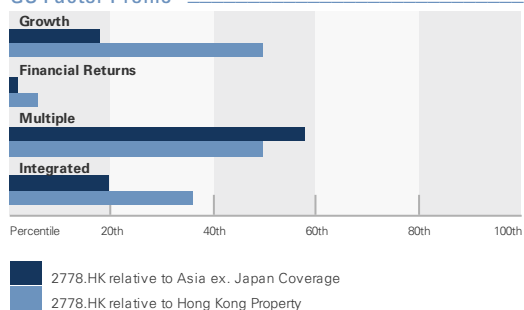
Key Data

Market cap: HK\$29.4bn / \$3.7bn
Enterprise value: HK\$43.1bn / \$5.5bn
3m ADTV: HK\$12.3mn / \$1.6mn
Hong Kong
Hong Kong Property
M&A Rank: 3

GS Forecast

	12/17	12/18E	12/19E	12/20E
Revenue (HK\$ mn) New	2,699.9	2,942.4	3,025.5	3,159.0
Revenue (HK\$ mn) Old	2,699.9	2,861.0	2,987.1	3,115.2
EBITDA (HK\$ mn)	1,885.7	2,069.6	2,122.6	2,211.3
EPS (HK\$) New	1.92	0.24	0.23	0.23
EPS (HK\$) Old	1.92	0.23	0.23	0.23
P/E (X)	2.7	21.4	22.3	22.2
P/B (X)	0.5	0.5	0.5	0.5
Dividend yield (%)	4.7	5.0	4.8	4.8
FCF yield (%)	36.9	4.4	4.5	4.4
	12/17	6/18	12/18E	--
EPS (HK\$)	1.80	0.12	0.12	--

GS Factor Profile



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

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Neutral

Champion REIT (2778.HK)

Rating since Jul 25, 2017

Ratios & Valuation

	12/17	12/18E	12/19E	12/20E
P/E (X)	2.7	21.4	22.3	22.2
P/B (X)	0.5	0.5	0.5	0.5
FCF yield (%)	36.9	4.4	4.5	4.4
EV/EBITDA (X)	23.3	21.2	20.8	20.1
CROCI (%)	16.6	2.4	2.5	2.5
ROE (%)	20.1	2.3	2.3	2.3
Net debt/equity (%)	22.5	22.8	23.0	23.2
Interest cover (X)	5.4	4.8	4.0	3.2
Days inventory outst, sales	-	-	-	-
Receivable days	42.0	37.4	36.4	34.8
Days payable outstanding	895.6	870.6	836.5	792.2
DuPont ROE (%)	18.5	2.3	2.3	2.3
Turnover (X)	0.0	0.0	0.0	0.0
Leverage (X)	1.3	1.3	1.4	1.4

Growth & Margins (%)

	12/17	12/18E	12/19E	12/20E
Total revenue growth	5.6	9.0	2.8	4.4
EBITDA growth	7.1	9.8	2.6	4.2
EPS growth	248.6	(87.4)	(4.1)	0.3
DPS growth	5.6	5.9	(3.5)	0.6
EBIT margin	69.8	70.3	70.2	70.0
EBITDA margin	69.8	70.3	70.2	70.0
Net income margin	412.6	48.0	45.0	43.4

Price Performance



Source: FactSet. Price as of 16 Aug 2018 close.

Income Statement (HK\$ mn)

	12/17	12/18E	12/19E	12/20E
Total revenue	2,699.9	2,942.4	3,025.5	3,159.0
Cost of goods sold	(533.6)	(561.0)	(583.8)	(616.5)
SG&A	-	-	-	-
R&D	-	-	-	-
Other operating inc./exp.)	(280.6)	(311.8)	(319.0)	(331.2)
ESO expense	-	-	-	-
EBITDA	1,885.7	2,069.6	2,122.6	2,211.3
Depreciation & amortization	0.0	0.0	0.0	0.0
EBIT	1,885.7	2,069.6	2,122.6	2,211.3
Net interest inc./exp.)	(334.5)	(413.1)	(517.3)	(573.7)
Income/(loss) from associates	-	-	-	-
Pre-tax profit	11,404.9	1,656.5	1,605.3	1,637.6
Provision for taxes	(265.3)	(244.0)	(244.7)	(266.2)
Minority interest	-	-	-	-
Preferred dividends	-	-	-	-
Net inc. (pre-exceptionals)	11,139.7	1,412.5	1,360.6	1,371.4
Post-tax exceptionals	-	-	-	-
Net inc. (post-exceptionals)	11,139.7	1,412.5	1,360.6	1,371.4
EPS (basic, pre-exception) (HK\$)	1.92	0.24	0.23	0.23
EPS (diluted, pre-exception) (HK\$)	1.92	0.24	0.23	0.23
EPS (basic, post-exception) (HK\$)	1.92	0.24	0.23	0.23
EPS (diluted, post-exception) (HK\$)	1.92	0.24	0.23	0.23
EPS (diluted, excl. ESO) (HK\$)	--	--	--	--
DPS (HK\$)	0.24	0.26	0.25	0.25

