PavREIT wants to 'set record straight' on Pavilion Bukit Jalil buy

BY **TAN CHOE CHOE** AND **CHERYL POO**

When Pavilion Real Estate Investment Trust (PavREIT) announced last November that it planned to buy the Pavilion Bukit Jalil (PavBJ) mall for RM2.2 billion from its sponsor Malton Bhd, some perceived that the deal would be of greater benefit to the sponsor than the REIT's unitholders.

Tan Sri Desmond Lim Siew Choon controls the sponsor Malton, which industry observers believe is eager to cash out of the mall. The tycoon is also a major unitholder of the REIT and its chairman.

As PavBJ had been in operation for less than a year at the time, there were questions about the urgency to acquire the mall, which comprises a five-storey retail portion and two basement car park levels with 4,800 parking bays.

Having opened in December 2021 with just over 50% of its lots occupied, occupancy was just a little over 78% as at Oct 31, 2022, based on committed/commenced tenancies — which included those that had signed the lease and were under renovation, so they had yet to open shop — with monthly footfall averaging 1.2 million in the six months between Dec 3, 2021 and June 3, 2022.

The proposed acquisition did not elicit much interest; in fact, the REIT's unit price dipped slightly after the news came out. It only started to gain momentum at the beginning of 2023, as retail sentiment was boosted by China's reopening in a final farewell to its zero-Covid policy after three years.

Investors were also encouraged by the REIT's strong post-pandemic recovery, as reflected in the set of results it announced at end-January, which lifted the unit price to about RM1.40.

The deal is being done at "a very good price" and at the right timing, following the normalisation of retail traffic and sales growth last year, Datuk Philip Ho, CEO of the REIT's manager Pavilion REIT Management Sdn Bhd, tells *The Edge* ahead of a meeting to be called to gain unitholders' approval for the acquisition.

Ho describes the price, at about RM1,207 psf, as one that is hard to get for a mall of that size in the Bukit Jalil residential enclave, amid increasing construction costs. The price tag, which is close to its audited net book value of RM2.18 billion as at June 30, 2022, makes it the single largest retail REIT exercise in nearly a decade, and about half the total RM4.7 billion in REIT acquisitions last year.

Ho acknowledges that the initial response to the proposed acquisition was the cash-out theory. "Yeah, but actually it is not. If you look at the costs attached — they announced before us that the cost was RM1.9 billion or thereabouts. After they took over, they managed it for over a year and their cost had gone up to over RM2.1 billion, and they are selling it to us for RM2.2 billion. Mathematically, they didn't make a lot of money from it. It's not a left to right hand. It's just timing."

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Ho: Property prices are coming back. If I don't do it (PavBJ purchase) now, the price will be higher later.

PavBJ's land spans 28 acres — more than double the 12 acres of Pavilion Kuala Lumpur (PavKL). The five-storey complex has a net lettable area (NLA) of 1.82 million sq ft, as opposed to the seven-storey PavKL's 1.36 million sq ft. And PavBJ sits on a freehold suburban plot, whereas PavKL is on leasehold land, albeit a prime one smack in the centre of the city.

Ho says the PavBJ deal will lessen the REIT's reliance on PavKL, which currently makes up about 82.5% of its RM5.9 billion portfolio and 90% of its profit and loss. These will be reduced to 60%, with PavBJ making up 27% of the enlarged asset portfolio of RM8.1 billion and contributing an expected 30% to its P&L. "Property prices are coming back. If I don't do it now, the price will be higher later," he asserts.

PavREIT is funding the acquisition via RM1 billion worth of bank borrowings and a two-tranche private placement by way of book building to raise a total of RM1.27 billion. It will raise RM720 million in the first tranche, expected to be completed in the second quarter of this year, and RM550 million in the second tranche, to be done within 24 months after the first. The bank borrowings will increase its total borrowings to RM3.17 billion from RM2.17 billion and raise its gearing to 37.6% from 34.8%.

Among others, the acquisition is conditional upon at least 80% of PavBJ's total NLA (excluding own use areas) having commenced rental billing, with the average rent of the tenanted NLA not less than RM9.50 psf per month. According to PavREIT, the mall had achieved 81% committed/commenced tenancy, with average rent of about RM9.30 psf, by last month.

"The chairman and QIA (Qatar Investment Authority) understand the importance of the REIT benefitting because they're also major unitholders. That's why this 80% and RM9.50 psf were negotiated," says Ho.

