INITIATION REPORT **31 March 2011**

KSL Holdings Bhd

Price :	**RM1.84**
Market Capitalization :	**RM718.6 mln**
Board :	**Main Market**
Sector :	**PROPERTIES**
Recommendation :	**BUY**

Bursa / Bloomberg Code: 5038 / KSL MK
Stock is Shariah-compliant.

Key Stock Statistics

FYE Dec	FY10	FY11f
EPS (sen)	31.6	20.1
P/E (x)	5.8	9.2
Net Div/Share (sen)	3.8	3.8
NTA/Share (RM)	2.27	2.41
Book Value/Share (RM)	2.27	2.41
Issued Capital (mln shares)	390.5	
52-week Hi-Low (RM)	1.20-2.12	
Major Shareholders:	**%**	
Ku family	51.0	
Lembaga Tabung Haji	8.4	
Templeton Emerging Markets Fund	5.0	

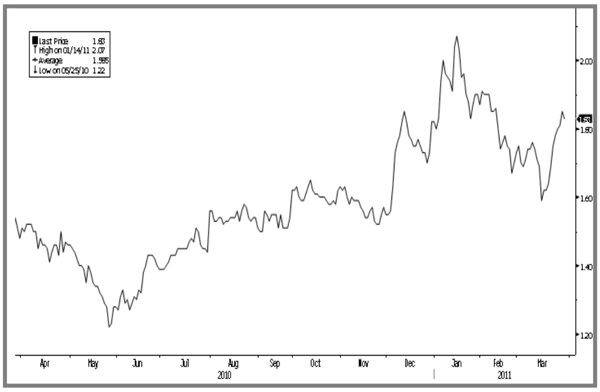
FY10 figures include a fair value gain of RM82.2 mln.

Per Share Data

FYE Dec	FY09	FY10	FY11f
Book Value (RM)	2.08	2.27	2.41
Cash Flow (sen)	26.4	32.0	20.6
Earnings (sen)	26.0	31.6	20.1
Net Dividend (sen)	3.8	3.8	3.8
Payout Ratio (%)	15.9%	12.2%	18.6%
PER (x)	7.1	5.8	9.2
P/Cash Flow (x)	7.0	5.7	8.9
P/Book Value (x)	0.9	0.8	0.8
Dividend Yield (%)	2.0%	2.0%	2.0%
ROE (%)	12.5%	13.7%	8.3%
Net gearing (x)	0.2	0.2	0.2

FY09 and FY10 figures include fair value gain on investment properties.

Last 12-Month Share Price Chart



Investment Highlights / Summary

- **Small property developer with big potential.** KSL has several ongoing township development projects in Johor that serves as bread-and-butter earnings. And it is now venturing into Klang Valley in a big way with a 446-acre township project in Klang.
- **Supported by recurring rental income.** To balance its property development earnings which may be lumpy at times, it has built a steady stream of recurring rental income from its flagship KSL City mall and other commercial complexes.
- **Impressive GP margin above 40%.** Since listing in 2002, KSL has consistently maintained GP margin in excess of 40%, attributed to management's acumen in securing landbank at low cost and strict procurement controls. Balance sheet too is solid with net gearing at 0.2x, backed by NTA/share of RM2.27.
- **Major launches in the pipeline.** Apart from ongoing development activities at its existing township projects in Johor, KSL is launching Phase 1 of its Klang project and a new development in Nusajaya in 1HFY11, followed by another low-rise, high-end residential project at Jalan Madge, Kuala Lumpur in 2012. The Group's total landbank of 2,300 acres, mainly in Johor and Klang, will sustain earnings over the next 8-10 years.
- **Risks** include slower-than-expected construction progress due to shortage of labour, delays in obtaining regulatory approvals and rising building materials costs.
- **Initiate coverage with Buy recommendation and a fair value of RM2.38,** based on a 50% discount to its RNAV of RM4.75. We like KSL for its i) prospective double-digit earnings growths; ii) clear growth strategy; iii) established recurring income stream, and iv) experienced and hands-on management team. Current valuation at FY11 PER of 9.2x (on core earnings without fair value gain on investment properties) also appears to be attractive.

