



AmInvestment Bank

## Company report

## PAVILION REIT

(PREIT MK EQUITY, PREI.KL)

28 Oct 2022

Recovery of occupancy rate seen for retail malls

BUY

(Maintained)

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Rationale for report: Company results

Price	RM1.25
Fair Value	RM1.59
52-week High/Low	RM1.42/RM1.19

## Key Changes

Fair value	↑
EPS	↑

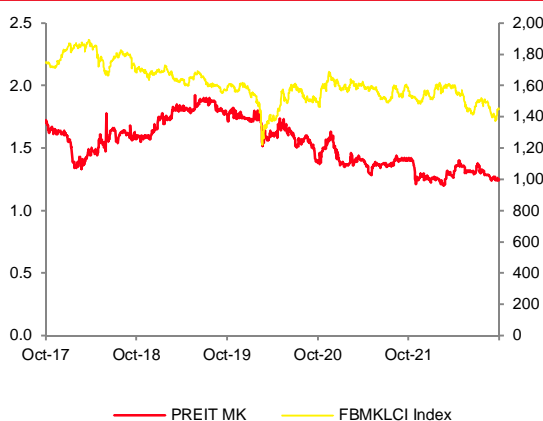
YE to Dec	FY21	FY22F	FY23F	FY24F
Gross Revenue (RM mil)	488.6	555.7	586.0	618.6
Distributable Income (RM mil)	134.7	252.1	258.3	272.9
EPU	4.1	8.3	8.4	8.9
Consensus Net Profit (RM mil)	—	229.5	242.4	252.7
DPU (sen)	4.4	8.3	8.4	8.8
DPU Growth (%)	6.8	87.3	1.3	5.5
PE (x)	28.1	15.0	14.7	13.9
EV/EBITDA (x)	41.3	27.1	18.7	17.8
Distribution yield (%)	3.6	6.7	6.7	7.1
ROE (%)	3.2	5.8	6.0	6.3
Debt/Assets (%)	34.8	35.3	35.2	35.2

## Stock and Financial Data

Shares Outstanding (million)	3,055.7
Market Cap (RMmil)	3,819.7
Book Value (RM/share)	1.27
P/BV (x)	1.0
ROE (%)	3.2
Debt/Assets (%)	34.8

Major Shareholders	Qater Investment Authority (33.0%) Lim Siew Choon (27.7%) EPF (10.1%)
Free Float	29.3
Avg Daily Value (RMmil)	0.4

Price performance	3mth	6mth	12mth
Absolute (%)	(5.3)	(1.6)	(12.0)
Relative (%)	(4.2)	7.4	(4.2)



## Investment Highlights

- We maintain BUY on Pavilion REIT (PREIT) with a higher fair value (FV) of RM1.59/unit (from RM1.56/unit previously) based on dividend discount model (DDM).
  - The increase in our FV is mainly attributed to the stronger-than-expected rental income from Elite Pavilion Mall, partially offset by higher risk-free rate due to a surge in 10-year Malaysian Government Securities (MGS) to 4.3% from 3.9%. No changes to our neutral 3-star ESG rating (Exhibits 5, 6).
  - PREIT's distributable income of RM188mil in 9MFY22 (Exhibit 1) came in above our and consensus' expectations. It accounted for 80% of our and 82% of consensus' FY22F earnings.
  - The variance to our forecast was mainly due to the better-than-expected rental revenue from Elite Pavilion Mall.
  - We raise our distributable income estimates by 7%/7%/6% for FY22F/FY23F/FY24F. This is after increasing our assumption on the monthly average rental per net lettable area (NLA) of Elite Pavilion Mall to RM23/sq ft from RM20/sq ft following our observation of a stronger rental income in 9MFY22.
  - In 3QFY22, PREIT's gross revenue rose 27% YoY due to higher rental revenue and income from advertising. Net property income (NPI) surged 90% YoY to RM90mil. This was supported by lower operating expenses (-19% YoY) given the lower rental assistance offered to tenants. As a result, distributable income jumped 2.9x YoY to RM64mil.
  - On a QoQ comparison, PREIT's 3QFY22 gross revenue expanded 2% while NPI improved 9%. The decrease in property operating expenses in 3QFY22 was mainly attributed to lower provisions for doubtful debts as compared to 2QFY22.
  - PREIT's debt-to-asset ratio stayed at 35%, well below the REITs' statutory limit of 50% (statutory limit after 31 December 2022).
  - PREIT proposed a gross distribution per unit (DPU) of 2.1 sen in 3QFY22, which represented a distribution payout ratio of 100%. It was 2.8x of the 0.73 sen declared in 3QFY21 and 2% higher than the pre-pandemic level (3QFY19) of 2.04 sen.
- Its distribution in 3QFY22 will be paid together with the distribution in 4QFY22 due to its semi-annual distribution policy.

