30 September 2016

Property | REITS

Buy

Al-Salam REIT

Truly Diversified *Shariah*-Compliant REIT

Target Price:	MYR1.18
Price:	MYR1.05
Market Cap:	USD148m
Bloomberg Ticker:	SALAM MK

Possessing the crown jewel of Johor Bahru, Komtar JBCC in its stable, Al-Salam REIT is a well-diversified *shariah*-compliant REIT that is set to reap the benefits of the massive redevelopments in Johor Bahru and the surrounding area. Managed by the highly experienced Damansara REIT Managers SB, the portfolio is also well-defended by the long-term leases of its QSR properties, KFCH College and Menara Komtar, which provides long-term stability. We initiate coverage with a BUY, attaching a DDM-based target price of MYR1.18 (12.7% upside).

Initiate coverage with a BUY call. We initiate coverage on Al-Salam REIT with a BUY recommendation, with a target price of MYR1.18, based on the dividend discount model valuation method. We believe the REIT is set for further re-rating, due to its mixture of stability and growth from its diversified asset base. We expect substantial future growth potential supported by both organic (leveraging on its sponsor JCorp) and future potential acquisitions.

Mid-sized REIT with an experienced management team. Al-Salam REIT is a mid-sized diversified Malaysian REIT with a total portfolio asset value of MYR911.5m. Its investment properties' GFA totals 1.9m sqf with 1.5m sqf of total NLA. Its properties are well-diversified into retail, office, and industrial segments. Al-Salam REIT's manager is Damansara REIT Managers SB (DRMSB), who also manages Al-Aqar Healthcare REIT, the only listed healthcare-focused REIT in Malaysia. As such, we believe DRMSB has the experience and capability to ensure Al-Salam REIT is managed prudently and efficiently, leading to a stable future growth.

One of a few *shariah*-compliant REITs. Al-Salam REIT is one of only four *shariah*-compliant REITs listed on Bursa Malaysia. The major advantage of being *shariah*-compliant is it gives the REIT an exposure to a bigger pool of potential investors, as *shariah*-compliant funds can only invest in *shariah*-compliant securities. With the scarcity of *shariah*-compliant REITs in the market, we expect Al-Salam REIT to continue to garner investors' interest, due to its diversified asset base and stable growth outlook.

Komtar JBCC the crown jewel. We believe Komtar JBCC, which contributes more than 50% of the REIT's revenue, has strong growth potential. The mall has only commenced operations in 2014, and we expect its occupancy rate to grow higher and its rental rate reversion to be strong, due to:

i. Its positioning, which targets the middle to upper class in Johor Bahru;
ii. Its relatively lower rental rates compared to its peer;
iii. Scarcity of premium shopping malls in Johor Bahru city centre.

Key risks that can affect our call and TP are:

i. Significant increase in interest rates;
ii. Weaker-than-expected consumer sentiment;
iii. Competition from new properties.

Forecasts and Valuations	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover (MYRm)		20.7	71.4	74.3	76.6
Net property income (MYRm)	0.0	15.7	52.4	54.5	56.2
Reported net profit (MYRm)	0.0	14.8	31.0	33.0	34.7
Total distributable income (MYRm)	0.0	7.1	31.0	33.0	34.7
DPS (MYR)	na	0.01	0.05	0.06	0.06
DPS growth (%)	0.0	0.0	341.3	6.5	5.0
Recurring P/E (x)		41.2	19.6	18.4	17.6
P/B (x)	na	1.04	1.04	1.04	1.04
Dividend Yield (%)	na	1.1	5.0	5.4	5.6
Return on average equity (%)	0.0	5.0	5.3	5.6	5.9
Return on average assets (%)	0.0	3.1	3.3	3.5	3.6
Interest cover (x)		1.88	2.57	2.67	2.75
Our vs consensus EPS (adjusted)					

Source: Company data, RHB

Share Data

Avg Daily Turnover (MYR/USD)	0.17m/0.04m
52-wk Price low/high (MYR)	0.90 - 1.07
Free Float (%)	22
Shares outstanding (m)	580
Estimated Return	13%

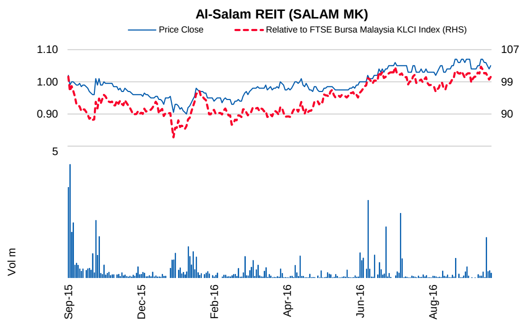
Shareholders (%)

Damansara Assets Sdn Bhd	48.1
Tabung Amanah Warisan Negeri Johor	17.2
Waqaf An-Nur Corp Bhd	10.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	12.9	0.0	1.9	6.6	0.0
Relative	14.3	0.7	0.2	9.3	(4.1)

Source: Bloomberg



Source: Bloomberg

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Financial Exhibits

Financial model updated on : 2016-09-27.

Asia
Malaysia
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Valuation basis

Dividend discount model

Key drivers

i. Strong rental rate growth at Komtar JBCC;
ii. Long-term leases at its Menara Komtar, KFCH College, and QSR properties

Key risks

A prolonged weak domestic consumer sentiment.

Company Profile

Al-Salam REIT is a well-diversified *shariah*-compliant REIT involved in the retail, office and industrial segments

Financial summary	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Recurring EPS (MYR)		0.03	0.05	0.06	0.06
EPS (MYR)	0.00	0.03	0.05	0.06	0.06
DPS (MYR)	0.00	0.01	0.05	0.06	0.06
BVPS (MYR)	0.00	1.01	1.01	1.01	1.01
Weighted avg adjusted shares (m)	580	580	580	580	580

Valuation metrics	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Recurring P/E (x)		41.2	19.6	18.4	17.6
P/E (x)	na	41.2	19.6	18.4	17.6
P/B (x)	na	1.04	1.04	1.04	1.04
FCF Yield (%)	0.0	(91.4)	6.6	5.4	5.7
Dividend Yield (%)	0.0	1.1	5.0	5.4	5.6
EV/EBITDA (x)	na	1.22	0.18	0.16	0.15
EV/EBIT (x)	na	1.22	0.18	0.16	0.15

Income statement	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover (MYRm)		21	71	74	77
EBITDA (MYRm)	0	15	49	51	53
Operating profit (MYRm)	0	15	49	51	53
Net interest (MYRm)	0	(8)	(19)	(19)	(19)
Pre-tax profit (MYRm)	0	15	31	33	35
Recurring net profit (MYRm)		15	31	33	35

Cash flow (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Change in working capital	0	11	9	0	0
Cash flow from operations	0	19	40	33	35
Capex	0	(576)	0	0	0
Cash flow from investing activities	0	(594)	0	0	0
Proceeds from issue of shares	0	252	0	0	0
Dividends paid	0	0	(31)	(33)	(34)
Cash flow from financing activities	0	590	(31)	(33)	(34)
Cash at beginning of period	0	0	16	25	26
Net change in cash	0	16	9	0	0
Ending balance cash	0	16	25	26	26

Balance sheet (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total cash and equivalents	0	25	35	35	36
Total investments	0	911	911	911	911
Total assets	0	950	953	953	954
Total long-term debt	0	346	346	346	346
Other liabilities		12	12	12	12
Total liabilities	0	362	365	365	365
Shareholders' equity	0	587	588	588	588
Total equity	0	587	588	588	588
Net debt	0	320	311	311	310
Total liabilities & equity	0	950	953	953	954

Key metrics	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Revenue growth			2.45	0.039	0.031
Recurrent EPS growth			1.1	0.064	0.049
Operating EBITDA margin		0.71	0.69	0.69	0.69
Net profit margin		0.71	0.43	0.44	0.45
Dividend payout ratio		0.47	0.99	0.99	0.99
Capex/sales		27.8	0	0	0
Interest cover (x)		1.87	2.56	2.66	2.75

Source: Company data, RHB

Valuation

Dividend discount model (DDM) methodology

We have opted to use the DDM methodology for the valuation of Al-Salam REIT, as MREITs are required to distribute at least 90% of their earnings as dividends, which provide a consistent stream of dividend payments to unitholders. Furthermore, this methodology will capture the REIT's future growth prospects as well as factor in the external market risks that could affect its future performance.

Initiate coverage with a BUY, target price of MYR1.18

As Al-Salam REIT has only been listed for less than a year, there is no historical beta figure available to be utilised for the cost of equity calculation. As such, we have taken the average beta of the eight Malaysia REIT stocks under our existing coverage as the figure to be assumed as beta for Al-Salam REIT. Under this method, we have arrived at a beta of 0.6x for Al-Salam REIT.

