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Defensive earnings, sustainable yield seen for KLCCP Stapled Group

KLCCP Stapled Group
(July 9, RM7.80)

Upgrade to buy with a higher target price (TP) of RM8.55: We view KLCCP Stapled Group (KLCCPSG) — comprises KLCC Property Holdings Bhd and KLCC Real Estate Investment Trust (REIT) — as an ideal bond proxy for investors seeking sustainable yield, given the defensive rental income from reputable tenants and high occupancy at its iconic Suria KLCC.

In line with the defensive stance from our house view for the second half of 2019 and the sustainable yield approach recommended by our alliance partner, we expect KLCCPSG to rerate on the back of higher demand for defensive assets and solid earnings delivery (higher dividend per share [DPS] year-on-year).

KLCCPSG has one of the most defensive earnings profiles among Malaysian REITs (MREITs), given: i) around 74% of its 2018 net profit was contributed by triple net and long-term leases with reputable companies. In addition, the rentals for these triple net leases are subject to 10% increment every three years; ii) the highly successful Suria KLCC has consistently maintained its occupancy rate between 96% and 99% and continues to grow its base rent; iii) KLCCPSG has a strong balance sheet and its gearing ratio of 12.7% is the lowest among MREITs; and iv) KLCCPSG has continually grown its dividend — KLCCPSG has raised its DPS by 1% to 3% per annum since 2014.

KLCCP Stapled Group

FYE DEC (RM MIL)	2017	2018	2019E	2020E	2021E
Revenue	1,366.8	1,405.9	1,390.9	1,501.8	1,528.3
Ebitda	1,032.9	1,049.0	1,030.8	1,113.9	1,133.4
Pre-tax profit	1,115.3	964.1	926.3	1,007.7	1,028.8
Net profit	877.9	724.9	729.9	769.8	782.9
EPS (sen)	48.6	40.2	40.4	42.6	43.4
PER (x)	16.0	19.4	19.3	18.3	18.0
Core net profit	720.4	726.7	729.9	769.8	782.9
Core EPS (sen)	39.9	40.3	40.4	42.6	43.4
Core EPS growth (%)	0.2	0.9	0.4	5.5	1.7
Core PER (sen)	19.5	19.4	19.3	18.3	18.0
Net DPS (sen)	36.2	37.0	38.0	40.1	41.4
Dividend yield (%)	4.6	4.7	4.9	5.1	5.3
EV/Ebitda (x)	15.1	14.9	15.1	14.0	13.7
Chg in EPS (%)			-2.6	1.2	1.6
Affin/Consensus (x)			1.0	1.0	1.0

Sources: Company, Affin Hwang forecasts, Bloomberg

We upgrade KLCCPSG to "buy" with a higher TP of RM8.55 after lowering our discount rate to 7.4% in anticipation of strong investor demand for defensive assets with sustainable yield. We have revised our 2019 to 2021 earnings forecasts to account for the ongoing reconfiguration exercise at Suria KLCC that should weaken 2019E retail earnings but lift 2020E to 2021E retail income.

Overall, our TP implies a fair 2020E yield of 4.7% (-1 standard deviation from five-year average), comparable with its peak valuation of 4.4% to 4.7% during the fourth quarter of 2016 to 2017. Key risk to our positive view a reversal in the global yield trend. — *Affin Hwang Capital, July 9*