

SUNeVision (1686.HK)

Annual result in line with expectations, yet gross profit margin deteriorating

Hong Kong | TMT | Company Report

4 October 2018

Investment Summary

SUNeVision is one of the leading carrier-neutral data center operators in Hong Kong, owned 74.04% by Sun Hung Kai Properties (16.HK). The 2018 annual result was satisfactory, and generally in line with our expectations except GPM. Besides, the group was applying for a judicial review on subletting restriction in industrial estates. Once successful, it could enhance the importance of Mega Plus in Hong Kong. Factoring in the severer deterioration in GPM, rising interest expense, and stronger estimated revenue growth, we derive our target price to be HK\$ 5.72, downgrading to “Accumulate”, with 9.79% potential upside. (Closing price at 2 Oct 2018)

Accumulate

CMP HKD 5.21

(Closing price at 2 October 2018)

TARGET HKD 5.72 (+9.79%)

COMPANY DATA

O/S SHARES (MN) :	2,325
MARKET CAP (HKDMN) :	12,115
52 - WK HI/LO (HKD):	7.14 / 4.21

SHARE HOLDING PATTERN • %

Sun Hung Kai Properties	74.04
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Corporate Update

2018 performance in line with expectations, except gross profit margin

The annual result for the group was generally in line with our forecasts, except the gross profit margin. The revenue reached HK\$1.36 billion, up 19.5% YoY, slightly over our previous estimate, 16.2%. However, the deterioration in GPM was larger than we expected, dropping by 3.2ppt to 58.5%, 1.5ppt lower than our estimate. The plunge in GPM was mainly due to higher operating costs and depreciation charges due to the opening of MEGA Plus. For selling expenses and administrative expenses, the actual amount generally matched with our expectations. The actual EBIT excluding gain on fair value reached HK\$738 million, generally in line of our estimate, HK\$742 million.

PRICE PERFORMANCE • %

	1M	3M	1Y
SUNeVision	-14.73	12.04	-0.76
HSI	-2.12	-4.97	-3.72

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

Judicial review on subletting restrictions in industrial estates

On 10 Sep 2018, the group applied for a judicial review, accusing Hong Kong Science & Technology Parks Corporation (HKSTP) of allowing its tenants subletting to a third party in the industrial estates, and asking for the enforcement of the lease terms. According to the lease terms in industrial estates, the tenants are prohibited to sublet its space to any third party, because the lease is subsidized by government, leading to a much lower rental than market price. Since data center business usually involves subletting, data center operators located in industrial estates may be considered in breach of the terms during the operations. However, it is allegedly some operators in industrial estates are taking advantage of the grey area in the lease terms to provide subletting, resulting in a judicial review from the group. Currently, there are 9 data center service providers in TKO Industrial estates, such as China Mobile, NTT Communications, HKCOLO, Digital Realty Trust, and etc. If the loophole is closed due to the success in judicial review, the operators in TKO Industrial Estate may be either slapped with penalties or forced to cease the lease agreement. In addition, Tseung Kwan O has been one of the favorite districts for data center, because four submarine cables are connected right there. If the data centers in TKO stop operation due to the subletting restrictions, Mega Plus will be the only data center located in TKO, and permitted to subletting, which enhance its importance in Hong Kong.

KEY FINANCIALS

HKD mn	FY17	FY18	FY19E	FY20E
Revenue	1,142	1,365	1,468	1,621
Net Profit	632	776	642	699
EPS, HKD	0.156	0.192	0.159	0.173
PER, x	33.44	27.13	32.79	30.13
BVPS, HKD	0.911	0.968	0.976	0.984
P/BV, x	5.72	5.34	5.38	5.29
ROE, %	17.4	20.4	16.4	17.6