Background

Corporate profile

A Johor-based property developer

Johor-based KSL Holdings Bhd (KSL) is an investment holding company while its subsidiaries are principally involved in property development, property management and property investment. KSL was listed on the Main Board (now known as the Main Market) of Bursa Malaysia in February 2002.

KSL was founded by Mr. Khoo Cheng Hai @ Ku Cheng Hai and his father, Mr. Ku Pon in 1979. Over the past thirty years, the Group has successfully established itself as a prominent property developer in Johor, focusing on mixed development projects comprising residential and commercial properties.

Foreign shareholder includes Templeton Emerging Markets Fund

Today, the Ku family continues to manage the Group with Mr. Ku Hwa Seng as the Executive Chairman, Mr. Ku Cheng Hai as the Group Managing Director and Mr. Ku Tien Sek as the Executive Director. The Ku family has collectively direct and indirect shareholdings of 50.96% in KSL, followed by Lembaga Tabung Haji (8.4%) and Templeton Emerging Markets Fund (5.03%).

Corporate structure.

KSL Holdings Bhd

Bintang Bintang Development Sdn. Bhd.	100%
Bintang Bintang Enterprise Sdn. Bhd.	100%
Clarion Housing Development Sdn. Bhd.	100%
Eversonic Sdn. Bhd.	100%
Exportex Sdn. Bhd.	100%
Goodpark Development Sdn. Bhd.	100%
Khoo Soon Lee Realty Sdn. Bhd.	100%
KSL Properties Sdn. Bhd.	100%
Harapan Terang Sdn. Bhd.	100%
Harapan Terang Properties Sdn. Bhd.	100%
Harapan Terang Realty Sdn. Bhd.	100%
Prosper Plus Industry Sdn Bhd	100%
KSL Properties Management Sdn Bhd	100%
Sejota Sdn Bhd	100%
Sering Cemerlang Sdn Bhd	100%
Sure Success Properties Sdn Bhd	100%
Tai Lik Development (Batu Anam) Sdn Bhd	100%
Villa Bestari Sdn Bhd	100%

Note: Only direct subsidiaries are shown.

Business

Existing Property Development Projects

Major township projects in Johor, and venturing into Klang Valley market

With its roots in Johor, KSL currently has four ongoing township developments in the southern state – Taman Nusa Bestari in Johor Bahru, Taman Bestari Indah in Ulu Tiram, Taman Kempas Indah in Johor Bahru and Maharani Riviera in Muar. Having established its reputation and track record, the Group has ventured into the Klang Valley market and will be launching its first property project in Klang in 2HFY11.

Meanwhile, on the property investment side, the Group's maiden self-managed integrated commercial complex, KSL City in Johor Baru, has begun operations in December 2010 and is expected to generate a healthy recurring rental income stream going forward.

<u>Taman Nusa Bestari, Johor Bahru (Nusa Bestari)</u>

The entire Nusa Bestari project spans across 227 acres of land located along Jalan Sungai Danga, on both sides of the Second Link Highway from Johor Bahru to Singapore. It is situated approximately 14 km northwest of Johor Bahru city centre, with accessability through Jalan Sungai Danga and the Second Link Highway. The mixed development project comprises residential units, shop-offices and shop-apartments with a total Gross Development Value (GDV) of RM1.0 bln. At present, approximately 55% of the land has been developed. The remaining 103 acres of land has an expected GDV of RM380 mln and will be developed gradually over the next 4-5 years.

<u>Taman Bestari Indah, Ulu Tiram (Bestari Indah)</u>

With land measuring about 715 acres, KSL is developing Bestari Indah as a township comprising residential and commercial units. The township is located 19 km north of Johor Bahru city centre and about 4 km west of Ulu Tiram town. Currently, 31% of the land has been developed. The balance of 493 acres has an estimated GDV of RM780 mln and will sustain the Group over the next 5 years at the minimum.

