

11 November 2022

# Sentral REIT (SENTRAL MK)

Brought Down By Lower Occupancy; **NEUTRAL**

- **Maintain NEUTRAL, new MYR0.94 TP from MYR0.97, 7% upside with c.8% yield.** Sentral REIT's 3Q22 results are in line with expectations. 3Q net profit declined QoQ due to it being a full quarter without contributions from Wisma Technip and QB2. The outlook for the office sector remains challenging as supply continues to outpace demand, but we think the REIT's occupancy rate should not fall further than the current 73%. We expect rental reversions to remain flat, as management focuses on maintaining its occupancy rate.
- **Results in line.** Sentral REIT's 3Q22 earnings of MYR18.2m (-1.2% QoQ, -17.7% YoY) brought 9M22 earnings to MYR57m (-7.6% YoY). This is in line with our expectations, at 75% of our full-year estimate, but ahead of the Street's FY22 forecast, at 80%. On a YoY basis, 9M22 revenue was 6.4% lower due to lower contributions from QB2 and Wisma Technip. This was slightly mitigated by the 8.1% decline in property operating expenses. On a QoQ basis, revenue and earnings dropped 3% and 1.2%, reflecting the full-quarter impact from the lack of contributions from the two vacated buildings.
- **Occupancy rate of 73% should be the bottom.** Sentral REIT's blended occupancy rate dropped slightly from 78% in 2Q22 to 73%, as the tenant only moved out of Wisma Technip at the end of June. Recall that QB2's tenant vacated the building in May. Despite the challenging outlook for the office market, we think there are limited downside risks of the occupancy rate falling lower, as other assets remain stable. Management is also intensifying efforts to market the available space under its portfolio, with a focus on bringing in new tenants from the IT, e-commerce, serviced office and shared service sectors. This, however, may take some time before the two buildings are fully occupied again – considering the size of the vacated space.
- **8% of NLA due for renewal in FY23.** In FY22, 16% of NLA was not renewed, 11% was renewed at flattish rental reversions, and only 1% is left to be renewed in the financial year. We think that there is a lower risk of non-renewals next year, as most of the leases up for expiry are for Sentral REIT's strategically located prime office buildings – Menara Shell and Platinum Sentral – which should remain competitive for the REIT.
- **We dial back FY23-24F earnings by -3%** after adjusting our occupancy rate assumptions. Our TP has a 0% ESG premium or discount applied, since its ESG score of 3.0 is in line with the country median. The key downside risk would be the oversupply of office properties affecting the portfolio's occupancy and rental rates. Upside risks are higher-than-expected demand for office space and inorganic growth opportunities.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (MYRm)	166	161	152	152	156
Net property income (MYRm)	128	124	117	117	120
Reported net profit (MYRm)	81.0	80.7	75.8	76.0	79.3
Total distributable income (MYRm)	81.0	80.7	75.8	76.0	79.3
DPS (MYR)	0.08	0.08	0.07	0.07	0.07
DPS growth (%)	10.9	4.4	(13.0)	1.3	4.4
P/B (x)	0.71	0.72	0.71	0.71	0.71
Dividend Yield (%)	8.6	9.0	7.8	7.9	8.2
Return on average equity (%)	6.1	6.1	5.7	5.8	6.0
Return on average assets (%)	3.6	3.7	3.5	3.5	3.6

Source: Company data, RHB

## Malaysia Results Review

Property | REITS

**Neutral** (Maintained)

Target Price (Return):	MYR0.94 (+7%)
Price (Market Cap):	MYR0.88 (USD201m)
ESG score:	3.00 (out of 4)
Avg Daily Turnover (MYR/USD)	0.31m/0.07m

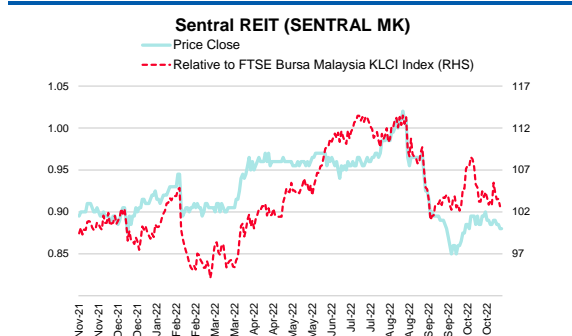
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### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(2.8)	0.6	(12.0)	(8.3)	(1.7)
Relative	5.0	(2.3)	(8.9)	(1.3)	3.2
52-wk Price low/high (MYR)				0.85 – 1.02	



Source: Bloomberg

### Overall ESG Score: 3.00 (out of 4)

#### E: GOOD

Sentral REIT decreased overall water consumption in FY19 by 2% YoY, and is developing its own water management policy. It also doubled the capacity of Platinum Sentral's solar power system, and subscribes to the Feed-In-Tariff (FiT) for the Solar PV programme.

