Asia Credit Research

OCBC Bank

Wharf Real Estate Investment Co Ltd: New Issue View

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New Issue View: Wharf Real Estate Investment Co Ltd ("Wharf REIC") priced its maiden USD600mn 10-year issue at T+110bps on the back of a USD1.5bn orderbook, tightening from an initial price guidance of T+135bps.

OCBC Credit Research currently does not cover Wharf REIC. We have presented this paper as a special interest commentary.

In our view, Wharf REIC's credit profile is most similar to Hongkong Land Holdings Ltd ("HKL") and Link REIT given their focus on Hong Kong investment properties. We hold HKL at an issuer profile of Positive (2) and do not cover Link REIT.

WREICL 3.5% '28s offers a 29.8bps yield spread pickup over HKLSP 4.5% '25, which appears high even adjusting for 5bps increase in credit spread per year. While HKL has a lower net gearing, we note that Hongkong Land Holdings Ltd still intends to focus on property development and net gearing is expected to increase due to land purchases, while Wharf REIC would be a near pure-play on Hong Kong investment properties following its exit from the non-core assets.

Similarly, WREICL 3.5% '28s offers 26bps yield spread pickup over LINREI 2.875% '26. Though Link REIT holds a more diversified portfolio with less single-asset concentration, Link REIT has less financial flexibility with a high distribution payout ratio of ~100% (Securities and Futures Commission regulations require REITs to payout at least 90%) while the dividend payout ratio of Wharf is 65%.

WREICL 3.5% '28 also trades at a slight wider over Swire Properties Ltd's SWIPRO 3.5% '28, which is similarly rated 'A2' by Moody's.

As such, we think that **WREICL 3.5% '28s looks attractive as we see the fair value at around 3.5% (Z-spread: 99)**, after accounting for the average of where its HK peers are trading at and adjusting for 5bps increase in credit spread per year.

Figure 1: Peer Comparison

Bond	Net gearing	Issuer Rating	Yield	Z-Spread
WREICL 3.5% '28	0.23x	NR/A2/NR	3.65%	113.4
HKLSP 4.5% '25	0.05x	A/A3/A	3.28%	83.6
LINREI 3.6% '24	0.23x	A/A2/NR	3.20%	78.0
LINREI 2.875% '26	0.23x	A/A2/NR	3.35%	87.4
SWIPRO 3.625% '26	0.14x	NR/A2/A	3.43%	97.4
SWIPRO 3.5% '28	0.14x	NR/A2/A	3.62%	110.6

Source: Bloomberg

Background: Wharf REIC is a real estate company which primarily holds commercial investment properties in Hong Kong. The key properties include Harbour City, Times Square, Plaza Hollywood, Crawford House, Wheelock House and The Murray with retail, office and hotel areas with a total attributable value of HKD251.6bn and GFA of 11.7mn sq ft. Wharf REIC owns 72% of Harbour Centre Development Ltd ("HCDL"), listed on the Hong Kong stock exchange with a market cap of HKD10.7bn as of 10 Jan 2018. Wharf REIC also operates Star Ferry. As mentioned in Wharf Holdings Ltd: Credit Update on 28 Aug 2017, Wharf REIC was spun-off from Wharf Holdings Ltd (**OCBC Issuer Profile: Neutral (3)**) by way of introduction following the completion of the demerger exercise in Nov 2017. Wharf REIC is 61.6% owned by Wheelock & Co Ltd (**OCBC Issuer Profile: Positive (2)**), which is a Hong Kong-listed investment holding company with a market cap of HKD122.5bn. Wharf REIC's market cap is HKD160.3bn as of 10 Jan 2018 and is the key subsidiary of Wheelock & Co, making up ~54% of its total equity.

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Key credit considerations

- **Strong earnings visibility from investment properties:** Wharf REIC is amongst the largest landlords in Hong Kong with HKD251.6bn in investment properties (Wharf REIC's total assets: HKD264mn). This is largely made up by Harbour City ("HC") and Times Square ("TS"), which anchor the portfolio by contributing 82.3% of the total revenue (ex-development). Both properties have a proven track record, with higher than 91% occupancy (for retail & office) since 2007 while rents at HC and TS grew at 16.7% and 12.9% CAGR over 2006-16 respectively. The recurrent annual gross rental revenue for the portfolio is HKD10bn, and we expect contributions to increase with The Murray (336 suites and guest rooms) opening in Jan 2018 and the opening of the new extension building at Ocean Terminal in 4Q2017.

