



Tai Cheung (88 HK)

Solid Hong Kong property developer at 79% discount to NAV with no debt



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Summary



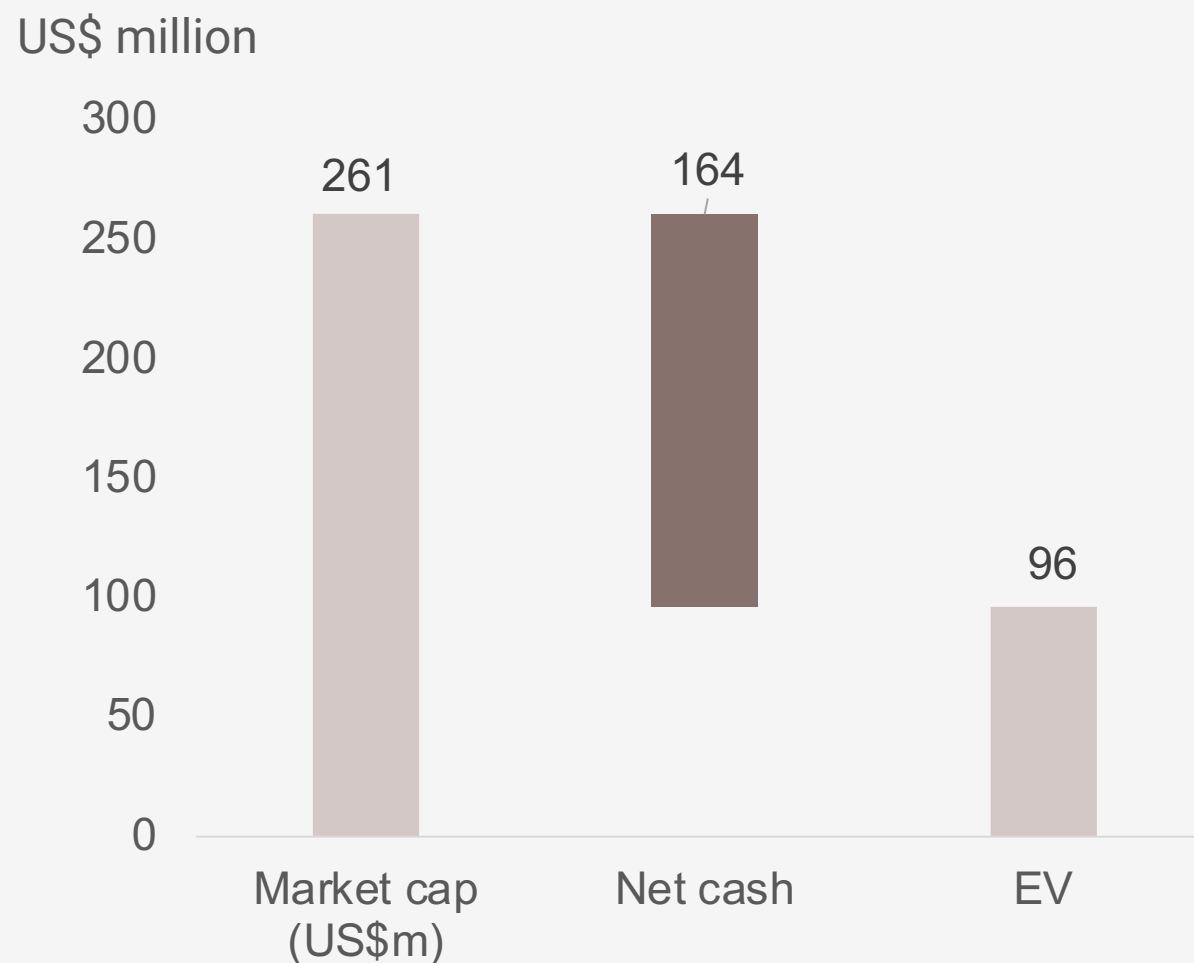
1. Tai Cheung (88 HK) is a well-managed Hong Kong property developer that owns 35% of Sheraton Hotel in Tsim Sha Tsui as well as premium residential properties on Hong Kong Island. Those developments include 3 Plunkett's Road on The Peak, PULSA in Repulse Bay and a new project on Praya Road on the island Ap Lei Chau. I consider them to be high-quality developments.
2. It was founded by a certain Edward TT Chan and became known in the 1970s as one of the top 5 Chinese-owned property developers in Hong Kong. When he passed away in 1981, his son David Pun Chan took over. Since then, the company has become more sleepy, but stands out among Hong Kong property developer small caps by being generous with dividends and having decent corporate governance. The company continues to be controlled and run by David and his family.
3. The company has had a few tough years. The anti-government protests in 2019 hurt tourism to Hong Kong, causing RevPAR at Sheraton to drop. Then came COVID-19, causing the border to close entirely. In 2020, Hong Kong introduced a National Security Law, which caused roughly 4% of the population to emigrate. Finally, from 2022 Hong Kong mortgage rates have gone up by almost 500 basis points, causing residential property prices to drop about 20%. Tai Cheung's own property price has dropped by almost 70% from its peak.
4. It now trades at about a 79% discount to my relatively conservative net asset value. I'm using a 6% capitalization rate for the after-tax profits from the Sheraton Hotel, and residential property prices with significant discounts to transaction prices for nearby properties. The dividend yield is 7.3% but probably could go up above 10% if a full-recovery scenario.
5. The outlook has turned positive. Hong Kong's borders opened up early last year, and tourist arrivals are now back to 60% of the pre-2019 level. While interest rates remain high, I personally believe that inflation pressures will allow central banks to lower rates in the next two years. The only question is whether the National Security Law has permanently damaged the attractiveness of Hong Kong as a destination for the ultra rich. I don't think so, but it's probably wise to assume an extra discount for this uncertainty.

Capitalisation



- Share price: HK\$3.30
- Shares outstanding: 618 million
- Market cap: US\$261 million
- Net cash: US\$166 million
- Enterprise value: US\$95 million

- Average daily trading volume: US\$21,000



* HK\$ = Hong Kong Dollar. HK\$/US\$ = 7.82

Business overview



- Tai Cheung Holdings (大昌集團) is a Hong Kong-based property developer and manager with a focus on hospitality, office and residential properties.
- The company started out as a construction company in 1956 and then shifted into property development and finally investment holding in the past 10 years.
- Today, its flagship assets include a 35% stake in Sheraton Hotel in Tsim Sha Tsui, and the residential developments 3 Plunkett's Road, PULSA as well as a new project on Praya Road on Ap Lei Chau.
- The company is run by Chairman and Managing Director David Pun Chan, who is the son of the founder and well-regarded in the industry.
- Earnings came off a bit during COVID-19 due to Hong Kong's border closures and delays in sales launches, but the business is now well on its way to a recovery.