<u>Taman Kempas Indah, Johor Bahru (Kempas Indah)</u>

Another township development by KSL, Kempas Indah covers an area of 237 acres, situated about 18 km north of Johor Bahru city centre along the North-South Highway and Jalan Maju Jaya, adjacent to north-east of the Kempas Interchange. The Group still has 175 acres of land to develop, with an estimated GDV of RM470 mln.

<u>Maharani Riviera, Muar (Riviera)</u>

The Riviera township is located immediately after the Muar Bridge from the Muar town centre, with good accessiblity through Jalan Kesang. KSL has thus far developed approximately 10% of the 188 acres, and the balance is to be developed gradually in the future according to market demand.

Property Investment

Expects RM24 mln rental income p.a. from its flagship KSL City

KSL City is the Group's maiden self-managed integrated commercial complex that houses Tesco hypermarket as the anchor tenant together with close to 500 retail outlets and MBO cinemas. The 4-storey shopping complex also has approximately 2,800 car park bays, providing ample parking facility to its patrons. KSL City was officially opened on 12 December 2010 and currently boasts a high occupancy rate of 98%, which is expected to generate about RM24 mln annually in rental income to the Group going forward.

Hotels & serviced residences above the KSL City mall

Above the shopping mall, KSL is constructing 600 units of luxury serviced apartments (in two blocks) named D'Esplanade with a GDV of RM320 mln, as well as two blocks of hotel with 960 rooms. KSL is selling the serviced apartments while keeping the hotel for future recurring income.

The first block of D'Esplanade is sold out save for the bumiputera units, while the second block has a 40% take-up rate currently. With built-ups ranging from 650sf to 2,000sf, the units are priced at approximately RM500 psf, which is certainly not cheap compared to others in the vicinity. Nevertheless, the encouraging take-up rates prove that property purchasers are receptive towards KSL's offerings. We understand the purchasers consist of both Singaporeans as well as Malaysians who work in Singapore. Currently, the serviced apartments and hotel are under construction with target completion by 1QFY12.

Apart from KSL City, the Group also has three other investment properties rented out on long-term leases to hypermarkets, generating steady recurring revenue of approximately RM12 mln a year. These three commercial complexes are leased out to Giant in Muar, Giant in Nusa Bestari and Best Mart in Nusa Bestari.

Future Launches

2011 is a busy year for KSL with several upcoming launches in the pipeline. In addition to the planned launches at its ongoing projects in Johor, the Group will be launching its maiden property project outside Johor in 2QFY11.

Bandar Bestari – upcoming major township launch in Klang

Located in Klang, Selangor, the project, which is named Bandar Bestari, spans across 446 acres and will be gradually developed over the next 8-10 years. It would be a mixed development comprising residential and commercial units with a total GDV of approximately RM2.5 bln. The land is strategically situated along Jalan Klang-Banting with main road frontage, and is next to Bandar Parklands. It is about 15 km from the Klang town centre. Under Phase 1, scheduled for launching in 2QFY11, the Group plans to sell 380 units of clustered and linked semi-Ds with an indicative starting price of under RM500,000 per unit. Management expected Phase 1's GDV at about RM230 mln.

Attractive land cost at RM8 psf for Bandar Bestari

KSL had completed the acquisition of the land in Klang in 2009 from the vendor, Prospell Enterprise Sdn Bhd, for RM156.5 mln, which translated into an attractive price of RM8 psf. Management noted that the current market price is at about RM35 psf. Given its low land cost, KSL is confident of maintaining its 30%-40% profit margin track record for its Klang project.

Another planned launch in Nusajaya – 1Mutiara

Apart from Bandar Bestari in Klang, the Group also plans to kick off another new major project in Johor towards the later part of 2011. Spanning across 99 acres, the development, named Taman 1Mutiara @ Nusajaya, will have a GDV of RM330 mln.

