Hysan Development (0014.HK)

Scenario analysis on cap rates change

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0014.HK | 0014.HK | 0014.HK
Industry: Local property

Phillip Securities (Hong Kong) Ltd
Phillip Securities Research

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Rating: Accumulate, CP: HKD34.95, TP: HKD39.00

Company Profile

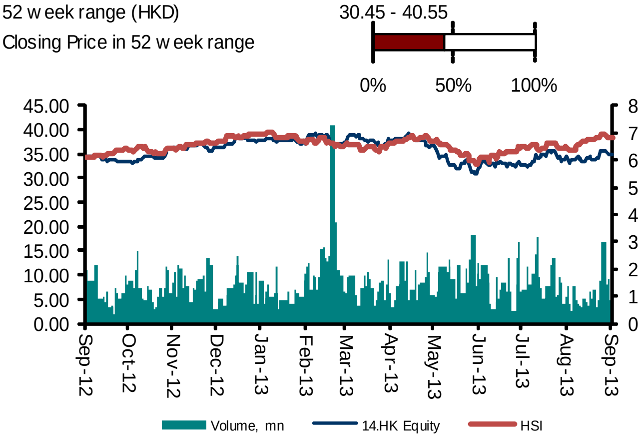
Hysan Development is principally engaged in property investment, management and development, which are mostly located in HK Causeway Bay. Investment properties include Hysan Place, Lee Theatre Plaza, Leighton Centre, Sunning Plaza, Lee Gardens, etc. In addition, the Group also holds high-end residential properties, Bamboo Grove in Mid-levels for rental purpose.

Investment rationale

Scenario analysis on cap rates change – Hysan's NAV is sensitive to cap rates change due to its pure landlord nature: We can see from fig. 1, Hysan's share price slumped 19.7% to the lowest point on 25 June since 1 May (before our coverage) with the U.S. 10-year treasury yield surge, which climbed from 1.63% on 1 May to the highest point of nearly 3% on 5 Sep. The interest rate hike obviously triggered investor concern of cap rates expansion on the rental properties. We were aware of the concern of negative impact from higher cap rates assumption on HK property sector, especially on the landlords, we did a scenario analysis on cap rates change for Hysan. We found that our NAV estimate would drop 4.7%/9.1% for 25/50 bps added to cap rates and in the extreme case of 100 bps cap rates expansion, our NAV estimate would decline 16.6%. Not surprising that Hysan's NAV is quite sensitive to the cap rates assumption, mainly due to its pure landlord nature (HK investment properties account for 95.2% of NAV, from our estimates). However, we would like to highlight that we have already given a conservative cap rates assumption, which is >5% for retail and ~4.8% for office portfolio. Moreover, U.S. 10-year treasury yield dropped to 2.64% yesterday after the outcome of the FOMC meeting that Fed will maintain the same pace of bond purchases. We believe it relieves investor concern of interest rate hike and give support to Hysan's valuation.

Upside potential for Hysan's valuation: Hysan showed strong growth in 1H13 net rental income, which was HKD1.35 bn, up 41.1% yoy due to decent rental reversion and contribution from Hysan Place. Our net rental income growth estimates for FY13 and FY14 are 28.8% and 8.5% respectively. The upside potential for our valuation will be better-than-expected rental growth, which drive Hysan's NAV. It would happen if the rental reversion rate beat expectation while Hysan has ~15% by occupied GRA of retail space and ~27% of office space is up for renewal in FY14. Also, if Fed policy makers give a clearer plan of their monetary policy like reducing bond purchase schedule, investor concern of interest rate hike may be relieved and may drive the market sentiment on property sector and lift Hysan's valuation (narrower NAV discount).

HYSAN DEVELOP CO		
Rating	**2.00**	**Accumulate**
- Previous Rating	*1.00*	*Buy*
Target Price (HKD)	**39**	
- Previous Target Price (HKD)	*41.35*	
Closing Price (HKD)	34.95	
Expected Capital Gains (%)	11.6%	
Expected Dividend Yield (%)	3.4%	
Expected Total Return (%)	**15.0%**	
Market Cap. (HKD mn)	37,174	
Enterprise Value (HKD mn)	43,220	
3M Average Daily T/O (mn)	1.4	
52 week range (HKD)	30.45 - 40.55	
Closing Price in 52 week range		



Key Financial Summary

FYE	FY11	FY12	FY13E	FY14E
Net Rental Income (HKD mn)	1,660	2,063	2,657	2,883
Net Profit, adj. (HKD mn)	1,310	1,622	2,038	2,158
EPS, adj. (HKD)	1.24	1.53	1.92	2.03
P/E, adj. (X)	19.3	23.9	20.3	19.2
BVPS (HKD)	46.00	54.68	60.16	66.11
P/B (X)	0.52	0.67	0.65	0.59
DPS (HKD)	0.79	0.95	1.19	1.26
Div Yield (%)	3.3%	2.6%	3.1%	3.2%

Source: Bloomberg, PSR est.

