

Fortune REIT (778.HK)

AEIs going to improve future profitability

Hong Kong | Property | Company Report

23 AUG 2018

Investment Summary

- Quality occupancy and stable growth;
- Effective cost control measures facilitating net income;
- Payback debt saving financing cost and ease pressure from interest hike.

Business Overview

Stable growth in first half. Fortune REIT manages 16 commercial properties in Hong Kong, with the total valuation of portfolio reaching HKD40.78bn (up by 8% from 2017 end). In 18H1, Fortune REIT realized revenue of HKD978.1mn (+2.2% YoY) implying a 4.2% YoY growth if we exclude the effect of selling Provident Square. Operating income totaled HKD748.6mn which is growing by 3% or 4.2% excluding the disposal. Income attributable to distribution amounted to HKD505.2mn up by 3.7% YoY. Distribution per unit reached HKD26.34 cents representing 3.2% YoY growth, implying an annualized yield of 5.8%.

Figure: 1H18 operating results

HKD/mn	18H1	17H1	Change (%)	Change excluding Provident Square effects (%)
Revenue	978.1	956.7	+2.2%	+4.2%
Operating expenses	-206.2	-207.1	-0.5%	-
Operating income	748.6	727.0	+3.0%	+4.6%
Financial costs	-131.9	-132.6	-0.6%	-
Distributable income	505.2	487.3	+3.7%	-
Distribution per unit (HK cents)	26.34	25.53	+3.2%	-

Source: Company, Phillip Securities

Quality occupancy performance. Fortune REIT maintains considerable occupancy rate outperforming the market average since listed in HK. Occupancy rate reached 98% in FY17 and 96% in 18H1 due to AEIs for Fortune Kingswood, for which the mall is under adjustment and renovation. We expect that occupancy will return to normal or even higher level after the accomplishment of AEIs. A rental reversion of 13.6% was recorded for renewals during 18H1 with the average rent of HKD45.9 per sqf. The tenant mix continues to diversify and over 60% rental income is from daily necessity industry.

AEIs facilitate future profitability. The company proactively progresses an asset enhancement to increase investing return. It launches an enhancement plan for Fortune Kingswood (which is set in 1996 with the total area of 665k sqf) and will be finished at 2019 end. Fortune Kingswood is the largest shopping mall in Tin Shui Wai area and accounted for 18.4% of total revenue. Now the company is promoting enhancement project of West Tower with an expected cost of HKD150mn. After the reorganization and building, it is expected to attract more customers and improve management efficiency. Profitability is also going to rise after appropriate adjustment.

Accumulate

CMP HKD9.42

(Closing price at 21 Aug 2018)

Target Price: HKD10.5 (+10%)

COMPANY DATA

O/S SHARES (MN)	1,914
MARKET CAP (HKDMN)	18,004
52 - WK HI/LO (HKD)	9.87 / 9.01

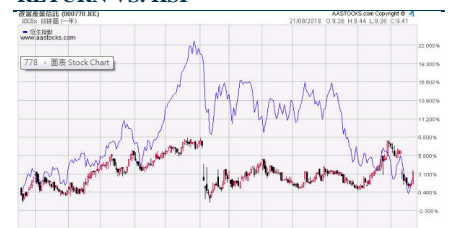
SHARE HOLDING PATTERN, %

CK Asset	27.59
Schroder Inv Mgt	12.01

PRICE PERFORMANCE, %

	1M	3M	1Y
Fortune REIT	-0.32	-0.85	4.32
HSI	36.1	-9.5	2.2

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

KEY FINANCIALS

HKD mn	FY16	FY17	FY18E	FY19E
Revenue	1975	2030	2071	2112
Net Income	1258	3201	2408	2428
EPU, HKD	0.66	1.68	1.34	1.35
PER, x	13.95	5.49	6.86	6.80
BVPU, HKD	12.90	14.05	14.58	15.02
P/BV, x	0.71	0.66	0.63	0.61
ROE, %	5.11	11.94	9.21	9.02

Source: Company, Phillip Securities Est.

