Still going steady

KLCC Property Stapled Group (KLCCPSG) held its 1H FY2016 corporate day yesterday and we believe that the company should be able to weather the challenging office, retail and hotel environment despite a huge pipeline of incoming supply and weak consumer sentiment. Maintain Hold with TP of RM8.00.

Office operations: stable with triple net leases, 100% occupancy

While the huge supply pipeline of office space will add pressure on occupancy rates, most of KLCCPSG's office portfolio are located in the KLCC precinct and remain steady with triple net leases (3+3+3) and 100% occupancy rates for Petronas Twin Towers (next rental revision in Oct 2018), Menara 3 Petronas (next rental revision in Dec 2017) and Menara Dayabumi Petronas (next rental revision in Jan 2017). Recall that a long-term lease with ExxonMobil has been secured for 15 years (9+3+3 years). The current Phase 2 extension for Kompleks Dayabumi is in progress with an NLA of 39,000 sq ft of office space targeted for completion in 3Q16. Management has guided that it is finalising and adding the office space into its current triple net lease agreement with existing tenants.

Retail operations: positive rental revision

About 1/3 of tenancy agreements are due for renewal this year with a positive rental revision rate of about 5%, which is lower compared to double digit growth (FY15: 10%) in previous years. Average rental rates are at RM30/sq ft/mth (vs. 2Q15: RM29/sq ft/mth). Suria KLCC's moving annual turnover (MAT) saw an improvement of 8% yoy to RM2,455m, its highest since the GST implementation. While this might signify a recovery as we see a slight increase in the consumer sentiment index for 2Q16 by 5.6ppts to 78.5, this is possibly also due to a lower base last year. We understand that level 1 is currently undergoing a reconfiguration to become the men's luxury floor and will see brands like Hugo Boss replacing British India; hence, it might also contribute to the drop in the occupancy rate to 96% this quarter as compared to 98% since 1Q15.

Hotel operations: remain cautious

While revenue increased by 7.5% yoy to RM7.5m due to contribution from room and spa operations, on the food and beverage side we saw a reduction in banquet activities due to the closure of Sultan's Lounge and Casbah in December 2015, as well as the soft oil and gas market with fewer events being held. The operating loss of RM1.8m was due to the write-off of furniture and fittings of the Sultan Lounge and Casbah restaurant which are due to reopen in August 2016 with a new concept to attract the younger crowd. Note that Mandarin Oriental will be undergoing a renovation of rooms, which will take two years to complete and is currently at the tender stage. This is necessary to keep up with the market which will experience an incoming supply of approximately 7,700 hotel rooms from 2016-2020.

Maintain HOLD with TP of RM8.00

We maintain a HOLD rating on KLCCPSG with a DDM-based TP of RM8.00 (including RM0.26 from the redevelopment of Dayabumi and RM0.24 from the potential development of Lot D1). KLCCCP's longer-term potential is underpinned by an asset-injection pipeline of approximately RM5.8bn (backed by its strong parent company) and its attractiveness as a Shariah-compliant stock.

Company Update

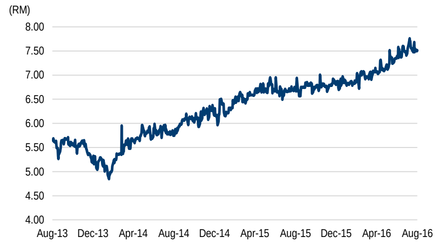
KLCCPSG

KLCCSS MK
Sector: M-REITs

RM7.51 @ 3 Aug 2016

HOLD (maintain)
Upside 6.5%

Price Target: RM8.00
Previous Target: RM8.00



Price Performance

	1M	3M	12M
Absolute	+1.3%	+2.9%	+6.8%
Rel to KLCI	+1.2%	+3.1%	+13.0%

Stock Data

Issued shares (m)	1,805.3
Mkt cap (RMm)/(US$m)	13,558.1/3,346.8
Avg daily vol - 6mth (m)	0.7
52-wk range (RM)	6.8-7.88
Est free float	11.3%
NAV per share (RM)	6.97
P/NAV (x)	1.08
Net cash/ (debt) (RMm) (2Q16)	(1,507.62)
ROE (2016E)	6.0%
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholders

Petronas	75.5%
ASB	6.2%

Source: Affin Hwang, Bloomberg

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Earnings & Valuation Summary

FYE 31 Dec	2014	2015	2016E	2017E	2018E
Revenue (RMm)	1,353.5	1,340.2	1,360.5	1,387.6	1,445.4
EBITDA (RMm)	1,011.9	1,004.2	1,075.6	1,066.5	1,097.3
Pretax profit	1,280.5	1,518.4	982.2	992.9	1,023.7
PATAMI (RMm)	937.9	1,131.5	756.3	764.5	788.2
EPS (sen)	52.0	62.7	41.9	42.3	43.7
PER (x)	14.5	12.0	17.9	17.7	17.2
Realised Profit RMm)	689.3	746.1	756.3	764.5	788.2
Realised EPS (sen)	38.2	41.3	41.9	42.3	43.7
Realised EPS growth (%)	10.3	8.2	1.4	1.1	3.1
Realised PER (x)	19.7	12.0	17.9	17.7	17.2
DPS (sen)	33.6	34.7	37.0	38.5	39.5
DPS Yield (%)	4.5	4.6	4.9	5.1	5.3
P/NAV (x)	1.1	1.1	1.1	1.0	1.0
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			1.0	1.0	1.0

Source: Company, Affin Hwang forecasts, Bloomberg

Medium to long-term AEI / asset injection plans

KLCCPSG's long-term (up to 2019) AEI as well as asset-injection plans are driven by: i) growth from the in-built pipeline (redevelopment of Citypoint Podium at Kompleks Dayabumi into a 200,000 sq ft retail area, 600,000 sq ft of office space, and a 500-room hotel [2015-2019]), and ii) a potential development of an office tower on Lot D1 (1.3m sq ft GFA).

Key risks – slowdown in expansion, upcoming supply of space

Downside risks: i) economic downturn; ii) inflationary pressure; iii) decline in tenancy rates; iv) incoming supply, 16m sq ft from the retail and 11.7m sq ft from the office markets (2016-21); v) higher debt-refinancing rates; and vi) correction in asset prices. Upside risks: i) rebound in tourist arrivals and ii) improvement in consumer and business sentiment.

Fig: 1H16 Key Matrix

Office Portfolio	Rental Rate (RM psf/mth)	Average occupancy rate
Petronas Twin Towers	9.95	100
Menara ExxonMobil	8.5	100
Menara 3 Petronas	8.03	100
Menara Dayabumi	4.5	100
Grade A office average		
-Golden Triangle	7.45	84.3
-KL Fringe	6.7	89.3
Retail		
Suria KLCC	30	96
Prime malls	24-30	>90%

Hotel	Average room rate (RM)	Average occupancy rate
Mandarin Oriental	690	45
KL Luxury Hotel	NA	67

Source: Company, various media

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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