Balance Sheet (HK\$ mn)

	12/17	12/18E	12/19E	12/20E
Cash & cash equivalents	1,190.4	1,130.1	6,206.9	6,968.8
Accounts receivable	301.3	301.3	301.3	301.3
Inventory	-	-	-	-
Other current assets	-	-	-	-
Total current assets	1,491.7	1,431.4	6,508.2	7,270.1
Net PP&E	76,704.0	76,762.9	76,823.0	76,884.4
Net intangibles	-	-	-	-
Total investments	0.0	0.0	0.0	0.0
Other long-term assets	257.1	257.1	257.1	257.1
Total assets	78,452.8	78,451.5	83,588.4	84,411.6
Accounts payable	1,338.0	1,338.0	1,338.0	1,338.0
Other short-term debt	0.0	5,200.0	-	5,800.0
Other current liabilities	1,422.6	1,451.0	1,480.1	1,509.7
Total current liabilities	2,760.6	7,989.1	2,818.1	8,647.7
Long-term debt	14,784.7	9,641.0	20,041.0	15,131.7
Other long-term liabilities	556.3	556.3	556.3	556.3
Total long-term liabilities	15,341.0	10,197.3	20,597.3	15,688.0
Total liabilities	18,101.6	18,186.4	23,415.4	24,335.7
Preferred shares	--	--	--	--
Total common equity	60,351.2	60,265.1	60,173.0	60,075.9
Minority interest	--	--	--	--
Total liabilities & equity	78,452.8	78,451.5	83,588.4	84,411.6
Net debt, adjusted	13,594.3	13,710.9	13,834.1	13,962.9
Average capital employed	69,130.9	73,960.8	73,991.6	74,023.0
RNAV	33,010.5	35,746.1	38,080.9	-
BVPS (HK\$)	10.36	10.31	10.24	10.18

Cash Flow (HK\$ mn)

	12/17	12/18E	12/19E	12/20E
Net income	11,139.7	1,412.5	1,360.6	1,371.4
D&A add-back	-	-	-	-
Minority interest add-back	-	-	-	-
Net (inc)/dec working capital	76.5	-	-	-
Other operating cash flow	41.4	(13.9)	57.9	26.4
Cash flow from operations	11,257.5	1,398.6	1,418.5	1,397.8
Capital expenditures	(57.8)	(58.9)	(60.1)	(61.3)
Acquisitions	-	-	-	-
Divestitures	-	-	-	-
Others	-	-	-	-
Cash flow from investing	(57.8)	(58.9)	(60.1)	(61.3)
Dividends paid (common & pref)	(1,371.7)	(1,456.2)	(1,481.6)	(1,465.3)
Inc/(dec) in debt	45.7	56.3	5,200.0	890.7
Other financing cash flows	(9,640.8)	0.0	0.0	0.0
Cash flow from financing	(10,966.9)	(1,399.9)	3,718.4	(574.6)
Total cash flow	232.9	(60.3)	5,076.8	761.9
Free cash flow	11,199.7	1,339.6	1,358.4	1,336.5

Source: Company data, Goldman Sachs Research estimates.

- The 13% yoy growth in retail rental revenue was mostly driven by a 1.3X growth in the turnover rentals (from HK\$41mn to HK\$94mn), which the latter accounts for 22% of total.
- Their 24% yoy growth in tenant sales, much ahead of overall market's 13% yoy, was partly driven by strong performance in their beauty/ cosmetic trades.
- While July's operations remain strong, management see uncertainties surrounding potential impact from recent RMB volatility.
- **M&A:**
 - While no offer has yet been received for the Langham Place office sale, management sees M&A opportunities with the existing debt headroom.
 - However, unlike previous communications where management were verbal on their focus to look for yield accretive opportunities, including office in Guangdong-Hong Kong-Macau Greater Bay Area, they now seem to be taking a relatively more conservative stance given the recent RMB volatility.
- **Finance costs**
 - At 54% fixed for their debt portfolio at c.3% effective interest cost as of Jun 2018.
 - Management see the rate volatility being one of the potential swings to their DPU which based on their current estimates, a 25bps increase in HIBOR will lead to c.1% cut in their DPU.