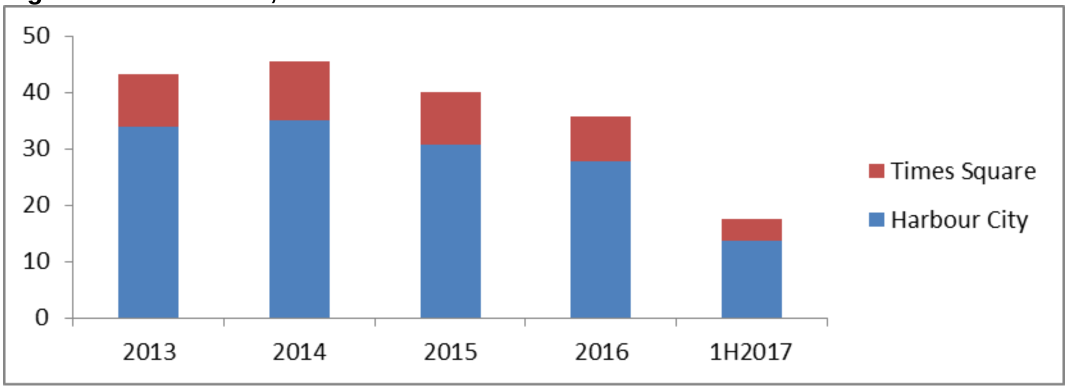
Figure 2: Key properties

Property	Valuation attributable to Wharf REIC (HKD mn)	GFA ('000 sq ft)
Harbour City	170,217	8,409
Times Square	54,540	1,976
Crawford House	5,910	189
Wheelock House	6,543	215
The Murray	4,831	336
Plaza Hollywood	9,550	562

Source: Company

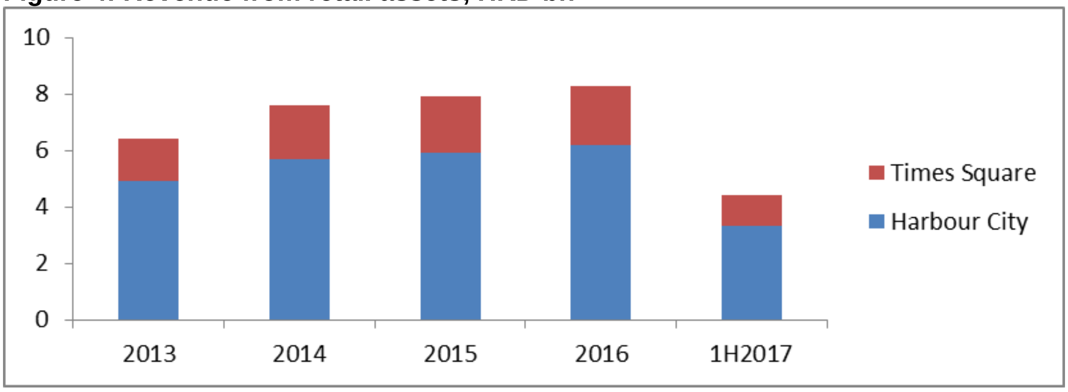
- **Revival in Hong Kong retail bodes well for Wharf REIC:** Revenue from retail assets contributes 71.3% of Wharf REIC's total Hong Kong investment property revenue. HC, TS and Plaza Hollywood makes up ~9% of total Hong Kong retail sales. After a period of decline since 2014, Hong Kong retail sales has rebounded since Mar 2017, with Nov 2017 posting a +7.5% y/y print, helped by an increasing visitor count from China. As such, we think this should boost retail sales numbers for Wharf REIC in 2H2017, with flows in HC and TS driven by tourists. In any case, retail revenue appears resilient with a sustained waiting list of tenants supporting occupancy. Retail revenue has held up (and increased) despite the volatility in retail sales.