We have used 3.55% as our risk-free-rate and 6.04% as our market risk premium assumptions, consistent with our in-house view. For terminal growth, we have assumed a 2% perpetual growth figure, which we believe is a fair assumption given the expected stable long-term growth outlook of the REIT.

Based on these assumptions, we have arrived at a target price of MYR1.18 for Al-Salam REIT, which indicates a 12.7% upside over its current price. Hence, we initiate our coverage on Al-Salam REIT with a BUY recommendation.

Figure 1: Cost of equity breakdown

Cost of equity Ke	
Risk free rate (RFR)	3.55%
Beta	0.62
Market return [E(Rm)]	9.59%
Market risk premium	6.04%
Cost of equity Ke	**7.29%**
1+Ke	**1.073**

Source: RHB

Figure 2: Terminal value assumptions

Terminal value	
DPU	7.95
Cost of equity Ke	7.29%
Terminal growth rate	2.0%
Terminal value	150.20

Source: RHB

Potential Re-Rating Catalysts

Year-to-date, unit prices of the Malaysia REITs have been performing well as a result of the recent overnight policy rate (OPR) cut by the Malaysian Central Bank. The OPR cut has driven the rally on Malaysian bonds, with the 10-year Malaysian Government Security (MGS) currently trading at 3.6%, 14% lower than the 4.2% yield registered at the beginning of the year. The bond rally has resulted in an overall re-rating for the Malaysia REITs sector, with the stock prices for the eight REIT stocks under our coverage appreciating between 2% and 25% year-to-date.

Within the same period, the stock price of Al-Salam REIT has appreciated by 11.8% year-to-date. Being a laggard among its peers, we believe there is still substantial upside potential to Al-Salam REIT's price moving forward, as we expect it to catch up with the price movements of its peers.

We believe there are a few potential further re-rating catalysts for the stock:

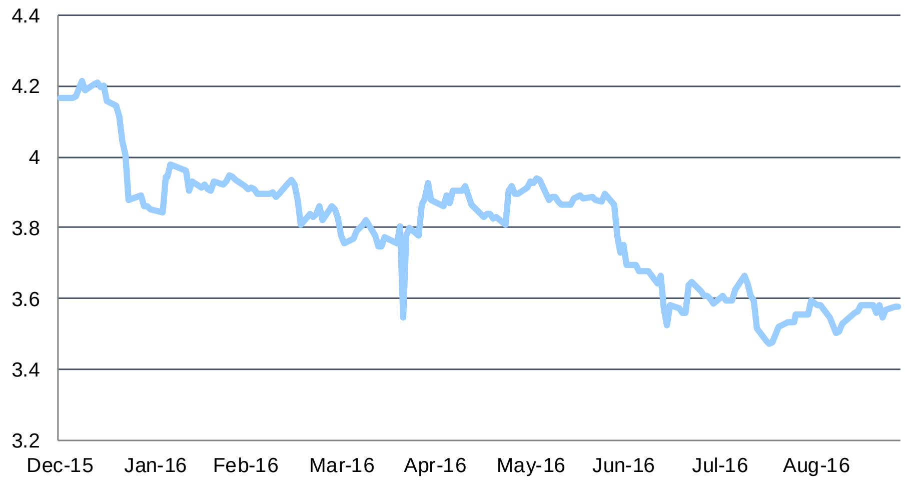
i. Being a well-diversified REIT with strategic locations of its assets would ensure a mixture of stability and growth of its future earnings;

ii. Its relatively new major assets provide the potential of strong rental reversions, moving forward.

iii. Sector-wise, we expect Al-Salam REIT to continue to benefit from the flight to safety among investors in view of the current economic uncertainties, with investors looking for dividend-yielding stocks.

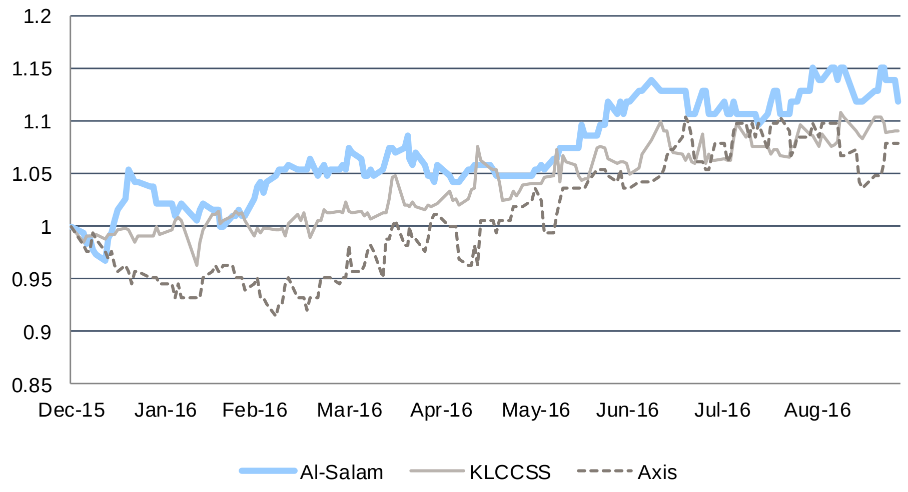
iv. With the scarcity of *shariah*-compliant REITs in the market, we expect Al-Salam REIT to continue to garner interest among *shariah*-compliant investors.

Figure 3: MGS 10-year YTD yield



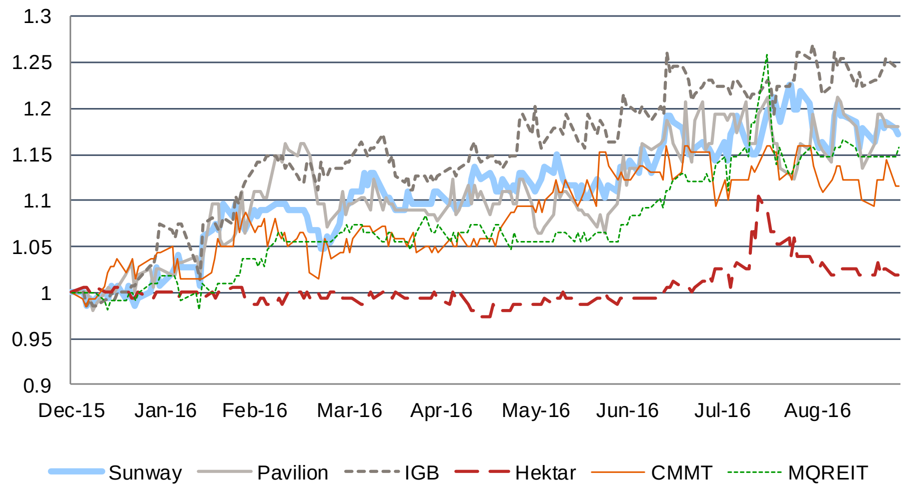
Source: RHB, Bloomberg

Figure 4: *Shariah*-compliant MREIT's YTD price movement



Source: RHB, Bloomberg

Figure 5: Non-*shariah*-compliant MREITs YTD price performance



Source: RHB, Bloomberg

Implied P/E and P/BV valuations

We have compared our DDM valuation to P/E- and P/BV-based valuations. Based on our valuation of MYR1.18 per share, the implied forward FY17F P/E and P/BV for Al-Salam REIT are 20.8x and 1.2x respectively. We believe these valuations are fair, as they are in line with our valuations of Al-Salam REIT's peers.

Currently, Al-Salam REIT is trading at 18.4x FY17F P/E and 1.0x FY17F P/BV. Comparing it against its peers: the average FY17F P/E and P/BV of the Malaysia REITs stand at 19.3x and 1.2x respectively. As such, we believe Al-Salam REIT's current valuation, which is slightly below the average valuations of its peers, means there is ample upside potential, moving forward.

Sector Comparison

Based on our forecasts, we project a 5.4% FY17 dividend yield for Al-Salam REIT based on its current price and a 4.8% yield, based on our target price. Although that is slightly below our current FY17 yield average of 5.7% for the overall sector, we believe our valuation is justified, as it is in line with the valuations for the *shariah*-compliant REITs in the market. Including Al-Salam REIT, there are currently four *shariah*-compliant REITs listed on Bursa Malaysia, namely KLCCP Stapled Group (KLCCPSG) (KLCCSS MK, BUY, TP: MYR8.42), Axis REIT (AXRB MK, NEUTRAL, TP: MYR1.78), Al-Aqar REIT (AQAR MK, NR) and Al-Salam REIT. The current FY17F dividend yield for these REITs stand at 4.7% (KLCCPSG), 5.4% (Axis REIT), and 5.4% (Al-Aqar REIT, consensus).