Tai Cheung was founded by Edward TT Chan, who pioneered the property development industry in Hong Kong



- Founder Edward TT Chan (陳德泰) was born in Guangzhou in 1918, studying at Lingnan University before becoming an engineer and fleeing to Hong Kong during the war.
- In 1952, Edward Chan went into the construction business through Tai Cheung Construction.
- Tai Cheung pioneered the concept of selling properties by floors and individual units by installment. It also pioneered the concept of pre-sales — getting paid before construction.
- In 1958, the Hong Kong government introduced new regulations that required developers to put up high levels of capital. Tai Cheung nearly went bankrupt but bailed out by HSBC. After this experience, Edward became more conservative and instead partnered with landowners instead of buying land on its own.
- By the 1970s, Tai Cheung became known as one of the “Five Tigers of HK Chinese Developers”, alongside Cheung Kong, Sun Hung Kai, Hang Lung and Hopewellin.
- In 1972, Tai Cheung did an IPO and during the boom of 1973 it conducted 15 follow-on offerings, taking advantage of high share prices at the time.
- Tai Cheung helped develop Hutchison’s HQ Hutchison House, and thanks to its relationship with Hutchison, it managed to acquire 35% of Sheraton, though at a high price. In the 1970s, it also worked with Swire to develop the first phase of Taikoo Shing.



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Sheraton Hotel in Tsim Sha Tsui in the 1970s



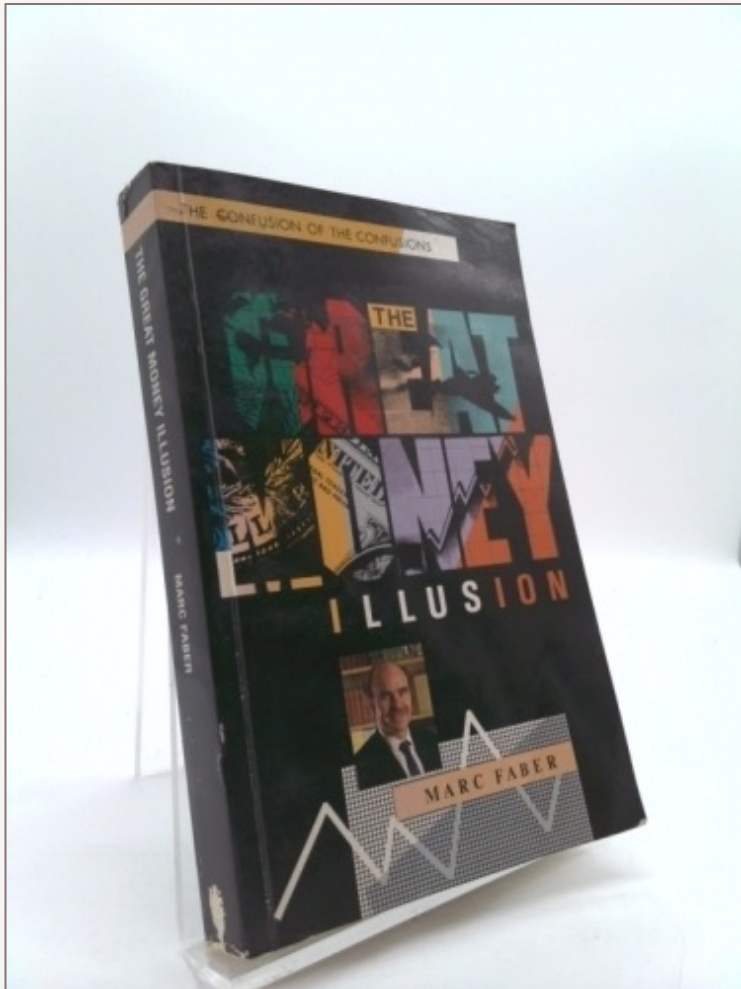
Today, Tai Cheung is run by Edward's son David Pun Chan

- Founder Edward Chan passed away in 1981 and Tai Cheung was then taken over by his son David Pun Chan (陳斌), who continues to control the company.
- David graduated from MIT with a degree in mathematics in 1972 and was only 30 years old when he took over the company.
- Since David took over the company, it's become more sleepy, engaging in occasional property development projects but now compounding the capital at a relatively slow pace.
- David belongs to the pro-Beijing / pro-establishment camp in Hong Kong politics, and maintains a cordial relationship with the communist party leadership. He is an honorary Chairman of the Chinese General Chamber of Commerce in Hong Kong. He is also a member of the HKSAR Election Committee and also a director of the Real Estate Developers Association of Hong Kong.



Chairman David Pun Chan

Marc Faber, 1988: *“Tai Cheung has continued to prosper under the management of his bright and conservative son”*

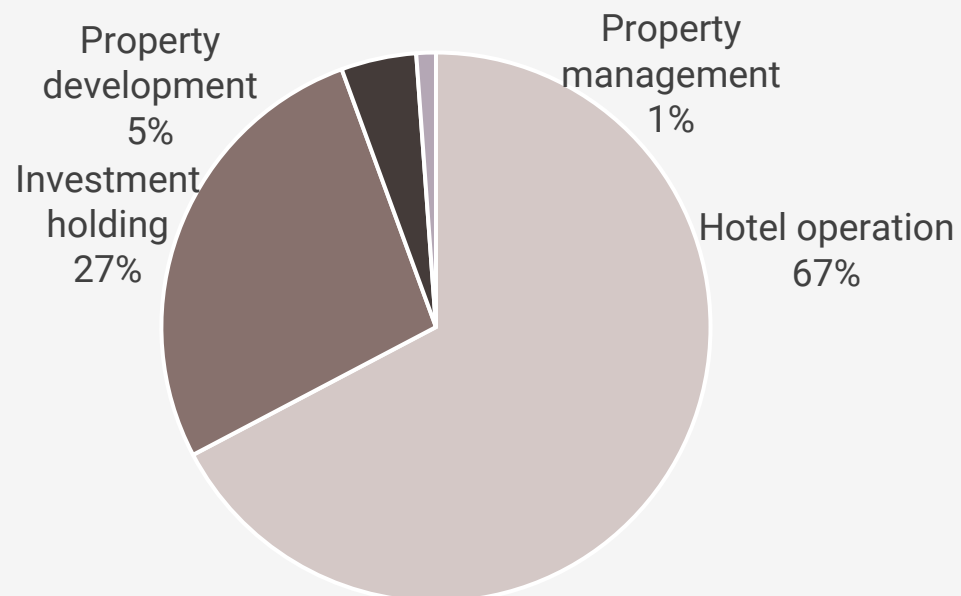


Hilton Hotel where I met a jovial and friendly Chinese who was, I guess, in his fifties. When Chan Tai-tak heard that I was in the investment business, he asked me what my views were about interest rates. When I told him that I thought the prime would go down from 12% to 6% within the next 12 months, he laughed and challenged me to a bet for a bottle of whisky. The prime rate didn't decline to 6%, but when it touched 6.25%, Chan Tai-tak sent me a bottle of Chivas Regal, invited me to lunch, and introduced me to his son David with whom I later did some business. David and I also became friends and still see each other from time to time. Chan Tai-tak started out penniless, but had become one of Hong Kong's most successful property developers. In the early 1970s, he made the headlines when he paid a record price for a Tsim Sha Tsui site on which he built the Sheraton Hotel. Sadly, he died a few years ago and Hong Kong lost one of its most colourful as well as successful personalities, a man who was always ready for a good laugh, a double whisky, and a heated discussion about anything from interest rates to pleasure boats. His company, Tai Cheung, has continued to prosper under the management of his bright and conservative son.

