

**BEA securities**

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HONG KONG RESEARCH**11th May 2006**

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Main Board Listing – Research

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Champion Real Estate Investment Trust [Stock Code: 2778]

Sole Global Coordinator and Sole Listing Agent : Merrill Lynch
Joint Bookrunners and Joint Lead Managers : Merrill Lynch Citigroup JP Morgan
Joint Financial Advisors : Merrill Lynch Citigroup

Sector : Financials**Business** : Real estate investment trust (REIT)

Total unit offer: <u>1,234,219,752</u> units (45.0% of the issued units) Public Offer: 123,422,000 shares (10%) Placing: 1,110,797,752 shares (90%) Greenshoe: 185,132,963 shares	<u>Business of Champion REIT</u> Champion REIT is a real estate investment trust formed primarily to own and invest in an income-producing portfolio of office and retail properties in Hong Kong. It offers investors direct exposure to a prime Grade A office property in the central business district (CBD) in Central, Hong Kong. Champion REIT will initially invest in and own the Property, which comprises 91.5% of the gross rentable area of <i>Citibank Plaza</i> (comprises the 47-storey Citibank Tower and the 37-storey ICBC Tower) and substantially all of the parking spaces at <i>Citibank Plaza</i> . The Property has an aggregate gross rentable area of 1,160,227 sq. ft., comprising 1,117,634 sq. ft. of office space, 42,593 sq. ft. of retail space, 55 private carparking space and a public carpark with 550 carparking spaces. Upon the completion of the Global Offering and assuming the Over-allotment Option is not exercised, Great Eagle, Kerry Properties and Wing Tai will own 49.2%, 4.2% and 1.6%, respectively, of the outstanding Units of Champion REIT. Meanwhile, each of the three parties has entered into a deed ("Distribution Entitlement Waiver Deed") with the Trustee and the Manager to waive 100%, 55% and 20% of the distributions entitled, respectively, for FY06, FY07 and FY08.
Price: HK\$5.00-HK\$5.75 per unit Market Cap.: HK\$13.7 billion – HK\$15.8 billion FY2006E Annualized Distribution Yield: 5.57%-4.84% Pro forma NTA per unit: HK\$5.94 The Manager: Eagle Asset Management (CP) Limited	
HK Public Offer period: 11 th May 2006 – 16 th May 2006 noon Receiving bank: The Bank of East Asia, Hang Seng Bank, HSBC & ICBC (Asia) Unit registrar: Computershare Hong Kong Investor Services Limited Listing date: 24 th May 2006	

Major Unit-holders after Listing (Assuming the over-allotment option is not exercised)

Great Eagle	49.2%
Kerry Properties	4.2%
Wing Tai	1.6%
	<u>55.0%</u>

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Use of Proceeds

Total proceeds from the offer are estimated to be HK\$6,171 million (based on an issue price of HK\$5.00) and HK\$7,097 million (based on an issue price of HK\$5.75).

(Assuming the over-allotment option is not exercised.)

The net proceeds, together with the funds drawn down from the Facility (a secured credit facility of HK\$7.2 billion, comprising a term loan facility of HK\$7,000 million and a HK\$200 million revolving credit facility), will be used to make payments to the Vendor Companies (Great Eagle, Kerry Properties and Wing Tai), for the upfront swap payments, and to meet the IPO-related costs and expenses and debt related costs.

	Based on the Minimum Offer Price of HK\$5.00	Based on the Maximum Offer Price of HK\$5.75
	(HK\$ million)	
Payments to the Vendor Companies	11,487	12,390
Upfront swap payments	1,417	1,417
Other costs	267	290

Financial Highlights

	Year ended 31 st December		
	2003 HK\$ '000	2004 HK\$ '000	2005 HK\$ '000
Rental income	449,328	329,142	319,549
Car park income	11,111	8,321	9,011
Building management fee income	<u>73,548</u>	<u>66,126</u>	<u>72,723</u>
Total rental and building management fee income	533,987	403,589	401,283
Net rental income	415,386	294,298	286,278
Increase/(decrease) in fair value of investment properties	(494,000)	1,988,859	11,925,276
Profit attributable to Unitholders	(201,976)	1,648,435	8,973,397

Statistics of the Properties

Year of Completion	May 1992	
Occupancy	Average for the year ended 31 st December 2005	As of 28 th February 2006
- Office	86.3%	86.1%
- Retail	100.0%	100.0%
Number of Parking Spaces	55 out of 58 private carparking spaces; Public carpark with 500 carparking spaces and 50 motorcycle parking spaces	
Total Floor Area (excluding the carpark)	1,492,526 sq. ft. (comprising 1,434,805 sq. ft. of office space and 57,721 sq. ft.)	
Gross Rentable Area	1,160,227 sq. ft. (comprising 1,117,634 sq. ft. of office space and 42,593 sq. ft.)	
Appraised Value	HK\$22,670 million (as of 28 th February 2006)	
Number of Tenants	81 office and retail tenants under 106 tenancies	
Government Grant Expiry	30 th June 2047	

Strengths/Opportunities

- ✓ Thanks to robust business confidence and solid economic growth, demand for Grade A office space continues to grow favourably, which helped bring the average vacancy rate of the HK Grade A office market down to 8.1% in 2005 from a high near 14% in 2003 when local business sentiments fell to a trough during the SARS outbreak. For the Citibank Plaza, vacancy rate of its office space was 13.9% by the end of 2005, well below the vacancy rate of the overall HK Grade office market as well as that in the central business district of around 5%. The higher-than-average vacancy rate should enable the Manager to seek for higher rental rates in the market and take full advantage from the current office up-cycle.
- ✓ According to market consultant Colliers International, redevelopment of the Central Market at Jubilee Street is seen the only potential new supply of office space in the Central district in the next couple of years. Apart from that, no other new supply of office properties in Central is expected to come to marketplace between 2007 and 2010.
- ✓ 55.2% of the Property's lease would expire in 2006-2008. Upward revision of rental rates during renewals should help maximize rental incomes and so enhance the expected yield of Champion REIT in the coming years.
- ✓ Champion REIT has entered into an interest rate swap with Merrill Lynch to fix the finance costs of the Facility, which would eliminate interest rate fluctuation from distorting income distribution during the course of the term loan.
- ✓ Champion REIT is to distribute 100% of its distributable income to Unit-holders as dividends for each financial year. With the guaranteed paid-out of no less than HK\$0.1694 per unit in 2006, Champion REIT will offer an annualized distribution yield of 5.57% based on the minimum offer price of HK\$5.00 and 4.84% based on the top end of the indicative price range at HK\$5.75, which would be in line with Prosperity REIT (HKEx: 0808)'s FY2006E yield of 5.2% but higher than the Link REIT (HKEx: 0823)'s FY2006E yield of 3.7%.

Weaknesses/Threats

- × In order to come up with the shortfall of distribution before any rental renewals and take-up of office spaces in the next couple of years, the Vendor Companies have agreed to waive all or part of the distributions entitled during FY06-FY08. However, if the anticipated rental growth rates do not materialize, the yield of Champion REIT would fall once the Distribution Waivers expires.
- × There is only one office premise (2 Towers) in Champion REIT, leading to a higher level of risk in geographic terms when compared with other REITs listed in Hong Kong.
- × The Property's rental incomes fell 26.7% and 2.9% in 2004 and 2005, respectively, due to removal of some tenants to other newly completed office spaces like *IFC Two*.
- × Valuation of the Citibank Plaza is circa around HK\$15,000 per sq ft, which may considered to be on the high side.

Recommendation: Subscribe

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