2012: Low-rise, high-end residences at Jalan Madge, KL

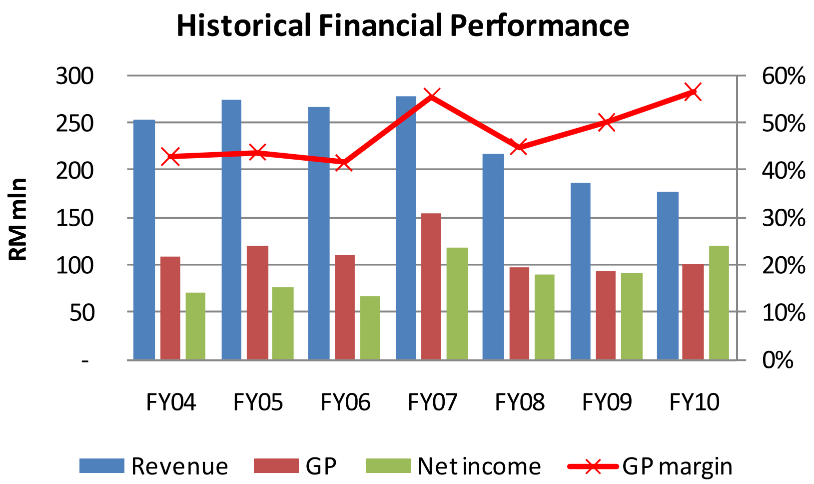
Looking beyond 2011, management is preparing its second property launch in Klang Valley, which is located at Jalan Madge near the embassy area and is only a few minutes away from KLCC. Likely to be launched sometime in 2012, the project comprises 50 units of low-rise, high-end boutique residential complex with an average price tag of RM4 mln each, yielding a GDV of RM200 mln.

In terms of total landbank, KSL has approximately 2,300 acres of land available for current and future development. About 50% of the land is located within the Iskandar Malaysia growth corridor and 20% in Klang Valley.

Financial Highlights

GP margin consistently above 40%

Considered a small-scale developer focusing on the Johor market (prior to its upcoming Klang project), KSL's revenue since listing has always been hovering under the RM300 mln mark. Despite its relatively small turnover base, KSL's gross profit (GP) margin is nevertheless impressive, consistently sustaining at above 40%. Management credits its consistent achievements to low land cost and stringent controls on materials procurement.



Lower revenue in recent years due to concentration on KSL City project to generate recurring income

From the chart above, KSL's revenue appears to be trending down in the last three years, falling to RM177.3 mln in FY10. We understand the lower revenue in recent years were a deliberate trade-off as management diverted resources to develop its KSL City to build its recurring income stream. As such, there were fewer launches at its ongoing property projects in Johor. Now that the KSL City has opened in December 2010 and is generating a recurring income of RM2 mln a month, we understand management has since redirected its focus and resources on property development activities, particularly in preparation for its upcoming launch in Klang.

Net income boosted by fair value gain on investment properties

In addition, the chart also shows rising net profit between FY08 and FY10 despite declining turnover. In fact, FY10 net profit of RM120.2 mln was higher than the GP of RM100.2 mln. The surge of net profits were largely attributed to fair value adjustments on KSL's investment properties, which amounted to RM44.1 mln in FY08, RM44.3 mln in FY09 and RM82.2 mln in FY10. The fair value adjustments in FY08 and FY09 pertain to KSL's commercial complexes rented to Giant and Best Mart while for FY10, it was the revaluation of the KSL City.

Low net gearing at 0.2x, backed by NTA/share of RM2.27

The Group's operations are backed by a solid balance sheet with a healthy net gearing of 0.2x and NTA per share of RM2.27 as at December 2010. We note that KSL's landbank is mostly valued at historical costs and given the boom in property market in recent years, the market value of its landbank is expected to be worth much higher than its book value.