- QoQ, average occupancy rate increased marginally to 80% from 79%. The improvement was mainly attributed to the improvement in occupancy rates of all its retail malls. Meanwhile, the occupancy rate for its office in Pavilion Tower remained stable at 74% (Exhibit 3).
- We understand from management that the rental reversion in 3QFY22 is largely flattish as some of the tenants will still require some time to recover to their pre-pandemic sales level.
- The occupancy rate in Da Men Mall expanded to 61% in 3QFY22 from 59% in 2QFY22. We expect the occupancy rate in Da Men Mall to rise to over 70% by the end of FY22 as PREIT has secured new tenants including A&W, Subway and Big Pharmacy.
- The recent aggressive policy rate hikes in the United States (US) have caused high volatility in 10-year MGS yield, which closely followed the rising trend of 10-year US Treasury (UST). However, we anticipate that the uptrend in 10-year UST yield to be tapering off with the expectation that the Federal Reserve may ease off aggressive rate hikes after the end of 2022 as a result of weaker economic data.
- Meanwhile, we anticipate the yield spread to be widening from FY22F onwards with the gradual recovery of retail footfalls and tenant sales, which translates into a higher distribution yield of 7% in FY22F-24F vs. 4% in FY21. We expect PREIT to be appealing to yield-seeking investors with its higher yield spread against 10-year MGS (Exhibit 4).
- PREIT currently trades at a compelling FY23F PE of 15x vs. its 2-year average (pre-pandemic FY18-19) of 19x. We also like the stock due to its key assets which are strategically located in the capital of Malaysia, providing a good platform for new international brands to establish footholds for expansion into the Malaysian market while supporting demand for retail space at the malls. Looking forward, we foresee a gradual pick-up in retail footfalls and tenant sales with the reopening of international borders.

