Guthrie GTS Limited

Victor Portfolio Management

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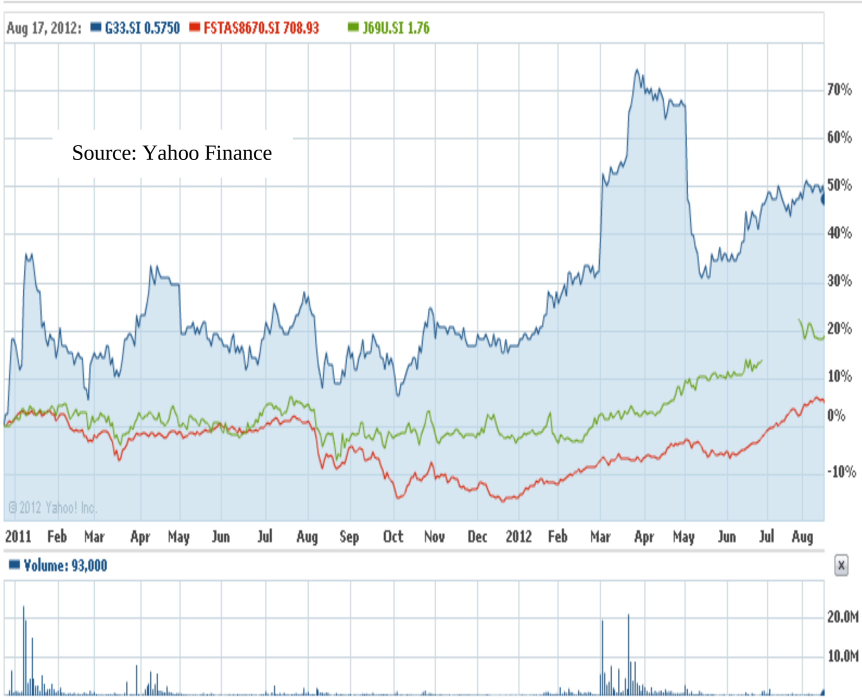


Ticker	G33
Exchange	Singapore Stock Exchange
Industry & Sector	Property and Commerce
Market Capitalization	S$ 619,814,195
52-wk Price Range	S$ 0.42 – S$0.70
Recent Price	S$ 0.575 (17/08/2012)
Net Asset Value	S$ 0.930 (30/06/2012)
Current P/E	5.88x
Projected 2014 P/E	4.05x
Dividend Yield	9.57%
Benchmark	FTSE ST RE Investment Trusts
Listed Peers	CapitaMall Trust, Frasers Centrepoint Trust

Recommendation

BUY

Pros

- Changing consumer patterns from city shopping to heartlands
- Managing Singapore mall retail space equivalent to approx. 16% market share
- Well-positioned for expanding engineering solutions business
- High but sustainable dividend yield
- Strong corporate governance

Cons

- Standstill engineering operations at Abu Dhabi (a major project)
- No guarantee of exponential fair value gains
- Leisure business segment subjected to high competition

Intrinsic Value

S$ 0.88

Based on Discounted Cash Flow (DCF)
Upside potential: 53%

1. Business Summary

The Guthrie Group's brand name and origin dated back to 1821 when it was founded by a Scotsman, Alexander Guthrie. Between then and 2007, the group engaged in a diversified business which included trading. Since 2007, Salim Group and Putra Masagung, CEO and Chairman, jointly hold majority stake in Guthrie GTS. Currently, the Guthrie Group has diverse interests in several industries both locally and in the Asian region. Its 3 main activities are Property Investment & development, engineering and leisure predominantly in Singapore and Indonesia.

