Asia Credit Research

Wharf Holdings Ltd: Credit Update

Thursday, 06 October 2016

A steady harbour

- Net gearing and gross debt levels have been declining since 1H13. A prudent land banking strategy coupled with strong execution in property sales have resulted in free cash flows soaring to HKD19.4bn in FY15.
- High income visibility from investment properties which comprises 72% of total assets. Moreover, the income stream has grown with core profits from investment properties increasing by 43% over 1H13-1H16 to HKD4.6bn. We expect this growth to continue with a large pipeline in China.
- The recent HKD9.5bn sale of Wharf T&T, in an all cash transaction, will further strengthen the balance sheet.

Recent Developments

- **Sale of Wharf T&T**: Wharf will be selling its fully-owned subsidiary Wharf T&T for HKD9.5bn (c.USD1.2bn). The buyer is a consortium of MKB Partners and TPG Capital, which has been buying telecom related assets in Taiwan and South Korea. Post-sale, we estimate net debt/equity to fall to very healthy levels of 0.12x (end-1H16: 0.15x). We think that part of the proceeds will fund the planned expenditure of HKD42.2bn as of 1H16, which will be used mainly to expand Wharf's China portfolio of investment properties and development properties. Meanwhile, Wharf is still reviewing third party proposals for its 74% stake in i-Cable, which is a pay-TV system operator in Hong Kong. We note that i-Cable is loss-making and its free cash flows are negative. Trading at HKD0.90 per share, the stake is worth HKD1.3bn.

- **Raising Panda bonds**: Wharf will be issuing RMB4bn of its maiden Panda bonds in China's onshore market. In addition to diversifying Wharf's funding sources, RMB bonds create a natural FX hedge as Wharf grows its China asset base.

Business and Financials Analysis

- **Good set of results in 1H16**: Core profits rose 14% YoY in 1H16 to HKD6.0bn, excluding revaluation surplus and exceptional items. Investment properties in Hong Kong and China accounted for the majority (HKD4.6bn) of the core profit, and increased by 11% YoY. China development property contracted sales surged 58.3% YoY to RMB16.3b, forming 68% of FY16's target.

- **Portfolio anchored by Hong Kong investment properties:** Two properties anchor Wharf's Hong Kong investment portfolio: i) Harbour City ("HC") and Times Square ("TS"). Despite weaker retail sales due to lower tourist arrivals and macro environment, HC and TS rental revenue rose 4% and 10%, due to solid rental reversions, to HKD3.1bn and HKD1.1bn respectively in 1H16. Going forward, we also expect the on-going asset enhancement at HC and a new extension building overlooking Victoria Harbour to mitigate the retail headwinds. Retail occupancy costs at HC and TS are 19.8% and 24.5% respectively, which are not excessive

Treasury Advisory
Corporate FX & Structured Products
Tel: 6349-1888 / 1881
Interest Rate Derivatives
Tel: 6349-1899
Investments & Structured Products
Tel: 6349-1886

GT Institutional Sales
Tel: 6349-1810

OCBC Credit Research
Andrew Wong
+65 6530-4736
wongVKAM@ocbc.com

in our view. Office revenue from HC and TS rose 8% YoY to HKD1.6bn, on the back of high occupancy (97%-98%) and positive rental reversion. Adding to the Hong Kong investment portfolio, Wharf acquired the entire office tower and prime shops in Wheelock House for HKD6.2bn in 1H16.

- **Growing recurrent income in China:** Chengdu IFS has been performing well since its opening, with retail revenue increasing 9% YoY to RMB312mn in 1H16. 100,000 sqm of the office space has also been leased at the highest rental rates in Chengdu. We will see China investment properties contributing in a bigger way, with the area from the existing and planned IFS totalling 2.0m sqm. Near-term income will be boosted by several openings. The Changsha Times Outlet (GFA: 72,000 sqm) opened last month, while the Chongqing IFS mall (GFA: 114,000 sqm) will open in April next year with 85% of the total retail area under offer/in serious discussion with key anchors. In 3Q17, Changsha IFS (254,000 sqm) is expected to open, and we note the space will be larger than HC.

- **Will the prudent developer turn net cash?:** Net gearing and debt levels have been declining since 1H13 due to Wharf's strong free cash flow generation. This is because Wharf has been selling its properties faster than it replenishes its land bank, in addition to receiving a steady income stream from its investment properties. Wharf has not been winning land bids, as Wharf is not comfortable bidding higher when land prices increase faster than finished properties. We are not overly worried about the depletion of the land bank in the near term, as 5.0m sqm of development properties land bank remains as of end-1H16, while 1H16 contracted sales area was 836,000 sqm.

- **Good credit metrics:** Post-sale of Wharf T&T, the balance sheet looks very healthy with an expected net debt/equity of 0.12x. Net gearing is expected to continue trending downwards if Wharf does not undertake major acquisitions. Despite the large projected FY16 capex of HKD15.8bn for China development properties, this is expected to be largely self-financed by sales. EBITDA/interest coverage as of FY15 is also strong at 6.4x.

Recommendation: We upgrade Wharf's Issuer Profile from Neutral to Positive, as its credit metrics have strengthened while the recurrent income base will be broadened. We keep our Neutral recommendation on WHARF '18s and WHARF '21s given the low yields of 1.9% and 2.8% respectively. However, we prefer the WHARF curve over HKLSP curve, trading c.1Y extension in maturity for a yield pickup of 60-80bps.