Valuation Method
NAV

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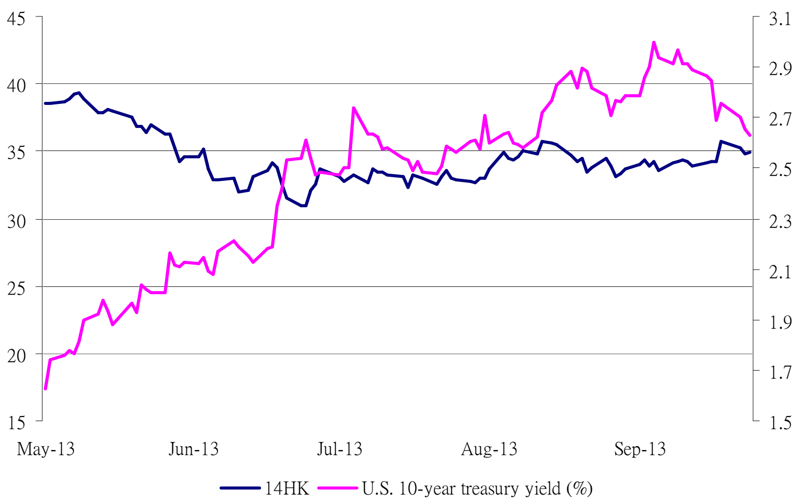
Downside potential for Hysan's valuation: Hysan's investment property portfolio is mainly located in Causeway Bay, a prime retail district in HK, so Hysan's performance is highly reliable on tourist spending, especially from the mainlanders. 55.7% and 35% of Hysan's net rental income came from retail and office sectors respectively in 1H13. Downside potential will be lower mainlander tourist spending and weaker HK economy, which gives negative impact on occupancy rate of office portfolio.

Valuation: We roll our NAV estimate to FY14, which is HK$61.4 per share, 5.7% lower than our previous FY13 estimate, due to a higher risk-free rate assumption. Hysan is now trading at P/B of 0.61 (vs. historical average of 0.73) or our 43.1% discount to our FY14 NAV estimate (vs. historical average of 36.5% discount). Hysan performed well in 1H13, Net rental income surged 41.1% yoy due to contribution of Hysan Place and robust organic growth, rental reversion of retail/office sectors reached 50%/40% in the period, occupancy rates were 99% and 93% for retail and office portfolio respectively. We don't see a high downside risk on the rental income and occupancy rates of Hysan's investment property portfolio, so current valuation is inexpensive in our view. We retain a same NAV discount target of 36.5% and get a TP of HK$39.00. We give an "Accumulate" rating to Hysan with upside potential of 11.6%.

Fig.1 Hysan share price vs. U.S. 10-year treasury yield



Source: Bloomberg, PSR

Fig.2 Dec-14 NAV estimates

Item	HKD mn	HKD per share	% of GAV	% of NAV
HK Invesment Properties	**62,134**	**58.4**	**90.2%**	**95.2%**
-Residential	7,217	6.8	10.5%	11.1%
-Office	22,554	21.2	32.7%	34.6%
-Retail	31,617	29.7	45.9%	48.4%
-Others	746	0.7	1.1%	1.1%
Shanghai Grand Gateway	**5,758**	**5.4**	**8.4%**	**8.8%**
Other Investments	**1,012**	**1.0**	**1.5%**	**1.6%**
Total gross asset value	**68,904**	**64.8**	**100.0%**	**105.6%**
Net debt	**(3,630)**	**(3.4)**		**-5.6%**
Net asset value	**65,274**	**61.4**		**100.0%**

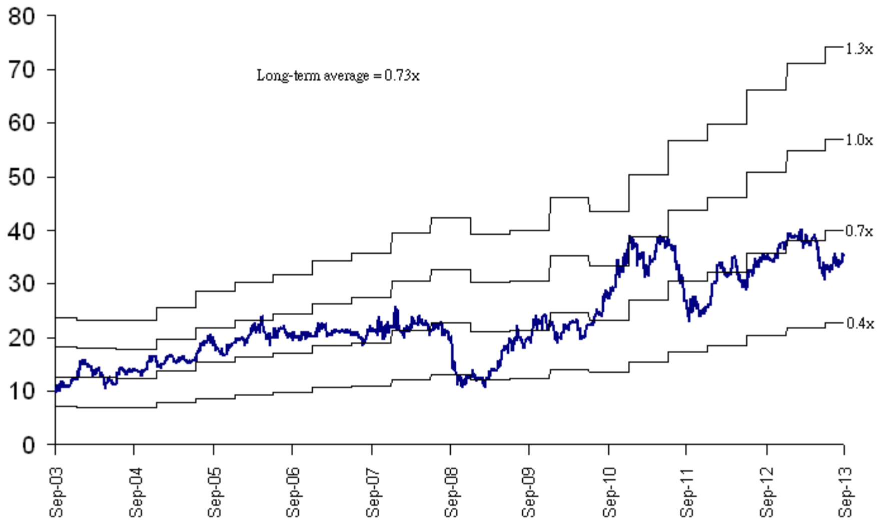
Source: Company report, PSR

Fig.3 NAV sensitivity analysis

Cap rate change %	NAV per share (HKD)	NAV change (%)
-25bps	64.6	5.2%
Base case	61.4	0.0%
+25bps	58.5	-4.7%
+50bps	55.8	-9.1%
+75bps	53.4	-13.0%
+100bps	51.2	-16.6%