We believe the scarcity of *shariah*-compliant REITs in the market has driven the prices of the REITs year-to-date, thus attaching a premium to the prices over the sector average.

Figure 6: MREIT sector comparison

	P/E (x)		EPS Growth (%)		P/BV (x)		P/CF(x)		ROE (%)		DY (%)	
	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F
*KLCCPSG	21.4	20.7	1.5	3.2	1.2	1.2	16.0	7.8	7.2	7.4	4.6	4.7
Pavilion REIT	20.4	19.9	12.1	2.8	1.4	1.4	15.2	16.0	7.0	7.2	5.0	5.2
Sunway REIT	19.4	18.7	8.2	3.5	1.2	1.3	18.0	16.1	6.5	6.7	5.5	5.4
CMMT	18.2	18.2	(0.2)	0.1	1.1	1.2	12.8	13.0	6.2	6.4	5.6	5.7
MRCB-Quill REIT	13.5	15.3	0.8	(11.6)	0.6	1.0	13.9	15.6	5.4	6.4	6.9	6.3
IGB REIT	20.3	19.2	10.5	6.1	1.6	1.6	16.3	15.6	7.7	8.2	5.6	5.9
*Axis REIT	20.0	18.4	6.2	8.3	1.4	1.4	11.3	10.0	7.2	7.8	5.0	5.4
Hektar REIT	13.3	13.1	2.8	1.4	1.0	1.0	24.4	24.4	7.4	7.5	6.8	6.9
*Al-Salam REIT	19.6	18.4	109.8	6.5	1.0	1.0	15.2	18.5	5.3	5.6	5.0	5.4
Sector Avg	**20.0**	**19.3**	**5.0**	**2.0**	**1.2**	**1.2**	**16.0**	**14.8**	**6.8**	**7.2**	**5.6**	**5.7**

*Note: * Shariah-compliant REIT*
Note 2: Data as of 26 Sep
Source: RHB

Investment Merits

Strategic location of the REIT's assets

One of the major competitive strengths of Al-Salam REIT is the strategic locations of its properties, mainly Komtar JBCC and Menara Komtar. Both of these properties are located in the prime area of Johor Bahru City Centre, right opposite the Johor Bahru Customs, Immigration and Quarantine (CIQ) complex. Additionally, its @Mart Kempas and KFCH College properties are also strategically located in the Johor Bahru.

Figure 7: Location of the REIT's assets

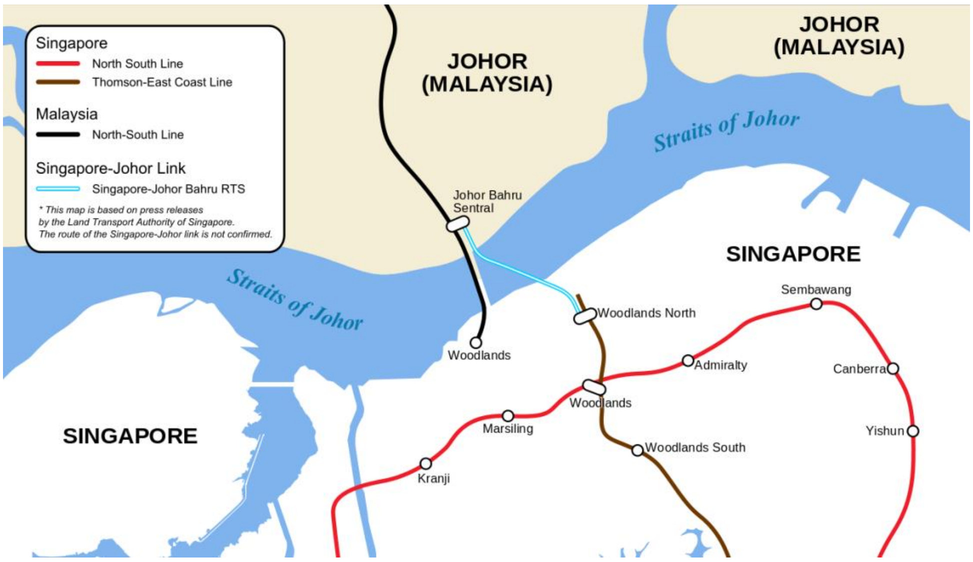
Source: RHB, Company

Due to their strategic locations, these properties are well-poised to benefit from rapid developments currently being undertaken around the Johor Bahru area, leveraging on the state's diversified economic activities and close proximity to Singapore, which presents great demand opportunities for commercial properties.

Moving forward, we expect demand for the REIT's properties, mainly its prime assets Komtar JBCC and Menara Komtar, to grow, driven by several potential catalysts. One of the most important potential catalysts is the completion of the proposed Johor Bahru-Singapore Rapid Transit System (RTS), which is a planned rapid transit system connecting Singapore and Johor Bahru, crossing the Straits of Johor. If built, it would be the second rail link between Singapore and Malaysia, after KTM Intercity's North-South line, and the first designed for high-volume local transit. Completion is targeted for 2019. Currently planned as a two-station line, the Singapore end would be located near Republic Polytechnic, with an interchange to Woodlands North MRT Station on the upcoming Thomson-East Coast MRT Line. The Malaysian end would be at Bukit Chagar, with interchange to Keretapi Tanah Melayu Intercity Services at JB Sentral and the planned JB Metro.

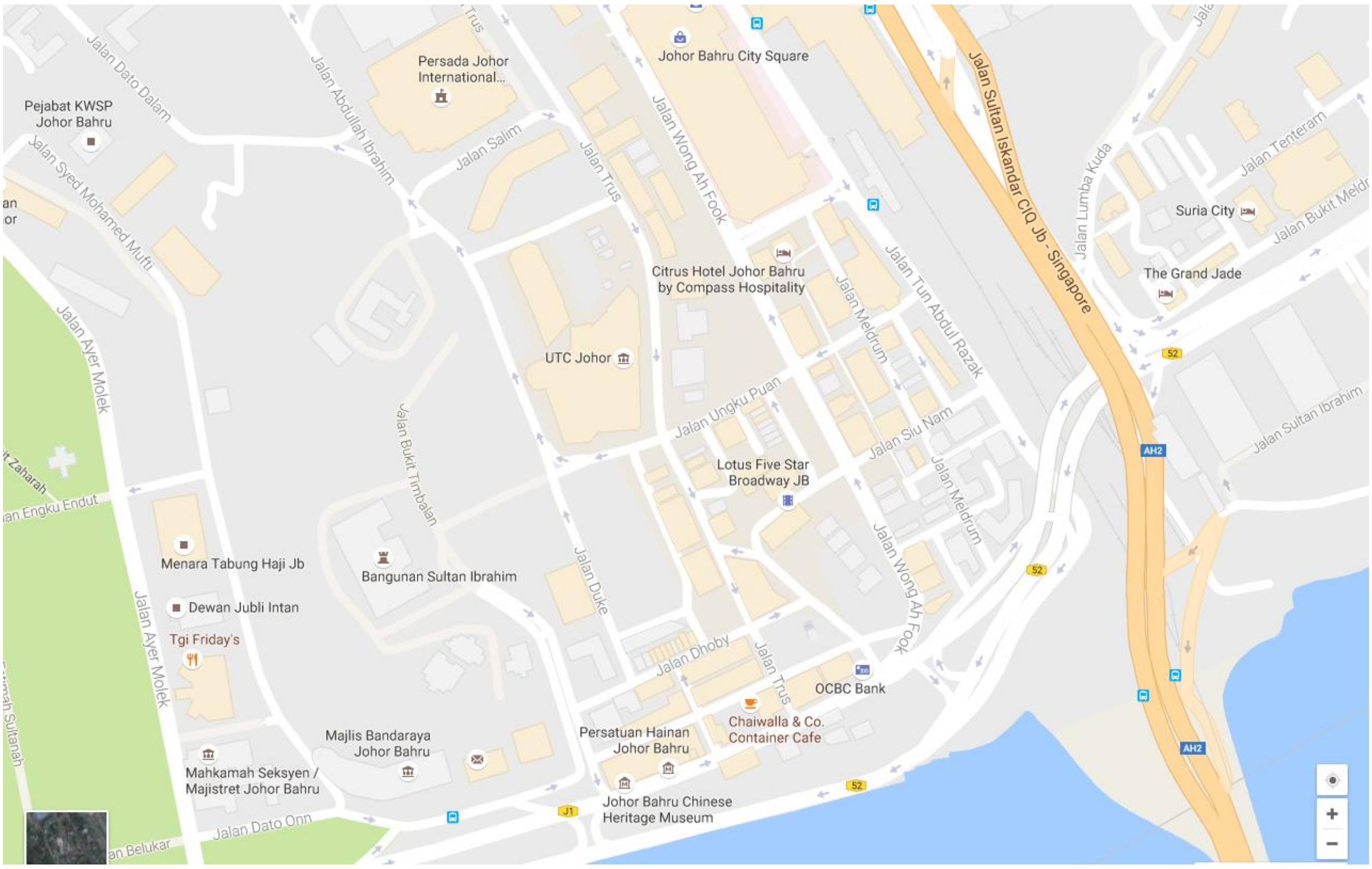
Southern Johor, and Johor Bahru specifically, would benefit immensely from the RTS project. It would overcome the inefficient road connectivity between the two countries, which could spur an influx of visitors from Singapore to Johor. Such an influx would benefit the state's retail and property sectors, leading to higher shopper traffic and stronger demand for Komtar JBCC and Menara Komtar.

