

## Wharf REIC (1997 HK) Cost reduction to boost margin

- Wharf REIC's FY22 core net profit declined 5% YoY to HK\$ 6,175mn, 2% better than our forecast.
- Driven by marketing cost reduction, the core IP business surprised on the upside in operating profit margin, which improved 4.1ppt YoY to 81.6% in FY22
- We expect the Group's rental income to grow 9% YoY for 2023E on HK retail sales recovery
- Maintain **BUY** with TP of HK\$54.9 (from HK\$ 53.7) based on a 40% discount to NAV

**FY22 core profit beats our forecast.** Wharf REIC's FY22 core profit declined 5%YoY to HK\$ 6,175mn, 2% higher than our forecast. Revenue declined 22% YoY to HK\$ 12,459mn, as revenue from Investment Properties (IP) and Development Properties (DP) dropped 2% and 92% YoY, respectively. Declining revenue from DP was mainly due to depleting sellable resources as the Group is phasing out the non-core segment. However, operating margin of the core IP business surprised on the upside by going up 4.1ppt YoY to 81.6% in FY22. In particular, revenue from Harbour City (HC)/ Times Square (TS) changed 2%/-12% YoY, but operating profit increased 7%/1% YoY on lower marketing expenses. Management indicated marketing activities are likely to shift from discount coupon targeting mainly the local spenders to the less expensive event model to attract tourists, which is similar to their usual practice during the pre-pandemic period. Despite falling total equity value (-8%YoY) due to revaluation deficit in IP (HK\$ 14.9bn), net gearing only edged up 0.7ppt YoY to 23.2% as of Dec 2022. Effective borrowing rate rose 1.1ppt YoY to 2.5% in FY22, or +2.0ppt HoH to 3.5% in 2H22. Total finance cost increased 145% YoY to HK\$ 1,861mn, factoring in the HK\$ 633mn mark-to-market losses on cross currency and interest rate swaps (fixed-to-floating). However, 1-mth HIBOR fell from 4.346% as of Dec 30, 2022 to 3.247% as of Mar 7, 2023, which should alleviate concerns on rising rates.

**Riding on retail sales recovery in HK.** Management also commented luxury goods have been outperforming the affordable goods within Wharf REIC's malls in 2023. This concurs with HK's Jan retail sales (+7% YoY) released by Census and Statistics department. In particular, sales of jewellery, watches and clocks, and valuable gifts jumped 23.1% YoY in HK, reflecting rising tourist spending. Together with the next round of HK\$ 5,000 consumption voucher program announced in the 2023 Hong Kong Budget, we predict Wharf REIC's rental income to grow 9% YoY to HK\$ 11.6bn for 2023E.

**Maintain BUY with TP of HK\$ 54.9.** On the back of better margin outlook due to lower marketing costs, we raise our core profit by 2.8/1.3% for 2023-24E and estimated NAV to HK\$ 91.48 (from HK\$89.45). We raise our TP to HK\$ 54.9 (from HK\$ 53.7), which is still based on a 40% discount to our NAV. Maintain **BUY**.

**Risk factors:** 1) Asset and revenue concentration risk, as IP accounts for 89.5% of total assets and 85.6% of total revenue in 2022; 2) Operating losses in hotels and DP business; 3) Rising finance cost on US rate hike; 4) Lack of new project pipeline; 5) Valuation gain/loss of IP

### Results and Valuations

FY ended Dec 31	2021A	2022A	2023A	2024E	2025E
Revenue (HK\$ mn)	16,043	12,459	13,753	15,272	17,260
Chg (% YoY)	3.4	(22.3)	10.4	11.1	13.0
Core profit ( HK\$ mn) <sup>1</sup>	6,518	6,175	6,877	8,151	9,618
Chg (% YoY)	(12.8)	(5.3)	11.4	18.5	18.0
Core EPS ( HK\$ )	2.15	2.03	2.27	2.68	3.17
Chg (% YoY)	(12.8)	(5.3)	11.4	18.5	18.0
BVPS ( HK\$ )	67.9	62.7	63.6	64.7	65.9
Chg (% YoY)	0.8	(7.6)	1.4	1.7	2.0
P/E (x)	20.6	21.8	19.5	16.5	14.0
P/B (x)	0.65	0.71	0.70	0.68	0.67
Core ROE (%)	3.2	3.2	3.6	4.2	4.8
Core ROA (%)	2.4	2.4	2.7	3.1	3.6
DPS (HK\$)	1.31	1.31	1.36	1.61	1.90
Yield (%)	2.96	2.96	3.07	3.64	4.30
Net gearing (%)	22.5	23.2	21.1	19.2	17.1

