

14 October 2014

FORTUNE REIT (778.HK)

Stable dividend payout is not affected by economic uncertainty



Rating: **Accumulate**

HONG KONG | REIT | COMPANY REPORT

- Fortune reported 1H14 NPI of HK\$ 581 mn, up 32.8% yoy, among that Fortune Kingswood, which was acquired in Oct 2013, accounted for 24.8% of the growth.
- DPU increased 16% yoy to HK\$ 0.2088, amounted to 6.2% of yield. NAV per unit increased to HK\$ 11.01.
- The occupancy rate was strategically remained high as 99.1%, with rental reversion of 21.2%. Passing rent edged up as HK\$ 34.2 psf.
- The company was not worrying on the slipping retail environment due to its focus on necessity consumption.
- Based on DDM valuation, we adjusted the target price to HK\$ 7.32, maintain the rating as "Accumulate".

Financial Highlights

In 1H14, Fortune reported total revenue of HK\$ 813.5 mn, up 33.5% yoy with net property income of HK\$ 581 mn, up 32.8% yoy. Only 8% was coming from the original portfolio, while 24.8% of growth was brought by the Fortune Kingswood acquired in Oct 2013. Distributable income reached HK\$ 390.5 mn, rose 27.2% yoy. The dividend per unit was HK\$ 0.2088, grew 16% yoy, which amounted to 6.2% of yield. NAV per unit increased 9.9% yoy to HK\$ 11.01.

How we view this

Fortune obtained good result when compared to last year. However, the growth quickly slowed down in the 2Q. This was mainly due to that the 1Q growth was driven by Fortune Kingswood acquired last year, while no more acquisition was made in this year. The management reiterated they were always considering potential M&A but needed to coordinate with the parent company. The passing rent edged up to HK\$ 34.2 psf from HK\$ 33.9 psf in 1Q, which still has upside room, when compared to other HK property REITs.

Investment Action

We believed the final DPU would be at least the same as the interim payout, which in total would be HK\$ 0.418 for FY14, increased 16% yoy compared to FY2013 and 4.7% higher than our previous estimate. Actually, according to Fortune's historical payouts, we are quite confident that it can achieve a long term dividend growth of 2%. In spite of the recent slump 10-yr US treasury yield, we adopt a conservative discount rate of 8.5%, based on the potential interest rate hike. We maintain the rating of "Accumulate" to Fortune REIT with target price HK\$ 7.32, based on DDM valuation.

Fig 1 DDM valuation

Discount rate (%)	Long term growth rate (%)					
	1.50%	1.75%	2.00%	2.25%	2.50%	
7.50%	8.04	8.33	8.66	9.01	9.40	
8.00%	7.42	7.67	7.93	8.22	8.54	
8.50%	6.89	7.10	7.32	7.57	7.83	
9.00%	6.43	6.61	6.80	7.01	7.23	
9.50%	6.03	6.18	6.35	6.52	6.71	

Source: PSR

Maintain at Accumulate

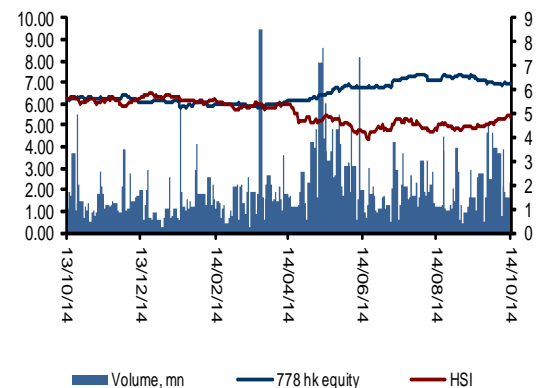
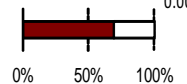
Target Price (HKD)	7.32
Forecast Dividend (HKD)	0.42
Closing Price (HKD)	6.92
Potential Upside	11.8%

Company Description

Fortune REIT mainly engaged in managing a portfolio of 17 retail properties in Hong Kong, comprising approximately 3.11 million Sq.ft. of retail space and 2,606 car parking lots, as at June 30, 2014. The company was listed on the Singapore Exchange in 2003 and started dual listing on HKEx main board in 2010.

Company Data

Raw Beta (Past 2yrs weekly data)	N/A
Market Cap. (HKD bn)	12,961
Enterprise Value (HKD mn)	21,857
52 week range (HKD)	5.68 - 7.45
Closing Price in 52 week range	0.00



Major Shareholders

1. CHEUNG KONG (HOLDINGS) LTD. (0001)	28.28%
2. Schroder Investment Management Limited	12.85%

Valuation Method

PE

Analyst

Kay Ng
kayng@phillip.com.hk
 +852 2277 6751

Key takeaways from the management:

1. How the weak retail sales, esp decrease on the consumption of Individual Visit Scheme affect the Fortune's rental business

The decline on retail sales figures had not yet shown influence on company's rental business. Clients were still keen on the rental renewal. The management indicated that it was the luxury segment most affected by the weakened sales volume, while Fortune primarily focused on the necessity consumption, such as supermarkets and F&B. According to company's data, over 60% of the rentable area and rental income was coming from services & education, F&B and supermarkets.