"Technically speaking, the DPU (distribution per unit) will be protected at the REIT level. It is still going to be eight sen or better [on completion of this deal]."

Once the conditions precedent are satisfactorily met, PavREIT will have 60 days to go to the market and raise the RM1.65 billion in initial payment to Regal Path Sdn Bhd, under which the ownership of the mall is now parked.

Regal Path is owned by Amberstraits Sdn Bhd, in which Lim's private vehicle Jelang Tegas Sdn Bhd has a 49% stake, while Malton's Khuan Choo Realty Sdn Bhd holds 51%. Lim controls 43.43% of Malton.

QIA owns 51% of Regal Path's redeemable preference shares (RPS), while Lim holds 24.02% and Malton, via Khuan Choo, owns the remaining 24.98%. Regal Path issued the RPS in 2019 when Malton needed to raise funds to complete the development of PavBJ by transferring the ownership to Regal Path for RM1.48 billion, which saw Lim and QIA injecting fresh capital of RM277.25 million and RM406.7 million respectively through the RPS subscription.

"This is the first time we are going to the market to raise money in 12 years. We started off with a 25% public spread 12 years ago, and it has only gone up to 30.1%. This placement will raise it to 47.5%, thereby increasing the REIT's liquidity," says Ho.

"Many investors complain we don't have enough liquidity — only less than a million units are traded a day. That's the irony of a REIT. When you do too well, people don't sell. So, there is no liquidity."

Although the two major unitholders can backstop the placement as they are confident of the deal, and they are prepared to take up RM600 million of the RM1.27 billion worth of shares, it makes better sense to go to the market, says Ho. "That [new] liquidity will also qualify us for FTSE4Good," he points out.

On fulfilling 75% of the acquisition price, the mall's revenue and profit will be fully recognised under PavREIT. It then has 24 months to pay the balance of RM550 million in three stages — called milestone payments — with no chargeable interest, Ho highlights.

The first stage is RM50 million on completion of defect rectifications within six months of the completion of the sale and purchase agreement (SPA), which Ho says will mitigate any major repair and maintenance spending in the next one to two years. The second is a payment of RM100 million upon the receipt of strata title documents, estimated to be by December this year.

The final sum of RM400 million will only be released if PavBJ achieves a net property income (NPI) of RM146 million on an annualised basis within 24 months, which translates into a yield of 6.6% based on the asset's RM2.2 billion purchase price.

This final condition is "the most critical", says Ho. If the targeted NPI is not met and a revised valuation then comes in lower, up to

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PavREIT's key performance indicators

	FY2018 (RM MIL)	FY2019 (RM MIL)	FY2020 (RM MIL)	FY2021 (RM MIL)	FY2022 (RM MIL)	FY2022 VS FY2021 (% CHANGE)
Gross revenue	554.9	585.35	510.2	488.59	569.69	16.6
Net property income	374.79	375.18	233.52	236.62	364.2	53.92
Distributable income	266.59	258.27	125.8	134.66	255.8	89.97
Distribution per unit (sen)	9.51	8.64	1.52	4.11	8.37	89.8

By asset

	NET PROPERTY INCOME			NET LETTABLE AREA (SQ FT MIL)	OCCUPANCY RATE (%)	
	FY2021 (RM MIL)	FY2022 (RM MIL)	%		AS AT DEC 31, 2021	AS AT DEC 31, 2022
Pavilion Kuala Lumpur mall	212.99	316.4	86.88	1.36	90.2	91.6
Intermark Mall	8.87	9.9	2.73	0.22	83.6	86.9
DA MEN Mall	-9.18	-7.1	-1.95	0.421	62.3	64.5
Elite Pavilion Mall	18.46	40.86	11.22	0.23	86.4	92.3
Pavilion Tower	5.5	4.1	1.12	0.16	79.1	72.8
Total	**236.6**	**364.2**	**100**	**2.391**	**–**	**–**

The expensive DA MEN lesson

Pavilion Real Estate Investment Trust (PavREIT) has generally done well in its choice of acquisitions. This is evident in the occupancy rates of Pavilion Kuala Lumpur (PavKL) and Elite Pavilion Mall, which were above 90% as at Dec 31, 2022, while Intermark's was at 86.9%.