<sup>1</sup>Core profit= Net profit attributable to equity shareholders, excluding investment property revaluation deficit, impairment provision on hotel properties and mark-to-market and exchange gain/loss on certain financial instruments  
Source(s): The Company, ABCI Securities estimates

## Company Report Mar 8, 2023 Rating: BUY TP: HK\$54.9

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Share price (HK\$)	44.25
Est. share price return	24.1%
Est. dividend yield	3.1%
Est. total return	27.2%
Previous Rating & TP	BUY; HK\$53.7
Previous Report Date	14 Feb 2023

Source(s): Bloomberg, ABCI Securities estimates

### Key data

52Wk H/L(HK\$)	30.45/47.8
Issued shares (mn)	3,036
Market cap (HK\$ mn)	134,343
3-mth Avg daily turnover (HK\$ mn)	172.08
Major shareholder(s) (%):	
Wheelock and Company Limited	49.98%

Source(s): Bloomberg, ABCI Securities

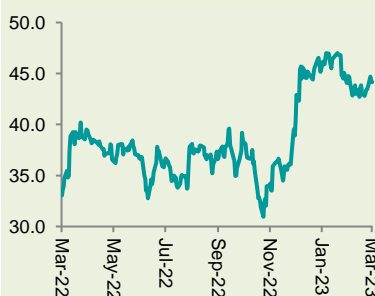
### Share Performance (%)

	Absolute	Relative*
1-mth	(1.8)	3.4
3-mth	11.9	6.3
6-mth	20.4	13.6

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### Share performance (HK\$)



Source(s): Bloomberg, ABCI Securities

**Exhibit 1: Revenue and operating profit breakdown (FY22)**

	2022	2021	YoY change
<b>Revenue</b>	<b>HK\$mn</b>	<b>HK\$mn</b>	<b>(%)</b>
Investment properties	10,662	10,889	-2%
Development properties	282	3,722	-92%
Hotel	932	838	11%
Investment	515	536	-4%
Inter-segment revenue	(33)	(30)	10%
Others	101	88	15%
<b>Total Revenue</b>	<b>12,459</b>	<b>16,043</b>	<b>-22%</b>
<b>Operating profit</b>			
Investment properties	8,699	8,441	3%
Development properties	(48)	543	-109%
Hotel	(230)	(356)	-35%
Investment	515	536	-4%
Others	(34)	(34)	0%
Corporate expenses	(61)	(66)	-8%
<b>Total operating profit</b>	<b>8,841</b>	<b>9,064</b>	<b>-2%</b>
	<b>2022</b>	<b>2021</b>	<b>YoY change</b>
<b>Operating profit margin</b>	<b>%</b>	<b>%</b>	<b>ppt</b>
Investment properties	81.6%	77.5%	4.1%
Development properties	-17.0%	14.6%	-31.6%
Hotel	-24.7%	-42.5%	17.8%
Investment	100.0%	100.0%	0.0%
Others	-33.7%	-38.6%	5.0%
<b>Overall</b>	<b>71.0%</b>	<b>56.5%</b>	<b>14.5%</b>

Source(s): The Company, ABCI Securities

**Exhibit 2: Changes in TP and profit forecasts**

	Old	New	Chg	Reasons
<b>TP (HK\$)</b>	53.70	54.90	2.2%	Raised NAV per share assumption from HK\$ 89.45 to HK\$ 91.48 due to better margin outlook; 40% discount to NAV unchanged
<b>Core profit (HK\$mn)</b>				
-2023E	6,690	6,877	2.8%	Better margin outlook on lower marketing cost
-2024E	8,043	8,151	1.3%	Better margin outlook on lower marketing cost