Figure 8: Future RTS line



Source: RHB, Wikipedia

Figure 9: Approximate location of IIBD



Source: Google Maps

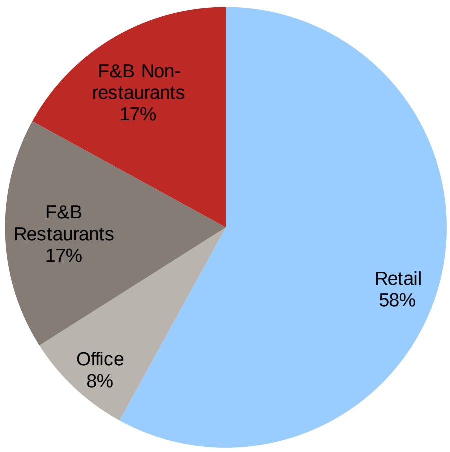
The second potential catalyst is the upcoming Ibrahim International Business District (IIBD), a 250-acre transformation plan developed by Johor Corporation (JCorp) to turn Johor Bahru into a metropolis of international standard. With an estimated gross development value of between MYR20bn and MYR25bn, the area covered by IIBD is bordered by Jalan Ayer Molek, Jalan Tun Sri Lanang, Jalan Tun Abdul Razak and Jalan Sultan Ibrahim. The IIBD is set to be a catalyst of growth for the international business district of Johor Bahru, although no deadline has been set for the completion of the transformation plan. Being adjacent to the proposed IIBD, the new development is set to benefit both Komtar JBCC and Menara Komtar significantly in the future.

Nationwide, the REIT's QSR properties – which comprise 27 restaurant and non-restaurant QSR properties that form an essential part of the operations of KFC and Pizza Hut in Malaysia – are mostly situated in strategic locations close to middle- and high-income established commercial and residential areas. This factor provides an immediate catchment that should sustain strong future customer traffic to these restaurants, ensuring sustainability in operations growth.

Diversified portfolio and earnings base

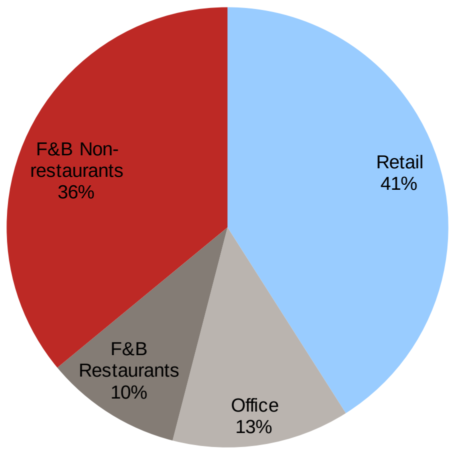
The properties under the portfolio of Al-Salam REIT are well-diversified across a few segments ranging from office buildings, shopping malls, college buildings, warehouses and food and beverage retail outlets. This would ensure resilience of the REIT's future earnings harnessing potential, as any slowdown in one particular sector would then be buffered by stable performance for the other segments. Additionally, the diversified asset base provides a combination of both stability and growth to the portfolio's future earnings potential. The QSR properties, KFCH College and @Mart Kempas provide stable and resilient earnings sources, while Komtar JBCC and Menara Komtar offer strong growth potential due to their strategic location and young age profile.

Figure 10: Property value breakdown by segment



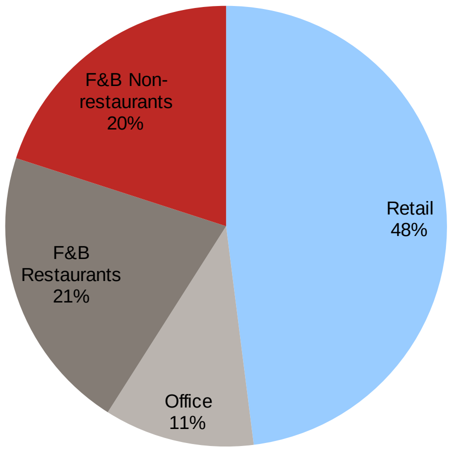
Source: RHB, Company

Figure 11: Portfolio's GFA breakdown by segment



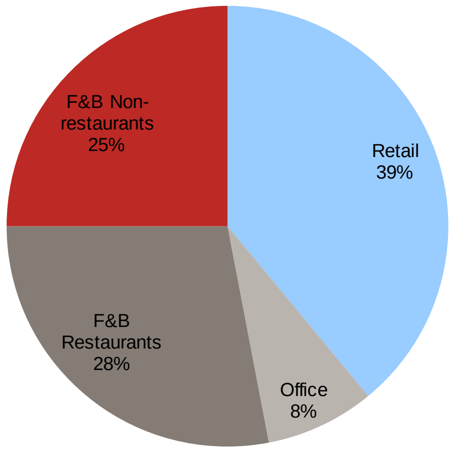
Source: RHB, Company

Figure 12: FY15 total revenue breakdown by segment



Source: RHB, Company

Figure 13: FY15 total NPI breakdown by segment



Source: RHB, Company

Substantial upside potential for Komtar JBCC

We believe that Komtar JBCC, which contributes more than 50% of the REIT's total revenue and earnings, still has room to grow further, moving forward. The mall, which commenced operations in 2014, is only in its first rental cycle, and is currently commanding an average rental rate of around MYR7 psf. Occupancy rate has been steadily rising, from 84% during the IPO to 93% currently, and we expect it to increase further towards the end of the year due to its location. The mall is strategically located in the heart of Johor Bahru, with a direct link bridge connecting it to the CIQ complex. We believe this is an important factor that would lead to a higher traffic flow into the mall.

Among the major factors that we expect to contribute to the mall's growth are:

i. Its low capex requirement in the near term as it is relatively new;

ii. Its niche positioning, targeting the growing middle to upper middle class segments in Johor Bahru;

iii. Its relatively low rental rate compared to its peers;

iv. Additional rental income from percentage rent (revenue sharing).

We understand that its nearest competitor, the more mature City Square Johor Bahru, currently commands an average gross rental rate of MYR12-15 psf. Hence, with the two malls located just next to each other, we believe there is substantial upside potential for Komtar JBCC in its next rental renewal cycle. Additionally, there is a scarcity of high quality malls in the Johor Bahru City Centre to accommodate new-to-market brands. Even though several new retail malls are expected to come into Iskandar Malaysia within the next few years, with a total expected NLA of 5m sqf, this upcoming new competition will be mitigated by Komtar JBCC's more strategic location in the heart of Johor Bahru. The other upcoming malls are generally in suburban locations.

In addition to the base rent, Komtar JBCC enjoys percentage rent from its tenants, as all tenants of Komtar JBCC (excluding money changers and ATM providers) are charged with additional rent based on a percentage ranging from 1% to 25% of total sales revenue generated by the tenants. In the event the percentage rent is higher than the base rent or gross rental income, the difference will be charged as additional rental. In the event the percentage rent is lower than the base rent or gross rental income, no additional rental will be charged. As Komtar JBCC is still in its infancy under its first rental cycle, we believe there is substantial growth potential for the sales revenue of its tenants. This is as the mall gets further recognition from shoppers and shopper traffic increases, this would turn into higher percentage rent and overall earnings for Komtar JBCC in the future. In FY15, percentage rent made up approximately 8% of the mall's total rental revenue.'

Figure 14: Some key tenants at Komtar JBCC

Flight to safety among investors

With the current uncertainties regarding the domestic economic outlook and volatility in local equity market, we believe the MREIT will be preferred due to its defensive nature that provides stable growth with consistent dividend payments. The recent OPR cut by Bank Negara with the purpose of stimulating the economy was a strong indication of a slowdown in the domestic economy, with uncertainties surrounding the outlook. As such, we believe the REIT sector will continue to be favoured in the foreseeable future, with investors looking to preserve capital while reaping a consistent dividend income.