#### S: GOOD

67% of the REIT's workforce are women. The REIT provides sufficient training to employees through MRCB Training Academy, MRCB Learning Zone and Industrial Practical Training. To ensure health and safety, it also conducts activities with external parties such as the fire brigade.

#### G: EXCELLENT

We are upbeat on its establishment of a policy on giving and receiving gifts, and its commitment to the Corruption-Free Pledge by the Malaysian Anti-Corruption Commission. Directors' tenures range 4-6 years on average.

#### Note:

Small cap stocks are defined as companies with a market capitalization of less than USD0.5bn.

## Financial Exhibits

<b>Asia</b>	<b>Financial summary</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
Malaysia	Recurring EPS (MYR)	0.08	0.08	0.07	0.07	0.07
Property	EPS (MYR)	0.08	0.08	0.07	0.07	0.07
<b>Sentral REIT</b>	DPS (MYR)	0.08	0.08	0.07	0.07	0.07
SENTRAL MK	BVPS (MYR)	1.23	1.23	1.23	1.23	1.23
Neutral	Return on average equity (%)	6.1	6.1	5.7	5.8	6.0
	Weighted avg adjusted shares (m)	1,071.78	1,071.78	1,071.78	1,071.78	1,071.78
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
DDM	Recurring P/E (x)	11.65	11.68	12.45	12.42	11.90
	P/E (x)	11.65	11.68	12.45	12.42	11.90
	P/B (x)	0.7	0.7	0.7	0.7	0.7
	FCF Yield (%)	8.1	8.1	7.5	7.5	7.9
	Dividend Yield (%)	8.6	9.0	7.8	7.9	8.2
	EV/EBITDA (x)	(3.48)	(3.90)	(3.26)	(3.23)	(3.11)
	EV/EBIT (x)	(3.48)	(3.90)	(3.26)	(3.23)	(3.11)
<b>Key drivers</b>	<b>Income statement (MYRm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
i. Higher-than-expected demand for office space;	Total turnover	166	161	152	152	156
ii. Inorganic growth opportunities arising from MRCB and Quill Group.	EBITDA	113	109	107	107	110
	Operating profit	113	109	107	107	110
	Net interest	(32)	(28)	(31)	(31)	(31)
	Pre-tax profit	81	81	76	76	79
	Recurring net profit	81	81	76	76	79
<b>Key risks</b>	<b>Cash flow (MYRm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
Downside risks include the oversupply of office properties, which might affect the portfolio's office property occupancy and rental rates. Upside risks are better-than-expected occupancy rates and rental reversion.	Change in working capital	(4)	(4)	(5)	(5)	(5)
	Cash flow from operations	79	78	73	73	76
	Capex	(2)	(2)	(2)	(2)	(2)
	Cash flow from investing activities	(2)	(2)	(2)	(2)	(2)
	Dividends paid	(77)	(83)	(79)	(74)	(76)
	Cash flow from financing activities	54	(24)	(79)	(74)	(76)
	Cash at beginning of period	63	85	94	17	14
	Net change in cash	131	53	(8)	(3)	(2)
	Ending balance cash	194	137	86	14	12
<b>Company Profile</b>	<b>Balance sheet (MYRm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
Sentral REIT is a mid-cap M-REIT that focuses on office/commercial assets. Assets are largely concentrated in the Klang Valley and Cyberjaya areas.	Total cash and equivalents	85	94	17	14	12
	Total investments	2,097	2,081	2,081	2,081	2,081
	Total other assets	40	0	0	0	0
	Total assets	2,227	2,180	2,183	2,185	2,187
	Short-term debt	218	130	130	130	130
	Total long-term debt	627	676	676	676	676
	Total liabilities	904	862	863	863	864
	Shareholders' equity	1,324	1,318	1,320	1,322	1,323
	Total equity	1,324	1,318	1,320	1,322	1,323
	Net debt	760	712	789	792	794
	Total liabilities & equity	2,227	2,180	2,183	2,185	2,187
	<b>Key metrics</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
	Revenue growth (%)	2.2	(3.0)	(5.3)	(0.1)	2.5
	Recurrent EPS growth (%)	12.3	(0.3)	(6.2)	0.3	4.4
	Operating EBITDA margin (%)	68.5	68.0	70.3	70.5	71.0
	Net profit margin (%)	48.9	50.3	49.8	50.0	50.9
	Dividend payout ratio (%)	100.0	104.6	97.0	98.0	98.0
	Capex/sales (%)	1.2	1.2	1.3	1.3	1.3
	Interest cover (x)	3.21	3.51	3.16	3.17	3.27

