

China / Hong Kong Company Update

Link REIT

Bloomberg: 823 HK EQUITY | Reuters: 0823.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Jun 2023

BUY

Last Traded Price (31 May 2023): HK\$45.50 (HSI : 18,234)
Price Target 12-mth: HK\$57.30 (26% upside) (Prev HK\$59.10)

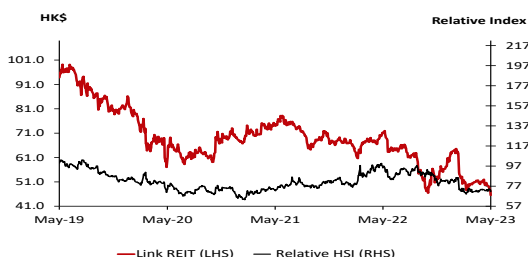
Analyst

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What's New

- FY23 distribution income came in at HK\$6.3bn, in line with our estimate but slightly below market consensus
- Hong Kong retail reversionary growth stood at 7.1%
- The worst for China retail portfolio should be over
- Stock offers an attractive dividend yield of c.6%, BUY with DDM-based TP of HK\$57.30

Price Relative



Forecasts and Valuation

FY Mar (HK\$ m)	2022A	2023A	2024F	2025F
Gross Revenue	11,602	12,234	13,594	14,142
Net Property Inc	8,776	9,198	10,257	10,759
Net Profit	6,894	15,451	6,889	7,213
Distribution Inc	6,419	6,311	6,889	7,213
DPU (HK\$)	3.06	2.74	2.70	2.82
DPU Gth (%)	5	(10)	(2)	5
Div Yield (%)	6.7	6.0	5.9	6.2
Gross Gearing (%)	22	24	21	21
Book Value (HK\$)	77.10	73.98	76.96	79.90
P/Book Value (x)	0.6	0.6	0.6	0.6

DPU Rev (%):	Nil	New
Consensus DPU (HK\$):	2.75	2.91
Other Broker Recs:	B:17	S:0

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Recovery play with enticing yield.

Investment Thesis

A leading and geographically diversified APAC REIT. As the largest listed REIT in Hong Kong, Link REIT's portfolio comprises mainly of neighbourhood malls in Hong Kong, representing >50% of its total portfolio valuation. The REIT is thus well-positioned to capture the post-COVID retail market recovery in Hong Kong. Since 2015, Link REIT has been exploring acquisition opportunities outside Hong Kong to diversify its earnings base and augment distribution growth. Following the latest acquisition in Singapore, its total portfolio valuation has reached >HK\$240bn, spanning 5 regions. Recent equity funding should further strengthen its war chest to pursue value-accretive acquisitions when opportunity knocks. But prolonged interest rate hikes remain a challenge for executing its acquisition growth strategy.

Moving towards post-COVID recovery. Thanks to robust tenant sales recovery, reversionary growth of Link REIT's Hong Kong retail portfolio remained solid at 7.1% in FY23. Overall occupancy cost ratio further improved to 12.5% in FY23, below pre-COVID levels. This, coupled with the post-COVID retail market recovery, should underpin continued retail reversionary growth in Hong Kong in FY24. Moreover, its China counterpart is seeing tenant sales growth gradually recovering towards pre-COVID levels, with positive rental reversions expected to resume in FY24.

Sustained retail market recovery to drive share price higher. As the largest suburban mall landlord in Hong Kong, Link REIT is well poised to capture the improving domestic consumption led by the economic recovery, which should support its earnings growth and share price performance.

BUY with DDM-based TP of HK\$57.30. Link REIT is trading at 5.9-6.2% distribution yields for FY24-25, the highest since May-09. Corresponding yield spreads stand at 2.4-2.7%, against its 10-year average of 2.4%. Valuation is inexpensive, even allowing for prolonged interest rate pressure. Our target price is based on Discounted Dividend Model (DDM) using a discount rate of 7.1%.