Another asset, the 20-storey Pavilion Tower, is only 72.8% occupied — not surprising given the persistent office glut in the city centre. Still, the property's latest appraised value at end-2022 was RM130 million, not much different from the RM123 million that PavREIT paid for it in 2011.

More significant is DA MEN's performance. Located in USJ, Subang Jaya, DA MEN saw its occupancy rate dive to 64.5% at end-2022 from 87% at end-2016, so much so that its latest valuation has dropped to RM180 million — a far cry from the RM487 million PavREIT forked out for it in 2016.

"I think DA MEN is an expensive learning exercise for us. The lesson to learn is very simple: you cannot have everything in a small mall. Big malls — that's what we're good at," says Datuk Philip Ho, CEO of the REIT's manager Pavilion REIT Management Sdn Bhd, explaining how the REIT tried to make DA MEN a place for shopping and fashion, with Parkson as its anchor tenant, but "failed badly" as there wasn't a lot of space left for much else.

While not the smallest in its portfolio, DA MEN, with its net lettable area of 421,303 sq ft, is significantly smaller than PavKL. The constant traffic snarl-ups in the area also proved too much of a challenge. On top of that, the mall does not have a frontage, but is surrounded by shoplots that are not doing well, he says. "If the shoplots do well, the mall will do well. The problem is the shoplots don't belong to us. That's where the issues start.

"Now, we're going to turn DA MEN into a place of gathering. For people to come and eat, pick up some groceries ... And we will call it DM Mall — for people who cannot properly pronounce DA MEN — and introduce more halal foods. If we work on it hard enough, the valuation will be back to some normality, though it might not go back to its original days," says Ho.

In the interim, DA MEN's F&B outlets have been increased to 40%, while its education element has been raised to 20%, with tuition centres, music school and a STEM (science, technology, engineering and maths) academy there.

Ho says the REIT had tried to sell the property before the pandemic struck, but there was no interest. "What we're trying to do is reposition it — we have a master plan for that. There should be some interest after that."

In the meantime, a flyover is being built nearby to address the traffic problems in the area. Construction will take about 18 to 20 months and will affect DA MEN, which is why the turnaround is expected to take 36 months, he adds.

From Burger King to banking, 99 Speedmart founder's intriguing moves

BY **ADELINE PAUL RAJ**

The emergence of Lee Thiam Wah (*pic*), founder of retail chain 99 Speedmart, as a substantial shareholder of Alliance Bank Malaysia Bhd last month has piqued the interest of many. While some wonder if there may be more than meets the eye with his move to raise his stake a little past 5%, sources close to Lee say it is purely for the purpose of investment as he believes in the bank's prospects.

A stock exchange filing on Feb 10 showed that Lee, through his investment vehicle Global Success Network Sdn Bhd (GSN), acquired 1.38 million of Alliance Bank's shares on the open market on Feb 9 at an undisclosed price. This lifted his stake in the lender to 5.076% (or 78.57 million shares) and solidified his position as the third-largest shareholder of Alliance Bank, after Verticle Theme Sdn Bhd (29.06%) and the Employees Provident Fund (10.43%).

Industry observers note that it is rare for individual investors to hold more than 5% interest in a Malaysian bank through the accumulation of shares on the open market, given that they would come under Bank Negara Malaysia's scrutiny.

The central bank requires any person who intends to hold 5% or more of a bank's shares — even if it is through accumulation of shares on the open market — to obtain its approval beforehand. Bank Negara would need to assess if the person is a "suitable" shareholder, as per the requirements set out in its policy document on shareholder suitability issued in August 2016. In general, the person would have to be of integrity, good reputation and sound financial position. If deemed suitable, the person would continue to be held up against Bank Negara's shareholder suitability criteria on an ongoing basis.

Under section 92 of the Financial Services Act 2013 (FSA), no individual is allowed to hold more than 10% interest in the shares of a bank. The only exceptions to this rule would be those whose shareholding had already exceeded this threshold when the FSA came into effect in 2013. These included Tan Sri Azman Hashim of AMMB Holdings Bhd, who currently has 11.83% interest in the banking group; Tan Sri Quek Leng Chan of Hong Leong Bank Bhd (64.51%) and the late Tan Sri Teh Hong Piow of Public Bank Bhd (23.4%)

"An investment in a bank is not a typical financial investment as it is so tightly regulated," a banking legal expert remarks.

Hence, it is no surprise that some wonder if Lee's investment in Alliance Bank is a strategic move.

