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Ireka – defensive, high yielding property play

InsiderAsia™
Decision-critical analysis

Our recent visit to Ireka Corp (RM1.52) reinforces our view that the stock is not only undervalued, but also shaping out to be a defensive and high yielding property play.

Ireka will enjoy recurring management fees from its London-listed property fund, plus upside potential from the fund's performance fees and capital appreciation, and a rapidly growing order book for its construction arm.

After surfacing the value of most of its property assets over the past few months, Ireka's net tangible assets (NTA) is expected to jump from RM1.12 to RM2.73 per share (cum dividends). From being highly geared, it will have pro-forma net cash of RM52.7 million, or a substantial 46.3 sen per share.

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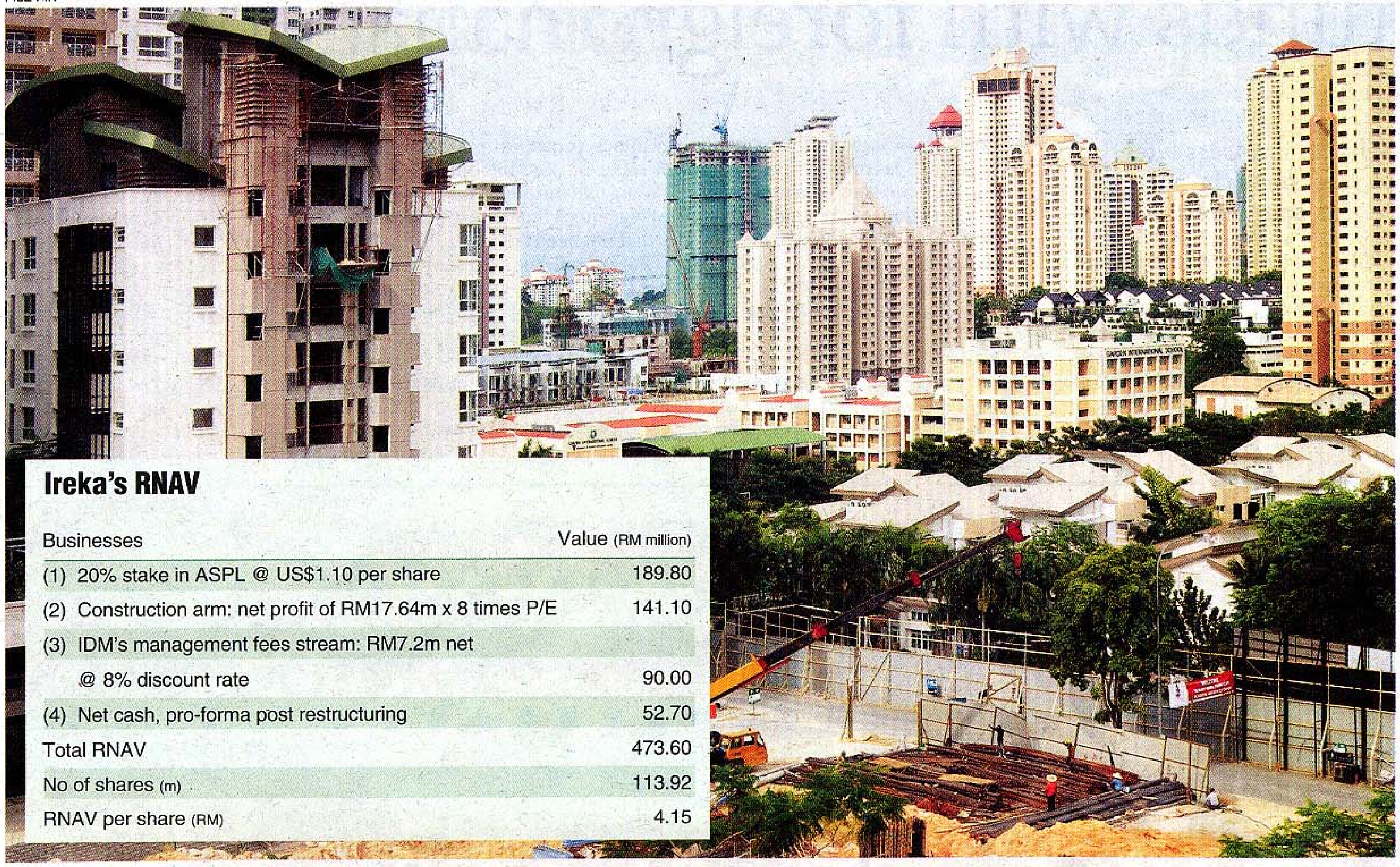

Ireka's RNAV

Businesses	Value (RM million)
(1) 20% stake in ASPL @ US$1.10 per share	189.80
(2) Construction arm: net profit of RM17.64m x 8 times P/E	141.10
(3) IDM's management fees stream: RM7.2m net @ 8% discount rate	90.00
(4) Net cash, pro-forma post restructuring	52.70
Total RNAV	473.60
No of shares (m)	113.92
RNAV per share (RM)	4.15

Recent corporate moves

Ireka made two significant corporate transactions this year, which have enabled the company to unlock properties worth RM673.8 million, pare debts and change its business model to a more sustaining one. It will book in total profits of RM203 million and NTA should rise to RM2.73.