One of the few *shariah*-compliant REITs in the market

Currently, Al-Salam REIT is one of only four *shariah*-compliant listed REITs in Malaysia. Being *shariah*-compliant gives Al-Salam REIT the advantage of being investable in by a *shariah*-compliant fund, with exposure to a wider pool of potential investors. With the scarcity of *shariah*-compliant REITs in the market and a growing size of *shariah*-compliant funds, we expect the market's appetite for Al-Salam REIT to grow stronger, due to its stable growth prospects. We believe there is a minimal risk of the REIT losing its *shariah*-compliant status, as its manager DRMSB also manages another *shariah*-compliant REIT, Al-Aqar Healthcare REIT – which is in its ninth year of operation. Hence, we expect the manager to have sufficient knowledge to ensure the *shariah*-compliant status is maintained, moving forward.

Strong sponsor provides inorganic growth opportunities

Having a strong sponsor in JCorp provides Al-Salam REIT with substantial potential to grow inorganically, with potential assets in the pipeline from JCorp that can be injected into the REIT in the future. Al-Salam REIT has been granted the first right of refusal (FROR) by JCorp over other properties owned by JCorp Group, where JCorp shall not dispose their assets without giving FROR to Al-Salam REIT's trustee to purchase the assets on behalf of Al-Salam REIT. As JCorp continues to develop its current real estate projects, we believe this would provide a potential pipeline of acquisitions for the REIT.

We have identified and listed the assets that belong to JCorp that could be injected into the REIT in the future. Additionally, JCorp is also looking to inject assets that are owned by QSR Brands Holdings SB, comprising restaurant properties and non-restaurant properties with total asset value of around MYR150m. Combining the potential pipeline of assets that could be injected from JCorp and other third-party opportunities, we believe the total asset value of Al-Salam REIT would be able to hit MYR1bn by 2017. Some of the properties that belong to JCorp that could be injected into Al-Salam REIT include:

i. Galleria @ Kotaraya, a shopping mall in Johor Bahru, Johor;

ii. Menara 238, an office tower, located at Jalan Tun Razak, Kuala Lumpur;

iii. Menara VSQ, an office tower, located in Section 14, Petaling Jaya, Selangor;

iv. Menara JCorp, an office tower, located at Jalan Tun Razak, Kuala Lumpur;

v. Other additional assets comprising restaurant properties and non-restaurant properties owned by QSR Brands (M) Holdings Sdn Bhd and its subsidiaries.

As for the concern that some of JCorp's assets are office towers – although we expect the Klang Valley office market to remain soft due to the oversupply situation, we believe this risk is mitigated due to the fact that JCorp's office assets are mainly tenanted by the subsidiaries within the group, or other long-term lessees such as Polis Diraja Malaysia (PDRM), which is currently the main tenant for Menara 238. Furthermore, the diversified locations of its assets limit the risk of overdependence on the Klang Valley office assets.

Long-term leases mitigate downside risks

Al-Salam REIT possesses an advantage over its peers, by the fact that some of its investment properties are tenanted under long-term leases, thus limiting its downside risks such as non-renewals and ensuring stable growth for the REIT in the future. The assets that are under long-term leases are Menara Komtar, KFCH College, and QSR properties.

Menara Komtar is currently more than 90% occupied by JCorp and its subsidiaries, with long-term leases up to nine years commencing in 2015, with options for renewals at every three-year interval. The rental reversion during the lease renewal is fixed at 10%, which gives a stability in rental rate growth moving forward.

KFCH College is currently under a master lease for a nine-year period commencing in 2010, with options for renewal in every three-year period. The rental reversion is fixed at 10%, providing transparency and stability in rental rate growth.

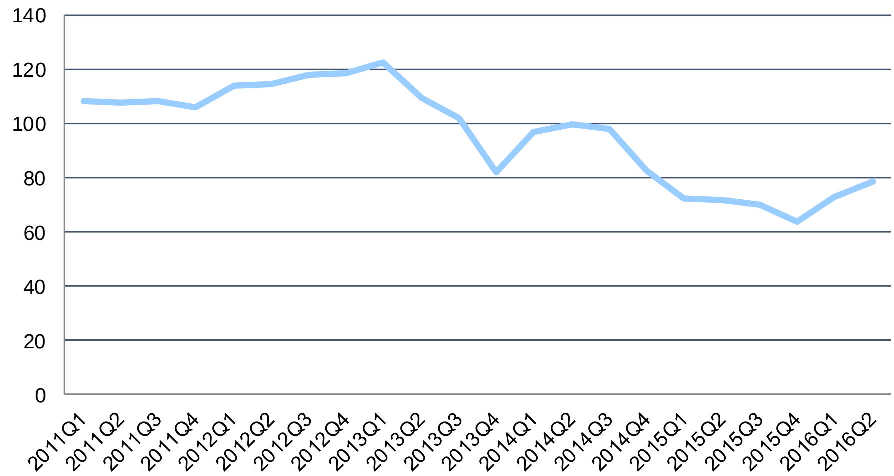
The QSR properties are currently on long-term fifteen-year triple net leases, with the renewal options and rental reversions being undertaken every three years. The next renewal will commence in 2018. Although its rental reversion will be capped at 5% against the preceding rate, we believe this is a fair rate, given the long-term nature of the lease and the triple net lease structure, with all the operating expenses borne by the lessee, hence minimising Al-Salam REIT's exposure to increases in property operating expenses.

Industry Overview

Retail sales to remain subdued

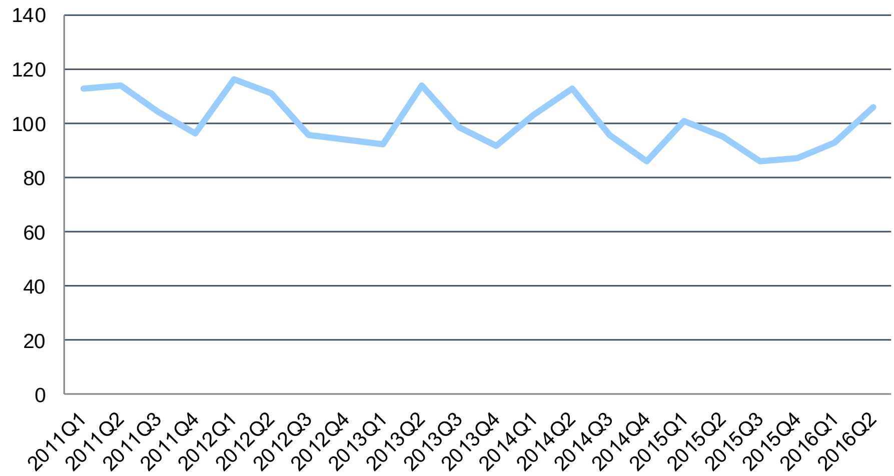
We expect retail sales to remain weak throughout 2H16 going into 1H17 due to the still-weak consumer confidence. The cautious sentiment was reflected in the recent 2Q16 consumer sentiment index, which stayed at 78.5, below the 100-point threshold of optimism.

Figure 15: Malaysia's consumer sentiment index (CSI)



Source: Malaysian Institute of Economic Research (MIER)

Figure 16: Malaysia's business conditions index (BSI)



Source: MIER

Nevertheless, we expect the Johor Bahru retail property market to remain resilient, going forward. According to the National Property Information Centre (NAPIC), currently there is a total of about 18m sqf of retail space in Johor, of which 11.8m sqf are shopping mall space. These include some recently-completed malls such as Komtar JBCC (397,443 sqf) and Sutera Mall – Entertainment City (300,000 sqf).

Johor Bahru has the largest concentration of shopping malls in the state, with about 67% of Johor's total shopping mall space. Despite the high concentration of retail space, we believe Johor Bahru will not suffer from oversaturation and cannibalisation of retail space as it currently lacks new, modern, well-managed and high-quality malls. As a comparison, there are only around 5m sqf of new retail space expected to be completed over the next three years in Iskandar Malaysia against around 18m sqf in the Greater Kuala Lumpur area over the same period.

Additionally, there are measures in place to boost Johor's economic activities, which we believe will help to support retail sales growth and increase market activities in the region.