"There's so much buzz about him becoming a substantial shareholder. People are wondering if he exceeded the 5% threshold by mistake, if at all that is possible. Also, given Alliance Bank's fragmented shareholding, some wonder if he may be a [friendly party] to other key individual shareholders," states a banking analyst.

Lee declined to comment when contacted.

Vertical Theme is 51%-owned by Langkah Bahagia Sdn Bhd, while the remaining 49% is held by Duxton Investments Pte Ltd, whose ultimate shareholder is Singapore state-owned investment firm Temasek Holdings Ltd.

Langkah Bahagia is 33.68%-owned by Richard Ong Tiong Sin (who runs private equity firm RRJ Capital), while corporate adviser Seow Lun Hoo and Singapore hotelier Ong Beng Seng hold 33.16% each. They bought their shares in April 2016 from Lutfiah Ismail, an associate of former finance minister Tun Daim Zainuddin. At the time, analysts said the three were believed to be parties friendly to Temasek and, as such, corporate developments down the road could not be discounted.

PATRICK GOH/THE EDGE

Sources note that Lee began acquiring shares in Alliance Bank at the onset of the Covid-19 pandemic in 2020, when bank shares took a beating. According to the bank's 2020 annual report, Lee — through GSN — was the eighth-largest shareholder as at June 15, 2020, with a 1.48% stake (22.9 million shares).

He went on to accumulate more shares and ended up as the third-largest shareholder, holding 4.8% (74.23 million shares), as at June 30, 2021, the bank's 2021 annual report shows. His shareholding then crept up to 4.83% (74.82 million shares) as at May 25 last year, based on the latest annual report.

"It [his investment] was a build-up over years, not something that happened overnight," one source points out.

A company search on CTOS shows that Lee owns GSN almost entirely, with only one share belonging to his wife, Ng Lee Tieng. The company made a net profit of RM13.81 million in the financial year ended Dec 31, 2021 (FY2021), down 70% from RM46.22 million a year earlier. Revenue fell 14.6% to RM124.95 million from RM146.35 million in FY2020.

It made a loss of RM126,502 in FY2018, before returning to the black in FY2019 with a net profit of RM470,574.

Alliance Bank shares, which have gained 6.8% over the last 12 months, closed at RM3.44 last Thursday, giving the lender a market capitalisation of RM5.3 billion. At that price, Lee's stake in the bank is worth RM270.3 million.

Wheelchair-bound Lee's rags-to-riches story is a well-documented and inspiring one as he beat the odds of a physical disability — he suffered from polio as an infant — and lack of higher education to emerge as a successful entrepreneur.

Lee, who turns 59 next month, started out in business selling snacks by the roadside before eventually saving enough to start a sundry shop at the age of 23, which launched his career in the retail industry. By Nov 25, 2021, 99 Speedmart had launched its 2,000th outlet, according to its website.

In 2015, Lee acquired the Burger King fast-food chain in Malaysia and Singapore from Ekuiti Nasional Bhd for RM74.6 million. He partnered with Datuk Chua Tia Guan, through their investment firm Newscape Capital Sdn Bhd, for that venture. Chua is Asia Business Centre's head of tax and financial consulting.

Lee was part of a consortium that included Singapore-listed wealth management firm iFast Corp Ltd and army credit cooperative Koperasi Angkatan Tentera Malaysia Bhd that had tried to secure a digital banking licence in Malaysia.

Through GSN, Lee has a 15.77% stake in Radiant Globaltech Bhd, making him the third-largest shareholder in the retail technology solutions provider.

GSN also has a 17.73% stake in digital solutions provider J&C Pacific Sdn Bhd. E

RM400 million could be deducted from the purchase price.

Should the NPI be met and the revised valuation come in higher than the purchase price, PavREIT would not have to pay more than RM400 million. Based on PavBJ's six months of operation from its opening in December 2021 — incidentally when acquisition talks began — until June 2022, the mall had an unaudited NPI of RM30.1 million.

"The deal has been structured in such a way that we have time to mature the assets, to achieve the promised returns.

"A lot of people asked me why the milestones are necessary when it's an RPT (related party transaction). It's precisely because it is an RPT that we require certain thresholds to be achieved ... When we signed the agreement on Nov 22, the lawyer and investment bankers took control of our press release. It was so legalistic that people had to make their own assumptions. We just want to set the record straight, that this is the structure and it is relatively straightforward and negotiated based on the best interests of PavREIT unitholders, including my chairman and QIA," says Ho.