At RM1.52, Ireka's shares are trading at a significant 45% discount to its NTA and 64% below our estimated revised net asset value (RNAV) of RM4.15.

On Jan 10, 2007, it sold the Westin Kuala Lumpur to Newood Assets Ltd for RM455 million cash. On April 5, 2007, Ireka listed its property fund, Aseana Properties Ltd (ASPL), on the London Stock Exchange. ASPL will focus on acquiring and developing properties in Malaysia and Vietnam.

Under the exercise, Ireka sold to ASPL stakes in two companies with four properties under construction for RM218.8 million, satisfied by a 20% stake in ASPL and RM50 million cash. ASPL also raised US$162 million (RM551 million) and has a market capitalisation of US$275 million. Its share price has since appreciated by 10% to US$1.10.

Management fees

Ireka will enjoy assured recurring annual income — with potential capital and profit upside as well.

Ireka Development Management Sdn Bhd (IDM), a wholly owned subsidiary of Ireka, acts as the fund manager of ASPL, and will derive recurring annual fees of 2% of net asset value (NAV), or US$5 million (approximately RM17.3 million), based on ASPL's US$250 million asset base.

IDM's cost structure is fairly low as the bulk of staff costs are in the operating property companies. As such, IDM's pre-tax profits are likely to be in the region of RM10 million annually.

Extra kickers

Ireka will also enjoy other sources of income, most notably from construction. From ASPL, it will also derive performance fees, dividends, share of profits plus capital appreciation gains. ASPL is expected to declare dividends of 3%-5% from its second year onwards.

There's an additional performance fee if ASPL's NAV growth exceeds 10% per year. Excess returns will be shared by Ireka and ASPL on a 20%-80% basis. Management expects this to kick in every two years or so as each major project is completed.

Construction

Ireka's construction arm has a sizeable order book of RM750 million — more than four times its market capitalisation.

With a strengthened balance sheet, Ireka is in a much better position to bid for external jobs, particularly those under the Ninth Malaysia Plan. Ireka will also be able to ride on ASPL's planned ventures in Vietnam, where five projects worth US$700 million are being evaluated and three projects worth US$210 million are expected to start by year-end.

Management expects revenue of RM350 million for the construction arm by financial year (FY) March 2009, when the new group structure is fully in place. Assuming a pre-tax margin of 7%, this implies RM24.5 million in pre-tax profit, which is sustainable given ASPL's pipeline of projects.

Attractive dividend yields

Thus, we reckon Ireka would have a fairly sustainable pre-tax profit base of around RM34.5 million in FY March 2009. This translates into a net profit of RM24.8 million, and earnings per share (EPS) of 21.8 sen. At RM1.52, the stock would be trading at just under seven times earnings.

Its dividend potential is even more exciting, as Ireka will offer above-REIT (real estate investment trust) equivalent yields, but with substantially better capital appreciation prospects.

Post restructuring, Ireka will have net cash of RM52.7 million or 46.3 sen per share, according to its pro-forma accounts, excluding a long proposed bumiputera issue and dividends. With assured income streams and little capex needed (except for the construction arm's working capital), there is ample room for higher dividends.

Management has not stated a dividend policy yet. Assuming a 60% payout, Ireka could distribute 13.1 sen, with a high gross yield of 8.6%. If the payout ratio is raised to 75%, dividends of 16.4 sen would yield 10.8%. If Ireka follows the 95% distribution policy of most REITs, equivalent dividends of 20.7 sen will provide a very generous yield of 13.6%.

For FY March 2007, an interim dividend of 8.8 sen was paid on March 8, 2007. This translates into a gross yield of 5.8%, excluding final dividends.

From the Westin sale proceeds, another RM15 million, or 13.2 sen per share, has been earmarked for dividends. This implies possible total dividends of 22 sen for FY07, or a generous gross yield of 14.5%. From the RM50 million cash received from the ASPL exercise, RM10 million (or 8.8 sen per share) has been allocated for future dividends.

RNAV of RM3.85

Ireka's 20% stake in ASPL is now valued at US$55 million, or RM189.8 million — more than Ireka's market capitalisation of RM173 million.

That means no value is accorded to its other assets, such as its well established and fast growing construction arm, management fee income streams and net cash of RM52.7 million.

Stripping out net cash, the market is effectively valuing Ireka at just RM120.3 million. This means investors are buying into ASPL at a significant 37% discount to its London-listed price, and getting the rest of the group for free!

If we value Ireka's sum-of-parts, we derive an RNAV of RM4.15 per share (see table). Assuming a 30% discount to RNAV, Ireka could trade to RM2.91 over the medium term, or just above NTA.

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