2. Industry Overview

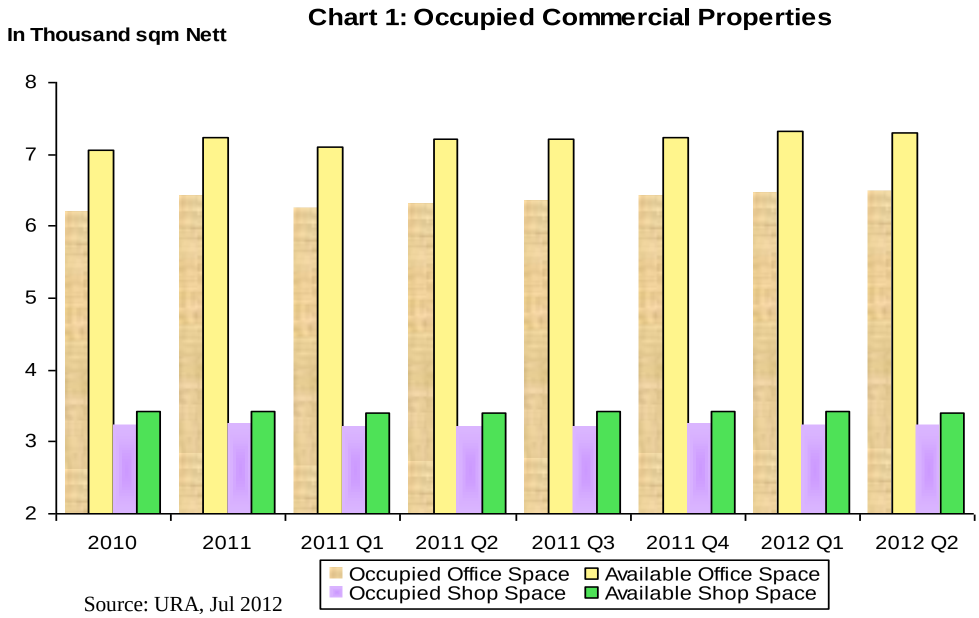
2.1. Property Development and Management

The Property division of the Group has two mainstream activities which are the ownership of commercial and residential assets as well as retail mall management. Some of its investments include a stake in Jurong Point Shopping Centre, the Heartland-Mall Kovan, the new Tampines One and the Jurong Point Shopping Centre 2 cum Centris condominium project. It also provides mall management services for Tiong Bahru Plaza, Century Square, Hougang Mall, White Sands, Liang Court and Central Plaza. Wisma Nusantara, a 30-storey office tower in Jakarta, Indonesia is owned by the Group and in Singapore its flagship commercial property is Guthrie House.

Despite government efforts to cool property demand, property price indexes of residential, office, retail and industrial properties hover near their respective historical highs.[1] Recent key real estate statistics released for 2Q2012 suggest that property markets are cooling, but at a slower pace than expected. Further decline in residential prices is highly likely, considering the highest ever recorded supply pipeline of 83,251 private residential units, of which about 46% remains unsold as of 2Q2012. Furthermore, in Dec 2011, the government, in a bid to cool investment demand, raised stamp duties for foreign buyers and 2nd home purchasers. Negative impact on property prices include tightening on immigration policy. Collectively, profit margin for this sector is likely to weaken for developers. The coming wave of business opportunities should be on construction and redevelopment of existing infrastructures.

Multiple factors such as geographical position, supply of human and technological resources and pro-business environment make Singapore a desirable location for small-medium enterprises to grow, as well as a prime target for multinational companies to set up regional office here. Given the tight supply of office space in CBD and central Singapore, the high office rental rate would drive cost-conscious smaller companies seek offices outside central region but with easy accessibility across Singapore and to the airport. As can be seen in Chart 1, office and retail spaces remain tight in Singapore market.

[1] URA, July 27, 2012, Property Price Index by Type of Property, http://www.ura.gov.sg/pr/graphics/2012/pr12-79a6.pdf



Shopping and dining out are activities much-enjoyed by Singaporeans and tourists alike. Instead of going to city center, retail malls at the heartlands boost many international and established brands. These malls offer similar dining and shopping pleasures. Characteristics of a mall with high volume of visitors include location near MRT station, having multinational retail brands and restaurants at the heartland mall, themed events, highly-maintained washrooms and spacious walkways. With good visitation, mall owners could collect higher rental revenue from leasing shop spaces and a percentage of sales made. As more heartland malls are being built, the success of a mall is likely to be determined by the management of a mall to source for unique stylized events, over and above managing turnover of tenants.

2.2. Engineering

The Group's Engineering arm is well-established in its field. It has an extensive track record in the mechanical and electrical (M&E) engineering domain and offers diversified products and services to the industrial, building and infrastructure sectors. It has provided engineering products and services to many public and private enterprises.

Upgrading of existing infrastructures and new construction works remain robust in Singapore as increasing emphasis is placed on developing efficient and environmentally sustainable projects. Such infrastructure demands drive Singapore engineering landscape to innovate. Leveraging on experience, local engineering companies may take on projects overseas to expand their expertise regionally. According to EDB Factsheet 2011, engineering services accounts for 1.2% of Singapore’s GDP and the sector is expected to grow 5-6%

annually till 2020.[2] Non-process engineering and architectural services such as installation of wall partitions, electrical and power cable transmissions are likely to remain strong, given the pressing demand for technologically-efficient buildings and urban living solutions.