Key Risks to Our View:

Any derailment in Hong Kong retail market recovery should be a drag on its rental income. Any prolonged interest rate upcycle would adversely affect its distribution and valuation.

At A Glance

Issued Capital (m shrs)	2,554
Mkt Cap (HKm/US\$m)	116,207 / 14,841
Major Shareholders (%)	
APG Asset Management NV	4.35
Free Float (%)	100.0
3m Avg. Daily Val. (US\$m)	51.72
GICS Industry: Real Estate / Equity Real Estate Investment	

WHAT'S NEW

Increased finance costs neutralized rental growth

Link REIT's FY23's distribution income came in at HK\$6.31bn, in line with our estimate but slightly below market consensus, representing 1.7% y-o-y decline, or 0.6% y-o-y increase if discretionary distribution of HK\$146m in FY22 was excluded. Higher rental earnings were partly offset by increased finance costs amid interest rate hikes. Nonetheless, with increased number of outstanding units following the 1-for-5 rights issue, final DPU sank 18.7% y-o-y to HK\$1.19. This brought the full year DPU to HK\$2.74, down 10.3% y-o-y.

Total revenue rose 5.4% to HK\$12.2bn. This was mainly brought by maiden contributions from the Australia retail portfolio acquired back in Jul-22, full year contribution from the two car park/car service centres and godown buildings in Hong Kong and logistics assets in China as well as revenue recovery from Hong Kong retail portfolio, partly offset by lower contribution from China retail portfolio which was disrupted by the Omicron outbreak.

Thanks to positive rental reversions and reduced rental relief measures in FY23, turnover from Hong Kong retail portfolio rose 3.6% to HK\$7.34bn. The improved leasing sentiment has underpinned a solid reversionary growth of 7.1% (FY22: 4.8%) for the Hong Kong retail portfolio in FY23. Markets and cooked food stalls were the main growth drivers, with reversionary growth strong at 15.1%. Meanwhile, general shops and education/welfare tenants also achieved positive rental reversions of 5.7% and 1.2% respectively in the same period. As such, average monthly unit rent rose 1.8% y-o-y to HK\$63.8psf in FY23. Portfolio occupancy climbed to an all-time high of 98% as of Mar-23 (Sep-22: 97.5%).

With a mid-single-digit increase in carpark tariffs and increased sales volume for hourly parking, receipts from monthly and hourly carpark grew 4.6% and 7.1% in FY23 respectively. Including the full year contribution from the two carpark/car service centres and godown buildings in Hung Hom and Chai Wan, the segmental contribution increased 12.3% y-o-y to HK\$2.4bn in FY23.

Tenant sales at Link REIT Hong Kong retail portfolio registered 6.2% growth in FY23, mainly driven by the robust sales growth of 10.5% and 9.6% from the F&B and general retail segment respectively. Thus, overall occupancy cost ratio edged down further to 12.5% in FY23 from FY22's 13.1%. The increase in minimum wage, effective from May-23, and distribution of consumption vouchers should underpin domestic consumption in Hong Kong, with economic recovery giving an additional momentum to post-COVID retail market recovery. Coupled with

healthy occupancy cost ratio, this should sustain steady reversionary growth for the portfolio in FY24.

Despite increased contributions from logistics assets, the China portfolio saw 5.9% lower in rental income amid the disruptions caused by pandemic-related restrictions. A total of Rmb48m of rental concessions and property management waivers were granted to tenants heavily impacted by the pandemic in FY23. In view of the challenging environment during the period under review, Link REIT has shifted its leasing focus to maintain occupancy in lieu of positive reversionary growth. As such, rental reversion for the retail portfolio, including the minority-owned Qibao Vanke Plaza, fell into the negative territory to -3% (1HFY23: 8.4%), while occupancy improved to 95.2% as of Mar-22 from Sep-22's 92.1%. Nonetheless, retail rental reversion is expected to resume positive growth in FY24 on the back of the market rebound following the end of pandemic measures. Meanwhile, rental reversions for the office property in Shanghai, Link Square, turned less negative at 14.5% in FY23 (1HFY23's 18.2%) with occupancy staying high at 95.5% as of Mar-23.