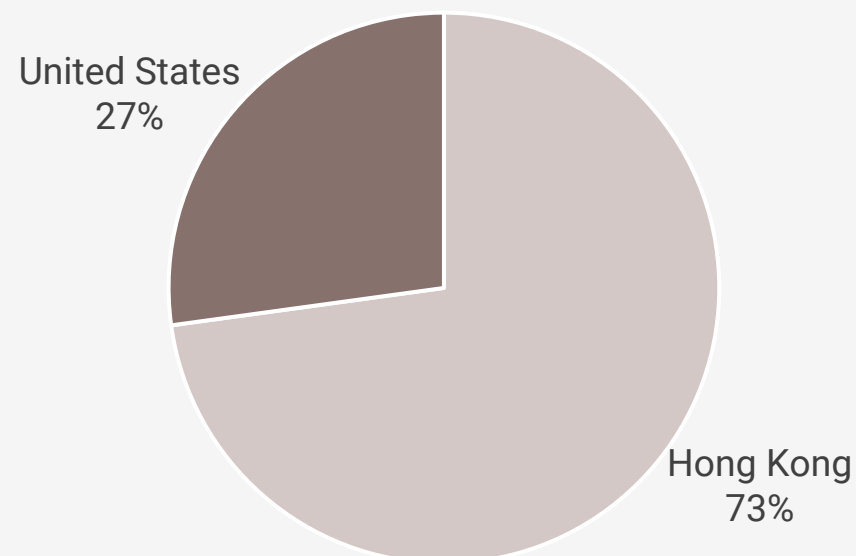
Tai Cheung owns a hotel and develops residential properties in Hong Kong



Operating profit by segment

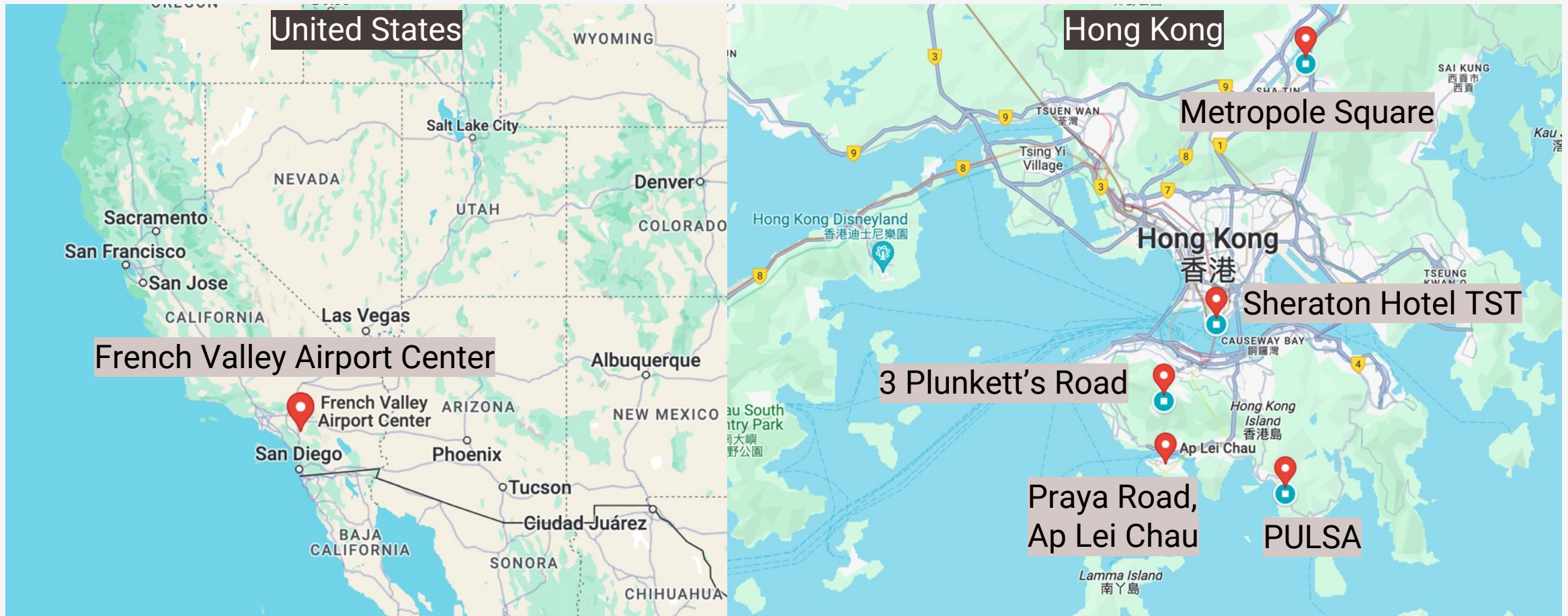


Completed GFA by region



Source: Spin-off prospectus, 2020

Most of Tai Cheung's properties are in Hong Kong



Sheraton Tsim Sha Tsui



- Sheraton Tsim Sha Tsui is a 209,000 square feet 5-star hotel in the middle of Tsim Sha Tsui, Kowloon island, Hong Kong.
- The hotel opened in 1974 and underwent renovations in the mid-1980s and 1990s. It also underwent renovation work from 2021 to 2023.
- A room with a king sized bed costs roughly US\$400/night, in line with other luxury hotels in Hong Kong. Tai Cheung's rental income is variable and a direct function of revenue per available room (RevPAR).
- The building has 18 floors with 780 guest rooms and suits. A stay at Sheraton also offers access to other amenities such as restaurants, a health club, a rooftop pool and a business center. Finally, it has a 15,000 square feet banquet hall with 14 function rooms for weddings and other major events.
- The restaurants in the hotel include Morton's, Unkai Japanese cuisine, Tianbaoge Chinese restaurant, Sky Lounge, etc.
- SOGO department store used to be the sole retail tenant from 2014 onwards, but eventually closed shop in March 2023, hurting rental income.



Sheraton is a jewel, located smack in the middle of Tsim Sha Tsui



The views inside and outside the rooms of Sheraton Hotel



Sheraton's Google reviews (4.2/5.0) emphasize its harbor views, proximity to shopping centers and its newly renovated rooms



- *"Pleasant hotel tug at a corner of Tsim Sai Tsui and **very close to the harbour**, grand old dame like the clock tower, peninsula hotel etc." – Choon Kit Leong*
- *"Great location, offering views of Hong Kong. The Symphony of light is visible from the hotel rooms... **Very close to shops and restaurants**. Everything is very walkable." – Robert Woods*
- *"Afternoon tea at the Sky Lounge was a lovely place to relax and chill out. **The view is spectacular**, afternoon tea was delicious" – Angela Cheng*
- *"The hotel is very well located on Nathan Road, close to the Victoria Harbour, **you can walk to metro station easily**, to Canton Road, there are all facilities nearby." – Felipe Chan*
- ***"Room are clean and full equipped.** Water pressure are good. Everything feel new to me and it might be renovated recently." – Supakij Khomvilai*
- ***"Rooms are renovated and look very fresh.** Astonishing view over HK island, just unparalleled, one can watch light show from the comfort of their couch." – V Y*
- ***"Excellent location...** We had a very nice room with king bed (2x super singles joined together) overlooking the harbour." – Michelle Liew*
- ***"Highly recommend this hotel. It looks modern now after the renovation** and the location is also pretty good - provides good view of the harbour." – Ronny Gosal*