Figure 17: Existing space and occupancy rate in Johor for commercial shopping complexes for 2014

	Total existing space (000 sqm)	Occupancy rate (%)
Johor	**1,665.0**	**74.1**
Johor Bahru	1,077.0	76.9
Kulaijaya	12.1	80.0
Kota Tinggi	36.7	63.1
Pontian	35.5	79.1
Batu Pahat	153.3	47.9
Muar	29.9	81.6
Kluang	114.8	60.2
Segamat	75.6	92.6
Ledang	21.2	99.9

Source: RHB, Raine & Horne, Smith Zander

Food and beverage (F&B) growth to remain resilient

According to research by Raine & Horne and Smith Zander, the sales transaction value of Malaysia's consumer foodservice market totalled MYR33.3bn in 2013 (up from MYR18.2bn in 2004). The fast food or quick service restaurant segment recorded a higher growth rate with a 9-year CAGR of 10.6%, as sales transactions value grew to MYR4.7bn in 2013 from MYR1.9bn in 2004. We believe this growth rate is sustainable in the foreseeable future, due to several key factors including:

i. Rapid urbanisation resulting in a shift of dining preferences;

ii. Increasing disposable income, that would lead to higher demand for food services – including fast food.

Office segment to remain stable outside the Klang Valley

We expect the outlook for the office segment in the Klang Valley to remain challenging in the next few years. According to Savills Research, there will be approximately 17m sqf of new office NLA coming into the Greater Kuala Lumpur area over the next few years. Due to the oversupply situation, we believe competition for new tenants and tenant retention to remain intense , leading to flat rental rate growth in the future.

Contrary to the Greater Kuala Lumpur area, the Johor Bahru office market is not facing an influx of new office space, hence we believe that the Johor Bahru office market will remain stable over the next few years. According to NAPIC, as at 4Q14, there was around 6m sqf of private office space NLA in Johor Bahru, with about 1.4m sqf of NLA coming into the market over the next few years. Currently, Menara Komtar is almost at full occupancy after completing its major refurbishment efforts in November 2014.

Sector to benefit from further interest rate cut

The MREIT sector has been one of the outperformers in the Malaysian equity market in 2016. The sector has been boosted by the OPR cut by the Malaysian Central Bank, which has led to a widening yield spread between the MGS and REITs. Additionally, the defensive nature of the sector is another pull factor contributing towards an increased interest to the sector, given the current market volatility and economic slowdown. As we do not discount the possibility of the Central Bank further lowering the OPR to encourage economic growth, another OPR cut would provide another boost towards elevating the valuation of the sector.

Industrial segment should sustain stable growth

We believe the outlook for the industrial property segment to remain positive in the next few years, with a stable growth in rental rate expected in 2016. The industrial production index (IPI) grew 5.3% YoY in June 2016, compared to a 2.8% YoY growth in May 2016. This segment growth would be supported by the absence of new industrial assets available in the market, as well as the long-term lease structures for most tenants. We expect the rental rate growth for the industrial segment to remain stable at around 2-3% pa.

Financials

DPU growth of 5.0-6.5% in FY17F-FY18F

We expect a strong and stable DPU growth for Al-Salam REIT moving forward, due to sustained high occupancy rates and strong rental reversions at its assets.

Figure 18: Al-Salam REIT's forecast assumptions

Asset	FY16F	FY17F	FY18F
Net lettable area (sqf)			
Komtar JBCC	397,443	397,443	397,443
Menara Komtar	160,592	160,592	160,592
@Mart Kempas	98,723	98,723	98,723
KFCH College	85,799	85,799	85,799
QSR properties	768,499	768,499	768,499
Average occupancy rate (%)			
Komtar JBCC	93.0	95.0	95.0
Menara Komtar	93.4	95.0	95.0
@Mart Kempas	93.0	95.0	95.0
KFCH College	100.0	100.0	100.0
QSR properties	100.0	100.0	100.0
Average monthly rental rate (MYR/sqf)			
Komtar JBCC	7.06	7.27	7.49
Menara Komtar	4.76	4.90	5.05
@Mart Kempas	5.71	6.14	6.16
KFCH College	2.42	2.42	2.42
QSR properties	1.96	1.96	2.06
Annual average rental rate growth (%)			
Komtar JBCC	3.0%	3.0%	3.0%
Menara Komtar	3.0%	3.0%	3.0%
@Mart Kempas	1.7%	7.6%	0.3%
KFCH College	10.0%	0.0%	0.0%
QSR properties	0.0%	0.0%	5.0%
DPU (sen)	5.30	5.64	5.92

Source: RHB

Gearing level not a cause for concern

Currently, Al-Salam REIT's gearing (total debt/total assets) stands at 36%. We believe this gearing level is very much manageable, as we expect the REIT's asset value to remain relatively stable. It still has total debt headroom of around MYR120m before breaching the Security Commission's (SC) 50% gearing limit. Moving forward, the management expects to maintain the REIT's gearing level below 40%, which we believe is a prudent strategy. Nonetheless, we believe that management will not hesitate to gear up over the short term if an opportunity to acquire an asset arises. We expect future acquisitions to be funded by a mix of debt and equity as a measure of optimum capital management as well as to improve the REIT's liquidity.

Upside potential mainly from Komtar JBCC

In the next few years, we believe the main growth driver will be contributed by Komtar JBCC, contributing to more than 50% of the REIT's total revenue. The mall is still in its infancy, having only commenced operations in 2014. As such, we believe there is a substantial upside potential for the mall in terms of higher occupancy rate and strong rental rate reversion in the future. As for its other assets, we expect a stable growth moving forward, especially for its KFCH College and QSR properties, with both on long-term leases with pre-agreed increases in rental rates, which should ensure a stable and consistent growth in the future.

Manager's intention to refinance borrowings with Sukuk issuance

Currently, Al-Salam REIT's borrowings are secured by the Commodity Murabahah Term Financing-I (CMTF-i) amounting to MYR350m from financiers to part-finance the acquisition of properties during the IPO stage. The financing facility was issued via the first tranche of MYR136m on 6 May 2015 and the second tranche of MYR214m on 29 Sep 2015. The CMTF-i profit is payable over a period of 60 months from the date of first disbursement, with full repayment of principal sum on the 60th month. The effective financing rate for the CMTF-i is based on cost of funds (COF) + 1.35% pa for the first two years and COF + 1.50% pa from the third year onwards.

Moving forward, as the profit rate for its CMTF-i is going to increase by 15bps next year, the manager has stated it is considering to refinance the CMTF-i financial commitment, acquisition of future assets as well as for the working capital requirement by establishing a *sukuk* program. This would allow Al-Salam REIT to enjoy a lower blended yield with fixed financing rate on longer tenure. Nonetheless, due to the current low interest rate environment, we believe management may take a "wait and see" approach to gauge the movement of interest rate and economic conditions before proceeding to issue the *sukuk* at the most appropriate time that would benefit the REIT the most.

Key Risks

Interest rate hike

Generally, the REIT sector is highly sensitive towards any movement in interest rates, as financing costs typically make up more than 50% of a REIT's total expenses. Hence, any future interest rate hike could be detrimental to Al-Salam REIT's future profitability.

Lower-than-expected occupancy rates

Lower-than-forecasted occupancy rates at its investment properties would lead to lower rental contribution from these assets, which would then cause lower overall earnings contributions from the portfolio, affecting the dividend-paying capability of the REIT. This risk is higher at the assets that have shorter-term tenancy leases, compared to those with longer-term tenancy leases.

Weak rental reversions

A weak consumer sentiment could lead to lacklustre sales performances for some of the tenants at the REIT's assets, which could then lead to lower rental reversion rates from the assets when the leases are renewed. This would hamper revenue and earnings growth of the REIT, which depends on the rental growth for its inorganic growth.

Non-renewal of expiring tenants

The majority of the tenants in Komtar JBCC and @Mart Kempas are up for rental renewals in FY17, with 47% for Komtar JBCC and 76% for @Mart Kempas. There is a risk that some of the tenants might not renew their leases, which would result in lower occupancy rates for these properties. Although the retail sales outlook is challenging, given the good locations of Komtar JBCC and @Mart Kempas, we believe the majority of the retailers would want to retain their presence in those properties.

Lack of quality assets for future acquisitions

In order to support its organic growth, Al-Salam might be looking to acquire assets from third parties to achieve inorganic growth. However, it might be difficult for the REIT's management to find high-quality assets that meet the criteria that would lead to yield-accretive acquisitions.