Link REIT has completed the acquisition of two logistics assets in Changshu in Apr-23 and May-23. Rental contributions should start to kick in from FY24, and hence, adding momentum to the rental income recovery of the China portfolio.

Thanks to maiden contributions from the Australia retail portfolio, revenue from the international portfolio rose 34.4% to HK\$648m. Since the acquisition in Jul-22, tenant sales of the Australia retail portfolio achieved 12.5% growth driven by the return of tourist spending and economic recovery. Occupancy also increased to 96.9% in Mar-23 (Sep-22: 95.9%) as a result of higher tenant demand. On the other hand, combined occupancy of the international office portfolio softened slightly to 90% in Mar-23 from Sep-22's 91.8%.

With overall NPI margin edging down slightly to 75.2% (FY22: 75.6%), net property income grew by a smaller 4.8% to HK\$9.2bn.

In FY23, Link REIT has completed the enhancement works at Lok Fu Market, Tai Yuen Market, Tak Tin Market and Fung Tak with a total capex of HK\$159m. Estimated ROI for the projects were 23.7%, 21.8%, 9.3% and 14.0% respectively. Meanwhile, Link REIT is working on the refurbishment at Tung Tau Market, Kai Tin, Butterfly and Sau Mau Ping with a budgeted capex of HK\$241m. In China, the first phase of AEI at Link Plaza Tianhe, formerly known as Happy Valley Shopping Mall, is well underway. With budgeted

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capex of Rmb200m, the enhancement works aim to bring in more leisure and entertainment facilities and optimize the tenant mix.

Finance cost surged 74.5% to HK\$1.75bn as a result of increased interest rates and higher debt balance due to new acquisitions. Average borrowing costs rose to 3% in FY23 from FY22's 2.3%.

Link REIT raised HK\$18.5bn (after netting expenses) through a rights issue, of which c.HK\$5.2bn were utilized for debt repayment. As of Mar-23, Link REIT had cash and bank balance of HK\$17.3bn. Total debt rose to HK\$65.7bn as of Mar-23 from Sep-22's HK\$55.1bn, mainly due to the acquisition of two suburban malls in Singapore, with no refinancing needs in the next twelve months. This resulted in net debt of HK\$48.4bn. Net gearing stood at 17.8% as of Mar-23. Interest costs for 56.8% of Link REIT's total debts was hedged. This should help mitigate interest rate risks.

Despite a strong war chest, the prolonged high interest rate environment should remain a key challenge facing Link REIT in pursuing yield-accretive acquisitions and introducing capital partners for existing investments.

Following the recent correction, Link REIT is trading at 5.9-6.2% distribution yields for FY24-25, the highest since May-09. This translates into yield spreads of 2.4-2.7%, against its 10-year average of 2.4%. Valuation is by no means expensive in view of the improving retail scene. Retail portfolios in Hong Kong, China,

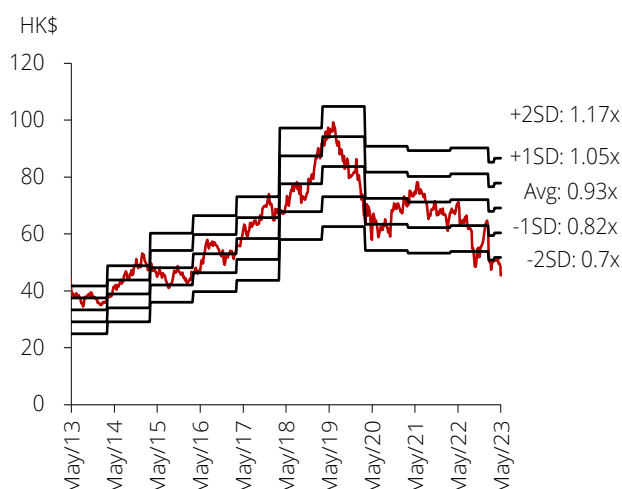
Australia and Singapore are well poised to capture the post-COVID retail market recovery. BUY with DDM-based TP of HK\$57.30. Prolonged interest rate upcycle remain the key investment risk, amongst others.