Metropole Square is right next to the Shek Mun MTR station



PULSA



- PULSA is a residential development on 108 Repulse Bay Road, on the Southern coast of Hong Kong Island. The land was purchased for HK\$1.7 billion in 2012. The all-in-cost has been estimated at HK\$54,000/sqft.
- Today, 8 houses have been built, each with panoramic views over Repulse Bay. They also offer access to well-equipped clubhouse facilities.
- The units are roughly 5,000-8,700sqft each and finished to an incredible standard. The total gross floor area is 42,000sqft.
- If I had to guess, I'd bet that they will cost HK\$60,000/sqft suggesting HK\$280 million each or HK\$2.5 billion. For reference, Cheung Kong sold three house on 90 Repulse Bay for HK\$83,000/sqft in 2018. And a nearby site was sold in 2022 for HK\$62,000/sqft, excluding construction costs. And a luxury house on 15 Shouson Road was just sold for HK\$108,000/sqft.
- Promotional video:
https://www.youtube.com/watch?v=_ZUVHwJfScE





The Ap Lei Chau project on Praya Road

- In 2020, Tai Cheung bought a plot of 50-year leasehold land on Praya Road in Ap Lei Chau for HK\$1.3 billion to be developed into a residential project.
- They justified the purchase by saying that luxury residential properties on Ap Lei Chau are still limited, despite its proximity to Repulse Bay it being next to a major marina.
- Foundation work began in June 2021 and construction will be completed in early 2025.
- Total square footage will reach 88,280sqft. At HK\$20,000/sqft, the project could bring in HK\$1.8 billion after additional capex of a few hundred million HK Dollar.



3 Plunkett's Road



- Tai Cheung owns terraced houses at 3 Plunkett's Road (賓吉道3號) on The Peak, Hong Kong Island.
- As of end-FY2023, Tai Cheung owned what I think was four houses of about 4,500sqft each, totalling 19,238sqft in total.
- The view towards the Southern part of Hong Kong Island is absolutely spectacular – this is prime real estate. It's roughly a 12 minute drive from Central on the northern part of Hong Kong Island.
- The project was launched in 2011 and it initially only sold 1 unit for HK\$400 million, or HK\$90,843/sqft. Since the units are not selling, expect a discount. HK\$70,000/sqft would imply a total value of HK\$1.7 billion.



French Valley Airport



- A business center in close connection to the French Valley Airport between San Diego and Los Angeles. It offers single-floor buildings for logistics companies and others that need to have presence near the airport.
- The land was acquired in 2005. Phase 1 of the project was completed in 2018, phase 2 in 2022 and phase 3 in 2023. Phase 4 will be completed by the end of 2024.
- As of the latest financial report, Tai Cheung owned 584,000sqft of floor area.
- I value the property at cost of HK\$93 million.



Metropole Square



- Metropole Square is an office building in Sha Tin, in Kowloon, Hong Kong. It's located 4 minutes away from the Shek Mun MTR station and has views over the Shing Mun river.
- It attracts tenants looking for premium office space in the district. One of the key tenant among the ground floor level retail shops is jewellery company Luk Fook.
- Tai Cheung developed the property and has been selling off strata-title office space over time, with most in 2019. As of end-FY2023, Tai Cheung only owned 6,789 square feet of office space in Metropole Square.
- Given valuations of about HK\$7,630 per sqft, the remaining parts of Metropole Square should be worth roughly HK\$52 million.



Competitive advantages



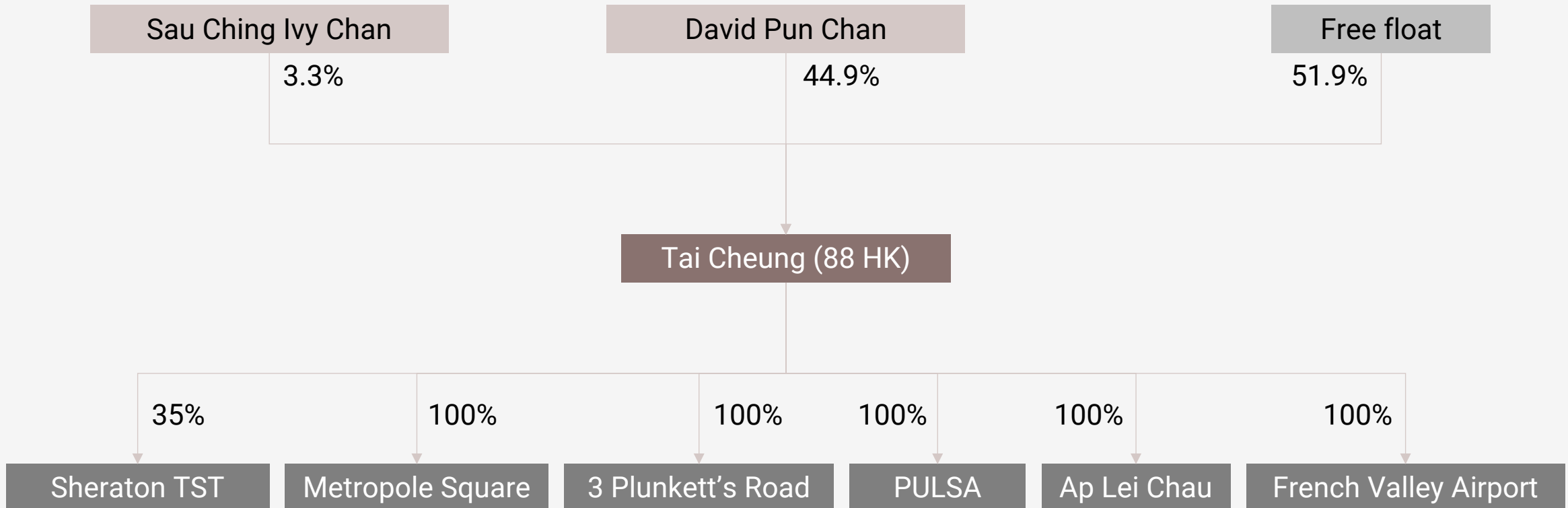
- **Scarcity of key properties:**

- An unrestricted view of Hong Kong island from Kowloon is a scarce resource – one that cannot be replicated easily. Sheraton is a close to irreplaceable asset. Land on The Peak, in Repulse Bay and on Ap Lei Chau are similarly scarce.
- I also think that Hong Kong is a unique city in a Chinese context. There is no other city in China offering a similar lifestyle – not Hangzhou, not even Xiamen. I'd bet that many rich Chinese would prefer to live in Hong Kong if they could, the National Security Law notwithstanding.
- **David Pun Chan:** I've met David a few times, and he strikes me as a trustworthy individual. I feel confident that Tai Cheung will not engage in related party transactions or in other ways funnel money out of the company.