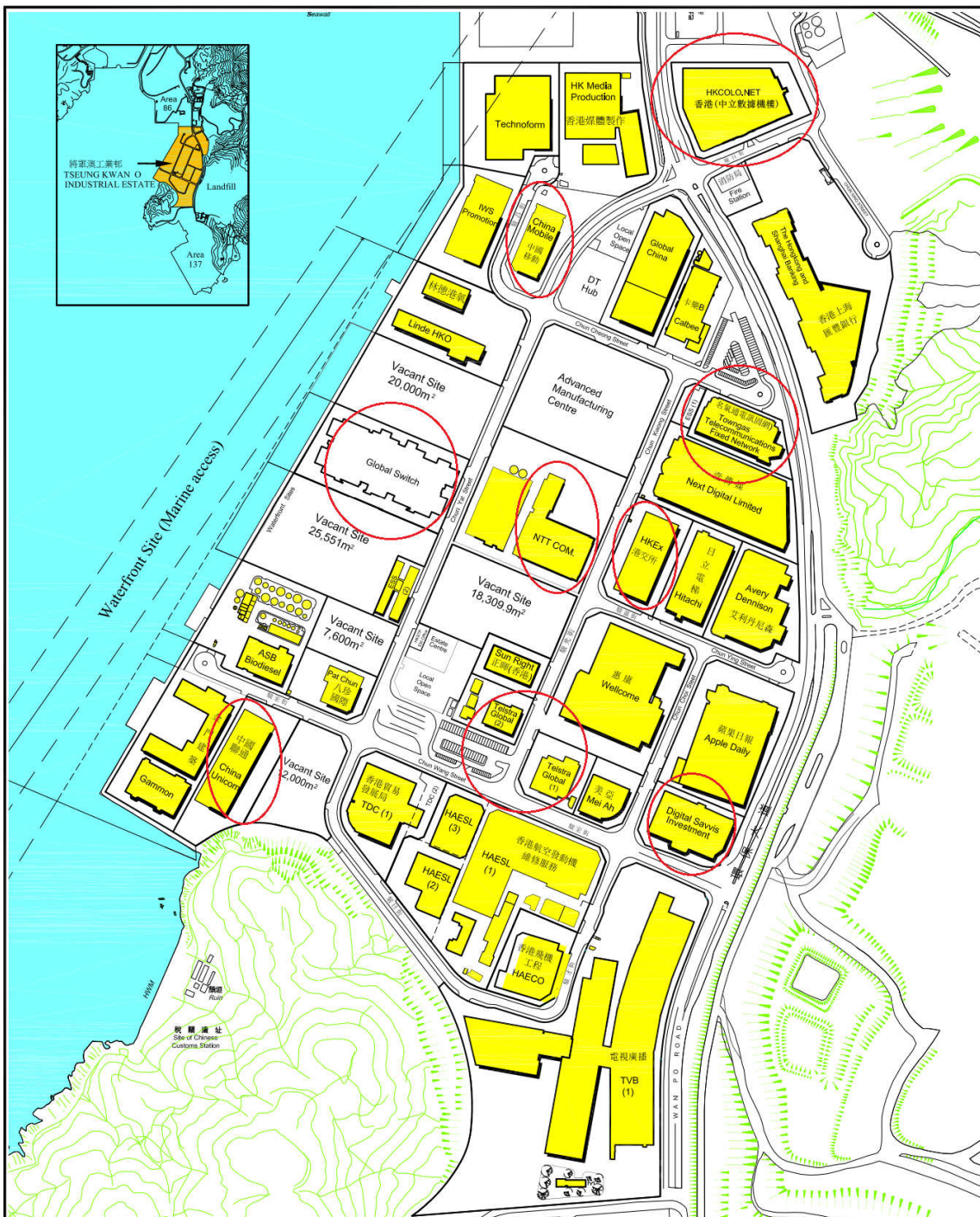
Source: Company reports, Phillip Securities Est.