Company Background

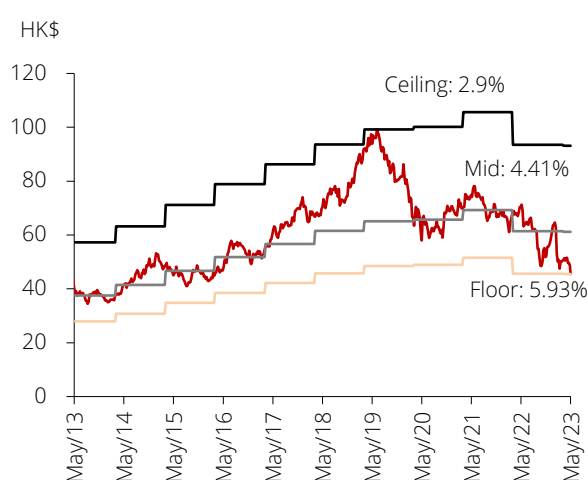
Link REIT is the largest listed REIT in Hong Kong. Its portfolio comprises mainly retail properties located adjacent to public housing estates and has a 60% stake in The Quayside in Kwun Tong. In China, Link REIT holds a portfolio of neighborhood malls in first-tier cities mainly Beijing, Guangzhou, Shanghai and Shenzhen, an office property in Shanghai and logistics assets in GBA and YRD region. Since 2020, Link REIT has been diversifying its portfolio through different regions. The REIT acquired two overseas office assets in 2020, namely 100 Market Street in Sydney and The Cabot in London. In Nov-21, Link REIT acquired 50% interest in three retail properties in Sydney, marking its first venture in the Australian retail market. Recently, Link REIT ventured into the Singapore retail market by acquiring the Mercatus portfolio. In Mar-23, Link REIT raised HK\$18.8bn through a 1-for-5 rights issue. This should pave its way to pursue the Link 3.0 strategy, which aims to optimise its portfolio through diversification while introducing capital partners to propel AUM growth.

Price to book NAV band and historical yield band

Price to book NAV band



Historical yield band



Source: Bloomberg Finance L.P. DBS HK

Result Summary

FY Mar (HK\$m)	FY22	FY23	% Chg	Comments
Rental income from HK retail and office properties	6,425	6,555	2	FY23: mainly due to portfolio reversion rate of 7.1%
Rental income from HK carparks and related business	2,130	2,395	12	FY23: full-year contributions from car park and godown buildings acquired in FY22
Rental income from Mainland China retail, office and logistics properties	1,380	1,256	(9)	FY23: dragged by weaker performance from retail portfolio as a result of pandemic restrictions, partly offset by increased contributions from logistics assets
Overseas retail and office properties	365	487	33	FY23: mainly boosted by maiden contributions from Australia retail portfolio
Other revenue	1,302	1,541	18	FY23: reduced property management fee waivers from Hong Kong portfolio
Revenues	11,602	12,234	5	
Property operating expenses	(2,826)	(3,036)	7	FY23: mainly due to higher promotion and marketing expenses and utilities expenses, partly offset by lower staff cost
Net property income	8,776	9,198	5	FY23: NPI margins dropped slightly to 75.2% from FY22's 75.6%
General and administrative expenses	(512)	(653)	28	
Change in fair values of investment properties and impairment of goodwill	426	9,317	2,087	
Operating profit	8,690	17,862	106	
Interest income	98	106	8	
Finance cost on interest bearing liabilities	(1,005)	(1,754)	75	FY23: Higher debt balance and cost of borrowing
Loss on disposals of financial assets at amortised cost	(11)	0	(100)	
Share of net profit of a joint venture	364	85	(77)	
Profit before taxation and transactions with unitholders	8,136	16,299	100	
Taxation	(1,229)	(1,006)	(18)	
Profit for the year, before transactions with unitholders	6,907	15,293	121	
Non controlling interest	(13)	158	n.a.	
Profit for the year, attributable to unitholders	6,894	15,451	124	
Adjustments:				
Change in fair values of investment properties and impairment of goodwill attributable to shareholders	(714)	(9,393)	1,216	
Deferred taxation on change in fair values of IP attributable to unitholders	172	(60)	n.a.	
Change in fair values of derivative components of convertible bonds	(32)	22	n.a.	
Change in fair values of financial instruments	(80)	51	n.a.	
Depreciation on amortisation of real estate and related assets	51	60	18	
Loss on disposals of financial assets at amortised cost	11	0	(100)	
Other non-cash Income	(29)	180	n.a.	
Total distributable income	6,273	6,311	1	
Discretionary distribution	146	0	(100)	
Total distributable amount	6,419	6,311	(2)	
Interim DPU (HK\$)	1.5959	1.5551	(3)	
Final DPU (HK\$)	1.4608	1.1880	(19)	
Total DPU (HK\$)	3.0567	2.7431	(10)	