2.3. Leisure

The Leisure division owns several hotels and a golf resort in the region. In Indonesia, its hotel assets are the Hotel Nikko in Jakarta, the Novotel Coralia Benoa in Bali and the Indah Puri Golf Resort in Batam. The Group also owns the Novotel Vientiane in Laos.

The global tourism landscape is likely to contract given the pessimistic macroeconomic outlook as Eurozone sovereign debt crisis and US fiscal cliff play out. However, intra-regional tourism in ASEAN is well-supported as the cost of travel between cities becomes increasingly affordable to suit different categories of travelers. With the exception of Malaysian tourists, currency exchange rates had helped in our tourism receipts from other nationalities, according to 1Q2012 data released by Singapore Tourism Board (STB). [3] Evidently, occupancy in gazetted hotels across most of countries also shows year-on-year increase from 2010.[4]

3. Porter's Five Forces

Guthrie has 3 main distinctive revenue reporting units. Each revenue reporting unit faces different competitive strengths and weaknesses, as a whole, I would attempt to assign a rating to each of the five forces below.

Rivalry among Existing Competitors: Med- Strong

Singapore land area is small but has many established property developers such as City Development and Keppel Land. Guthrie is relatively new to property development arena with project DBSS Adora Green at Yishun, generating a return on capital of about 9.63%.[5] Similar DBSS project at Bedok Belvia by seasoned CEL Development has an estimated return of

[2] EDB, Engineering Services Factsheet 2011, http://www.edb.gov.sg/etc/medialib/downloads/industries.Par.47067.File.tmp/Engineering%20Services%20Factsheet.pdf
[3] STB, First Quarter 2012. Malaysians Tourism Receipts to Singapore fell 11% while overall tourism spending upped 7% y-o-y. https://app.stb.gov.sg/Data/news/3/c7f1734f2e7b3ea403e447de4a566ed2/tourism%20performance%20quarterly%20report%20-%20q1%202012.pdf
[4] Ministry of Tourism and Creative Economy using Central Statistic Board Figures, Indonesia, Dec 2011. Average Bali, Jakarta and Riau Archipelago classified hotel occupancy increased 3.65%, 2.06%, 3.41% from 2010, respectively. http://www.budpar.go.id/userfiles/file/RORDec2011.pdf
[5] Cost of project is $340m and expected revenue (from 168 x $350k, 510 x $470k, and 128 x $580k) is $372m. AR2010 and www.adoragreen.com.sg

9.25%.[6] As housing supply increases in the coming years, profit margin for this segment would likely be driven lower.

Guthrie competes in the office and retail space rental in which they face strong competitions from Frasers Commercial Trust, Lend Lease and CapitaMall Trust (CMT). With Singapore's retail mall space estimated to be at 24.3 million sqf[7], Guthrie manages (direct/indirect) approximately 4 million sqf. In the same report, it was estimated that CMT manages 16.6% of all major shopping centers in Singapore. While CMT and Guthrie have different niches- central and heartland respectively, it is likely that CMT recognizes the shift in retail spending geography to the heartlands and starts gaining market share in the heartlands. Separately, Frasers Centrepoint Trust manages many heartland malls and is a larger player in this field than Guthrie.

For the Leisure business, Guthrie recognizes strong competitive environment in their overseas properties, in particular Indah Puri Batam Golf Resort. New entrants and existing competitors are eyeing a piece of the emerging middle class golfers and an aging affluent class. Its leisure properties targeting business travelers at Jakarta, Bali and Vientiane is likely to face stiff competition as many existing hotels and resorts offer business facilities.

Threat of New Entrants: Low- Med

Strong barriers exist for new entrants. A new entrant would have to convince the owners of its ability to generate a steady and attractive property income. Being able to undercut existing mall managers in management fees may not be convincing for the owner as inexperienced or failed mall management is costly. Events and marketing of malls need to be aggressive to generate visitation for the tenants. Economies of scale in management would greatly reduce such expenses.

Housing supply saturation in Singapore would constrict the already stiff competition arena among developers. Property development is a field in which Guthrie has not fully invested in, but by partnership in development projects such as DBSS Adora Green and The Centris condominium, which all units have been fully sold.