Issue	Maturity	Ask Price	Ask YTW	Bond Ratings	Recommendation	
					Current	Previous
WHARF 4.3 '18	10/28/2018	104.80	1.90	NR/NR/A- (Issuer)	N	N
WHARF 4.5 '21	7/20/2021	107.50	2.81	NR/NR/A- (Issuer)	N	N
HKLSP 3.86 '17	12/29/2017	103.35	1.11	A/A2/NR	UW	UW
HKLSP 3.43 '20	5/14/2020	104.25	2.20	A/A2/NR	N	N

Indicative prices from Bloomberg as of 5 October 2016

Wharf Holdings Ltd

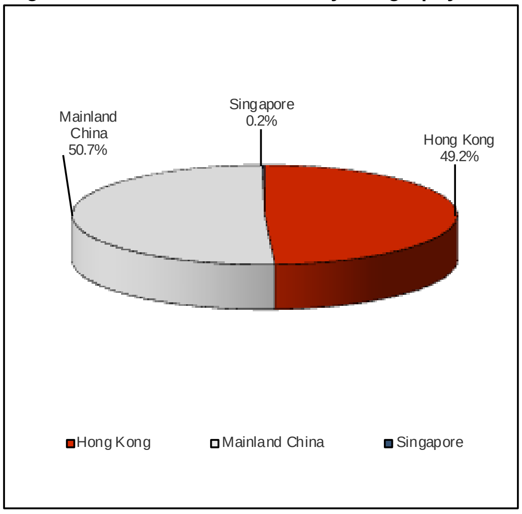
Table 1: Summary Financials

Year Ended 31st Dec	FY2014	FY2015	1H2016
Income Statement (HKD'mn)			
Revenue	38,136	40,875	20,021
EBITDA	15,805	16,401	8,803
EBIT	14,283	14,853	8,075
Gross interest expense	2,604	2,557	636
Profit Before Tax	40,154	20,635	8,644
Net profit	35,930	16,024	6,725
Balance Sheet (HKD'mn)			
Cash and bank deposits	18,725	23,510	18,536
Total assets	444,658	443,916	439,829
Gross debt	77,984	70,707	66,686
Net debt	59,259	47,197	48,150
Shareholders' equity	314,111	317,180	316,129
Total capitalization	392,095	387,887	382,815
Net capitalization	373,370	364,377	364,279
Cash Flow (HKD'mn)			
Funds from operations (FFO)	37,452	17,572	7,453
CFO	18,253	24,053	12,290
Capex	11,277	6,849	9,645
Acquisitions	2,084	1,340	NA
Disposals	56	6,727	NA
Dividends	5,871	5,851	4,092
Free Cash Flow (FCF)	6,976	17,204	2,645
* FCF Adjusted	-923	16,740	NA
Key Ratios			
EBITDA margin (%)	41.4	40.1	44.0
Net margin (%)	94.2	39.2	33.6
Gross debt to EBITDA (x)	4.9	4.3	3.8
Net debt to EBITDA (x)	3.7	2.9	2.7
Gross Debt to Equity (x)	0.25	0.22	0.21
Net Debt to Equity (x)	0.19	0.15	0.15
Gross debt/total capitalisation (%)	19.9	18.2	17.4
Net debt/net capitalisation (%)	15.9	13.0	13.2
Cash/current borrowings (x)	2.2	2.8	1.3
EBITDA/Total Interest (x)	6.1	6.4	13.8

Source: Company, OCBC estimates

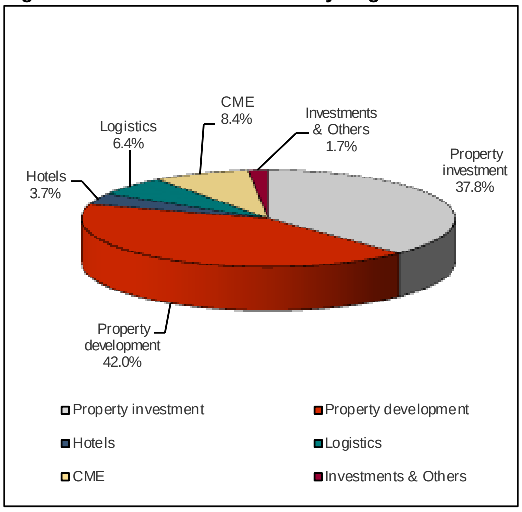
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals*

Figure 1: Revenue breakdown by Geography - 1H2016



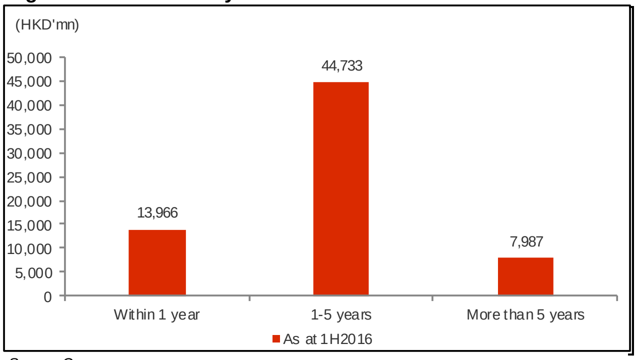
Source: Company

Figure 2: Revenue breakdown by Segment - 1H2016



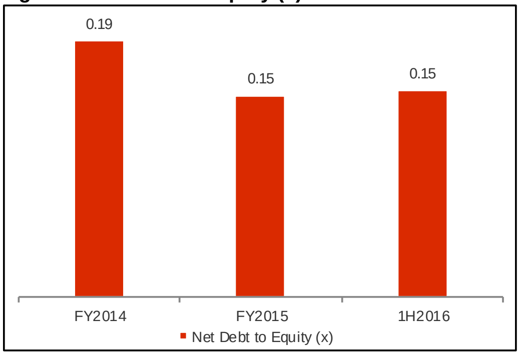
Source: Company

Figure 3: Debt Maturity Profile



Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates