PP14767/04/2012(02960)

Tuesday, September 22, 2015

Market Access

"Another Islamic REIT by JCorp"

Al-Salam REIT (Al-Salam) will be making its grand entrance on the Main Market of Bursa Malaysia on 29th September 2015. Upon listing, Al-Salam's initial portfolio will comprise real estate investment encompassing assets in commercial retail, office and industrial sectors with total Net Lettable Area (NLA) and Gross Floor Areas (GFA) of 1.52 million sq.ft and 1.91 million sq.ft respectively. As we see, its catalysts and key strengths are well supported by: 1) well diverse portfolio of assets with exposure in strategic locations, 2) potential upside from rental enhancements and well defined acquisition growth strategy, and 3) strong commitment from sponsor.

On the flipside, Al-Salam's risks may include 1) increasing competition from present and upcoming new malls in Johor Baharu; 2) risk of non-renewal of tenancies that are expiring in 2017, 3) high borrowing level post-listing, and 4) potentially escalating borrowing rate.

Our target price of RM1.13, is derived using Dividend Discount Model (DDM) based on our assumption that Al-Salam's is committed to pay 99.9% of its distributable income in FY16, with a WACC of 7.8% and 2% of growth potential, translating into a yield of 5.66% on an annualised basis for FY16F and 5.75% for FY17F respectively.

At 13% upside potential and estimated dividend per unit (DPU) of 6.4% on initial public listing price of RM1 per share, Al-Salam may benefit the most from the uncertainties of market conditions including the elevation of OPR ceiling cap to 3.5% from 3.25% currently which may re-ignite some interest in REITs investment. Note that Bank Negara has been keeping the OPR unchanged at 3.25% and our in-house view

Research Team
research@mna.com.my
03-22877228

Target Price: RM1.13

IPO Retail Price (RM)	**RM1.00**
Target Price (RM)	**RM1.13**
Previous Value (RM)	**NA**
Previous Recomm.	**NA**
Upside To Fair Value	**13%**
Dividend Yield (FY16F)	**6.4%**

Listing Details

Listing Sought	Main Market
Indicative Listing Date	29th Sept 2014

Stock Information

Shariah Status	**Yes**
Sector	REIT
Approved Fund Size (mn)	580.0
Total IPO Shares (mn)	252.4
Institutional Offering	240.8
Retail Offering	11.6
Market Cap (RM mn)	580.0
Share Capital (mn)	580.0
Par Value (RM)	1.00

Major Shareholders

Damansara Aset S/B (DASB)	56.5%

remains that the OPR may reach 3.5% when US-Federal Fund Reserves starts adjusting their interest rate policy.

IPO Background

Al-Salam REIT (Al-Salam) is an Islamic REIT with 100% of its income primarily derived from Shariah-compliant real estate and Shariah-compliant real estate related activities. Upon listing, Al-Salam's initial portfolio will comprise assets in real estate encompassing portfolio in commercial retail, office and industrial sectors, amongst others, shopping malls, office buildings, college buildings, warehouses and food and beverages retail outlets. Note that on 2 April 2015, 10 April 2015 and 27 April 2015, the Trustee on behalf of Al-Salam REIT had entered into a SPA with the Vendors for the acquisition of the Subject Properties for a total purchase consideration of RM903.14 million, which will be satisfied by:

i) The issuance of 327.64 million consideration units; and

ii) Cash consideration of RM575.5 million which will be funded through the IPO proceeds and the funds received from the drawdown of a portion of the financing facility (IPO: RM242.86 million; Borrowing: RM332.64 million).

Table 1: Details of the Subject Properties

	SUBJECT PROPERTIES				
	KOMTAR JBCC	Menara KOMTAR	@Mart Kempas	KFCH College	QSR Properties
Description	A 4-level shopping mall located in JB City Centre, JB, Johor	A 21-storey office building located in JB City Centre, JB, Johor	A single-storey hypermarket known as '@Mart Kempas Community Hypermarket" located within Kempas, JB, Johor	A 4-storey building known as "KFCH International College" located in Bandar Dato' Onn, Johor Bahru, Johor	27 properties comprising 22 restaurant properties and 5 units of industrial premises.
Tenure	Freehold	Freehold	Leasehold 99-years, expiring on 23 January 2106	Freehold	12 Freehold properties and 15 Leasehold properties.
Appraised Value (RM'000)	462,000	70,000	65,000	28,200	277,940
Purchase Consideration (RM'000)	462,000	70,000	65,000	28,200	277,940
NLA as at 1 June 2015 (sq.ft.)	401,623	160,592	98,083	85,799	768,499
GFA as at 1 June 2015 (sq.ft.)	623,374	242,195	164,460	92,157	789,386
Occupancy rate as at 1 June 15	81%	96%	91%	100%	100%
Number of parking bays	1,187 car park and 480 motorcycle bays	145 car park bays	478 car park and 221 motorcycle bays	131 car park plus 2 disabled car park and 18 motorcycle bays	426 car park plus 6 disabled car park and 162 motorcycle bays

Source: Prospectus

Research Team
research@mna.com.my
03-22877228

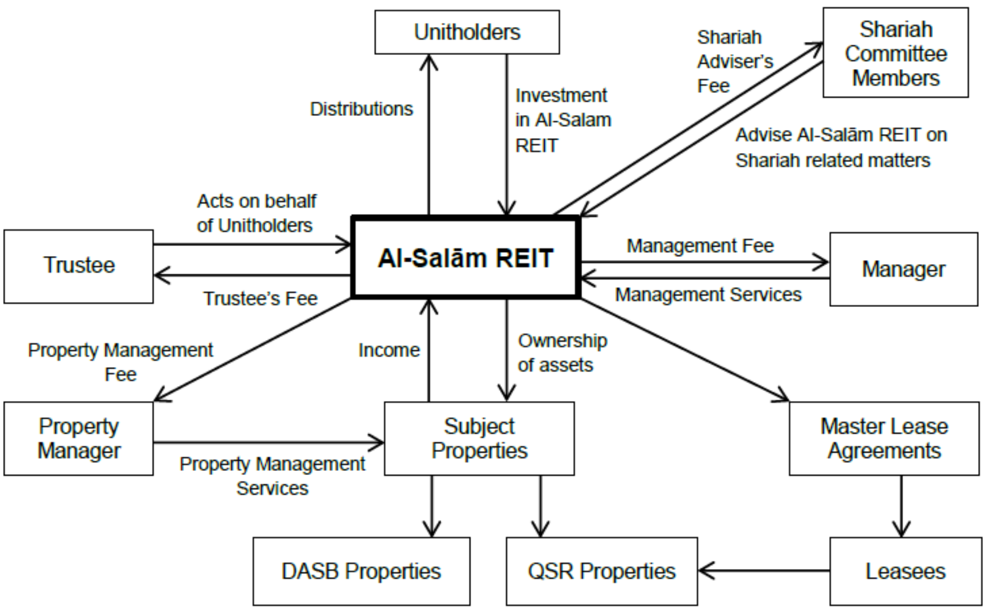
Table 2: Details of the Purchase Consideration and Mode of Satisfaction for the Acquisition

Subject Properties	Vendor	Purchase Consideration (RM Million)	To be satisfied by	
			Consideration Units (mn)	Cash Consideration (RM Million)
KOMTAR JBCC	DABS	462.00	281.04	180.96
Menara KOMTAR	DABS	70.00	-	70.00
@Mart Kempas	DABS	65.00	32.50	32.50
KFCH College	DABS	28.20	14.10	14.10
QSR Properties	QSR Vendor	277.94	-	277.94
TOTAL		**903.14**	**327.64**	**575.50**

Source: Prospectus

Backed by reputable sponsor in Malaysia (JCorp Group), Al-Salam REIT, without difficulty, would easily grow its assets base by leveraging on JCorp Group, tapping into its pool of assets or suitable properties for acquisition opportunities. According to management, the group will inject RM300-400 million into Al-Salam from FY16 onwards and expects to double Al-Salam asset base from its current total value of RM903.1 million to RM2 billion within two to three years. Note that the sponsor is the holding company of Damansara Asset Sdn Bhd (DASB), a major unit-holder of Al-Salam REIT who is the ultimate holding company of the Manager, Damansara REIT Managers Sdn Bhd (DRMSB).

Figure 1: Structure of Al-Salam REIT



Source: Prospectus

Research Team
research@mna.com.my
03-22877228

IPO Size and Proceed Utilisation. The approved fund size of Al-Salam is 580 million units. The IPO offers up to 252.36 million of new shares, comprising 240.76 million for institution investors and 11.6 million for retail offerings. The group is expected to make its debut on the Main Market of Bursa Malaysia on 29th September 2015. Al-Salam is expected to raise gross proceed of RM252.36 million (based on IPO price of RM1.00/unit and 252.36 million units offer for sales) from the IPO and intends to use 96% of the proceed as part funding of purchase consideration for the acquisitions of DASB and QSR properties. The remaining proceeds will be used for listing expenses.

Table 3: IPO Details

Activity	No of share (million)
Approved fund size	**580.00**
Consideration units to be issues as part payment for the acquisition	327.64
Public issue	**252.36**
- Retail investors	11.60
- Institutional investors	240.76

Source: Prospectus

Table 4: Utilisation of Proceed

Details	Estimated Timeframe	RM mil	%
Part payment of the purchase consideration for the acquisition	Immediate	242.86	96
Listing expenses	Immediate	9.50	4
Total		**252.36**	**100**

Source: Prospectus

Investment Highlights and Growth Strategy

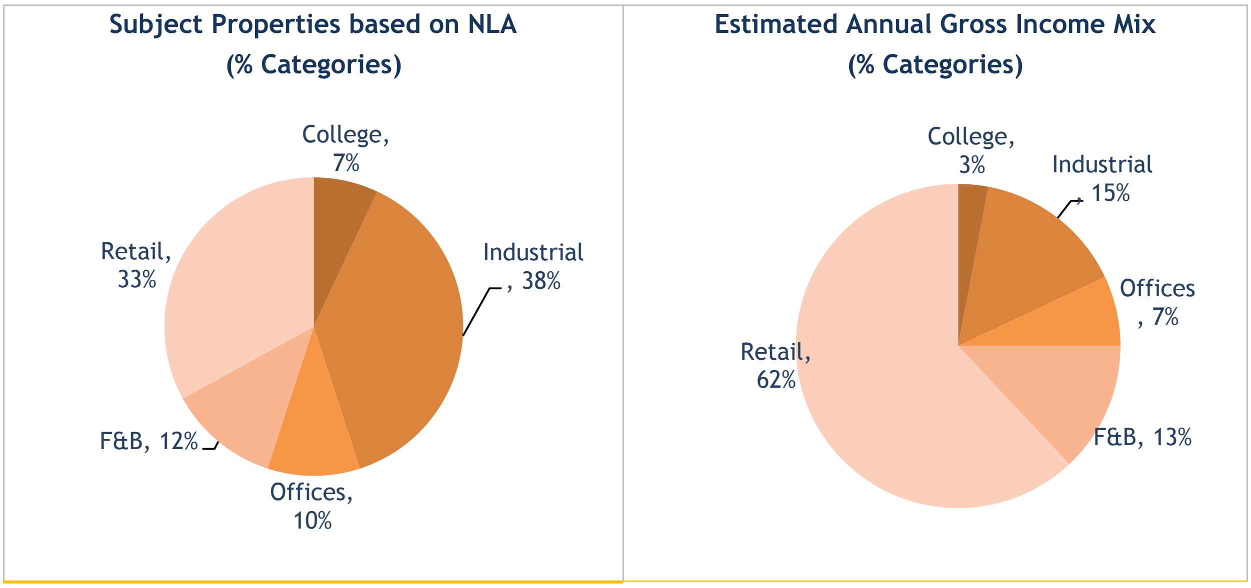
1. Strategic location of the subject properties

We understand that most of the subject properties are located in strategic locations in proximity within middle and high income established commercial and residential areas comprising some of the more established and matured neighborhoods with good rental demand and hence, able to generate a stable stream of high recurrent rental income. KOMTAR JBCC, Menara KOMTAR, @Mart Kempas and KFCH College are all situated in JB, within the core development precinct of Flagship Zone A of Iskandar Malaysia. On the other hand, the QSR properties are largely located in strategic location in Penang, Johor and Klang Valley.

2. Diverse portfolio strategy with high occupancy rates or diversified tenant base

Upon listing, Al-Salam's initial portfolio will comprise 31 properties, ranging from real estate ownership in commercial retail, office, education and industrial sectors, amongst others, shopping malls, office buildings, college buildings, warehouses and food and beverages retail outlets. Out of the 31 properties, 10 are located in Johor with the remaining of which QSR properties are situated in Penang, Klang Valley, Malacca, Negeri Sembilan, Perak, Kedah, Perlis and Sabah. QSR properties are consists of 9 drive-through outlets, 4 outlets at malls, 9 outlets at shop-houses and

5 industrial premises or warehouse. Its well diversified portfolio strategy in our view will augur well in mitigating unfavorable risks associated in each category and hence, would stabilize their income generation since the volatility associating the property market such as changes in economic and property market conditions may affect rental rates, occupancy levels as well as the tenants' abilities to pay rents. According to the prospectus, as at 1 June 2015, Al-Salam enjoyed an overall occupancy rate of approximately 94%.



Source: Prospectus

Based on the prospectus, the main income contributors are KOMTAR JBCC, @Mart Kempas and F&B retail outlets. KOMTAR JBCC has positioned itself as regional premium fashion mall targeting the middle and upper income level population in Iskandar Malaysia and tourist area especially from Singapore and other parts of Malaysia. It has diverse tenants mix with anchor tenants include Metrojaya Department Store and Angry Birds Activity park, with other tenants, amongst others, Mark & Spencer, Padini Concept Store and Brand outlet, Tony Roma's, Charles & Keith, Tissot and Selangor Pewter. As at 1 June 2015, the occupancy rate and average rental rates of KOMTAR JBCC based on committed tenancies were at 81% and RM5.63 per sq.ft, respectively.

@Mart Kempas is located approximately 10km from both Johor Bahru City Centre and Skudai, serving the lower and middle income market and offers shoppers an affordable "one stop convenience hypermarket". The major tenant of the hypermarket is retail mart occupying 38% of the total NLA and 48% of gross rental income followed by supermarket tenants that occupies about 33% of total NLA (contributing 10% of gross rental income), and the fresh mart occupies 15% of NLA and contributing double the gross income of the supermarket at 24%. As at 1 June 2015, the occupancy rate and average rental rates of @Mart Kempas were at 91% and RM5.59 per sq.ft, respectively.

On the other hand, the F&B retail outlets form part of the QSR properties comprising 27 restaurant properties and non-restaurant properties located across Malaysia, supporting the food and beverages operations of QSR Group that specifically related to the fast food brands KFC and

Pizza Hut. The occupancy rate of QSR properties is 100% and all the properties are leased back to QSR Stores Sdn Bhd, Efinite Revenue Sdn Bhd, Pizza Hut Restaurants Sdn Bhd and PHB Delivery Sdn Bhd based on a leased term “Triple Net Lease basis”. We understand that the annual rental from QSR properties is currently at RM18.066 million. We are of the view that QSR properties may provide a stable income given its steady cash flow from the lengthy nature of the lease and triple net lease basis arrangement that can minimize the property operating cost. Note that, the lease will be for a period of 3 years with the rights to renew the said leases every 3 years up to a maximum period of 15 years.

3. Reputable Sponsor and experienced REIT Manager

Al-Salam is backed by JCorp Group which has an established track record in plantation, property, healthcare, food and restaurant services sector amongst its other core business. On the other hand, the manager of Al-Salām, Damansara REIT Managers Sdn Bhd (DRMSB) who is also the manager of Al-Aqar REIT has a team of highly experienced asset management professionals in Malaysian REITs sector. Track record showed that under DRMSB management, Al-`Aqar REIT’s assets have tripled from RM480 million upon listing to RM1.5 billion as at 31 Dec 2014.

4. Potential of new acquisition in the pipeline

Backed by JCorp Group, a reputable sponsor in Malaysia, Al-Salam REIT without difficulty would easily grow its assets base by leveraging on the JCorp Group, tapping into its pool of assets or suitable properties in the market for acquisition opportunities. According to management, the group will inject RM300-400 million into Al-Salam from FY16 onwards and expects to double Al-Salam asset base from its current total value of RM903.1 million to RM2 billion within two to three years. Nonetheless, this will not stop the Al-Salam REIT managers from acquiring 3rd party properties. With gearing level of approximately 38% post-listing against the maximum limit of 50%, there is room for Al-Salam REIT to acquire more yield enhancing assets, via debt financing. As such, it still has 12% limit or another RM105.9 million to borrow via debt financing to fund its future acquisition. We understand that Al-Salam is currently talking to 3rd parties for potential acquisitions of 2 properties (office and retail) to be injected into its REIT as early as next year.

5. First right of refusal of JCorp Group’s properties

JCorp Group, as the sponsor, has granted the Trustee of Al-Salam REIT a letter of FROR (right of first refusal) to purchase the assets on behalf of Al-Salam REIT which are from time to time owned or intended to be sold by the sponsor or any of its subsidiaries, provided that due diligence and assessment of commercial viability are done. We view this positively as this will cushion the future growth of the REIT as it would easily grow its assets base by leveraging on JCorp Group. We understand that the sponsor has identified some of the properties to be injected into Al-Salam in the near future with an estimated total assets value of RM770 million which include Menara JCorp, Menara 238, Menara VSQ, Galleria@Kotaraya and other QSR properties.

Research Team
research@mna.com.my
03-22877228

Table 5: Potential Asset Acquisition from Sponsor

Subject Properties	Location	Description of properties	NLA (sqft)	Estimated Value (RM Million)
Menara Jcorp	Jalan Tun Razak, KL	Office Building	168.25	100
Menara 238	Jalan Tun Razak, KL	Office Building	483.79	230
Menara VSQ	Jalan Utara, PJ	Office Building	172.17	140
Galleria or Kotaraya	Jalan Trus, JB	Shopping Mall	156.89	150
Other QSR properties	Various parts of M'sia	Restaurant and non-restaurant properties	-	150

Source: Prospectus

Financial Highlights

At present, Al-Salam's earnings will be dependent entirely on 31 properties' rental income. We are of the view that prolong softness in property market demand will somehow affect rental rates, occupancy levels as well as the tenants' abilities to pay rents. However, according to management, the group will inject RM300-400 million into Al-Salam from FY16 onwards and expects to double Al-Salam asset base from its current total value of RM903.1 million to RM2 billion within two to three years of which will support their revenue expansion. In order to expand its asset base, Al-Salam may require significant capital expenditure for them to secure the funding.

Post listing, Al-Salam will have initial gearing of approximately RM350 million, or 38% guided to partially finance its Phase 2 acquisition. With gearing level of approximately 38% post-listing against the maximum limit of 50%, there is room for Al-Salam REIT to acquire more yield enhancing assets, via debt financing. As such, it still has 12% limit or another RM105.9 million to borrow via debt financing to fund its future acquisition. Moving forward we foresee that its top-line may increase marginally but nonetheless steadily judging by the step-up provisions and turnover provisions as well as potential increase in NLA. The only risk is that without an acquisition, we do not expect its gross rental income and NLA to improve significantly in the next two to three years. As such, net property income margin will remain stable due to minimal capital expenditure, and the assumption that the number of tenancies and NLA remain at status quo.

Minimum Distribution Policy of 90%. Al-Salam intends to adopt a distribution policy of at least 90% of its distributable income each year. However, it only intends to pay in full in the first year of establishment, with every subsequent year's payment on a half-yearly basis. According to the prospectus, Al-Salam expects to distribute a yield of 6.41% for FY16F, based on a distribution rate of 99.9% of its distributable income. Note that the actual level of distribution may be different from the forecast as it will be determined by the Manager at its absolute discretions.

Research Team
research@mna.com.my
03-22877228

Selected Risks

1. **Increase competition from present and upcoming new malls in JB.** Key risk of Al-Salam depends in its ability to improve rental income. Since the rate of rental increase could be capped by stiff competition, we believe that Al-Salam's efforts to step-up rental and turnover rental provision would depends on its ability to compete against other properties for tenants and sufficient funds to refurbish, renovate and improve the subject properties, coupled with any value accretive acquisitions in future that would help drive the group's longer term earnings. Nevertheless, we believe competition is manageable since the properties have their own unique catchment area with some of the tenants have related parties to its Sponsor, while some of the properties (i.e. Menara KOMTAR) has done major refurbishment works on its interior and exterior. Note that the internal renovation of Menara KOMTAR was completed last year, while its on-going external refurbishment is expected to be completed end-2015.

2. **Risk of non-renewal of tenancies.** Another risk that associating with Al-Salam is the risk of non-renewal of tenancies, reduced occupancy rates and lower rental income. Volatility of property market such as changes in economic and property market conditions will also affect rental rates, occupancy levels as well as the tenants' abilities to pay rents. As per market practice in Malaysia, retail tenancy normally is for a period of 3 years. As for Al-Salam, KOMTAR JBCC's tenants have an average of 3-year lease terms, especially for retail tenants, while anchor tenants take up longer lease terms of 6 to 15 years. Based on the data in the prospectus, we note that about 87 tenancies that contribute approximately 78% of the total gross rental income will be expiring in FY17. Given its prominent location with an immediate catchment comprising of the tourists coming from Singapore and other states in Malaysia through the Custom, Immigration and Quarantine Complex transportation hub and the JB Sentral train station, we expect KOMTAR JBCC will enjoy steady renewal rates of up to 90% (currently 81%).

   Similarly, @Mart Kempas' tenancy expiry profile indicates that 137 tenancies that contribute approximately 67% of the total gross rental income will also expire in FY17. The key challenge for Al-Salam is to retain the key tenant, such as retail mart, fresh mart and supermarket, as the renewal rates by number of expired tenancies in FY14 has reduced to 86% from 89% in FY13. However, we are optimistic on the renewal rates of @Mart Kempas as it purpose is to service the local residents within Kempas area targeting on the lower and medium market based on affordable "one stop convenience supermarket" and hence, the chances of not renewing the tenancies are low. We are of the view that @Mart Kempas has served its purpose judging by the continued softening of consumer spending due to GST and job retrenchments that make consumers more prudent on spending. On the other hand, we have no doubt on Menara KOMTAR and QSR properties since JCorp and its subsidiaries are the major tenants of the buildings.

3. **High borrowing level.** We assume that Al-Salam will have bank borrowings of approximately RM350 million, representing 38% of total asset value upon listing. This raises the risk associating with rising interest rates, which could pressure Al-Salam's unit prices as investors may expect the same yield spread between the government bonds and the REIT instruments. In addition, rising interest rate will result in higher borrowing costs (currently COF + 1.35% (to 1.5% p.a. over

the next 3 years)) and may dampen their appetite to fund future expansion and operational needs.

4. **High interest rates.** Gross yield for Al-Salam is forecasted to be at 6.4% (upon listing) against an average 10 year MGS yield of 4.04%. The expected hike in interest rates (another 25bps if the US Fed changes its policy rate under house view) could result in investors shying away from REITs. This is because given the current yield is much higher than other fixed income instruments, any future interest rate hikes will narrow the spread and makes it less attractive. In addition, the higher interest rate would result in higher discount rates used in our DDM valuation models, and hence resulting in lower values for the REIT.

Valuation and Recommendation

As note earlier, Al-Salam's earnings will be dependent entirely on its 31 properties' rental income. In order to derive at its valuation using DDM approach, we have pegged Al-Salam beta against other real estate investment trusts as there are traded in the same REIT segment even though these trust funds are not investing in the same asset class, i.e. Pavilion Real Estate Investment Trust, Sunway Real Estate Investment Trust, KLCCP Stapled Group, Hekta Real Estate Investment Trust and YTL Hospitality Real Estate Investment Trust. Assuming the market accepts similar risk profile over stock's price variability of these REITs, Al-Salam should be traded at beta ranging from 0.48 to 0.66, or averaging at 0.58 and thus deriving its cost of equity at 9.3% (assuming a risk premium of 9% and risk free of 4.1% that based on 10-years average MGS). Based on its 62-38 of equity-to-debt capital structure and cost of debt assumption of approximately 5.3% (based on RM18.6 million borrowing), we estimate that the REIT should be discounted at a WACC of 7.8%.