Source: Company data, RHB

## Results At a Glance

Figure 1: Sentral REIT's results summary

FYE Dec (MYRm)	3Q21	2Q22	3Q22	QoQ (%)	YoY (%)	9M21	9M22	YoY (%)	Comments
Revenue	40.8	37.1	35.9	(3.0)	(11.9)	120.0	112.3	(6.4)	Declined, due to the loss of tenants in QB2 and Wisma Technip
Net property income (NPI)	32.7	28.5	28.7	0.7	(12.5)	93.8	88.2	(6.0)	
Interest expense	(7.7)	(7.1)	(7.6)	7.6	(1.2)	(23.2)	(22.0)	(4.9)	
Interest income	0.6	0.4	0.6	33.5	(14.1)	1.6	1.4	(11.9)	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Others	(3.6)	(3.3)	(3.4)	0.9	(4.9)	(10.5)	(10.6)	0.3	
Pretax profit	22.1	18.5	18.2	(1.3)	(17.7)	61.7	57.0	(7.6)	In line with expectations
Tax	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Minority Interest	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Net Profit	22.1	18.5	18.2	(1.3)	(17.7)	61.7	57.0	(7.6)	
Core Profit	22.1	18.5	18.2	(1.3)	(17.7)	61.7	57.0	(7.6)	
Core earnings per unit (sen)	2.1	1.7	1.7	(1.2)	(17.5)	6.1	6.1	0.0	
Dividends per unit (sen)	0.0	3.4	0.0	nm	nm	3.4	3.4	(0.9)	
NPI Margin (%)	80.3	76.9	79.7			78.1	78.5		
Pretax Margin (%)	54.2	49.8	50.6			51.4	50.8		
Net Margin (%)	49.5	51.8	49.8			50.0	50.8		

Source: Company data, RHB

## Recommendation Chart

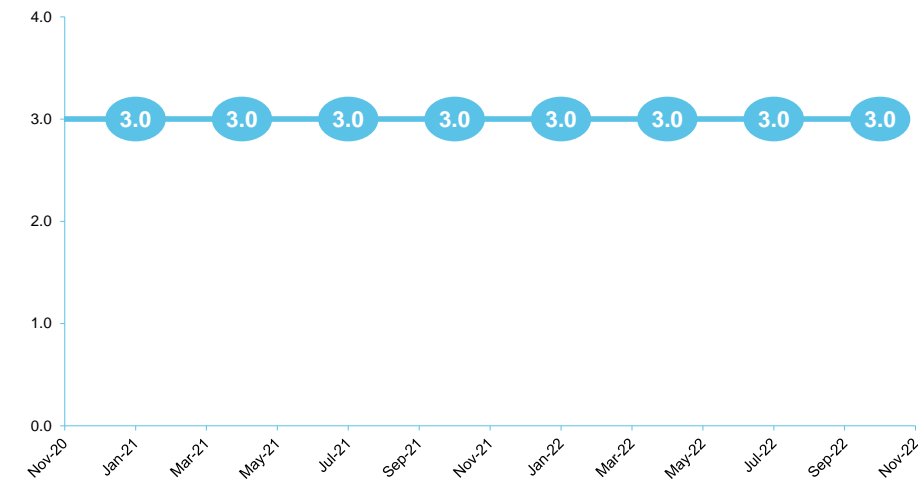


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-08-23	Neutral	0.97	0.96
2022-05-13	Neutral	1.00	0.96
2022-01-21	Buy	1.02	0.92
2021-11-11	Buy	1.02	0.90
2021-08-06	Buy	1.00	0.90
2021-01-19	Buy	1.00	0.91
2020-12-09	Buy	0.95	0.87
2020-11-13	Buy	0.87	0.88
2020-11-12	Buy	0.87	0.83
2020-08-17	Buy	0.83	0.78
2020-06-18	Buy	0.78	0.71
2020-04-06	Neutral	0.78	0.74
2020-01-20	Neutral	0.97	1.00
2019-11-26	Neutral	0.96	1.02
2019-08-08	Neutral	0.97	1.07

Source: RHB, Bloomberg

## ESG Rating History



Source: RHB

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<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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