Slightly Positive On PAVREIT's Hotel Diversification

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Editor

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Pavilion REIT announced yesterday it is acquiring two premier hotels i.e. Banyan Tree hotel and Pavilion hotel in Kuala Lumpur for a sum of RM480m. The group plans to fund the acquisition through the issuance of new shares. While the assets are expected to generate 7% yield, the potential earnings accretion may be tempered by share dilution from the placement. Kenanga IB has raised its FY25F earnings by 5%, fine-tuned TP to RM1.63 from RM1.66 after the effects of share dilution, and maintained OUTPERFORM call.

PAVREIT is acquiring BTKL from Lumayan Indah Sdn Bhd for a consideration of RM140m. The five (5)-star hotel operated and managed by Banyan Tree Hotels & Resorts Pte Ltd. comprises 55 well- appointed rooms. Its average occupancy up to Sep 2024 stood at 83%.

PAVREIT is also acquiring PHKL from Harmoni Perkasa Sdn Bhd ("HPSB") for RM340m. Banyan Tree Hotels & Resorts operates and manages the five-star hotel, which comprises 325 well-appointed rooms in a 13-storey hotel block erected on Pavilion Kuala Lumpur shopping mall (Pavilion KL). Its average occupancy up to September 2024 stood at 82%.

The subject hotels are related-party- transactions with the total amount for the purchase to be satisfied by both cash and the proceeds from a proposed private placement. In conjunction with the two acquisitions, the group has announced new shares issuance to raise up to a maximum of RM552m. The proceeds will be used to fund the acquisitions and the balance to repay existing bank borrowings. At an illustrative price of RM1.43 for new issue, we anticipate 386m new units to be issued.

In the lease agreement, the operator will lease the abovementioned properties for a term of 10 years at a combined fixed rental of RM33.5m with 5% step-up after 5 years which translates into an initial gross asset yield of 7%. The operator has an option to renew for the second term upon expiry. In the event that the hotel’s net operating income is higher than the fixed rental, the lessor will be entitled to 40% of the difference between the Subject Hotels’ net operating income and the fixed rental.

Subject to approvals, both the proposed acquisitions and proposed placement are targeted to be completed by 1HFY25. The house said it is slightly positive on the acquisition to diversify its portfolio into the hospitality segment on the back of strong tourism recovery ahead in Malaysia.

Kenanga has raised its FY25F earnings by 5% on the hotels’ income contribution from 2HFY25, assuming the deal is completed as intended. It has also fine-tuned its TP from RM1.66 to RM1.63 as the house took into account share dilution effects from new shares issue (by 11% to 4.04b shares). Our TP is based on an adjusted FY25F NDPU of 9.4 sen.

This is against an unchanged target yield of 5.75% (derived from a 2.0% yield spread above our 10-year MGS assumption of 3.75%). The low yield spread is to reflect its prime asset portfolio as anchored by Pavilion KL and Elite Paviliion Mall. There is no adjustment to TP based on ESG given a 3-star rating as appraised by us.

The house believes PAVREIT’s premium retail assets are still resilient and will only see marginal impacts from the
entry of TRX, which it believes has been largely priced into the market. They will also benefit from the return of international tourists and higher tourist spending spurred by the government’s higher budget allocation on tourism.