Earnings Outlook

Bright prospects with new launches in the pipeline, supported by recurring income

With the planned launches in the pipeline and the opening of the KSL City, the Group's prospects are promising. Going forward, KSL's earnings will be supported by two income streams – property development and property investment. For FY11, we expect earnings to be derived from its ongoing property development activities in Johor as well as full-year rental income from the newly opened KSL City, in addition to its other existing rented properties.

As at December 2010, the Group's unbilled sales stood at RM143 mln. These unbilled sales are from Nusa Bestari (7%), Bestari Indah (7%), Kempas Indah (1%) and D'Esplanade @ KSL City (85%). We expect minimal contribution from the Klang project in FY11. We anticipate the Klang project and the 1Mutiara development to contribute significantly to bottomline from FY12 onwards. Meanwhile, the recurring rental income, expected at about RM36 mln per annum, would provide comfortable earnings cushion.

Revaluation exercise on investment properties to continue

We understand from management that it would undertake an annual revaluation exercise for its KSL City and this would certainly boost earnings as we expect the property value to continue appreciating. However, at this juncture we decided to focus on its core earnings and have not factored the fair value adjustment into our earnings model.

Expects double-digit earnings growth in the next two years

For FY11, we project a 39% y-o-y increase in revenue to RM246.8 mln on the back of more launches at its existing Johor township projects, higher recognition from the construction of D'Esplanade as well as new rental income stream from the KSL City. Meanwhile, we estimate FY11 net profit to rise 33% y-o-y to RM78.5 mln (after stripping off the net fair value gain of RM61 mln in FY10). For FY12, we forecast revenue and net profit to further grow by 37% and 41% y-o-y respectively to RM338.1 mln and RM111.1 mln respectively on expected additional recognition from its new Klang and 1Mutiara projects.

Investment Risks

Shortage of construction workers. The construction industry has been and continues to face shortage in both skilled and manual labour workers. As such, construction progress may be slower-than-expected, which in turn, may affect earnings should KSL not able to source sufficient workforce to support its upcoming major launches especially the Klang project.

Delay in regulatory approvals. For large-scale development such as the Bandar Bestari township, various regulatory approvals are required and these approvals may take longer than expected. Any delays in securing these consents may result in delay in launching, affecting earnings streams.

Rising building materials prices. Rising costs of cement and steel would have an adverse impact on developers' margins. However, given KSL's track record and its experienced management, we believe it would be able to manage the rising cost issue. Furthermore, as launches are planned in phases, the Group would have opportunity to adjust pricing at each phase after taking into consideration of its cost structure.

Valuation

The table below lists some of the peers in the property sector under RM1 bln market capitalization:-

Peer comparison

Company	Share Price (RM)	PER (x)	P/BV (x)	Mkt Cap (mln)	Net gearing (x)
KSL	1.74	5.5	0.8	679.6	0.2
Crescendo Corp	1.37	8.2	0.5	236.4	0.2
YNH	2.19	15.7	1.2	888.9	0.2
Plenitude	2.26	6.6	0.8	610.2	net cash
Paramount Corp	4.65	6.8	1.0	561.0	net cash
Glomac	1.81	9.7	0.9	537.9	0.1
Dijaya Corp	1.14	11.5	0.6	518.7	net cash
Avg excl KSL		**9.8**	**0.8**		

Source: Bloomberg, Company data. Net gearing calculation based on info from latest quarterly results.

From the table above, KSL's trailing PER of 5.5x appears undemanding by comparison to its peers, especially considering its prospective double-digit earnings growth over the next few years.