As per the prospectus, Al-Salam REIT indicative plans is to distribute 99.9% of its FY15- FY16 distributable income, translating into gross yield of above 6% over the 2 years period. Assuming that of Al-Salam's is committed to pay 99.9% of its distributable income for the FY16 onwards, our Dividend Discount Model (DDM) valuation for Al-Salam REIT implies a target price of RM1.13 (+13%) based on WACC of 7.8% and 2% of growth potential, translating into a yield of 5.66% on an annualised basis for FY16F and 5.75% for FY17F.

Table 6: Valuation Methodology

		2015F RM ('000)	2016F RM ('000)	2017F RM ('000)
Distributable Income		10,522	37,229	37,782
Payout Ratio		100%	100%	100%
		10,511	37,191	37,745
Constant Growth	3%			
WACC	7.8%			
DDM Valuation		10,511	37,192	37,745
Discount Factor		1	0.927953677	0.861098026
		10,511.48	34,512.24	32,502
Terminal value				575,159
SUM of PVCF				652,685
Number of Units ('000)				580,000
DDM Fair Value / share				**1.13**

Research Team
research@mna.com.my
03-22877228

Table 7: Key Financial Forecast Data

YE: Dec (RM'000)	2015F	2016F	2017F
Revenue	26,497	79,430	80,621
Net Property Income	20,098	59,007	59,887
Pre-tax Profit	10,522	37,229	37,783
Distributable Income	10,522	37,229	37,783
EPS (sen)	1.8	6.4	6.5
PER (x)	55.1	15.6	15.4
DPS (sen)	1.8	6.4	6.5
Dividend Yield (%)	1.8	6.4	6.5

Source: Prospectus, M&A Securities
Note: 2015F is based on 9-months period

Table 8: Prospectus Revenue, NPI and Statistics (FY15F - FY16F)

RM'000	2015F (9-mths)	2016F (12-mths)
Gross rental income	24,927	72,576
Other income	1,570	6,854
Total revenue	**26,497**	**79,430**
Utilities expenses	-1,825	-5,527
Maintenance expenses	-799	-2,615
Quit rent and assessment	-200	-1,332
Other operating expenses	-3,608	-10,990
Property manager fee	-118	-270
Property operating expenses	**-6,550**	**-20,734**
Net property income/Loss	**19,947**	**58,696**
Other income	151	311
Net Income/Loss	**20,098**	**59,007**
Manager management fees	-858	-2,258
Trustee's fees	-80	-114
Shariah adviser fees	-3	-6
Borrowing costs	-8,418	-18,639
Other trust expenses and miscellaneous	-217	-761
Profit Before Tax	**10,522**	**37,229**
Taxation	0	0
Distributable Income	**10,522**	**37,229**
Num. of units issue ('000)	580,000	580,000
Distribution rate (%)	99.9	99.9
Distribution per unit (sen)	1.81	6.42
IPO price (RM/Unit)	1.00	1.00
Distribution yield on IPO price (%)	1.81	6.42

Source: Prospectus

Research Team
research@mna.com.my
03-22877228

Market Access

M&A Securities

STOCK RECOMMENDATIONS

BUY	*Share price is expected to be ≥+10% over the next 12 months.*
TRADING BUY	*Share price is expected to be ≥+10% within 3-months due to positive newsflow.*
HOLD	*Share price is expected to be between -10% and +10% over the next 12 months.*
SELL	*Share price is expected to be ≥-10% over the next 12 months.*

SECTOR RECOMMENDATIONS

OVERWEIGHT	*The sector is expected to outperform the FBM KLCI over the next 12 months.*
NEUTRAL	*The sector is expected to perform in line with the FBM KLCI over the next 12 months.*
UNDERWEIGHT	*The sector is expected to underperform the FBM KLCI over the next 12 months.*

M & A Securities Sdn Bhd (15017-H)
(A wholly-owned subsidiary of INSAS BERHAD)
A Participating Organisation of Bursa Malaysia Securities Berhad

Principal Office:
Level 1,2,3 No.45 & 47
The Boulevard, Mid Valley City,
Lingkaran Syed Putra,
59200 Kuala Lumpur
Tel: +603 – 2282 1820   Fax: +603 – 2283 1893
Website: www.mnaonline.com.my

Research Team
research@mna.com.my
03-22877228