Source: Link REIT

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Key Assumptions (%)

	2023F	2024F
Retail rental (Shopping centre) -HK	5	5

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Mar	2021A	2022A	2023A	2024F	2025F
Revenues (HK\$ m)					
Hong Kong retail and office properties	6,294	6,425	6,555	6,754	6,991
Hong Kong car parks and related business	1,883	2,130	2,395	2,487	2,581
Mainland and overseas properties	1,493	1,745	1,743	2,741	2,837
Other revenue	1,074	1,302	1,541	1,611	1,734
Total	10,744	11,602	12,234	13,594	14,142

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Mar	2021A	2022A	2023A	2024F	2025F
Gross revenue	10,744	11,602	12,234	13,594	14,142
Property expenses	(2,506)	(2,826)	(3,036)	(3,336)	(3,383)
Net Property Income	8,238	8,776	9,198	10,257	10,759
Other expenses	(428)	(512)	(653)	(686)	(710)
Joint ventures	0	364	85	366	372
Interest (Exp)/Inc	(644)	(907)	(1,648)	(1,578)	(1,574)
Exceptionals	(5,322)	415	9,317	0	0
Pre-Tax Profit	1,844	8,136	16,299	8,359	8,847
Tax	(1,092)	(1,229)	(1,006)	(1,388)	(1,548)
Non-Controlling Interests	433	(13)	158	(83)	(86)
Net Profit	1,185	6,894	15,451	6,889	7,213
Distribution income	6,010	6,419	6,311	6,889	7,213
Revenue Gth (%)	0	8	5	11	4
NPI Gth (%)	0	7	5	12	5
Dist. Inc Growth (%)	1	7	(2)	9	5
DPU Growth (%)	1	5	(10)	(2)	5

Source: Company, DBS HK

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Balance Sheet (HK\$ m)

