

# Fortune REIT (778.HK)

## Steady Growth Continues

Hong Kong | Property | Company report

7 August 2017

### Investment Summary

- Tenants in the shopping malls engage mainly in the consumer staples industry, providing stability to the rental income
- High and stable dividend yield, and dividend is expected to grow at a mild rate

### Business Overview

**1H2017 result is in line with our expectation:** In 1H2017, Fortune REIT's revenue had a YoY increase of 2.5% to HK\$1,003.3Mn and net property income had a YoY increase of 3.0% to HK\$727.0Mn. The differential between the two is caused by the lower YoY increase of property operating expenses due to effective cost control by the Trust. In fact, the cost to revenue ratio decreased from 25.7% in 1H2016 to 25.3% in 1H2017, contributing to a higher increase in net property income. Income available for distribution increased 3.7% and is mainly caused by the decrease in borrowing cost, which decreased significantly in 1H2017 and had a 5.2% decrease, a result of the Trust refinancing its debt at a lower cost. In 1H2017, the Trust raised its dividend per unit by 3.0% and declared an interim dividend of HK\$0.2553 per unit.

**Effective cost management promotes growth of net property income:** In 1H2017, the Trust achieved a 25.3% cost to revenue ratio. This cost to revenue ratio is the lowest ever since FY2010. The decrease in the operating expenses is mainly caused by the decrease in energy consumption and the receipt of the one off rebate for energy charges, resulting in a decrease in utility charges. However, the cost to revenue ratio for the FY2017 full year is expected to be higher than that of the 1H2017 because in 1H2017 there was a one off energy charge rebate. Due to the non-existence of one off rebate of energy charges, we expect the net property income margin to follow the past years trend and narrow. The following tables list the cost to revenue ratio as well as the property operating expenses incurred by the Trust's properties between FY2010 and FY2017, with FY2010 having the lowest cost to revenue ratio across a decade.

	2010	2011	2012	2013	2014	2015	2016	2017
<b>Cost to Rev Ratio</b>								
- 1H	24.7%	26.3%	26.7%	26.0%	26.3%	26.9%	25.7%	25.3%
- Full Year	26.5%	27.2%	27.0%	27.4%	27.7%	27.5%	26.4%	--

Source: Fortune REIT

(HK\$Mn)	2010	2011	2012	2013	2014	2015	2016	2017
<b>Operating Exp</b>								
- 1H	102.2	117.4	143.4	158.1	214.3	247.9	251.3	253.8
- 2H	119.8	129.9	157.6	202.3	244.1	269.2	270.6	--
<b>Full Year</b>	<b>222.0</b>	<b>247.3</b>	<b>301.0</b>	<b>360.4</b>	<b>458.4</b>	<b>517.1</b>	<b>521.9</b>	<b>--</b>

Source: Fortune REIT

### Neutral

CMP: HKD 9.69

(Closing price as at 3 Aug 2017)

TARGET: HKD 9.50 (-1.96%)

#### COMPANY DATA

O/S SHARES (MN) :	1,908
MARKET CAP (HKDMN) :	18,490
52 - WK HI/LO (HKD):	10.18 / 8.51

#### SHARE HOLDING PATTERN • %

Li Ka Shing	27.96
Schroders	10.98

#### PRICE PERFORMANCE • %

	1M	3M	1Y
Fortune REIT	0.10	7.19	(1.12)
HSI	6.78	11.48	25.87

#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

HKD mn	FY15	FY16	FY17E	FY18E
Revenue	1,882	1,975	2,032	2,084
NPI	885	934	950	980
EPD, HKD	1.3200	0.6633	1.1391	1.0140
PER, x	6.89	13.12	7.90	9.09
BVPU, HKD	12.7554	12.9417	13.4417	13.8448
P/BV, x	0.71	0.67	0.67	0.68
ROE, %	10.3	5.1	5.1	5.4

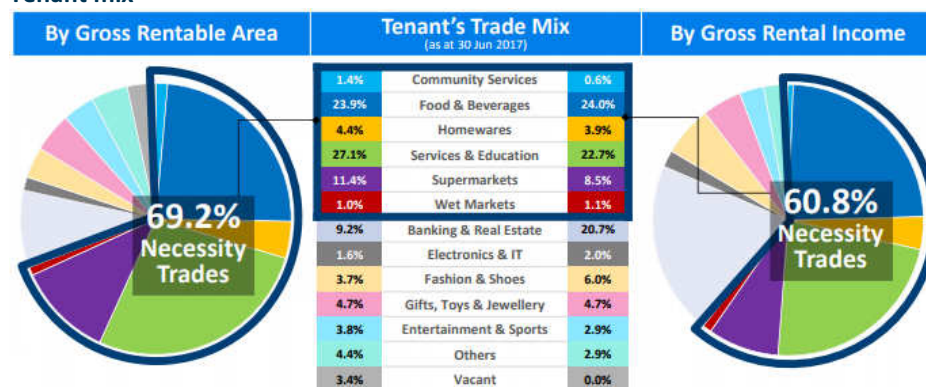
Source: Company reports, Phillip Securities Est.

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**Balance sheet continues to be well-managed:** In April 2017, Fortune REIT completed refinancing its loan maturing in FY2018. The new HK\$1,200Mn loan will mature in FY2022, maintaining the weighted average maturity of the Trust's debts at around 3.6 years as at 30/6/2017, which is a slight decrease in the term in comparison with the 3.7 years as at 31/12/2016. The effective borrowing cost maintains at around 2.41% in 1H2017, a 2 basis point increase in comparison with FY2016. In particular, 60% of the debt has been hedged via interest rate swaps and caps, allowing the company to lower the interest rate risk due to the possible rate hike. Gearing ratio maintains at a healthy level of 28.4% on 30/6/2017, with only 5 investment properties used to secure for the loans and debts. Since the Trust has a stable stream of cash flow in the form of rental income, effective cost management and large number of unsecured investment properties, the capital structure is considered to be healthy and we believe the Trust is able to finance its asset enhancement initiative with ease.

