

Looking at KrisAssets as a REIT

| BY SIOU CHEN MING |

What if KrisAssets Holdings Bhd were a real estate investment trust (REIT)?

A further cut in taxes for REITs would have given the company a strong reason to convert itself into one. Unfortunately, the recently announced Budget 2008 did not feature such a tax cut, much to the disappointment of property players.

Still, it is worth looking at how KrisAssets would benefit if it were a REIT, even under the present tax regime.

A conversion of KrisAssets, the listed vehicle for Mid Valley Megamall, into a REIT may immediately enhance the company's returns to shareholders, say some analysts. The present tax treatment for REITs is more favourable to KrisAssets than its existing form as a listed property investment company, they add.

As long as a REIT distributes 90% or more of its profits, its total profits are exempted from corporate tax. As for the distributed profits, a withholding tax of 15% is imposed on local shareholders and 20% on foreign institutional investors. This is valid for five years, beginning this year.

On the other hand, the profits of conventional companies are subject to a statutory corporate tax rate of 27%. It is noteworthy that Budget 2008 has proposed that the corporate tax rate be reduced to 26% next year and 25% in 2009.

"Becoming a REIT could mean a lot of tax savings for shareholders. It is a more efficient structure," says a head of research.

KrisAssets' tax expense amounted to RM16.4 million for the six months ended June 30, 2007. This translates into an effective tax rate of 31.8% out of a pre-tax profit of RM51.6 million during the period. After deducting the tax expense, net profit was RM35.2 million.

The effective tax rate is higher than the statutory tax rate because certain expenses are disallowed for tax deduction purposes, the company said. The rate was similar in the previous corresponding period, with tax expense at RM15.6 million or 31.4% of pre-tax profit of RM49.8 million.

Under a REIT structure, and assuming that 90% of its profits are distributed, the entire RM51.6 million of profits would be exempted from tax. As for the 90% or RM46.4 million distributed, local shareholders would only be taxed at 15% and foreign institutional investors at 20%.

Thus, IGB Corp Bhd, which owns 74.9% of KrisAssets, would receive RM29.5 million in net dividends, compared to about RM23.7 million in the present scenario.

But tax benefits aside, a REIT structure may be deemed less flexible. For instance, under the present structure, the tax benefits are lost if a REIT does not distribute at least 90% of its income. Also, a REIT can only borrow up to 50% of its total asset value. Exceeding this level would require shareholders' approval.

"There will also be more pressure in meeting investor expectation. You have to look out for yield-accretive properties to enhance yield as well as the share price," says an analyst.

He says if management has no intention of distributing 90% of the company's profits or wants to have the flexibility to increase its gearing to acquire land or develop other projects, a REIT structure would be less favourable.

In the first place, KrisAssets was set up by IGB as a pure property investment company. The plan was for IGB to develop more income-yielding properties and inject these assets into KrisAssets to unlock value and degear at parent company level. However, IGB has not injected new properties into KrisAssets to enhance its appeal other than Mid Valley Megamall three years ago.

KrisAssets' earnings have grown substantially over the last three years, backed by rental re-

newal and adjustment in parking rates. But this is not reflected in the total returns to shareholders. Dividend growth has been slow. An interim gross dividend of 10 sen per share was paid in July. The company paid a total gross dividend of 15 sen a share or RM49.6 million in FY2006, out of a net profit of RM72.5 million. In FY2005, total gross dividend paid was 13 sen a share or about RM43 million.

KrisAssets' share price has also under-per-

formed. It hit nearly RM3 in September 2004 after the injection of Mid Valley Megamall, but had fallen to RM2.27 by June 2006. The stock registered a high of RM3.24 during the rally in July this year but has subsequently fallen to about RM2.68.

Analysts blame the company's lacklustre share price performance on its lack of liquidity. Trading volume remains low because the shares are tightly held by IGB. Due to the dis-

parity between KrisAssets' market price and its perceived fair value, IGB continues to face difficulty in placing out some of its shares to meet the bumiputera shareholding requirement.

It is highly anticipated that IGB may inject its new mall The Gardens, due to be opened this week, into KrisAssets, but this may take time.

Meanwhile, KrisAssets risks losing investor interest if management does not take proactive steps to enhance shareholder returns. ■



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