

12 May 2023

Hold

Price
RM0.86

Target Price
RM0.85

Market Data

Bloomberg Code	SENTRAL MK
No. of shares (m)	1,071.8
Market cap (RMm)	921.7
52-week high/low (RM)	1.02 / 0.85
Avg daily turnover (RMm)	0.2
KLCI (pts)	1,433.7

Source: Bloomberg, KAF

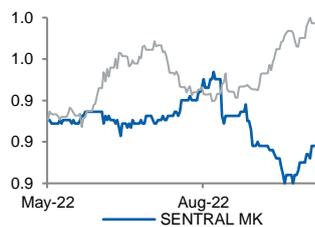
Major Shareholder (%)

MRCB	(27.8%)
EPF	(12.1%)
CapitalLand Ltd	(10.9%)
Free Float	347.8

Source: Bloomberg, KAF

Performance

	3M	6M	12M
Absolute (%)	(1.7)	(2.8)	(10.4)
Rel Market (%)	0.8	(2.3)	(2.3)



Source: Bloomberg, KAF

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Sentral REIT

Earnings fell short, dearth of catalysts

In 1Q23, Sentral REIT (SENTRAL) reported a -13% YoY decline in core net profit, primarily due to a decline in revenue and higher financing expenses. The decline in NPI of -4% YoY was predominantly attributable to lower contributions from certain properties. For the quarter under review, there was no dividend declared as it is paid semi-annually. The occupancy rate remained stable at ~77%, and it is expected to remain moderate in the following quarter. Two of Sentral REIT's buildings are presently vacant, and AEIs are deemed necessary in order to remain competitive in the market. Management has also hinted to implement countermeasures to address the stagnant office market. The outlook for the office market is expected to be flattish, but KL Sentral fringe has promise for a better rental reversion. Gearing remained stable at ~37%. Overall, we deemed the yield of 7% and a forecast DPU of 6.3sen to be moderately attractive. Maintain Hold.

Financial Highlights

FYE Dec	2021	2022	2023F	2024F	2025F
Revenue	159.6	147.3	143.3	144.1	145.0
Net property income	122.6	114.7	111.5	112.2	112.9
Reported net profit	70.2	52.3	67.3	68.6	70.2
Normalised net profit	84.5	76.2	67.3	68.6	70.2
EPS (sen)	7.9	7.1	6.3	6.4	6.5
DPS (sen)	7.4	6.9	6.3	6.4	6.5
P/E (x)	11.4	12.7	14.3	14.1	13.7
ROE (%)	5.3	4.0	5.2	5.3	5.4
Net yield (%)	8.2	7.7	7.0	7.1	7.3
Net gearing (%)	37.0	37.5	37.5	37.5	37.5

Source: Company, KAF

Financial Snapshot

Sentral REIT (SENTRAL) reported a 1Q23 core net profit of RM17.7m (-13% YoY vs. RM20.4m in 1Q22), attributable to the -3% YoY drop in revenue from RM40.4m to RM37.5m and a higher financing cost from RM7.3m to RM9.1m (+25% YoY).

For the 3-month period, NPI fell by -4% YoY from RM30.5m to RM29.3m, mainly stemming from a -3% drop in revenue, bolstered by lower contributions from Wisma Technip FMC and Quill Building-2.

For the quarter under review, there was no dividend declared as it is paid semi-annually. Overall, we deem this to be in line with ours and the street's estimates, making up 26% and 24% respectively.

Occupancy rate to remain moderate

To recap, 28% of the NLA, or ~590,800 sq.ft, was up for renewal last year, yet less than 50% of it was renewed. As a result, occupancy dropped to 77% (from 86% in 1Q22, -10% YoY).

10% or ~211,000 sq.ft of the NLA is up for renewal this year, and as far as we are aware, 4% of it will be renewed. In actuality, the occupancy rate has remained stagnant at ~77% level since the 3Q22. Hence, we anticipate that it will remain moderate in the following quarter.

In need of AEIs

Note that two of the REIT's nine buildings are presently vacant: the 1994-built Wisma Technip FMC and the 2003-built Quill Building 2. Observing the current trend, it is undeniable that occupants would prefer contemporary buildings with cutting-edge services, technologies, and amenities. In addition to this, tenants, particularly MNCs, will also consider ESG requirements when selecting an office space. Given the property's age, we believe it will be challenging to locate tenants for these buildings. In order to remain pertinent and competitive in the market, we believe that AEIs are essential for these buildings in particular.

Positively, management has alluded to implementing a few tactical countermeasures to address the stagnant office market, ie: i) Being competitive with rental terms and rates, ii) Extending marketing initiatives beyond office tenants, and iii) Repurposing the vacant building to accommodate the needs of other industries and tenants.

Outlook

Given the relatively abundant supply of existing and upcoming office spaces, we anticipate that rent growth in the office market will be limited and essentially flat. In certain areas, such as KL Sentral, there is however still promise for a better rental reversion.

Elsewhere, gearing remained stable at approximately 37%, giving SENTRAL a healthy debt headroom for prospective acquisitions, assuming the SC's 50% gearing restriction.

Overall, we deemed the yield of 7% and a forecast DPU of 6.3sen to be moderately attractive. Maintain Hold at a lower TP of RM0.85 as we rolled forward our valuation to FY24.

Exhibit 1: Quarterly Earnings Trend

FYE December	1Q22	2Q22	3Q22	4Q22	1Q23	%QoQ	%YoY	3M22	3M23	%chg	FY23F	3M/F
Revenue	38.8	36.5	35.7	36.4	37.5	3	(3)	38.8	37.5	(3)	143.3	26
Property operating expenses	(8.3)	(8.6)	(7.3)	(8.5)	(8.2)	(4)	(1)	(8.3)	(8.2)	(1)	(31.7)	26
Net property income	30.5	27.9	28.4	27.8	29.3	5	(4)	30.5	29.3	(4)	111.5	26
Interest income	0.5	0.4	0.6	0.9	0.6	(34)	35	0.5	0.6	35	3.4	18
Trust expenses	(3.8)	(3.3)	(3.4)	(3.6)	(3.4)	(8)	(13)	(3.8)	(3.4)	(13)	(13.8)	24
Borrowing costs	(7.3)	(7.1)	(7.6)	(8.8)	(9.1)	3	25	(7.3)	(9.1)	25	(33.9)	27
Exceptional items	-	-	-	(23.7)	-	-	-	-	-	-	-	-
Profit before tax	20.4	18.5	17.9	(7.3)	17.7	(141)	(13)	20.4	17.7	(13)	67.3	26
Tax	-	-	-	2.6	-	-	-	-	-	-	-	-
Net profit	20.4	18.5	17.9	(4.7)	17.7	(126)	(13)	20.4	17.7	(13)	67.3	26
Normalized net profit	20.4	18.5	17.9	16.3	17.7	(9)	(13)	20.4	17.7	(13)	67.3	26

Source: Company, KAF

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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