Despite clinching multiple high profile engineering projects, segmental revenue has been declining at an annualized rate of 15.4% since AR2008. However, from its annual reports, we can see the segmental margin has improved from 4% to 9% over the same period. This is a testament to effective cost control to maintain positive bottom line for engineering division.

[6] Cost of Project= $0.5psf x 502366ft2 gross= $251183. Revenue (102 x $401k + 209 x $535k + 177 x $670k) is $274405. Hence, return on capital is 9.25%. http://belvia.org/project-details/

[7] Peter Holland of Urbis, 28 Feb 2012, Independent Retail Market Overview http://capitamall.listedcompany.com/misc/capitamall_ar2011/independent_retail_market_review.html and Guthrie AR2011

Engineering solutions business segment is highly competitive with numerous small entrants meeting industry standards to bid for available projects, although bigger projects tend to go to bigger companies.

Availability of Substitutes: High

Guthrie oversea leisure segment clearly identifies its target consumer group: business travelers. Through partnerships and acquisitions, it has hospitality presence in Laos and Indonesia (Jakarta and Bali). An easy search online reveals substitutes aplenty similar to the hotel facilities Guthrie offers.

In the mall management business, mall owners have a few managers to choose from. These mall managers do not offer specialized and unique services other than properly maintaining the properties and generate healthy profit for mall owners. Hence, substitutability is very high.

Buyers' Power: Low

Mall tenants typically have weak bargaining power, evident in the high rental cost and allowing the mall owners to take 2% off their monthly net sales at Jurong Point, as an example. As 24-hr supermarkets like Giant, Carrefour and NTUC compete for spaces in retail malls, gone were the days when mall owners offer steep discounts for these brands to operate in their malls. Furthermore, Guthrie malls organize recruitment campaigns to staff shops in need of manpower. From lease agreements to ensuring operation efficiency, these are valuable considerations for big market players to set up branches at the heartlands.

The bulk of Guthrie's property business comes from mall management. Mall owners have many choices to the better and cost-efficient managers. In this respect, buyers' power can be significant. However, I see synergy across Guthrie's business units, which may offset partially the buyers' power.

There are plenty of engineering and construction contracts available but Guthrie has filled its current capacity order book till at least the middle of next year. Amongst the notable projects awarded are Downtown and Circle lines fire protection installation, partitioning of Connexion at Farrar Park and facility maintenance for more than 200 schools.

Suppliers' Power: Low- Med

Suppliers to Guthrie's engineering divisions are competitive and having economies of scale gives Guthrie a strong bargaining power in the purchase of materials. The main concern is the manpower cost, which will increase due to the tightening of labor policy in Singapore. It is likely to affect Property and Engineering segments of Guthrie's.

Remarks

Overall operating climate of Guthrie business divisions is mildly competitive. Property management faces mature industry leaders of whom have vast networks in Central and Heartland malls. In addition, property construction and development is likely to face softening prices. On the other hand, property re-development and upgrading of existing infrastructure are picking up. Hence, this should put Guthrie in a competitive position as it has experience in mixed-use complexes (residential/retail, office/retail) and synergy in construction and mall management. Leisure business, however, faces challenging operating environment as the affluent and business travelers have more options.

On corporate governance, the Board has majority Independent Directors and are not related. They carry with them a wealth of experience to lead the company. Independent directors are salaried while the management members sitting in the Board have at least 85% of their remuneration tied to the Group's stock performance. All audit committee members are independent directors and have attended all meetings diligently for the past year. Hence, the strong corporate governance ensures shareholders' interests are taken care of.