## EXHIBIT 1: RESULT SUMMARY

FY ended Dec (RMmil)	3QFY21	2QFY22	3QFY22	QoQ (%)	YoY (%)	9MFY21	9MFY22	YoY (%)
Gross rental income	111.7	138.2	139.4	0.8	24.7	357.9	412.8	15.4
Other income	1.6	3.2	4.3	31.0	>100	6.4	11.0	72.0
<b>Gross Revenue</b>	<b>113.3</b>	<b>141.5</b>	<b>143.6</b>	<b>1.5</b>	<b>26.7</b>	<b>364.3</b>	<b>423.9</b>	<b>16.4</b>
Property operating costs	(65.8)	(58.4)	(53.4)	(8.5)	(18.9)	(210.4)	(156.6)	(25.6)
<b>Net property income</b>	<b>47.5</b>	<b>83.1</b>	<b>90.2</b>	<b>8.6</b>	<b>90.1</b>	<b>153.9</b>	<b>267.3</b>	<b>73.7</b>
<b>Net Investment Income</b>	<b>47.5</b>	<b>83.1</b>	<b>90.2</b>	<b>8.6</b>	<b>90.1</b>	<b>153.9</b>	<b>267.3</b>	<b>73.7</b>
Manager's fee	(6.1)	(7.2)	(7.4)	2.0	21.6	(18.6)	(22.1)	18.9
Trustee's fee	(0.1)	(0.1)	(0.1)	0.8	0.0	(0.4)	(0.4)	0.0
Other trust expenses	(0.3)	(0.5)	(0.2)	(55.2)	(14.5)	(0.8)	(1.1)	38.3
<b>EBIT</b>	<b>41.0</b>	<b>75.2</b>	<b>82.5</b>	<b>9.6</b>	<b>&gt;100</b>	<b>134.2</b>	<b>243.8</b>	<b>81.6</b>
Net interest income/expenses	(21.0)	(20.2)	(21.3)	5.2	1.5	(62.5)	(62.4)	(0.2)
<b>Profit before EI</b>	<b>20.0</b>	<b>55.0</b>	<b>61.2</b>	<b>11.3</b>	<b>&gt;100</b>	<b>71.7</b>	<b>181.4</b>	<b>&gt;100</b>
<b>Profit Before Taxation</b>	<b>20.0</b>	<b>55.0</b>	<b>61.2</b>	<b>11.3</b>	<b>&gt;100</b>	<b>71.7</b>	<b>181.4</b>	<b>&gt;100</b>
<b>Net Profit</b>	<b>20.0</b>	<b>55.0</b>	<b>61.2</b>	<b>11.3</b>	<b>&gt;100</b>	<b>71.7</b>	<b>181.4</b>	<b>&gt;100</b>
Distribution adjustment	2.1	2.1	2.3	10.8	10.6	6.4	6.9	6.7
<b>Distributable Income</b>	<b>22.1</b>	<b>57.1</b>	<b>63.5</b>	<b>11.2</b>	<b>&gt;100</b>	<b>78.1</b>	<b>188.3</b>	<b>&gt;100</b>
<u>Distribution:</u>								
EPU - Diluted (Sen)	0.7	1.8	2.0	11.1	>100	1.7	5.9	>100
Proposed DPU (Sen) - Interim	0.7	1.9	2.1	11.2	>100	1.8	6.2	>100
Distribution Yield (as at the end of the period) (%)	2.4	5.2	4.9	(6.0)	>100	3.2	4.9	53.3
NAV/unit	1.2	1.2	1.2	(0.1)	(0.8)	1.3	1.2	(1.8)
Weighted average unit ('000)	3,047.6	3,052.1	3,052.8	0.0	0.2	3,047.1	3,052.8	0.2
<u>Margin:</u>								
NPI margin (%)	42.5	60.1	64.7	7.7	52.4	43.0	64.7	50.5
EBIT margin (%)	36.7	54.4	59.2	8.8	61.3	37.5	59.0	57.5
Net Interest coverage (x)	2.0	3.7	3.9	4.2	98.2	2.1	3.9	82.1
Net gearing ratio (x)	49.9	46.6	48.5	4.0	(2.9)	49.9	48.5	(2.9)
Debt-to-Asset Ratio (%)	35.0	34.7	35.1	1.0	0.1	35.0	35.1	0.1
<u>Composition of Borrowings:</u>								
Fixed Rate (%)	42.5	35.4	35.3	(0.1)	(7.2)	42.5	35.3	(7.2)
Floating Rate (%)	57.5	64.6	64.7	0.1	7.2	57.5	64.7	7.2