**High and stable dividend yield but growth will be mild only:** The REIT has a good dividend yield and dividend is steadily rising across years. The tenants of the properties owned by the REIT are highly diversified, with about 60.8% of the gross rental income being generated by the daily necessity industry, such as food and beverages, education, supermarkets and wet markets, thus enabling the Trust to be less affected by shocks in the economy.

#### Tenant mix



Source: Fortune REIT

The Trust is expected to have no major capital expenditure other than the asset enhancement work on Fortune Kingswood. Moreover, the properties of the Trust has an average occupancy rate of 96.6% throughout the reporting period. Therefore, future growth will likely be fueled by the increase in rent. The Trust can also benefit from the increase in rent collected from the consumer discretionary sector, which contributes to the remaining 39.2% of the rental income, during good time in the economy. Therefore, we expect in the foreseeable future, the growth of the Trust will grow, but at a relatively slower rate.

### Occupancy rate of the properties

	Occupancy	
	30 Jun 17	31 Dec 16
1. Fortune City One	98.3%	98.4%
2. Fortune Kingswood	97.7%	98.4%
3. Ma On Shan Plaza	99.4%	99.2%
4. Metro Town	100%	100%
5. Fortune Metropolis	96.2%	95.5%
6. Laguna Plaza	82.7% <sup>1</sup>	97.0%
7. Belvedere Square	99.9%	100%
8. Waldorf Avenue	100%	100%
9. Provident Square	94.0%	84.6%
10. Caribbean Square	100%	98.3%
11. Jubilee Square	99.6%	96.9%
12. Smartland	95.9%	96.1%
13. Tsing Yi Square	100%	99.0%
14. Centre de Laguna	98.9%	100%
15. Hampton Loft <sup>1</sup>	66.4%	66.4%
16. Lido Avenue	100%	100%
17. Rhine Avenue	100%	100%
<b>Portfolio Total</b>	<b>96.6%</b>	<b>96.7%</b>

Source: Fortune REIT

### Investment Thesis, Valuation and Risk

**Our valuation model suggests a target price of HK\$9.50:** Fortune REIT receives a stable stream of income from its investment properties, whose tenants largely engage in the consumer staples sector, allowing the Trust to be less affected by the turbulent economic environment. The Trust also has effective cost management and financial management strategies, as evident by the low cost to revenue ratio and the healthy capital structure. Therefore, a target price of HK\$9.50, corresponding to a 30% discount to NAV, and a 'Neutral' rating, have been assigned. (Closing price as at 3 Aug 2017)

<i>Downside Risks</i>	(1): Worse than expected return on investment in Fortune Kingswood renovation project (2): Decreasing tenant retention rate
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## Financials

FYE	FY2014	FY2015	FY2016	FY2017F	FY2018F
<b>Valuation Ratios</b>					
Price Earnings (P/E)	3.63	6.89	13.12	7.90	9.09
Price to Book (P/B)	0.64	0.71	0.67	0.67	0.68
<b>Per Unit Data (HKD)</b>					
EPU	2.1019	1.3200	0.6633	1.1391	1.0140
Book Value Per Unit	11.9254	12.7554	12.9039	13.4417	13.8448
Dividend Per Unit	0.4168	0.4688	0.4923	0.5944	0.6047
<b>Growth &amp; Margins (%)</b>					
<b>Growth</b>					
Revenue	25.7	13.7	5.0	2.9	2.5
Pretax Income	8.5	(34.6)	(45.2)	60.9	(11.0)
Income Available for Distribution	21.5	13.3	5.7	1.5	3.2
<b>Margins</b>					
Net Property Income Margin	70.1	70.3	71.4	72.5	71.9
Pretax Income Margin	247.7	142.5	74.4	116.3	101.0
Income Available for Distribution Margin	47.2	47.0	47.3	46.7	47.0
<b>Key Ratios</b>					
ROE (%)	17.6	10.3	5.1	5.1	5.4
ROA (%)	11.7	6.8	3.4	3.4	3.4
<b>Income Statement (HKD Mn)</b>					
Revenue	1,656	1,882	1,975	2,032	2,084
- Property Exp & Mgr Fee	(495)	(558)	(566)	(559)	(585)
<b>Net Property Income</b>	<b>1,161</b>	<b>1,324</b>	<b>1,409</b>	<b>1,473</b>	<b>1,499</b>
- Base Fee & Other Expense	2,941	1,359	60	892	606
<b>Pretax Income</b>	<b>4,102</b>	<b>2,683</b>	<b>1,469</b>	<b>2,365</b>	<b>2,105</b>
- Income Tax Expenses	(171)	(196)	(212)	(204)	(182)
<b>Income Before Distribution</b>	<b>3,931</b>	<b>2,487</b>	<b>1,257</b>	<b>2,161</b>	<b>1,923</b>
- Distribution & Adjustment	(3,150)	(1,602)	(323)	(1,210)	(943)
<b>Income Available for Distribution</b>	<b>781</b>	<b>885</b>	<b>934</b>	<b>951</b>	<b>980</b>

Source: Company, Phillip Securities (HK) Research Estimates  
(Financial figures as at 3 Aug 2017)

### 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

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