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Valuation

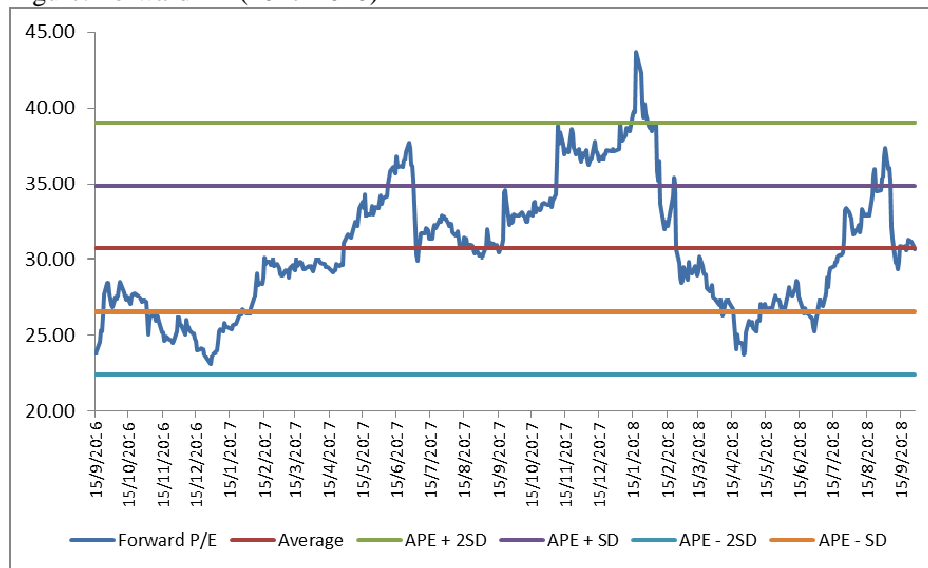
We adjust the GPM downward from 59/58% to 57.5%/57% in 2019/20F, in reflection of the severer deterioration in GPM then our previous estimate. Besides, we also lift the estimated revenue growth from 7.9%/9.2% to 9.3%/10.4% in 2019/20F, in light of the strong growth from Mega Plus as well as the optimization and expansion in Mega Two and Mega-i. Assuming 2019F P/E 36x, we give a target price of HK\$5.72, down 4.2% then previous TP, due to the increasing interest expenses and dropping GPM. With 9.79% potential upside, we downgrade to the rating to “Accumulate”.

Figure: Data center providers in TKO Industrial Estate



Source: HKSTP, Phillip Securities (HK) Research

Figure: Forward PE (2017-2018)



Source: Bloomberg, Phillip Securities (HK) Research

Risk

1. Slower than expected demand on data center
2. Significant increase in land supply for data centers within a short period
3. The entry of cloud service giant players to data center industry in Hong Kong

Financials

FYE JUN	FY15	FY16	FY17	FY18	FY19F	FY20F
Valuation Ratios						
P/E (X), adj	36.99	38.36	33.44	27.13	32.79	30.13
P/B (X)	6.01	5.91	5.72	5.38	5.34	5.29
Dividend Yield (%)	2.4%	2.4%	2.6%	2.9%	2.9%	3.2%
Per share data (HKD)						
EPS, (Basic)	0.141	0.136	0.156	0.192	0.159	0.173
EPS, (Basic) (Excluding gain on fair value)	0.125	0.128	0.140	0.157	0.159	0.173
EPS, (Diluted)	0.141	0.136	0.156	0.192	0.159	0.173
DPS (HKD)	0.123	0.126	0.137	0.151	0.151	0.164
BVPS	0.866	0.882	0.911	0.968	0.976	0.984
Growth & Margins (%)						
Grwoth						
Revenue	8.5%	8.8%	14.3%	19.5%	9.3%	10.4%
EBIT	-1.0%	-2.1%	14.0%	22.4%	-6.9%	9.4%
Net Income (Excluding gain on fair value)	5.7%	2.0%	9.9%	11.8%	1.4%	9.7%
Margins						
Gross margin	65.6%	63.9%	61.7%	58.5%	57.5%	57.0%
EBIT margin	72.0%	64.8%	64.7%	66.2%	53.5%	53.1%
Net Profit Margin (Excluding gain on fair value)	55.1%	51.6%	49.7%	46.4%	46.1%	43.7%
Key Ratios						
ROA	13.7%	12.4%	12.3%	12.2%	8.8%	9.9%
ROE	16.5%	15.5%	17.4%	20.4%	16.4%	17.6%
Income statement (HKD mm)						
Revenue	918	999	1,142	1,365	1,468	1,621
Gross Profit	602	638	704	799	844	924
EBIT	661	648	738	904	786	860
Interest expense	-	-	-	(7)	(23)	(30)
Net profit	569	549	632	776	642	699
Minority Interest	-	-	2	-	-	-
Net profit for owners	569	549	630	776	642	699

Source: Company, Phillip Securities (HK) Research
 (Financial figures as at 2 October 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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