Sheraton Hotel in Tsim Sha Tsui in the 1970s

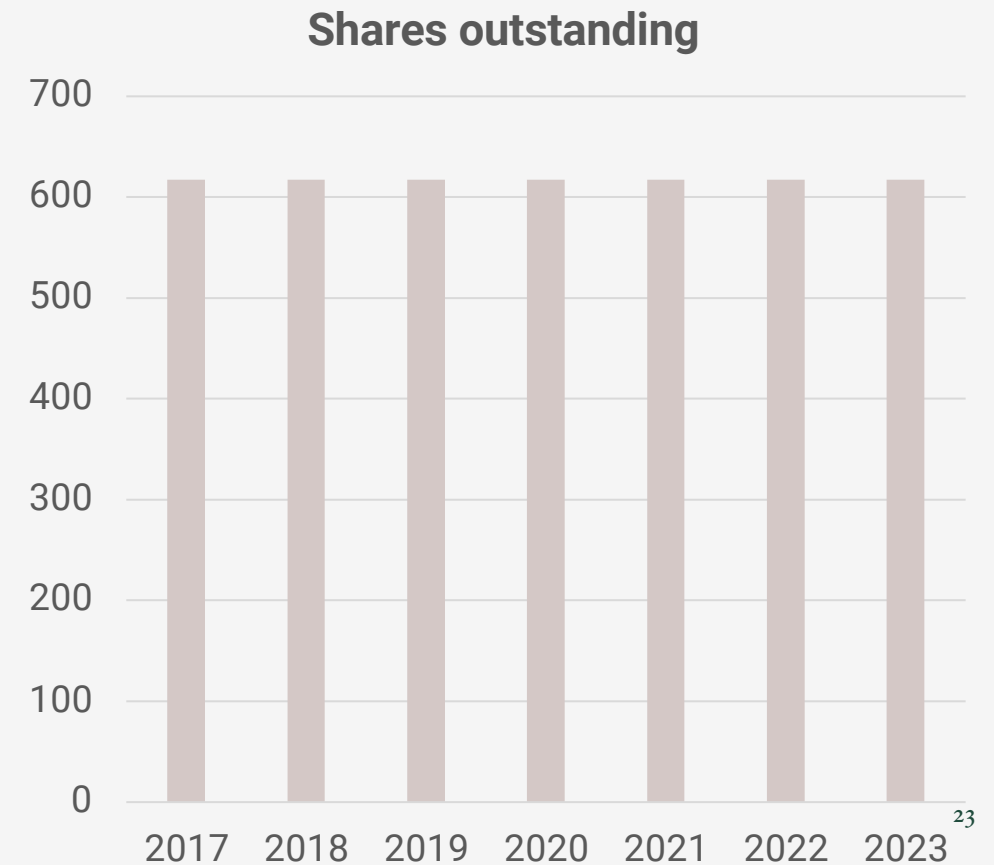
Tai Cheung is controlled by the Chan family with their almost 50% ownership





Tai Cheung's capital allocation: not bad, not great

- In the past ten years, Tai Cheung has been a sleepy operation not being particularly aggressive when it comes to property sales and also not being active in M&A or share buybacks.
- The share count has been flat over the past ten years. There was a share buyback announcement back in 2018, but nothing has been repurchased so far.
- The HK\$1.3 billion acquisition of a plot of land on Ap Lei Chau seems expensive, and at HK\$20,000/sqft I fail to see how Tai Cheung can make much money out of it.
- The sleepy nature of the business can also be seen in the compounding of book value, which has been non-existent since 2015.
- On the other hand, Tai Cheung has been generous with its dividends, paying out 90% of earnings back in FY2019 and continuing to pay out a generous dividend throughout COVID-19.

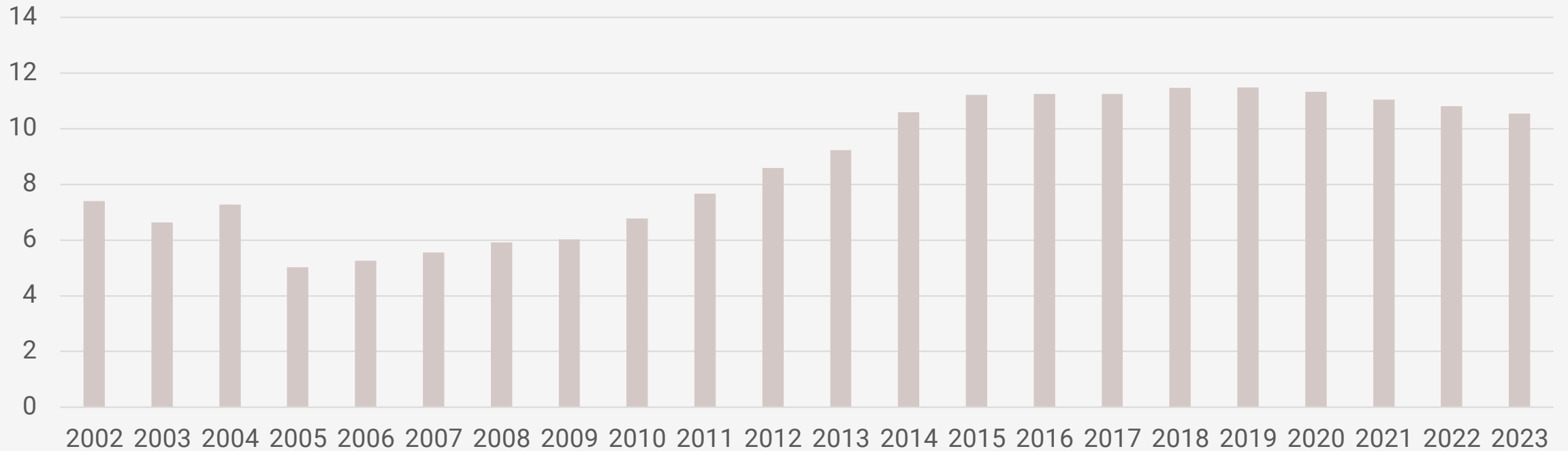


Source: TIKR

Tai Cheung's tangible book value per share stopped growing in the mid-2010s... not amazing, but plenty of dividends and COVID-19 headwinds



Tangible book value per share



Source: TIKR

The share price has dropped by 60% since the start of COVID-19

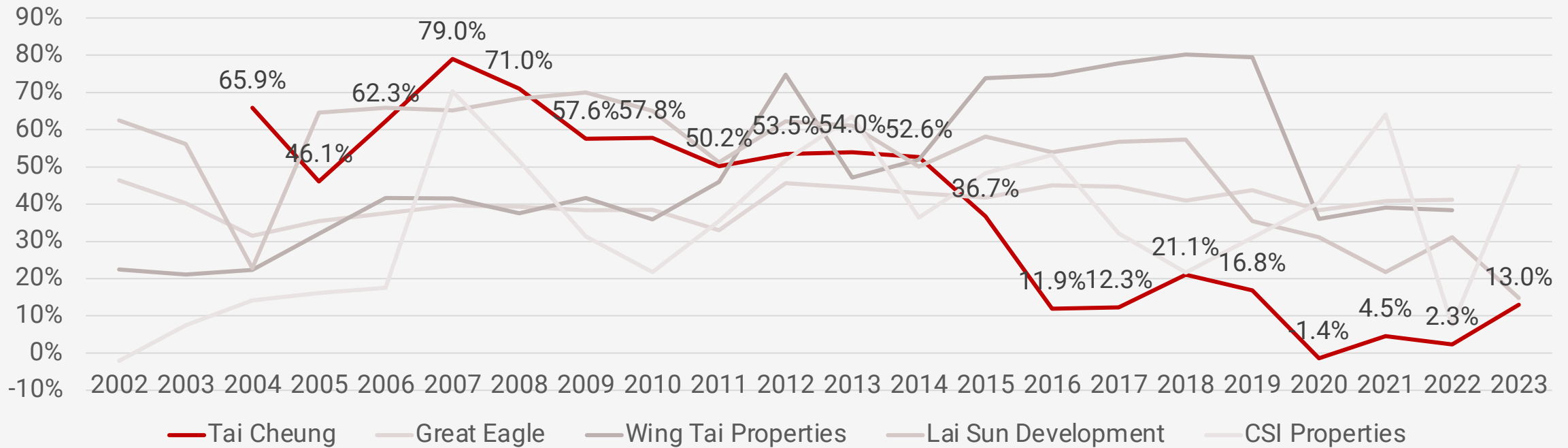


Source: Yahoo Finance

Gross margins used to be a lot higher... while recent projects have not been profitable, I would not extrapolate that experience.