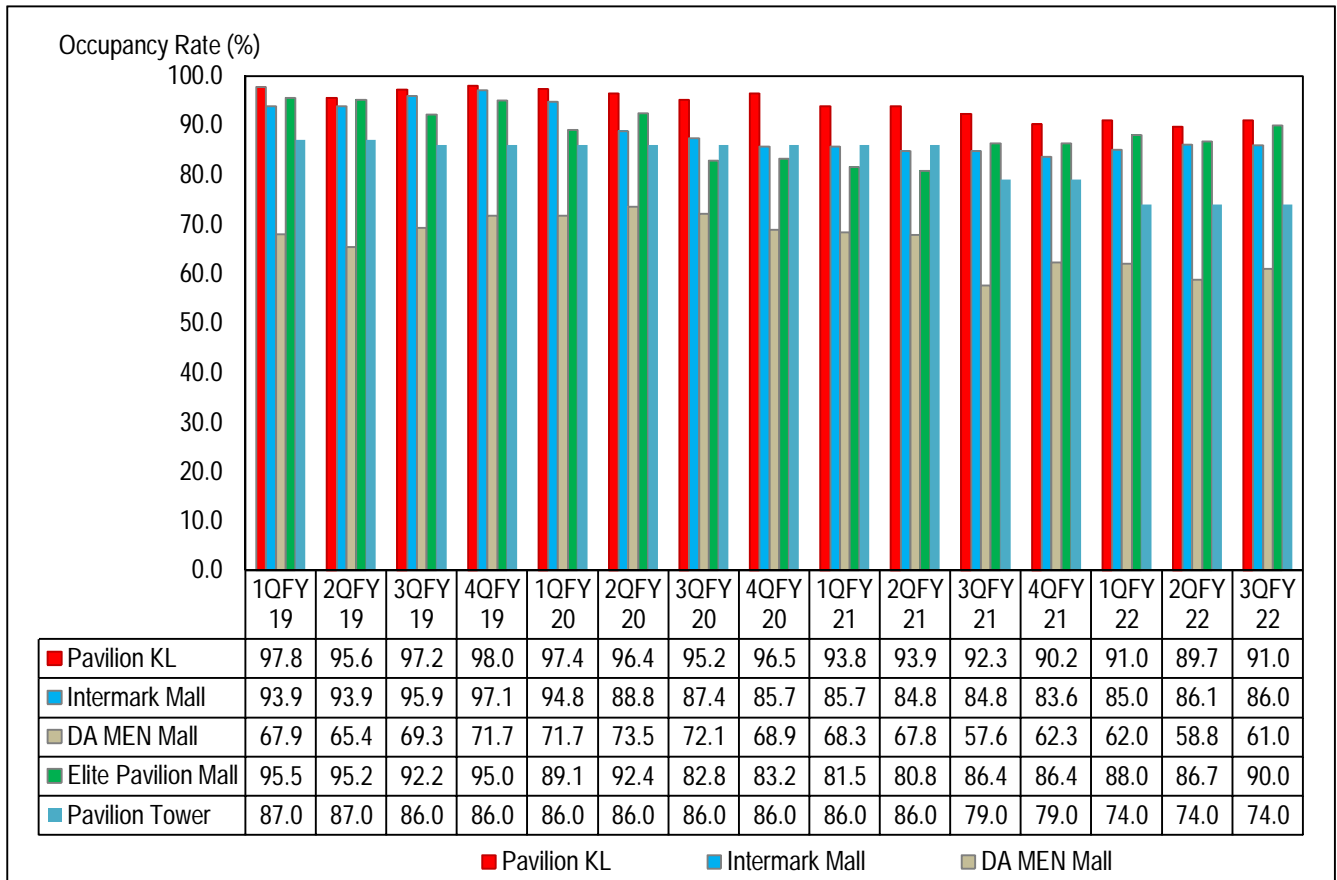
Source: Company, AmInvestment Bank Berhad

## EXHIBIT 2: SEGMENTAL BREAKDOWN

FY ended Dec (RMmil)	3QFY21	2QFY22	3QFY22	QoQ (%)	YoY (%)
<b>Gross Revenue</b>					
<b>Retail rental:</b>					
Pavilion KL Mall	91.8	114.2	115.3	0.9	25.6
Intermark	5.7	5.8	6.1	4.0	5.7
Da Men Mall	2.6	3.1	3.4	12.0	29.7
Elite Pavilion Mall	10.4	16.0	16.5	3.0	57.8
<b>Total Retail</b>	<b>110.5</b>	<b>139.1</b>	<b>141.2</b>	<b>1.5</b>	<b>27.7</b>
<b>Office rental:</b>					
Pavilion Tower	2.8	2.4	2.4	0.1	(12.9)
<b>Total Gross Revenue</b>	<b>113.3</b>	<b>141.5</b>	<b>143.6</b>	<b>1.5</b>	<b>26.7</b>
<b>Net Property Income</b>					
<b>Retail rental:</b>					
Pavilion KL Mall	44.8	74.1	78.8	6.4	75.8
Intermark	1.6	1.1	2.3	>100	43.0
Da Men Mall	(3.2)	(2.9)	(2.7)	(7.5)	(17.3)
Elite Pavilion Mall	2.5	9.8	10.8	10.6	>100
<b>Total Retail</b>	<b>45.7</b>	<b>82.1</b>	<b>89.2</b>	<b>8.7</b>	<b>95.2</b>
<b>Office rental:</b>					
Pavilion Tower	1.8	1.0	1.0	(3.5)	(44.8)
<b>Total Net Property Income</b>	<b>47.5</b>	<b>83.1</b>	<b>90.2</b>	<b>8.6</b>	<b>90.1</b>

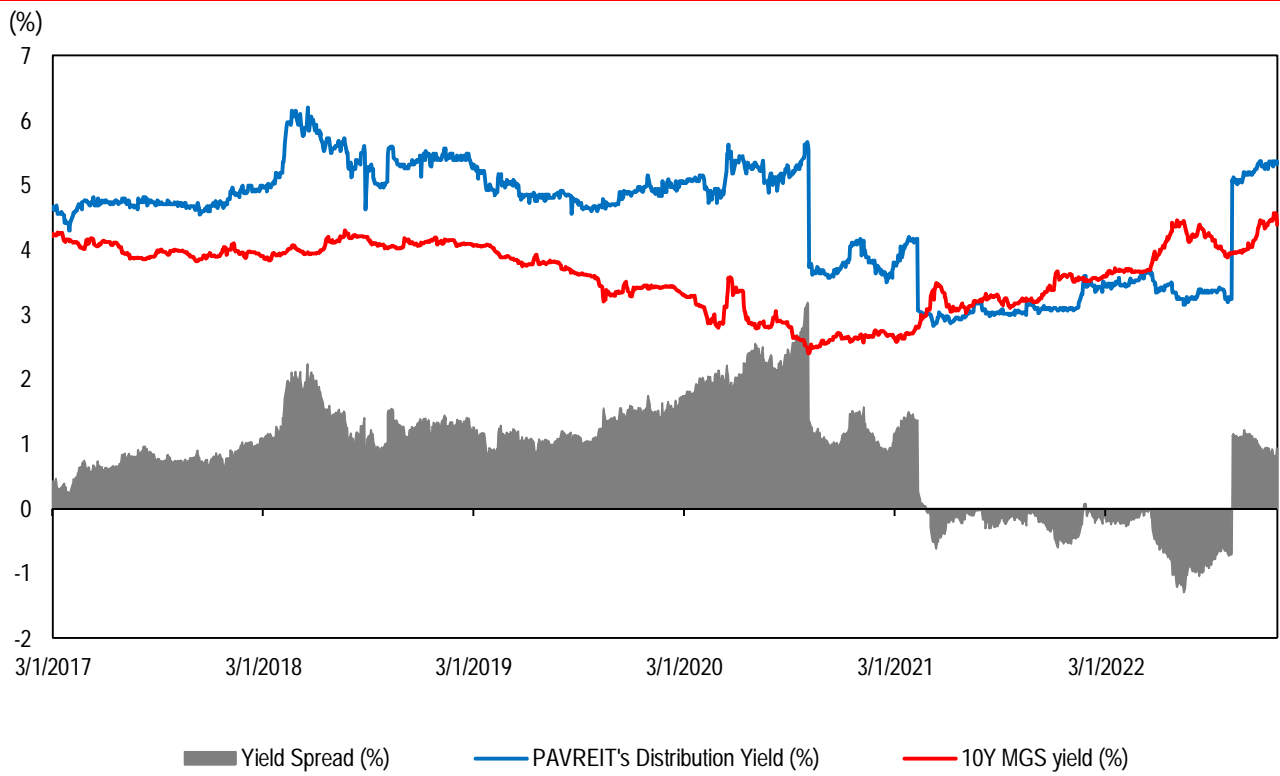
Source: Company, AmInvestment Bank Bhd

**EXHIBIT 3: OCCUPANCY RATES FOR RETAIL MALLS, 2019–2022**



Source: Company, AmInvestment Bank Bhd

**EXHIBIT 4: YIELD SPREAD AGAINST 10-YEAR MALAYSIAN GOVERNMENT SECURITIES (MGS)**



Source: AmInvestment Bank Bhd, Bloomberg

## EXHIBIT 5: DIVIDEND DISCOUNT MODEL (DDM)

## Assumption for Weighted Average Cost of Capital (WACC)

Risk Free Rate (as at 27 October 2022)	4.3%
Beta	0.6
Market Return	12.0%

<b>Cost of Equity (Ke)</b>	<b>8.6%</b>
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<b>Average Cost of Debt</b>	<b>4.7%</b>
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## Capital Structure: (RM Mil)

Market Cap	3,789.1	63.5%
Total Borrowing	2,173.3	36.5%
Total	5,962.4	100.0%

## Weighted Average Cost of Capital (WACC):

	Weight	Cost	W X C
Cost of Equity (Ke)	63.5%	8.6%	5.5%
Average Cost of Debt	36.5%	4.7%	1.7%
<b>WACC</b>			<b>7.2%</b>

Multi-Stage DDM	2022	2023	2024	2025	2026	Terminal Value
Period	1	2	3	4	5	
Dividends (RM)	0.08	0.08	0.09	0.09	0.10	1.73
Present Value (RM)	0.08	0.07	0.07	0.07	0.07	1.23
<b>Valuation</b>	<b>1.59</b>					
Rate of Return (%)	7.2%					
Growth Rate (%)	1.5%					

Source: Company, AmInvestment Bank Berhad

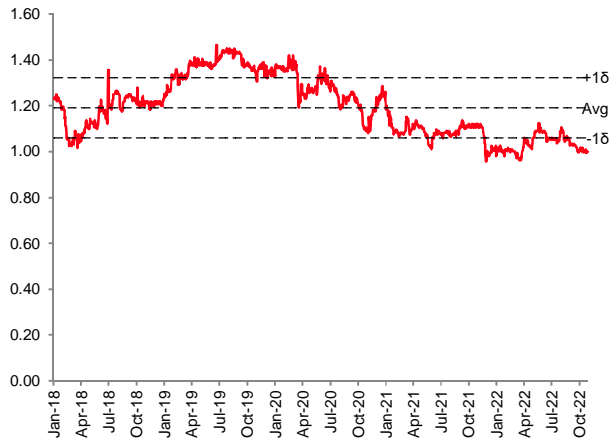
## EXHIBIT 6: ESG RATING

Overall	★	★	★		
Zero-carbon initiatives	★	★	★		
Waste management	★	★	★		
Pollution Control	★	★	★		
Sustainable industrialization	★	★	★		
Diversity and inclusion	★	★	★		
Employees welfare	★	★	★		
Corporate social responsibility	★	★	★		
Gender diversity	★	★	★		
Accessibility & transparency	★	★	★		

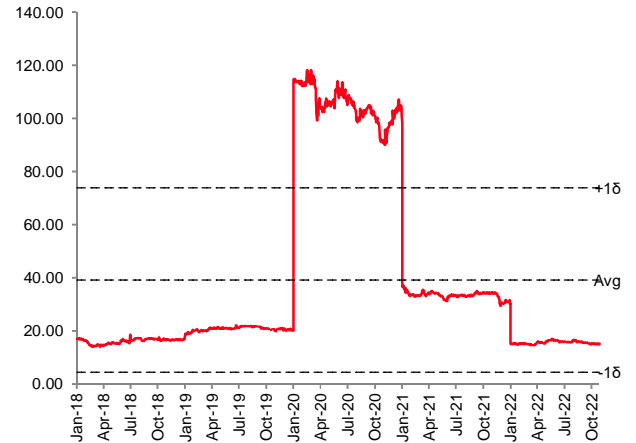
We accord a discount/premium of -6%, -3%, 0%, +3% and +6% on fundamental fair value based on the overall ESG rating as appraised by us, from 1-star to 5-star

Source: AmInvestment Bank Bhd

**EXHIBIT 7: PB BAND CHART**



**EXHIBIT 8: PE BAND CHART**





## EXHIBIT 9: FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	FY20	FY21	FY22F	FY23F	FY24F
<b>Gross Revenue</b>	<b>510.2</b>	<b>488.6</b>	<b>555.7</b>	<b>586.0</b>	<b>618.6</b>
Net Property Income	233.5	236.6	367.2	386.9	407.8
Net Investment income	163.2	236.0	367.2	386.9	407.8
<b>EBITDA</b>	<b>135.8</b>	<b>208.8</b>	<b>336.6</b>	<b>354.6</b>	<b>373.7</b>
Net interest	(89.4)	(83.5)	(84.5)	(96.3)	(100.8)
Exceptional items (EI)	-	-	-	-	-
<b>Pretax profit</b>	<b>46.3</b>	<b>125.2</b>	<b>252.1</b>	<b>258.3</b>	<b>272.9</b>
Taxation	-	-	-	-	-
<b>Net Income</b>	<b>46.3</b>	<b>125.2</b>	<b>252.1</b>	<b>258.3</b>	<b>272.9</b>
<b>Distributable Income</b>	<b>125.8</b>	<b>134.7</b>	<b>252.1</b>	<b>258.3</b>	<b>272.9</b>
<b>Balance Sheet (RMmil, YE 31 Dec)</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22F</b>	<b>FY23F</b>	<b>FY24F</b>
Plant and equipment	1.2	0.7	0.8	0.8	0.8
Investment Properties	5,863.0	5,880.0	5,880.0	5,880.0	5,880.0
<b>Total non-current assets</b>	<b>5,864.2</b>	<b>5,880.7</b>	<b>5,880.8</b>	<b>5,880.8</b>	<b>5,880.8</b>
Cash & equivalent	341.2	312.2	217.9	227.3	237.6
Inventories	3.0	3.1	2.1	2.2	2.4
Trade receivables	33.5	42.7	59.3	62.6	66.0
<b>Total current assets</b>	<b>377.7</b>	<b>358.0</b>	<b>275.5</b>	<b>288.1</b>	<b>301.7</b>
Trade payables	151.6	125.3	135.8	143.4	151.9
Short-term borrowings	1,088.9	395.0	395.0	395.0	395.0
<b>Total current liabilities</b>	<b>1,240.5</b>	<b>520.3</b>	<b>530.8</b>	<b>538.4</b>	<b>546.9</b>
Long-term borrowings	1,074.4	1,778.3	1,778.3	1,778.3	1,778.3
Other long-term liabilities	67.7	81.7	55.2	58.3	61.8
<b>Total long-term liabilities</b>	<b>1,142.1</b>	<b>1,860.0</b>	<b>1,833.5</b>	<b>1,836.6</b>	<b>1,840.1</b>
<b>Total Unitholders' funds</b>	<b>3,859.3</b>	<b>3,858.5</b>	<b>3,803.9</b>	<b>3,806.4</b>	<b>3,809.0</b>
Minority interests	-	-	-	-	-
NAV per unit (RM)	1.27	1.27	1.25	1.25	1.24
<b>Cash Flow (RMmil, YE 31 Dec)</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22F</b>	<b>FY23F</b>	<b>FY24F</b>
Pretax profit	46.3	125.2	252.1	258.3	272.9
Depreciation/Amortisation	-	-	-	-	-
Net change in working capital	26.4	(17.7)	54.7	(2.5)	(2.7)
Others	177.3	87.1	84.6	96.6	101.1
<b>Cash flow from operations</b>	<b>250.0</b>	<b>194.7</b>	<b>370.6</b>	<b>330.3</b>	<b>347.8</b>
Capital expenditure	(0.5)	(0.1)	(0.1)	(0.0)	(0.0)
Net investments & sale of fixed assets	(20.3)	(17.6)	0.0	0.0	0.0
Others	4.9	10.4	(87.9)	16.4	18.1
<b>Cash flow from investing</b>	<b>(15.9)</b>	<b>(7.3)</b>	<b>(88.0)</b>	<b>16.4</b>	<b>18.1</b>
Debt raised/(repaid)	(16.4)	8.2	0.0	0.0	0.0
Equity raised/(repaid)	-	-	-	-	-
Distribution paid to unitholders	(173.7)	(132.5)	(252.1)	(255.7)	(270.2)
Others	(73.3)	(86.4)	(91.0)	(103.2)	(108.7)
<b>Cash flow from financing</b>	<b>(263.3)</b>	<b>(210.7)</b>	<b>(343.0)</b>	<b>(359.0)</b>	<b>(378.8)</b>
<b>Net cash flow</b>	<b>(29.2)</b>	<b>(23.3)</b>	<b>(36.1)</b>	<b>9.4</b>	<b>10.3</b>
<b>Net cash/(debt) b/f</b>	<b>306.5</b>	<b>277.3</b>	<b>254.0</b>	<b>217.9</b>	<b>227.3</b>
<b>Net cash/(debt) c/f</b>	<b>277.3</b>	<b>254.0</b>	<b>217.9</b>	<b>227.3</b>	<b>237.6</b>
<b>Key Ratios (YE 31 Dec)</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22F</b>	<b>FY23F</b>	<b>FY24F</b>
Revenue growth (%)	(12.8)	(4.2)	13.7	5.5	5.6
Net Property Income growth (%)	(37.8)	1.3	55.2	5.4	5.4
Pretax margin (%)	9.1	25.6	45.4	44.1	44.1
Distribution income margin (%)	24.7	27.6	45.4	44.1	44.1
Net Interest cover (x)	1.5	2.5	4.0	3.7	3.7
Effective tax rate (%)	-	-	-	-	-
DPU payout (%)	138.0	98.4	100.0	99.0	99.0
Receivable turnover (days)	37.4	28.4	39.0	39.0	39.0
Inventory turnover (days)	3.9	4.4	4.1	4.1	4.1
Payable turnover (days)	196.7	200.6	262.9	262.9	262.9

Source: Company, AmInvestment Bank Bhd estimates

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