The occupancy rate was 99.1% in 1H14. The management explained that they were trying to keep this rate high due to the renovation in Belvedere Square commenced in the 2H of 2014 would drag down the overall occupancy rate.

2. The influence on US interest rate hike to Fortune's borrowing cost and asset valuation

As at June 30, 55% of the total debt exposure was hedged. The effective interest cost reduced sharply from 2.81% in 1H13 to 2.2%. Although the gearing ratio increased from 20.9% in 1H13 to 31.1%, the management was feeling comfortable on it. From company's data, there are no refinancing needs until 2016.

The company did not deny on the potential pull back on asset valuation after the rise in interest rate. We expected that may happen in 2015 or 2016, which the overall property price in HK will drop, thus lower the NAV per unit for the company. However, the management indicated that the company is not going to sell out the assets for cash, while investors holding Fortune are aimed for stable dividend. Since the property price may not directly link to the rental income, thus the distributable income, this is not a major concern for investors.

Valuation

We assume the final DPU to be the same as the interim payout, which in total would be HK\$ 0.418 for FY14. The DDM valuation is based on discount rate of 8.5% and long term growth rate of 2%. We thus maintain the rating of "Accumulate" to Fortune REIT with target price HK\$ 7.32.

Potential Risks

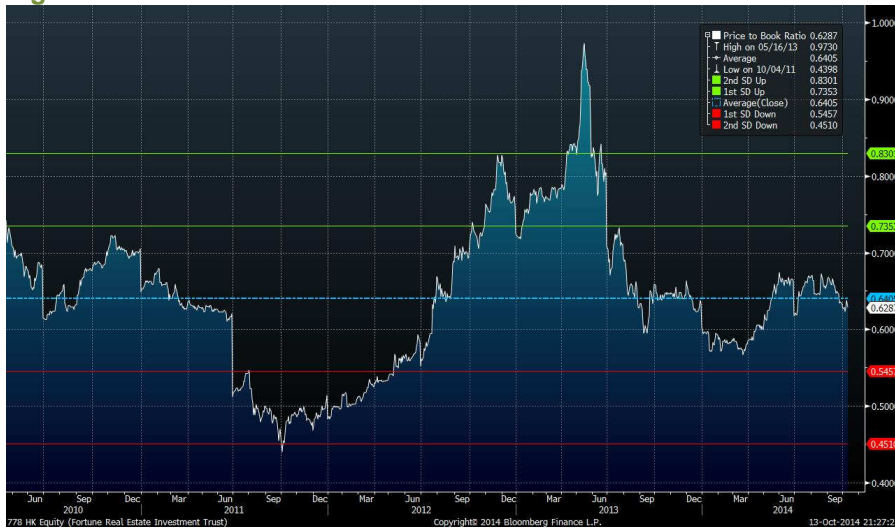
Faster than expected interest rate surging pushes up Hibor.

Fig 2 Price vs 10-yr US Treasury yield



Source: PSR, Bloomberg

Fig 3 Historical PB



Source: PSR, Bloomberg

Fig 4 Historical dividend yield



Source: PSR, Bloomberg

Fig 5 Peer comparison

Stock name	Stock code	Mkt Cap	Closing Px	PE	NAV per Unit	Yield	Occupancy rate	Gearing	Passing Rent
Link REIT	823.HK	105,947.80	46.20	6.15	41.69	4.3%	94.4%	11.0%	42.1 psf
Fortune REIT	778.HK	12,961.50	6.92	4.09	11.01	6.2%	99.1%	31.1%	34.2 psf
Prosperity REIT	808.HK	3,480.80	2.46	12.95	4.56	6.7%	97.8%	28.9%	20.2 psf
Sunlight REIT	435.HK	5,240.80	3.22	4.26	7.06	6.1%	98.6%	24.3%	38.2 psf
Champion REIT	2778.HK	19,072.90	3.32	23.71	7.85	6.1%	88.6%/ 98.8%	23.5%	96.4/ 28.6 psf

Source: Company data as at Mar 31/ Jun 30, 2014; Bloomberg as at Oct 13, 2014

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 \pm 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

GENERAL DISCLAIMER

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

Disclosure of Interest

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

Availability

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2014 Phillip Securities (Hong Kong) Limited

Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005