Gross margins



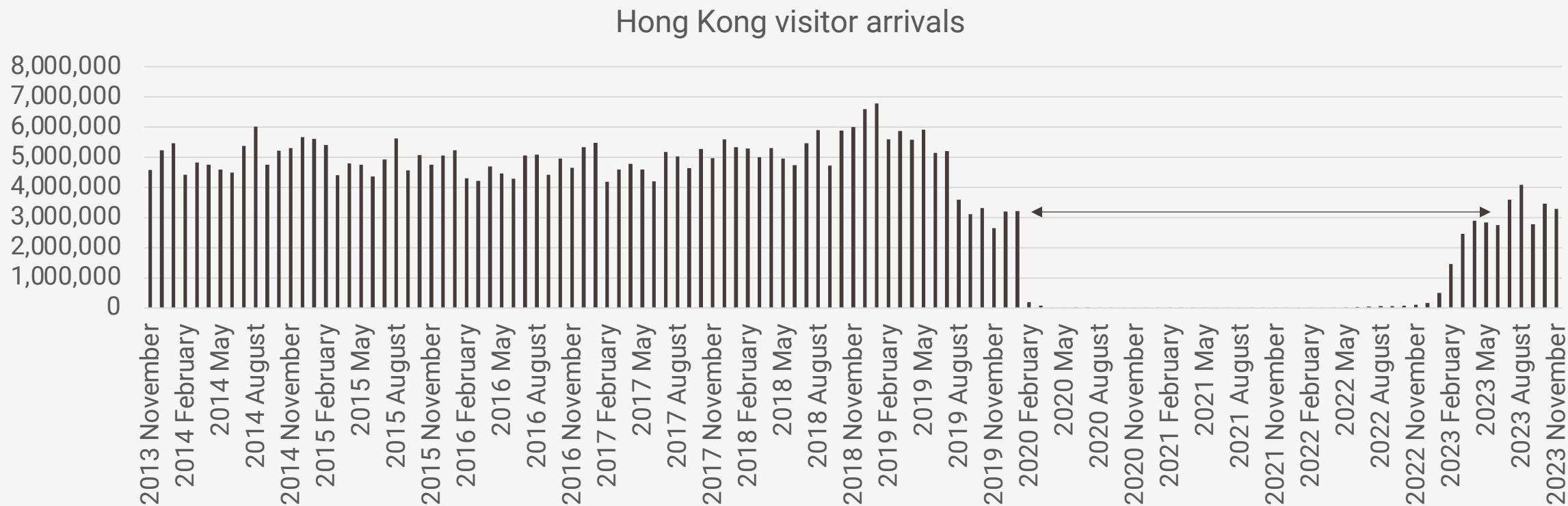
Source: TIKR



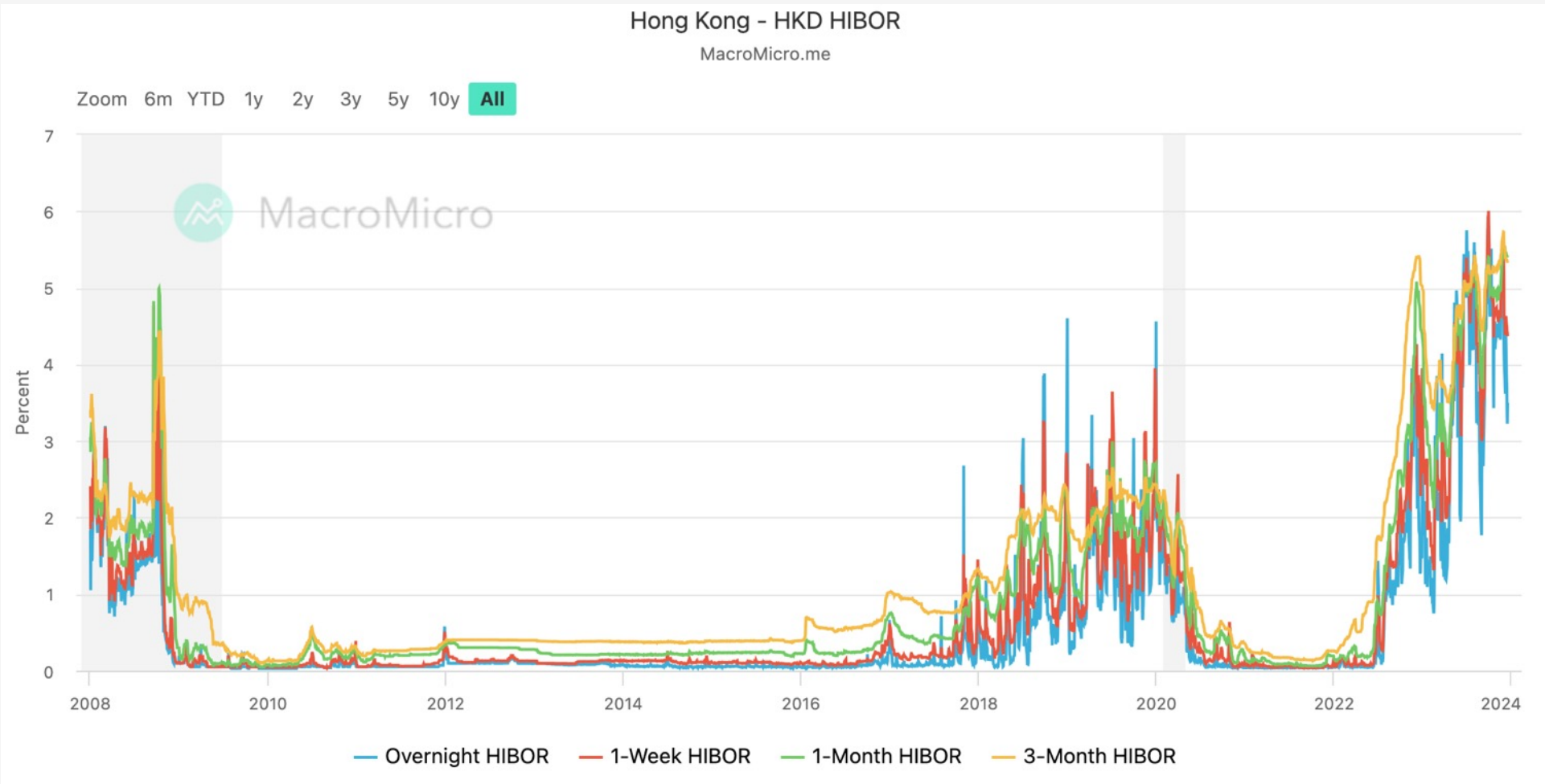
Long-term industry trends

- **Interest rates:** Since 2022, the US Fed Funds rate has gone up over 500 basis points, impacting Hong Kong interest rates as well, including mortgage rates. These higher interest rates have impacted housing affordability and caused property prices to slump.
- **Residential property slump:** Hong Kong residential property prices are now down about 20%, though the magnitude might be even greater for luxury housing, which used to trade well below 2% cap rates. The market is illiquid so it's difficult to get a grip on the problem.
- **Emigration:** After the National Security Law was put into place in 2020, roughly 4% of Hong Kong's population has left, though I believe that this emigration has dropped to a trickle. And it can easily be counteracted through immigration from mainland China.
- **Tourism recovery:** Hong Kong's tourist arrivals recovered nicely this year after the borders opened up. But they're still about 40% below their pre-2019 levels, and this has an impact on occupancy and room rates for Hong Kong hotels.
- **Vacancy tax:** Hong Kong has been discussing introducing a vacancy tax on homes yet to be sold. Such a tax could force Tai Cheung to sell some of its residential properties at below market rates.