Figure 3: Retail sales, HKD bn



Source: Wharf Holdings

Figure 4: Revenue from retail assets, HKD bn



Source: Wharf Holdings

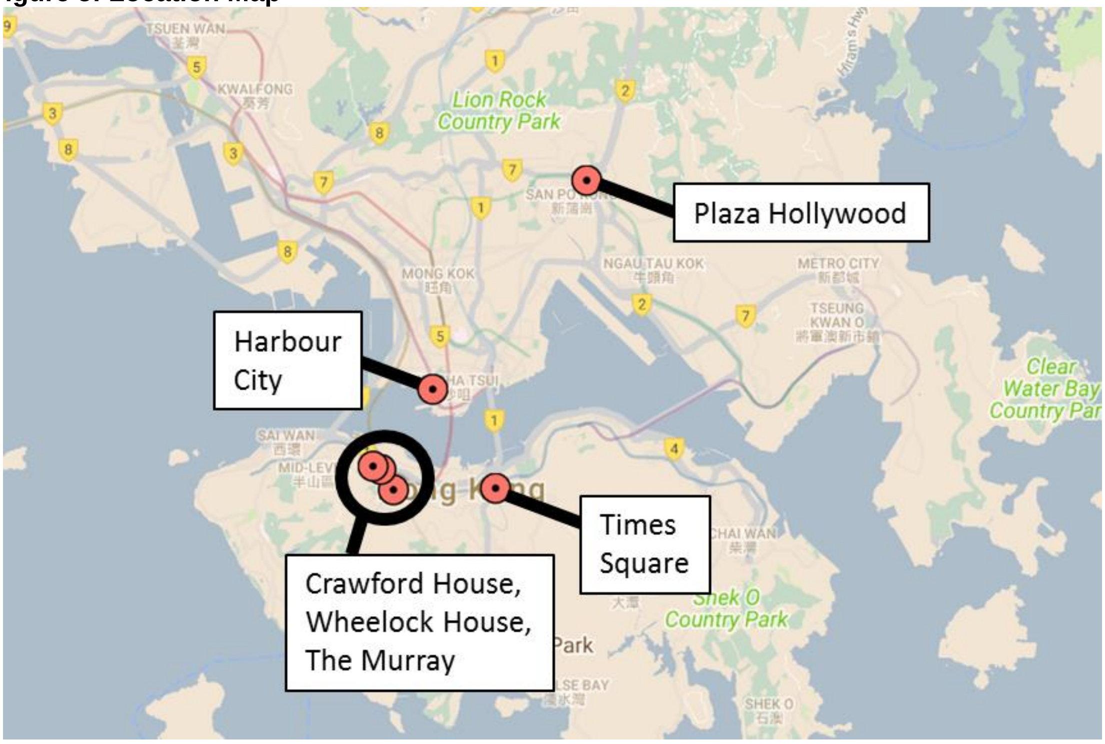
- **Exiting non-core property assets:** Wharf REIC intends to divest most of the non-core assets. These include (1) Suzhou IFS (80%-owned by HCDL), which is a 3.2mn sq ft GFA development in the CBD of Suzhou that is expected to complete by end of 2018 and (2) Marco Polo Changzhou, which is a 302-room hotel. In addition, Wharf REIC does not intend to replenish its landbank of (3) development properties in the PRC, which currently comprises 4 projects that are 93% sold or pre-sold by saleable GFA in Chongqing, Changzhou, Suzhou and Shanghai. What remains of Wharf REIC would be the investment properties in Hong Kong.

- **Better asset diversity to be desired but remains manageable:** HC makes up ~67.7% of the investment properties by valuation as of 31 Aug 2017. Despite the concentration, we think risks are manageable as the tenants are diversified, with the top 5 tenants in Wharf REIC's portfolio contributing less than 10% of the total revenue. Harbour City is host to 1,250 tenants (retail: 570, office: 680), though the retail tenant profile is 38.4% made up by the fashion trade. Nevertheless, we are not overly worried given high occupancy (retail: 96%, office: 97%) and continued revenue growth. In addition, base rent comprises more than 90% of the total retail revenue while leases are typically 3Y, buffering any short term volatility.

- **Stable contribution from office:** Wharf REIC's office revenue (1H2017: HKD1.7bn) is largely represented by the leases at HC (HKD1.2bn) and TS (HKD350mn). Revenue continued to increase by 2% and 1% y/y at HC and TS respectively due to positive reversions despite higher supply.

- **Good credit metrics:** While the demerger shifted the debt burden to Wharf REIC, net gearing remains decent at 23% (pro-forma). A more termed out debt profile could be desired though, with a lumpy HKD20bn out of HKD48.3bn debt maturing in 2018, though we expect this to be improved with time after refinancing. In comparison to REITs which have a higher dividend payout, Wharf REIC has better financial flexibility as the guidance for dividend payout is set at 65% of realized recurrent profit from investment properties and hotels in Hong Kong, which we estimate may reach over HKD5bn a year. In the longer term, we see the potential for Wharf REIC's credit profile to remain supported by divestments in the non-core property assets.

Figure 5: Location Map



Source: BatchGeo, OCBC

Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either poor on an absolute basis, or expected to deteriorate to a poor level over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

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