Source(s): The Company, ABCI Securities estimates

## Financial statements

### Consolidated income statement (2021A-2025E)

FY Ended Dec 31 (HK\$ mn)	2021A	2022A	2023E	2024E	2025E
<b>Revenue</b>	<b>16,043</b>	<b>12,459</b>	<b>13,753</b>	<b>15,272</b>	<b>17,260</b>
Cost of sales	(5,338)	(2,481)	(2,280)	(2,132)	(2,178)
<b>Gross Profit</b>	<b>10,705</b>	<b>9,978</b>	<b>11,472</b>	<b>13,141</b>	<b>15,082</b>
Selling and marketing expenses	(1,089)	(562)	(590)	(690)	(808)
Administrative and corporate expenses	(222)	(295)	(325)	(380)	(444)
Depreciation and amortisation	(330)	(280)	(294)	(309)	(324)
<b>EBIT</b>	<b>9,064</b>	<b>8,841</b>	<b>10,264</b>	<b>11,762</b>	<b>13,506</b>
Finance cost	(760)	(1,861)	(2,299)	(2,257)	(2,222)
Share of profit of associates	(125)	(68)	6	3	2
Other income/ (expenses)	62	426	426	426	426
Fair value gain of investment properties	(2,203)	(14,913)	-	-	-
Disposal/one-off items	-	-	-	-	-
<b>Profit before tax</b>	<b>6,038</b>	<b>(7,575)</b>	<b>8,396</b>	<b>9,934</b>	<b>11,712</b>
Tax	(1,599)	(1,368)	(1,468)	(1,738)	(2,049)
<b>Profit after tax</b>	<b>4,439</b>	<b>(8,943)</b>	<b>6,928</b>	<b>8,196</b>	<b>9,663</b>
Minority interest	(48)	87	(50)	(45)	(44)
<b>Reported net profit</b>	<b>4,391</b>	<b>(8,856)</b>	<b>6,877</b>	<b>8,151</b>	<b>9,618</b>
Less: Exceptional non-cash items*	2,127	15,031	-	-	-
<b>Core net profit</b>	<b>6,518</b>	<b>6,175</b>	<b>6,877</b>	<b>8,151</b>	<b>9,618</b>
<b>Per share</b>					
Reported EPS (HK\$)	1.45	(2.92)	2.27	2.68	3.17
Core EPS (HK\$)	2.15	2.03	2.27	2.68	3.17
DPS (HK\$)	1.31	1.31	1.36	1.61	1.90
Payout ratio (%)	61%	64%	60%	60%	60%
BVPS (HK\$)	67.88	62.70	63.60	64.68	65.94
<b>Growth %</b>					
Revenue	3.4%	-22.3%	10.4%	11.1%	13.0%
Gross Profit	-3.9%	-6.8%	15.0%	14.5%	14.8%
EBIT	-9.1%	-2.5%	16.1%	14.6%	14.8%
Underlying net profit	-12.8%	-5.3%	11.4%	18.5%	18.0%
<b>Margin %</b>					
Gross margin	66.7%	80.1%	83.4%	86.0%	87.4%
EBIT margin	56.5%	71.0%	74.6%	77.0%	78.2%
Core net margin	40.6%	49.6%	50.0%	53.4%	55.7%
<b>Revenue breakdown</b>					
- Sales of properties	3,722	282	572	300	225
- Rental income of investment properties	10,889	10,662	11,620	13,152	14,972
- Hotels	838	932	1,110	1,240	1,342
- Investment	536	515	328	341	355
- Others	58	68	123	239	366
<b>Total</b>	<b>16,043</b>	<b>12,459</b>	<b>13,753</b>	<b>15,272</b>	<b>17,260</b>

Remarks: In our model, we did not project forecast for fair value gains/(losses) in IP for 2023-25E, as this non-cash item does not reflect the underlying performance of group's core business.

\* Mainly represents investment property revaluation deficit, impairment provision on hotel properties and mark-to-market and exchange gain/loss on certain financial instrument

Source(s): The Company, ABCI Securities estimates



Consolidated balance sheet (2021A-2025E)