Hong Kong's visitor arrivals have recovered nicely... though not to pre-2019 levels



HIBOR has gone up significantly since early 2022, reducing homebuyer affordability



Hong Kong's residential property prices have started to weaken





What is going to change for Tai Cheung?

1. **Partial RevPAR recovery for Sheraton:** The company has completed the renovation that began in 2021 and the occupancy rate has continued to improve throughout 2023. Room rates are now about US\$400/night, quite high. In their own words, as per the FY2024 interim report:
“Hotel occupancy increased significantly in the 2nd quarter and 3rd quarter of 2023 with higher room rates driven by market conditions.”
1. **PULSA:** The PULSA development has now been completed and in late 2023, Tai Cheung was preparing for the sales launch. Though, as far as I’m aware, none of the units have been sold so far.
2. **Ap Lei Chau project:** Piling began in 2021 and superstructural work is not progressing according to plan, with a project completion planned for 2025.
3. **Hong Kong property tax reform:** In October 2023, Hong Kong chief executive John Lee cut the 30% stamp duty in half (“BSD” & “NSRD”) and promised that certain professionals that subsequently obtained permanent residency would no longer need to pay the special stamp duty (“SSD”). Since then, there’s been a slight uptick in transactions but many are still cautious due to currently-high interest rates.
4. **Lower interest rates:** I personally believe that global inflation has peaked and is going lower due to tight monetary policy in the United States and elsewhere. If that’s the case, expect interest rates to come down again, and for cap rates on Hong Kong property to compress yet again.

Knight Frank Dec 2023 residential property commentary emphasize an ongoing recovery but a continued headwind of high interest rates

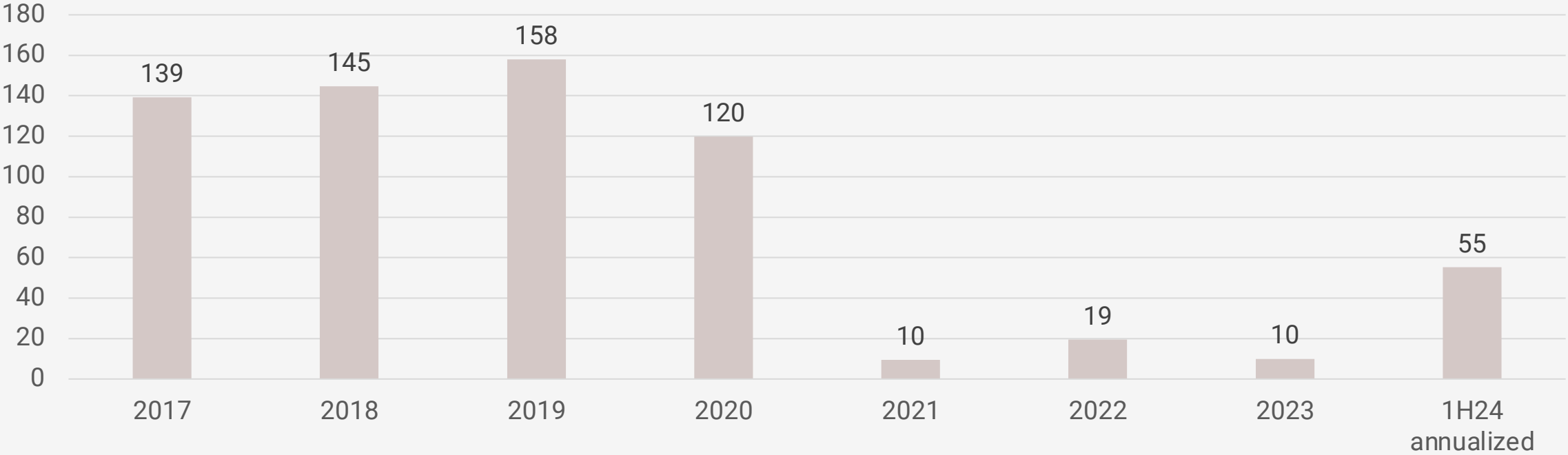


- *“Residential prices declined at a faster pace as market sentiment deteriorated. Thanks to the easing of property stamp duties, **residential transaction volume rebounded considerably in November**, with the total number of transactions surging by 20.3% MoM, the Land Registry shows. Primary and secondary sales rose by a significant 53.7% and 13.6% MoM, respectively.”*
- *“Launches in the primary market continued to be the spotlight, as **developers offered deep discounts** and flexible mortgage schemes to clear unsold inventories. Some developers were willing to provide longer completion times to buyers and higher commissions to agents to increase their competitiveness in the challenging market.”*
- *“Looking ahead to 2024, the **high interest-rate environment will continue to weigh on home prices**, leading to a higher number of foreclosed properties. **Volume is expected to rise steadily** in light of government’s relaxation of “cooling measures” and **more incoming Chinese mainland talent**. We expect home prices to decline up to 5% in 1H 2024, but leasing momentum to continue, with a 5-8% rise, given ongoing demand from newcomers.”*

Rental income from Sheraton Tsim Sha Tsui is now on a recovery path from COVID-19



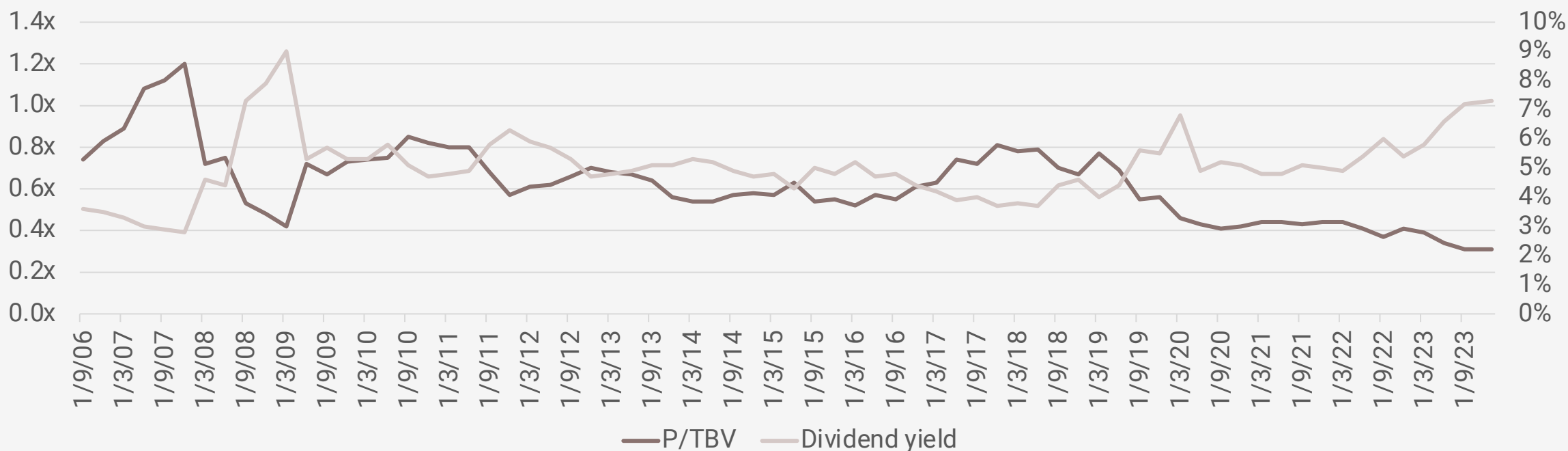
Sheraton associate income



Tai Cheung now trades at the exact same P/TBV as in the Great Financial Crisis of 2008, and nearly the same dividend yield