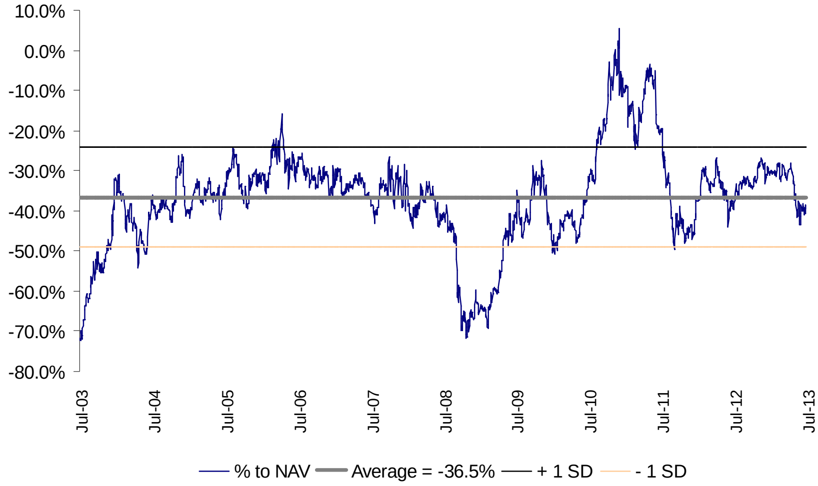
Source: PSR

Fig.4 P/B band



Source: PSR, Bloomberg

Fig.5 Historical discount/premium to NAV



Source: PSR, Bloomberg

Major risks

Earlier interest rate hike

Decline in HK retail sales or mainlanders' spending

Lower rental reversion

Lower occupancy rate

Financial Status

Valuation Ratios	FY11	FY12	FY13E	FY14E
P/E (X), adj.	19.3	23.9	20.3	19.2
P/B (X)	0.52	0.67	0.65	0.59
Dividend Yield (%)	3.3%	2.6%	3.1%	3.2%
Per share data (HKD)				
EPS, reported	8.08	9.38	1.92	2.03
EPS, adj.	1.24	1.53	1.92	2.03
DPS	0.79	0.95	1.19	1.26
BVPS	46.00	54.68	60.16	66.11
Growth & Margins (%)				
Growth				
Net rental income	9.6%	24.3%	28.8%	8.5%
Operating profit	11.7%	26.3%	31.6%	10.7%
EPS, adj.	13.5%	23.4%	25.7%	5.9%
Margins				
Net rental income margin	86.4%	83.0%	86.2%	89.3%
Net profit margin	68.2%	65.2%	66.1%	66.8%
Key Ratios (%)				
ROE	2.9%	3.0%	3.3%	3.2%
ROA	2.4%	2.5%	2.8%	2.8%
Net Gearing	7.6%	6.2%	5.8%	5.4%
Dividend payout	63.8%	62.2%	62.0%	62.0%
Income Statement (HKD mn)	**FY11**	**FY12**	**FY13E**	**FY14E**
Revenue	**1922**	**2486**	**3083**	**3229**
Property expenses	(262)	(423)	(426)	(346)
Net rental income	**1,660**	**2,063**	**2,657**	**2,883**
Other revenue/(expenses)	56	73	132	198
Administrative expenses	(173)	(187)	(224)	(242)
Operating profit	**1,543**	**1,949**	**2,565**	**2,839**
Finance expense	(122)	(156)	(174)	(178)
Revaluation gain	7,532	8,533	0	0
Share of profits/(losses) of Asso & JCE	254	334	340	330
EBT	**9,207**	**10,660**	**2,731**	**2,991**
Taxation	(217)	(289)	(372)	(412)
Net Profit	**8,990**	**10,371**	**2,359**	**2,579**
Minority interest	(445)	(416)	(321)	(421)
Attributable net profit	**8,545**	**9,955**	**2,038**	**2,158**
Net Profit, adj.	**1,310**	**1,622**	**2,038**	**2,158**
Balance Sheet (HKD mn)	**FY11**	**FY12**	**FY13E**	**FY14E**
Cash & cash equivalents	2,961	2,311	2,512	2,734
Account receivable	134	158	158	158
Inventories	0	0	0	0
Other current assets	507	605	710	808
Current assets	**3,602**	**3,074**	**3,380**	**3,700**
Investment properties	49,969	60,022	65,989	72,587
PP&E	530	580	612	667
Other fixed assets	5,267	4,747	4,747	4,747
Total assets	**59,368**	**68,423**	**74,728**	**81,701**
ST loans	1,507	699	699	699
Other current liabilities	1,121	1,068	1,068	1,068
LT debts	5,156	5,242	5,494	5,860
Other non-current liabilities	840	967	967	967
Minority interest	1,991	2,324	2,625	2,912
Shareholders' equity	**48,753**	**58,123**	**63,875**	**70,195**

Source: Company report, PSR

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20%upside from the current price
-5% to +5%	Neutral	3	Trade within ± 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20%downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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