As of Dec 31 (HK\$ mn)	2021A	2022A	2023E	2024E	2025E
<b>Current assets</b>	<b>5,389</b>	<b>4,816</b>	<b>7,138</b>	<b>9,722</b>	<b>12,802</b>
Bank balances and cash	1,800	1,340	3,743	6,155	9,000
Trade and other receivables	1,161	1,338	1,338	1,338	1,338
Properties for sales	2,308	1,793	1,712	1,884	2,119
Other current assets	120	345	345	345	345
<b>Non-current assets</b>	<b>266,879</b>	<b>250,433</b>	<b>250,545</b>	<b>250,639</b>	<b>250,717</b>
Hotel and club properties, plant and equipment	7,794	7,315	7,221	7,112	6,988
Investment properties	243,348	228,559	228,759	228,959	229,159
Investment in Associate and JCE	983	835	841	844	846
Other long term investment	13,870	13,130	13,130	13,130	13,130
Other non-current assets	884	594	594	594	594
<b>Total Assets</b>	<b>272,268</b>	<b>255,249</b>	<b>257,683</b>	<b>260,361</b>	<b>263,519</b>
<b>Current Liabilities</b>	<b>12,979</b>	<b>11,328</b>	<b>12,010</b>	<b>12,133</b>	<b>12,150</b>
Short term borrowings	4,500	3,580	3,580	3,580	3,580
Trade and other payables	7,717	6,812	6,812	6,812	6,812
Pre-sales deposits	244	222	904	1,027	1,044
Other current assets	518	714	714	714	714
<b>Non-current liabilities</b>	<b>48,413</b>	<b>49,040</b>	<b>48,040</b>	<b>47,340</b>	<b>46,640</b>
Long term borrowings	44,834	42,909	41,909	41,209	40,509
Other non-current assets	3,579	6,131	6,131	6,131	6,131
<b>Total Liabilities</b>	<b>61,392</b>	<b>60,368</b>	<b>60,050</b>	<b>59,473</b>	<b>58,790</b>
<b>Net Assets</b>	<b>210,876</b>	<b>194,881</b>	<b>197,632</b>	<b>200,888</b>	<b>204,730</b>
<b>Shareholders' Equity</b>	<b>206,106</b>	<b>190,364</b>	<b>193,115</b>	<b>196,375</b>	<b>200,223</b>
Minority Interest	4,770	4,517	4,517	4,513	4,507
<b>Total Equity</b>	<b>210,876</b>	<b>194,881</b>	<b>197,632</b>	<b>200,888</b>	<b>204,730</b>
<b>Key ratio</b>					
Gross debt (HK\$mn)	49,334	46,489	45,489	44,789	44,089
Net debt (HK\$mn)	47,534	45,149	41,746	38,634	35,089
Net gearing (%)	22.5%	23.2%	21.1%	19.2%	17.1%

Source(s): The Company, ABCI Securities estimates



Consolidated cash flow statement (2021A-2025E)

As of Dec 31 (HK\$ mn)	2021A	2022E	2023E	2024E	2025E
<b>Operating Cash flow</b>	<b>7,968</b>	<b>5,805</b>	<b>7,554</b>	<b>8,026</b>	<b>9,340</b>
Purchase of PP&E	(196)	(200)	(200)	(200)	(200)
Addition of investment properties	(197)	(200)	(200)	(200)	(200)
Purchase of other long term investments	(128)	-	-	-	-
Disposal of other long term investments	720	-	-	-	-
Others	-	426	426	426	426
<b>Investing Cash flow</b>	<b>199</b>	<b>26</b>	<b>26</b>	<b>26</b>	<b>26</b>
Debt raised	25,967	3,000	9,000	6,300	6,300
Debt repaid	(30,285)	(5,264)	(10,000)	(7,000)	(7,000)
Dividend to shareholders	(4,129)	(3,977)	(4,126)	(4,891)	(5,771)
Others	(180)	(50)	(50)	(50)	(50)
<b>Financing Cash flow</b>	<b>(8,627)</b>	<b>(6,291)</b>	<b>(5,176)</b>	<b>(5,641)</b>	<b>(6,521)</b>
<b>Net cash inflow/ (outflow)</b>	<b>(460)</b>	<b>(460)</b>	<b>2,403</b>	<b>2,412</b>	<b>2,845</b>
Cash- beginning	2,260	1,800	1,340	3,743	6,155
<b>Cash- year-end</b>	<b>1,800</b>	<b>1,340</b>	<b>3,743</b>	<b>6,155</b>	<b>9,000</b>

Source(s): The Company, ABCI Securities estimates

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Rating	Definition
Buy	Stock return rate $\geq$ Market return rate ( $\sim 9\%$ )
Hold	- Market return rate ( $\sim 9\%$ ) $\leq$ Stock return rate $<$ Market return rate ( $\sim 9\%$ )
Sell	Stock return $<$ - Market return ( $\sim 9\%$ )

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2006 (For reference: HSI total return index 2006-22 averaged at 8.4%)

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