Tai Cheung (88 HK)



Source: TIKR

Tai Cheung's peers trade at lower P/B but the dividend yield ranks among the top of its peer group

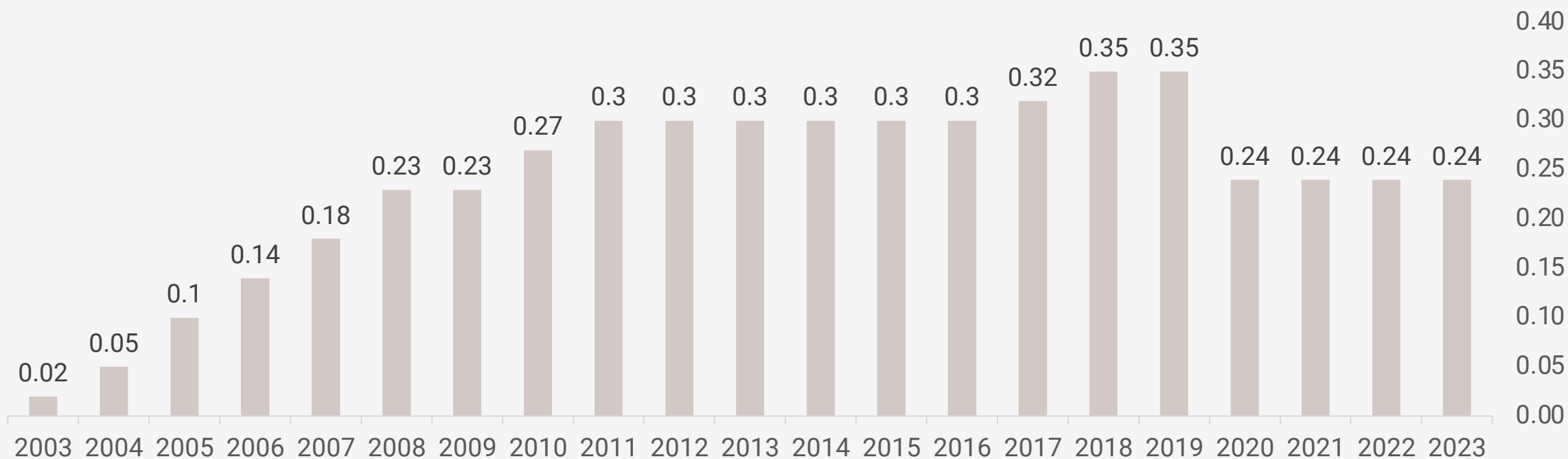


HK small-cap property developers	Ticker	Region	Mkt cap (US\$m)	P/B	EV/EBITDA	P/E	Div yield
Tai Cheung	88 HK	Hong Kong	261	0.31x	3.7x	7.3x	7.3%
Hysan Development	14 HK	Hong Kong	1,910	0.22x	18.1x	7.6x	9.3%
Great Eagle	41 HK	Hong Kong	1,142	0.16x	13.1x	5.9x	7.3%
Wing Tai Properties	369 HK	Hong Kong	469	0.15x	8.2x	n.a.	7.4%
Magnificent Hotels	201 HK	Hong Kong	89	0.16x	16.9x	1.5x	n.a.
Soundwill	878 HK	Hong Kong	229	0.10x	12.6x	n.a.	3.2%
Lai Sun Development	488 HK	Hong Kong	139	0.04x	61.5x	n.a.	n.a.
CSI Properties	497 HK	Hong Kong	113	0.06x	13.4x	2.5x	4.8%
Average ex-Tai Cheung			544	0.15x	18.4x	5.0x	6.6%
Median ex-Tai Cheung			245	0.16x	13.2x	5.9x	7.3%

Tai Cheung pays out HK\$24 cent per share, though pre-COVID it used to be as high as HK\$35 cent



Tai Cheung dividend per share



A sum of the parts valuation suggests a discount to NAV of 79%



Tai Cheung (88 HK)	Calculation	Value (HK\$m)
Sheraton	35% share, 6% cap rate vs 2019 rent	2637
3 Plunkett's Road	HK\$65,000/sqft x 19,238 sqft	1250
PULSA	HK\$60,000/sqft x 42,000 sqft	2520
Ap Lei Chau project	HK\$25,000/sqft x 88,280 sqft	2007
Metropole Square	HK7,630/sqft x 6789 sqft	52
French Valley Airport	Low estimate	93
Cash	From 1HFY2024 report	1285
Total liabilities	Conservative estimate	-183
<u>Net asset value</u>		<u>9661</u>
Shares (million)		618
<u>Value per share (HK\$)</u>		<u>15.6</u>
Share price (HK\$)		3.3
<u>Discount to NAV</u>		<u>-79%</u>

David is buying shares on an almost daily basis... very small amounts, but still



David Pun Chan: insider purchases



Source: Yahoo Finance

DATE TYPE	SHAREHOLDER TITLE	TRANSACTION TYPE SHARE PRICE	SHARES VALUE
Oct 27, 2023 PURCHASE	Pun Chan	\$3.27 PER SHARE	1,000 \$3,270
Oct 18, 2023 PURCHASE	Pun Chan	\$3.29 PER SHARE	2,000 \$6,580
Oct 12, 2023 PURCHASE	Pun Chan	\$3.34 PER SHARE	2,000 \$6,680
Oct 9, 2023 PURCHASE	Pun Chan	\$3.35 PER SHARE	1,000 \$3,350
Sep 29, 2023 PURCHASE	Pun Chan	\$3.32 PER SHARE	1,000 \$3,320
Sep 26, 2023 PURCHASE	Pun Chan	\$3.28 PER SHARE	2,000 \$6,560
Sep 15, 2023 PURCHASE	Pun Chan	\$3.34 PER SHARE	1,000 \$3,340
Sep 11, 2023 PURCHASE	Pun Chan	\$3.38 PER SHARE	2,000 \$6,760
Sep 4, 2023 PURCHASE	Pun Chan	\$3.48 PER SHARE	1,000 \$3,480
Aug 24, 2023 PURCHASE	Pun Chan	\$3.45 PER SHARE	1,000 \$3,450

Source: Marketwatch

Potential downside risks



- **Investor disinterest:** Tai Cheung is barely covered by sell-side, and David Pun Chan has apparently no interest in meeting investors or promoting the stock
- **High interest rates:** If interest rates stay at these levels for an extended period of time, property prices might come down further.
- **Poor capital allocation:** The Ap Lei Chau plot was expensive, and the risk is that the cash is spent on other, similarly high-priced projects.
- **COVID-24:** If Hong Kong's borders are closed yet again, Sheraton rental revenues would be hit.



Catalysts



- Tourism recovery: higher Sheraton rental income
- High transaction volumes post-October 2023
- Lower interest rates
- Sales of units at PULSA or 3 Plunkett's Road
- Successful launch of Ap Lei Chau project in 2025