What to do with stock

- We revise our 2018E to 2020E EPS by up to 3.3% and raise our 12-month target price to HK\$6.39 from HK\$6.29 on the back of the latest operating run-rates.
- Maintain Neutral and we prefer other landlords such as Hongkong Land and Wharf REIC for a relatively cheaper access to quality HK rental income stream.
- Key risks: Accretive asset monetization, faster-than-expected office growth (upside); Faster-than-expected rates hike, weaker-than-expected retail tenant sales (downside).

Exhibit 1: Champion REIT 1HFY18 results review

(HK\$ mn)	1H17	2H17	1H18	YoY chg	HoH %	Remarks (1H18)
Three Garden Road	669	708	750	12.1%	5.9%	Three Garden Road expects to achieve positive rental reversion in 2018 as
Langham Place Office	199	193	192	-3.7%	-0.4%	spot rents is considerably higher than the passing rents
Langham Place Mall	450	481	503	11.8%	4.5%	Mgmt guided LP office to deliver growth in 2018 amid contribution from health care & beauty segment
Total revenue	1,318	1,382	1,445	9.6%	4.5%	LP shopping mall rental income grew largely inline with HK retail growth in 1H18
Property operating expenses	(253)	(280)	(268)	5.8%	-4.4%	
Net property income	1,064	1,102	1,177	10.6%	6.8%	
<i>NPI margin %</i>	<i>80.8%</i>	<i>79.7%</i>	<i>81.4%</i>	<i>0.7 pp</i>	<i>1.7 pp</i>	
Manager's fee	(128)	(132)	(141)	10.6%	6.8%	
Trust and other expenses	(9)	(11)	(16)	73.0%	45.1%	
Net finance costs	(158)	(173)	(187)	18.7%	7.9%	Effective interest at 3.0%, vs. 2.6% from FY17. 54.2% fixed-rated debt as
Operating profit	770	785	832	8.1%	6.0%	of Jun 18 vs. 50% as of Dec 17
Other exceptionals	3,963	5,887	4,033	1.8%	-31.5%	HK\$4,033mn of increase in fair value of inv. Prop.
Profit before tax	4,732	6,673	4,865	2.8%	-27.1%	
Tax	(131)	(134)	(143)	9.1%	6.6%	
Net profits/ (Loss)	4,601	6,538	4,722	2.6%	-27.8%	
Underlying profit	679	6,498	729	7.4%	-88.8%	Est. underlying profit excl. effect of property revaluation and deferred tax
EPU (HK\$)	0.79	1.12	0.81	2.2%	-28.0%	
Adj. to distributable income	(3,844)	(5,809)	(3,910)	1.7%	-32.7%	Mainly reversal of non-cash items
Distributable income available	758	730	812	7.2%	11.3%	
Payout ratio	90%	100%	90%	0.0 pp	-10.2 pp	
Distribution to unitholders	682	731	731	7.2%	0.0%	
DPU (HK\$ cents)	11.71	12.55	12.53	7.0%	-0.2%	
Property valuation (HK\$m)	70,806	76,704	80,744	14.0%	5.3%	Increase driven by higher rental assumptions
- Three Garden Road	42,464	46,161	48,527	14.3%	5.1%	Cap rate at 3.6%, unchanged since Dec-15
- Langham Place complex	28,342	30,543	32,217	13.7%	5.5%	Cap rate at Langham Place Mall remains at 3.75%, same as Dec 17
BVPS (HK\$/unit)	9.36	10.36	11.05	18.1%	6.7%	Cap rate at Langham Place Office remains at 4.00%, same as Dec 17
						Gearing at 20.5% vs. 18.9% at Dec 17

Source: Company data, Goldman Sachs Research estimates.

(HK\$ mn)	1H17	2H17	1H18	YoY chg	HoH %
Revenue	1,318	1,382	1,445	9.6%	4.5%
DPU (HK\$ cents)	11.71	12.55	12.53	7.0%	-0.2%

Source: Company data, Goldman Sachs Global Investment Research

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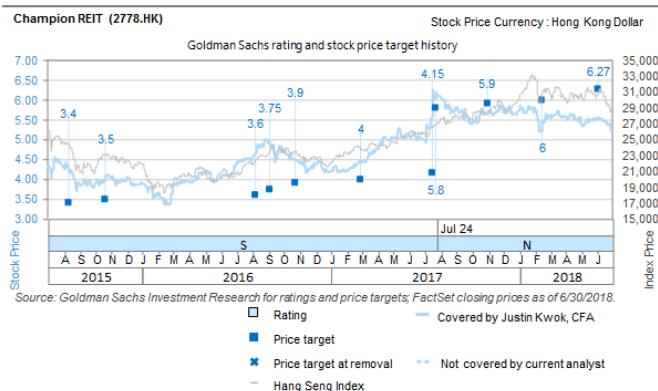
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