Pavilion Mall retail sales see recovery

PREIT's 1H16 realized net profit of RM121m (+1% yoy) was in line with our expectations and street estimates. The retail portion remained the key revenue contributor, accounting for 97% of total rental income. Retail spending at Pavilion Mall has seen a recovery of 10% yoy, while new acquisitions in the pipeline such as the Pavilion Extension should be additional catalysts for the share price. Reaffirm BUY with higher TP of RM2.11. A DPU of 4.14 sen was proposed.

1H16 realized net profit within expectations

Pavilion REIT's (PREIT) 1H16 realized net profit of RM121m (+1% yoy) came within our and consensus expectations, accounting for 45% and 46% of forecasts. While 1H16 revenue saw an increase of 8% yoy to RM224.7m due to rental income from the newly injected properties, i.e., Da:Men USJ and the Intermark Mall, realized net profit was relatively flat as a result of higher borrowing costs due to the drawdown of additional borrowings for the acquisition of investment properties. Earnings are expected to pick up in 2H16 due to the tenancy renewal of 69% of the outstanding net lettable area in Pavilion KL, which is set to expire in 3Q-4Q16, as well as income from the two new malls. As at 1H16, a DPU of 4.14 sen was proposed (1H15: 4.09 sen). The Pavilion Mall occupancy rate dropped to 97% from 98% last quarter, and will likely experience a drop to 95% towards end-2016 as the reconfiguration of tenants and the relocation to the Pavilion Extension is happening in September. Nonetheless, management has said that retail sales have seen a pick-up of 10% yoy ytd.

Maintain BUY with higher TP of RM2.11

We maintain our **BUY** rating on PREIT based on a higher DDM-based 12-month TP of **RM2.11** as we update our risk-free assumption from 4% to 3.5% due to the recent OPR cut by Bank Negara. We continue to expect interest in the stock due to its acquisition pipeline. Recall that PREIT has right of first refusal for the Pavilion Extension (NLA of 250,000 sq ft) and Fahrenheit 88 (NLA of 300,000 sq ft).

Key risks – slowdown in spending, upcoming supply of space

Risks to our call: i) a sharp slowdown in upper-middle-class and upper-class retail spending; ii) negative effects of price hike adjustments arising from imported inflation due to a stronger US$; iii) non-renewal of tenancies; iv) competition from 16m sq ft incoming retail supply (2016-21).

Earnings & Valuation Summary

FYE 31 Dec	2014	2015	2016E	2017E	2018E
Revenue (RMm)	402.1	413.9	509.8	620.8	653.3
Net Property Income (RMm)	282.7	291.5	341.6	416.4	440.6
Net profit (RMm)	510.5	282.3	269.1	286.3	309.2
EPU (sen)	16.9	9.4	8.9	9.5	10.2
PER (x)	10.6	19.2	20.2	19.0	17.6
Distrib. net profit (RMm)	239.9	248.9	288.6	329.8	341.7
Realised net profit (RMm)	232.4	241.3	269.1	286.3	309.2
Realised EPU (sen)	7.7	8.0	8.9	9.5	10.2
Realised EPU growth (%)	8.4	3.8	11.4	6.2	7.8
Realised PER (x)	23.3	22.5	20.2	19.0	17.6
DPU (sen)	7.96	8.23	9.54	10.89	11.26
DPU Yield (%)	4.4	4.6	5.3	6.0	6.3
P/NAV (x)	1.42	1.42	1.42	1.42	1.43
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			1.0	1.0	1.0

Source: Company, Affin Hwang forecasts, Bloomberg

Results Note

Pavilion REIT

PREIT MK
Sector: M-REITs

RM1.8 @ 28 July 2016

BUY (maintain)
Upside 17%

Price Target: RM2.11
Previous Target: RM1.90

Price Performance

	1M	3M	12M
Absolute	+3.4%	+7.1%	+20.0%
Rel to KLCI	+1.9%	+8.2%	+23.0%

Stock Data

Issued shares (m)	3,019.8
Mkt cap (RMm)/(US$m)	5,435.6/1,340.6
Avg daily vol - 6mth (m)	1.8
52-wk range (RM)	1.39-1.9
Est free float	17.3%
NAV per share (RM)	1.26
P/NAV (x)	1.43
Net cash/ (debt) (RMm) (2Q16)	(1,053.8)
ROE (2016E)	7.0%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

Qatar Holdings	35.9%
Datuk Lim Siew Choon	28.0%
Datin Tan Kewi Yong	9.3%

Source: Affin Hwang, Bloomberg

Tan Ei Leen
(603) 2146 7543
eileen.tan@affinhwang.com

Yap Po Leen
(603) 2146 7547
poleen.yap@affinhwang.com

Fig 1: Results Comparison

FYE 31 Dec (RMm)	2Q16	QoQ % chg	YoY % chg	1H16	YoY % chg	Comments
Revenue	**118.0**	10.6	14.7	**224.7**	*8.0*	1H16 revenue was up by 8% yoy, driven primarily by the retail segment (97% of total revenue) and rental income from newly acquired properties Da:Men USJ and the Intermark Mall.
- Gross rental income	*101.2*	13.1	14.4	*190.6*	*8.1*	
- Other income	*16.8*	(2.5)	16.4	*34.1*	*7.7*	
Operating expenses	(36.6)	17.8	18.1	(67.6)	*7.1*	Maintenance costs increased due to operating costs incurred for new malls.
Net Property Income	**81.4**	7.7	13.3	**157.1**	*8.4*	
NPI margin (%)	*69.0*	*(1.9)*	*(0.9)*	*69.9*	*0.1*	NPI margin remained relatively stable at 70%.
Revaluation surplus/others	2.23	28.5	52.1	3.97	*31.1*	
Net Investment Income	**83.7**	8.1	14.0	**161.0**	*8.9*	
Interest expense	(17.0)	75.4	>100	(26.7)	*71.6*	Increase in total debt due to drawdown of additional borrowings for recent acquisitions.
REIT's expenses	(7.1)	14.2	13.5	(13.3)	*6.2*	
Pretax profit	**59.6**	(3.1)	0.4	**121.0**	*1.0*	
Comprehensive income	**59.6**	(3.1)	0.4	**121.0**	*1.0*	
Realized net profit	**59.6**	(3.1)	0.4	**121.0**	*1.0*	Realized net profit in line with Affin and consensus. Profit expected to pick up in subsequent quarters with additional contributions from recent acquisitions and tenancy renewal at Pavilion KL in 3Q-4Q16.
Distributable income	**62.3**	(1.9)	1.8	**125.7**	*1.8*	
Per share:						
Realized EPU (sen)	2.0	(3.1)	0.3	4.0	*0.9*	
DPU (sen)	4.14	*n.m.*	*1.2*	4.14	*1.2*	A DPU of 4.14sen was proposed.
Distributable income (sen)	2.06	(1.9)	1.7	4.16	*1.7*	
DPU payout ratio (%)	99.9	*n.m.*	*0.1*	99.9	*0.1*	
DPU yield (%)	2.30	*n.m.*	*1.2*	2.3	*1.2*	

Source: Affin Hwang, Company data

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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A Participating Organisation of Bursa Malaysia Securities Bhd
Chulan Tower Branch,
3rd Floor, Chulan Tower,
No 3, Jalan Conlay,
50450 Kuala Lumpur.
www.affinhwang.com
Email : affin.research@affinhwang.com
Tel : + 603 2143 8668
Fax : + 603 2145 3005