Lim held a 36.89% stake in PavREIT as at Jan 31 — 9.22% under his wife Puan Sri Tan Kewi Yong — while QIA, via Qatar Holdings LLC, owned 33%. The Employees Provident Fund is the third largest unitholder, with 9.94% as at Feb 10.

PavREIT currently owns five properties: four malls — PavKL and the connected Elite Pavilion Mall, Intermark and DA MEN — and an office building, Pavilion Tower (PavTower).

The REIT's NPI for FY2022 increased 53.92% to RM364.2 million from RM236.62 million, as the NPI for most of the malls under its portfolio had improved. PavTower was the only asset that registered a weaker NPI.

Distributable income jumped 89.97% to RM255.81 million from RM134.66 million, with the DPU almost doubling to 8.37 sen from 4.41 sen.

'Very empty still'

While its monthly footfall, which started at about 500,000 to 600,000, had increased to 1.9 million last month, PavBJ seems "very empty still", Ho acknowledges but assures that this is "normal" due to the large size of the lots taken up. For instance, Parkson signed up for 220,000 sq ft, Harvey Norman 50,000 sq ft, and a 16-screen cinema that is about to open has taken 90,000 sq ft. Even the Haidilao hotpot outlet that recently opened is the biggest in Malaysia and can seat 1,000 people per session.

This reflects how PavBJ, which targets to have about 600 brand names and has already secured over 400, was designed with future expansion in mind. Ho says the developer learnt from PavKL, which was able to attract demand for its 7,000 to 8,000 sq ft lots — easily double the size of those in other malls when it opened 15 years ago — despite scepticism about the demand for bigger lots in the market.

PavKL was also the first mall in the region that offered duplexes, he notes, satisfied to have the results validate the decision. Prior to the pandemic, PavKL's occupancy rate stood at 98%, with its spacious hallways dotted with kiosks. At end-2022, it was 91.6% occupied.

PavBJ has even bigger hallways, which Ho says will be great for kiosks in the future. And while PavKL has only one centre court, which "makes money and attracts people", PavBJ has seven.

Yet in terms of positioning, PavBJ is a very different mall compared to the tourist-centric PavKL, owing to the different target markets. "The concentration in PavKL is tourists, with luxe brands like Prada, Gucci ... whereas at PavBJ, it's a family, suburban mall," he says.

"Our survey indicates there are 30 developments with 80 apartment towers constructed within 5km of this mall, comprising over 17,000 apartment units. Of the population there, over 30% are 1 to 19 years old and 42% are 20 to 45 years old, and 80% are Chinese."

By and large, analysts are positive on the proposed acquisition as they note that PavBJ offers more growth opportunities coming from a low base, with its average rent of about RM9.30 psf now — much lower than the RM12 to RM14 psf of other suburban malls such as Mid Valley Megamall and Sunway Pyramid.

This represents ample upside for PavBJ in terms of rental reversion, Hong Leong Investment Bank Research previously noted when it upgraded the REIT to "buy" last November following the acquisition news.

There are seven "buy" calls on the REIT and three "hold", with a consensus target price of RM1.45. The REIT closed at RM1.36 last Thursday for a market capitalisation of RM4.16 billion.

"An occupancy rate of 90% to 95% will definitely be achieved by the end of this year. The question is whether we can achieve [a rental rate of] more than RM10 psf," says Ho, adding that RM10.40 psf is required for the mall to achieve its NPI target of RM146 million.

Rental revision on the cards

There are no immediate plans for another acquisition for now, says Ho, though he notes that the Pavilion Damansara Heights Mall being built by Malton is expected to be completed by the middle of this year. "We will evaluate that when the offer comes. For now, we will concentrate on delivering the numbers for PavBJ first."

For tenants that are performing well — either back to pre-pandemic levels or better — the REIT plans to adjust the rental rates accordingly or negotiate for better terms. Its tenancy renewal takes place every three years and about 30% of PavKL's tenancy is up for renewal this year.

"Tenants at PavKL saw their business perform better coming out of the pandemic, with more tourists coming back to Malaysia, so they share our positive outlook. If their performance is better, we will negotiate for better rates," says Ho.

Conservatively, Ho sees rent increases of between 4% and 6% on average. For those who are taking more time to recover, the REIT is allowing a staggered approach in rental revision. E