RNAV method

We have decided to adopt the RNAV method to arrive at our fair value, which we believe better reflect the underlying value of the Group. Based on our RNAV approach, we have arrived at a fair value of RM2.38 for KSL, as illustrated below:-

Asset Location	Acreage	Psf (RM)	Value (RM mln)
LANDBANK			
Johor			
Johor Bahru	1,117	17	827.2
Segamat	490	5	106.7
Muar	194	5	42.3
Batu Pahat	8	7	2.4
Mersing	19	5	4.1
Kluang	12	3	1.6
Pontian	1	5	0.2
Klang Valley			
Klang	446	27	524.5
Jalan Madge	1	697	25.4
INVESTMENT PROPERTIES			
Giant, Muar	4	364	63.4
Giant, Nusa Bestari	4	364	63.5
KSL City (RM24 mln rental p.a. @ 6% cap rate)			400.0
Gross Value			**2,061.3**
Less: NBV of assets @ 31 Dec 2010			(1,082.9)
Add: Shareholders' equity @ 31 Dec 2010			876.9
RVAV (RM mln)			**1,855.3**
Shares outstanding			390.5
RNAV per share (RM)			**4.75**
RNAV per share after 50% discount (RM)			**2.38**

The discount was applied to reflect the gestation time needed to develop the various landbank before realizing its full potential value (which usually spans above 5 years for the larger tract of land).

We note that on 21 March 2011, KSL has proposed to undertake a renounceable rights issue of up to 97.7 mln warrants at an issue price of 20 sen each on the basis of one warrant for every four existing ordinary shares. The exercise price will be determined based on the 5-day volume weighted average price immediately preceding the price fixing date which will be announced later. The warrants may be exercised any time from the date of issue up to the 5-year expiry period.

From this exercise, KSL would raise RM19.5 mln in the near term from the rights issue, and approximately RM171 mln upon exercise of the warrants (assuming an exercise price of RM1.75). The proceeds will be used for working capital needs of the Group. We believe management would largely earmark the proceeds for the funding needs of its Bandar Bestari project in Klang. As the rights issue of warrant is still pending shareholders and regulatory approvals, we have not factored it into our fair value at this juncture. Nevertheless, our initial calculation indicates a potential 11% adjustment to our fair value to RM2.10 upon approval and completion of the proposed rights issue of warrants.

Recommendation

BUY with fair value of RM2.38

We initiate our coverage on KSL with a **Buy** recommendation and a fair value of **RM2.38**.

In our opinion, KSL is a relatively small property developer but with great prospects, which we expect to materialize into earnings over the next few years. We like KSL for its i) prospective double-digit earnings growths; ii) clear growth strategy; iii) established recurring income stream, and iv) experienced and hands-on management team. Current valuation at FY11 PER of 9.2x (on core earnings without fair value gain on investment properties) also appears to be attractive.

P&L Summary

FYE Dec (RM mln)	FY09	FY10	FY11f	FY12f
Revenue	186.2	177.3	246.8	338.1
EBIT	117.7	170.1	109.3	152.8
Net Int Exp	(2.5)	(6.2)	(7.3)	(8.6)
Pre-tax Profit	115.2	163.8	102.0	144.2
Eff. Tax Rate	18.6%	22.8%	23.0%	23.0%
Net Profit	91.4	120.2	78.5	111.1
EBIT Margin (%)	63.2%	95.9%	44.3%	45.2%
Pre-tax Margin (%)	61.9%	92.4%	41.3%	42.7%
Net Margin (%)	49.1%	67.8%	31.8%	32.8%

Notes: FY09 and FY10 figures include fair value gain on investment properties amounting to RM44.3 mln and RM82.2 mln respectively.
Source: Company, ZJ Research

Balance Sheet Summary

FYE Dec (RM mln)	FY09	FY10
Total Assets	963.0	1,207.1
Non-Current Assets	684.3	943.9
Current Assets	278.7	263.3
Current Liabilities	93.1	122.4
Long Term Liabilities	140.1	207.8
Share Capital	177.7	195.3
Shareholders' Equity	729.7	876.9

Source: Company

Analyst: Nicole Tan Yoke Ping (nicole@zj.com.my)

RATING GUIDE

BUY	Price appreciation expected to exceed 10% within the next 12 months
SELL	Price depreciation expected to exceed 10% within the next 12 months
HOLD	Price movement expected to be between -10% and +10% over the next 12 months from current level

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