Company Background

Overview

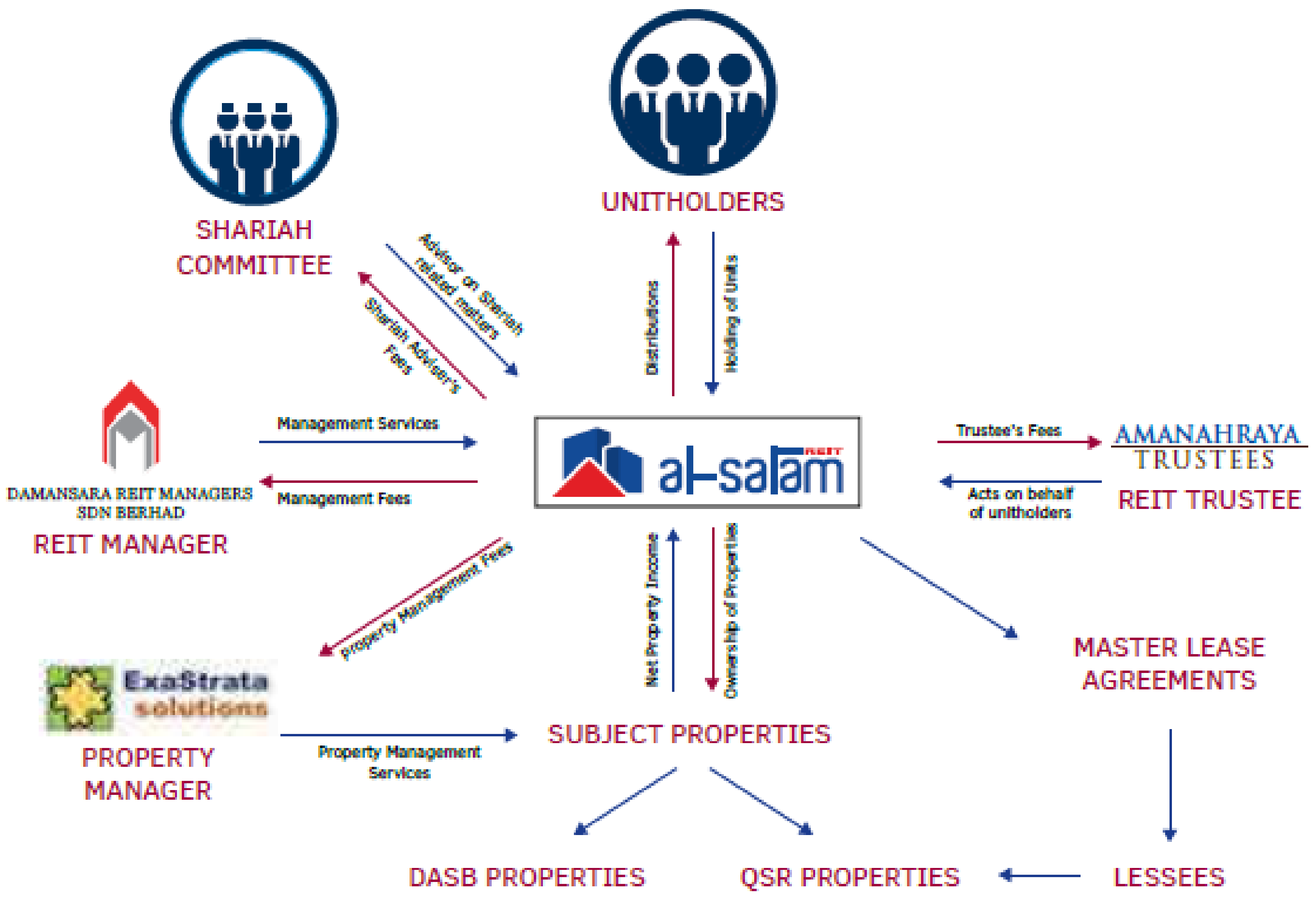
Al-Salam REIT is an Islamic REIT established with the principal investment policy of investing – directly and indirectly – in a *shariah*-compliant diversified portfolio of income-producing real estate used for commercial retail, office and industrial purposes in Malaysia as well as real estate-related assets.

Its key objective is to provide unitholders with stable and regular income distributions that are sustainable in the long run. It also strives to provide distributable income and capital growth while maintaining an appropriate capital structure.

Structure of Al-Salam REIT

The following diagram illustrates the structure of Al-Salam REIT. It includes the relationship between the manager, the trustee, the *shariah* committee members, the property manager and unitholders.

Figure 19: Al-Salam REIT's structure



Source: RHB, Company

As shown in Figure 19, DRMSB is the manager of Al-Salam REIT and is responsible for:

i. Managing the REIT's assets and liabilities for the unitholders;

ii. Setting the strategic direction for the REIT;

iii. Offering recommendations to the trustees on matters relating to acquisitions, divestment, and enhancement of the REIT's assets.

DRMSB is also the manager of Al-Aqar Healthcare REIT, the only listed healthcare REIT in Malaysia. Hence, we believe DRMSB has the proven track record and capability to execute Al-Salam REIT's growth plans effectively.

JCorp, the sponsor of Al-Salam REIT, is a company principally involved in plantation, property development and management, as well as investment holding. JCorp is the REIT's largest unitholder at 48.1% through its wholly-owned Damansara Assets Sdn Bhd.

The trustee for Al-Salam REIT is AmanahRaya Trustees (ART), which provides corporate trusteeship services for the REIT, while the property manager for the REIT is ExaStrata Solutions SB (ES). ES is responsible for providing property management services to the REIT in terms of managing, operating, maintaining, and marketing the abovementioned properties.

Asset portfolio

Currently, Al-Salam REIT''s total asset value stands at MYR911.5m, made up of five major assets, namely Komtar JBCC, Menara Komtar, @Mart Kempas, KFCH College, and its QSR properties. In total, the properties have 1.51m sqf of GFA and offer 1.51m sqf of NLA. The REIT's crown jewel, Komtar JBCC, was completed in 2014, and currently contributes more than 50% to the REIT's total revenue.

Al-Salam REIT's portfolio consists of these investment properties:

i. Komtar JBCC – a four-level shopping mall together with 1,187 car park bays located in the city centre of Johor Bahru, Johor;

ii. Menara Komtar – a 25-storey office building with 145 car park bays located in Johor Bahru city centre;

iii. @Mart Kempas – a single-storey hypermarket known as @Mart Kempas Community Hypermarket located in Kempas, Johor;

iv. KFCH College – a 4-storey building known as KFCH International College, located in Bandar Dato' Onn, Johor;

v. QSR Brands' properties – a group of 27 properties comprising 22 restaurant and 5 non-restaurant properties.

The details of Al-Salam REIT's investment properties are given below:

Figure 20: Komtar JBCC

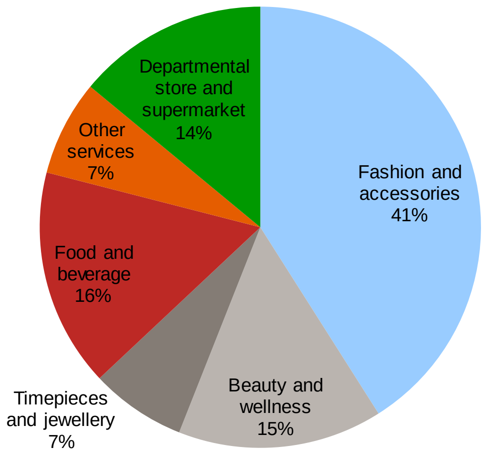
Source: RHB, Company

Figure 21: Komtar JBCC details

Komtar JBCC Details	
Location	Johor Bahru City Centre, Jalan Wong Ah Fook, Johor Bahru
Description	A four (4)-level shopping mall located in Johor Bahru City Centre
Acquisition price (30 Sep 2015)	MYR462m
Appraised value (31 Dec 2015)	MYR462m
GFA (sq ft)	623,374
NLA (sq ft)	397,555
No. of parking bays	1,187
No. of tenancies (31 Dec 2015)	114
Occupancy as at 31 Dec 2015	89%
Annual shopper traffic (2015)	6.5m
Revenue (FY15)	MYR8.2m
NPI (FY15)	MYR5.1m