FY Mar	2021A	2022A	2023A	2024F	2025F
Fixed Assets	200,375	214,009	238,932	246,619	254,538
Other LT Assets	218	414	809	809	809
Intangibles Assets	392	400	387	387	387
Associates/JVs	0	3,756	6,769	7,135	7,506
Bank Balance/Cash & Liquid	2,530	2,949	17,339	8,007	7,859
ST Investments	2,742	2,082	1,188	1,188	1,188
Inventory	0	0	0	0	0
Debtors	1,195	1,384	2,283	2,298	2,313
Other Non Cash Current	2,433	722	212	212	212
Total Assets	209,885	225,716	267,919	266,655	274,812
ST Debt	3,248	5,735	4,133	8,509	10,573
Creditors	2,504	2,700	3,024	3,044	3,064
Other Current Liab	2,893	2,832	3,313	3,343	3,373
LT Debt	35,388	44,010	60,780	47,404	45,840
Deferred Tax Liabilities	3,029	3,348	3,330	3,330	3,330
Other LT Liabilities	4,130	4,101	4,279	4,279	4,279
Non-Controlling Interests	(27)	302	120	203	288
Unitholders' funds	158,720	162,688	188,940	196,543	204,065
Total Capital	209,885	225,716	267,919	266,655	274,812
Share Capital (m)	2,082	2,110	2,554	2,554	2,554
Gross Debt	(38,636)	(49,745)	(64,913)	(55,913)	(56,413)
Working Capital	255	(4,130)	10,552	(3,191)	(5,438)
Book NAV (HK\$)	76.24	77.10	73.98	76.96	79.90
Gross Gearing (%)	18	22	24	21	21

Source: DBS HK

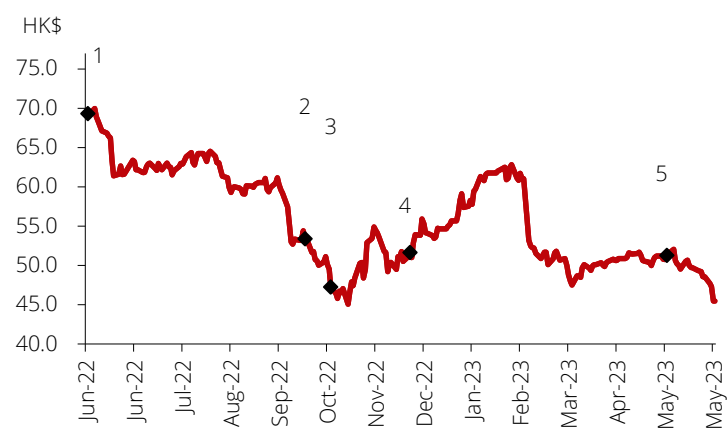
Cash Flow Statement (HK\$ m)

FY Mar	2021A	2022A	2023A	2024F	2025F
Pre-Tax Income	1,844	8,136	16,299	8,359	8,847
Associates' Profits	0	(364)	(85)	(366)	(372)
Tax Paid	(737)	(1,456)	(901)	(1,388)	(1,548)
Depr/Amort	75	75	62	62	62
Disposal of Fas/Subsidiaries	0	0	0	0	0
Chg in Wkg.Cap.	(70)	(174)	(65)	35	35
Other Non-Cash	5,966	481	(7,669)	1,578	1,574
Operational CF	7,078	6,698	7,641	8,281	8,599
Net Capex	(8,375)	(9,896)	(19,391)	(625)	(625)
Net change in asso/jv	0	(947)	(3,065)	0	0
Net Change in Investments	0	647	881	0	0
Assoc, MI, Invsmt	(2,167)	(386)	(3,059)	580	400
Investment CF	(10,542)	(10,582)	(24,634)	(45)	(225)
Net Chg in Debt	3,169	9,576	16,193	(9,000)	500
New issues/Unit Buyback	(379)	(82)	18,406	0	0
Distribution Paid	(3,966)	(4,405)	(5,050)	(6,410)	(7,048)
Other Financing CF	(884)	(951)	(1,282)	(2,158)	(1,974)
Financing CF	(2,060)	4,138	28,267	(17,568)	(8,522)
Chg in Cash	(5,524)	254	11,274	(9,332)	(149)

Source: Company, DBS HK

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Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	2-Jun-22	HK\$71.20	HK\$81.80	Buy
2:	6-Oct-22	HK\$56.00	HK\$70.00	Buy
3:	21-Oct-22	HK\$51	HK\$66.85	Buy
4:	6-Dec-22	HK\$52.60	HK\$65.00	Buy
5:	4-May-23	HK\$50.75	HK\$59.10	Buy

Source: DBS HK

Analyst: Percy Leung

Jeff Yau

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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