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Disposal of Provident Square. The company sold out Provident Square at consideration of HKD1.988bn. The disposed value is 3.1 times its purchase price and 88% over its appraised value as at 30Nov 2017 after 5-year holding period. The deal results in a gain of HKD921mn after completion on 28 Feb 2018. The proceeds will be used in asset enhancement initiatives, debt repayment, etc.

Healthy financial condition. The company increases financial flexibility and safety through selling out asset and prudential management of risk. It paid back HKD1.1bn debt and now the debt to asset ratio only reaches 22.3%. Meanwhile, Fortune REIT has kept borrowing cost around 2.72% with the interest risk of 54% debt having been hedged.

Valuation & Risks

Our target price is HKD10.5. We highlight 1) As most of tenants are engaged in daily necessity business, the rental income is relatively stable and less impacted by any economic recession. 2) AEs will be growth momentum to improve profitability. 3) healthy financial condition and appealing yield. Thus we give target price HKD10.5, implying 35% discount to NAV. **Risks include:** Interest hike drives up debt cost; AEs plan fail expectations.

Figure: Property Assets

Property	GRA (Sq.Ft.)	Valuation HK\$ million	Number of Carpark Lots
Fortune City One	414,469	7,939	653
Fortune Kingswood	665,244	7,462	622
Ma On Shan Plaza	310,084	5,489	290
Metro Town	180,822	3,590	74
Fortune Metropolis	332,168	2,557	179
Laguna Plaza	163,203	2,450	150
Belvedere Square	276,862	2,370	329
Waldorf Avenue	80,842	1,651	73
Caribbean Square	63,018	1,080	117
Jubilee Square	170,616	892	97
Smartland	123,544	723	67
Tsing Yi Square	78,836	656	27
Centre de Laguna	43,000	299	N/A
Hampton Loft	74,734	283	35
Lido Avenue	9,836	190	N/A
Rhine Avenue	14,604	120	N/A

Source: Company (as at Mar 2018), Phillip Securities

Financials

FYE	2015	2016	2017	2018E	2019E
Valuation Ratios					
Price to Earnings (P/E)	7.14	14.27	5.62	7.01	6.95
Price to Book (P/B)	0.74	0.73	0.67	0.65	0.63
Per Share Data (HKD)					
EPU	1.32	0.66	1.68	1.34	1.35
Book Value Per Unit	12.76	12.90	14.05	14.58	15.02
Dividend Per Unit	0.47	0.49	0.51	0.54	0.54
Growth (%)					
Revenue	13.67	4.95	2.77	2.00	2.00
Pretax Income	-34.60	-45.22	132.75	3.00	3.00
Income Available for Distribution	13.29	5.72	3.80	3.00	3.00
Margins (%)					
Net Property Income Margin	72.53	73.58	73.98	74.00	74.00
Pretax Income Margin	142.53	74.39	168.48	124.38	122.96
Income Available for Distribution Margin	47.00	47.34	47.82	47.00	47.00
Key Ratios					
ROE (%)	10.35	5.11	11.94	9.21	9.02
ROA (%)	6.77	3.39	8.08	7.37	7.22
FYE					
2015					
2016					
2017					
2018E					
2019E					
Income Statement (HKD Mn)					
Revenue	1,882.1	1,975.4	2,030.2	2,070.8	2,112.2
-Property Exp & Mgt Fee	(558.1)	(565.6)	(573.4)	(584.0)	(595.6)
Net property income	1,324.0	1,409.8	1,456.7	1,486.8	1,516.5
- Basic Fee & Other Expense	1,358.6	59.8	1,963.6	1,088.8	1,080.6
Pretax Income	2,682.6	1,469.6	3,420.3	2,575.6	2,597.2
-Tax Expenses	(196.5)	(211.7)	(219.3)	(167.4)	(168.8)
Income Before Distribution	2,486.2	1,257.9	3,201.0	2,408.2	2,428.4
-Distribution & Adjustment	(1,601.6)	(322.7)	(2,230.2)	(1,434.9)	(1,435.6)
Income Available for Distribution	884.6	935.2	970.8	973.3	992.7

Source: Company, Aastocks, Phillip Securities (HK) Research
(Financial figures as at Aug 21 2018)

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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