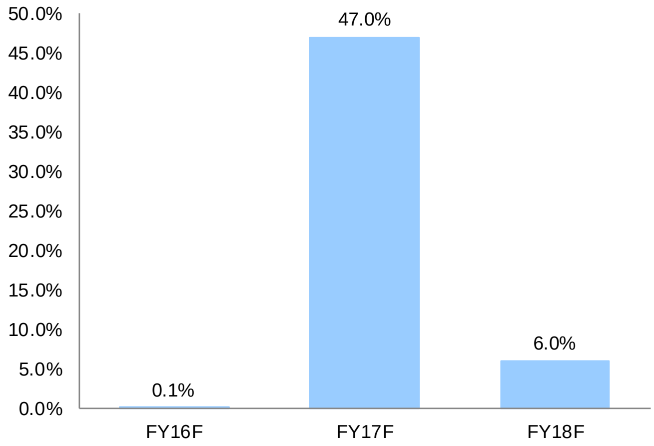
Source: RHB, Company

Figure 22: Komtar JBCC's tenant mix by trade sector



Source: RHB, Company

Figure 13: Komtar JBCC's lease expiry profile



Source: RHB, Company

Figure 24: Menara Komtar

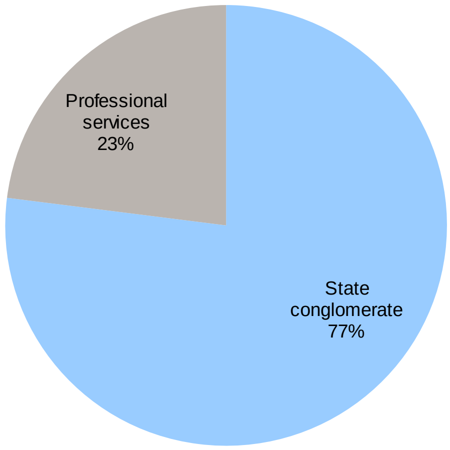
Source: RHB, Company

Figure 25: Menara Komtar details

Menara Komtar Details	
Location	Johor Bahru City Centre, Jalan Wong Ah Fook, Johor Bahru
Description	A twenty-five storey office building located in Johor Bahru City Centre
Acquisition price (30 Sep 2015)	MYR70m
Appraised value (31 Dec 2015)	MYR70m
GFA (sq ft)	242,195
NLA (sq ft)	160,592
No. of parking bays	145
No. of tenancies (31 Dec 2015)	26
Occupancy as at 31 Dec 2015	96%
Revenue (FY15)	MYR2.3m
NPI (FY15)	MYR1.3m

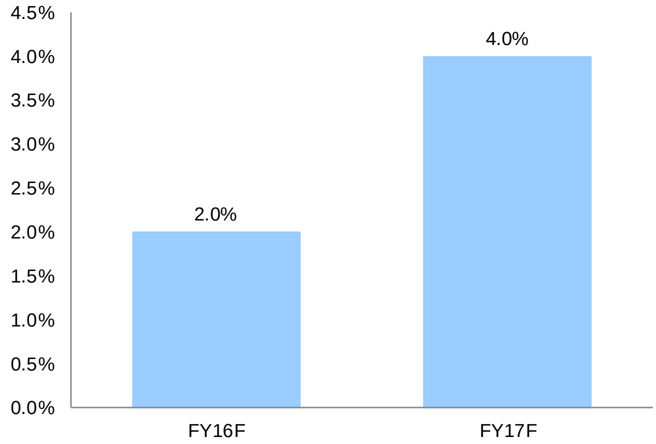
Source: RHB, Company

Figure 26: Menara Komtar's trade mix by trade sector



Source: RHB, Company

Figure 27: Menara Komtar's lease expiry profile



Source: RHB, Company

Figure 28: @Mart Kempas

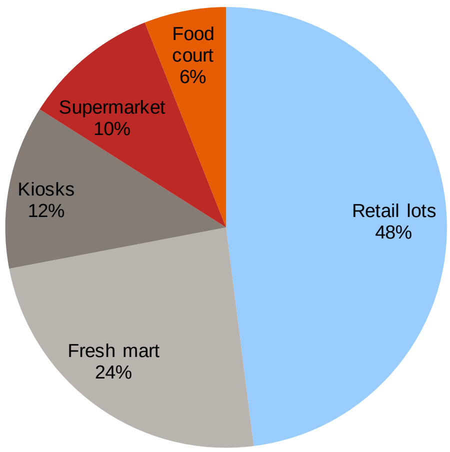
Source: RHB, Company

Figure 29: @Mart Kempas details

@Mart Kempas Details	
Location	Jalan Persiaran Tanjung, Taman Cempaka, Johor Bahru
Description	A single-storey hypermarket located within Kempas, Johor bahru
Acquisition price (29 Sep 2015)	MYR65m
Appraised value (31 Dec 2015)	MYR65m
GFA (sq ft)	164,460
NLA (sq ft)	98,723
No. of parking bays	478
No. of tenancies (31 Dec 2015)	198
Occupancy as at 31 Dec 2015	95%
Revenue (FY15)	MYR1.8m
NPI (FY15)	MYR1.0m

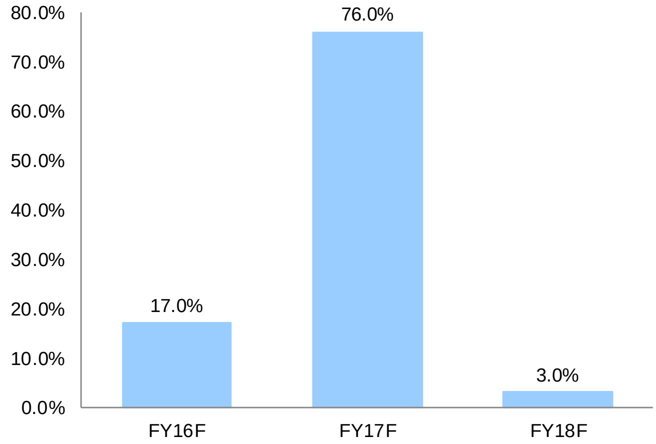
Source: RHB, Company

Figure 30: @Mart Kempas tenant mix by trade sector



Source: RHB, Company

Figure 31: @Mart Kempas lease expiry profile



Source: RHB, Company

Figure 32: KFCH College

Source: RHB, Company

Figure 33: KFCH College details

KFCH College Details	
Location	No. 1, Jalan Dato' Onn 1, Bandar Dato' Onn, Johor Bahru
Description	A four (4)-storey college building in Bandar Dato' Onn, Johor Bahru
Acquisition price (29 Sep 2015)	MYR28.2
Appraised value (31 Dec 2015)	MYR28.2
GFA (sq ft)	92,157
NLA (sq ft)	85,799
No. of parking bays	133
No. of tenancies (31 Dec 2015)	1
Occupancy as at 31 Dec 2015	100%
Revenue (FY15)	MYR0.6m
NPI (FY15)	MYR0.5m

Source: RHB

Figure 34: QSR properties

Source: RHB, Company

Figure 35: QSR properties details

QSR Properties Details	
Description	27 properties (22 restaurant and 5 industrial) located across Malaysia
Acquisition price (30 Sep 2015)	MYR227.94m
Appraised value (31 Dec 2015)	MYR286.3m
GFA (sq ft)	789,386
NLA (sq ft)	768,499
Occupancy as at 31 Dec 2015	100%
Revenue (FY15)	MYR7.9m
NPI (FY15)	MYR7.9m

Source: RHB, Company

Al-Salam REIT's strategies

Moving forward, the REIT will focus on increasing the income and the value of its properties through:

i. Active asset management strategy – the manager will seek to optimise rental rates, occupancy rates and NLA of its properties in order to improve returns from the portfolio.

ii. Acquisition growth strategy – the manager will source and acquire properties that fit Al-Salam REIT's investment strategy to enhance returns to unitholders and capitalise on opportunities for future income NAV growth.

iii. Capital and risk management strategy – the manager will endeavour to employ an appropriate mix of debt and equity in financing its acquisitions, seek to manage financing and refinancing risks, and adopt an active financing rate management strategy to manage the risks associated with changes in financing rates.

SWOT Analysis

S

- Diversified portfolio of assets
- Strategic location of assets
- One of the few *shariah*-compliant REITs
- Experienced REIT manager

T

- Competition from larger REITs
- Scarcity of quality third-party assets available for future injections
- Non-renewal of expiring tenants

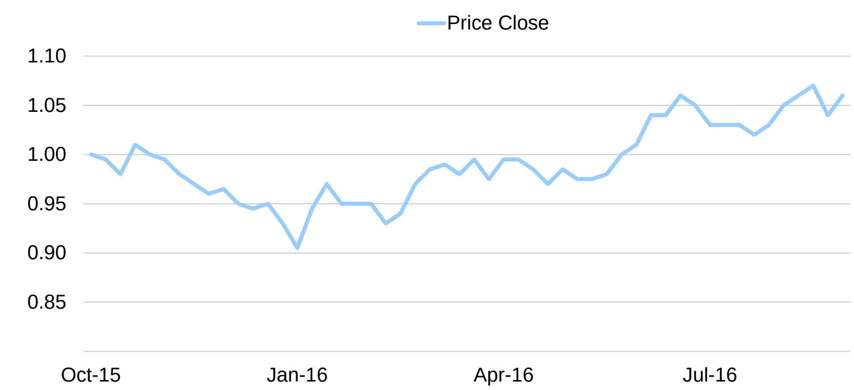
O

- Potential asset injections from its sponsor, JCorp
- Potential upside to Komtar JBCC's average rental growth due to scarcity of quality malls in the area

W

- High gearing ratio vs sector peers

Recommendation Chart



Source: RHB, Bloomberg

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Neutral: Share price may fall within the range of +/- 10% over the next 12 months
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