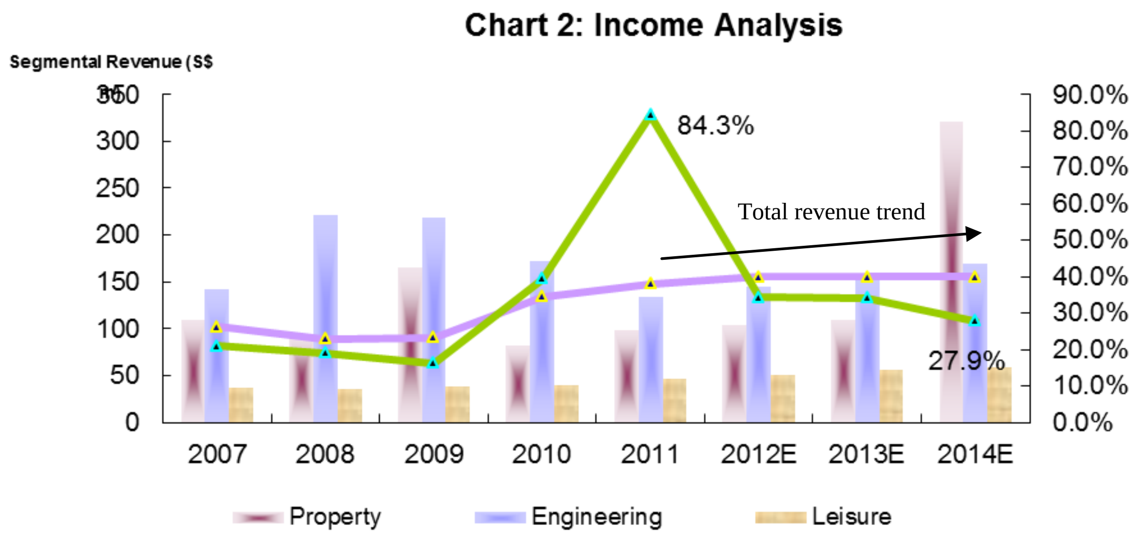
4. Opportunities

Experience in mixed-use mall management is an advantage Guthrie could leverage overseas. Its current property management presence in Malaysia, Indonesia, Taiwan and China (Shenyang) is not strong enough. In my opinion, there are many opportunities in emerging ASEAN economies as new consumption pattern appreciates a retail complex with cinema and quality eateries in their local vicinity. Partnership with existing tenants to expand overseas could be viable by offering discounted rentals in oversea malls.

Environmental consciousness might urge the demand for greener shopping malls. Thence, there is a vast opportunity in adding solar panel installation to the engineering segment by importing, install and maintain solar modules.

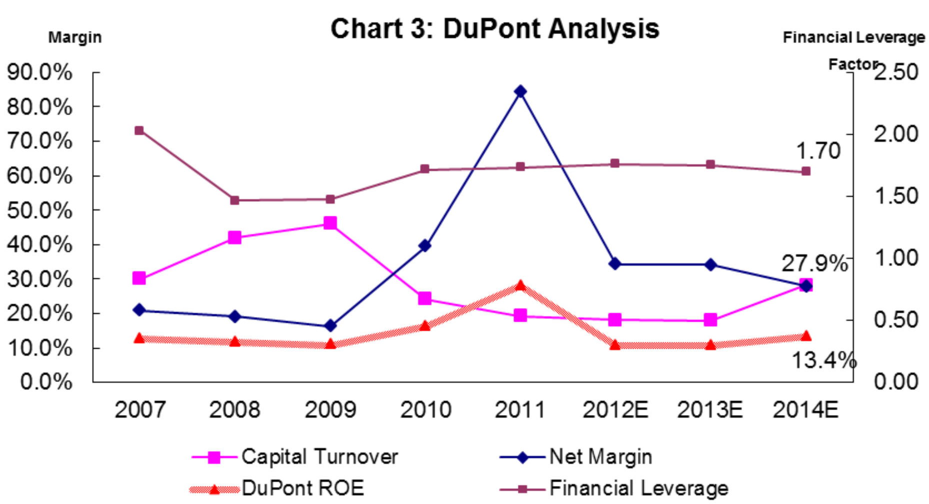
5. Financial Analysis

Guthrie's adoption of new accounting standard INT FRS 115 with effect from FY 2011 would require that the revenue of $205m from sale of Adora Green be deferred until TOP, which is expected to be in 2Q2014. In addition, there is no certainty that the fair value gain on properties can be maintained. Chart 2 shows net profit margin declining from FY2011 high of 84.3% to a forecasted margin of 27.9% on modest fair value property gain. Gross margin, which excludes fair value gains, is expected to moderate at 40%.



Sources: Annual Reports, VPM estimates

DuPont Analysis, as shown in Chart 3 below, will give us a better understanding of Guthrie's overall efficiency and profitability. As can be observed, Guthrie's return on shareholders' equity (ROE) increased substantially in 2011 due to fair value gain of $159m on its existing properties. However, I do not see the trend to continue at the exponential rate. Hence, pro forma ROE to 13.4% based on projected earnings attributable to common shareholders and equity.



Sources: Annual Reports, VPM estimates

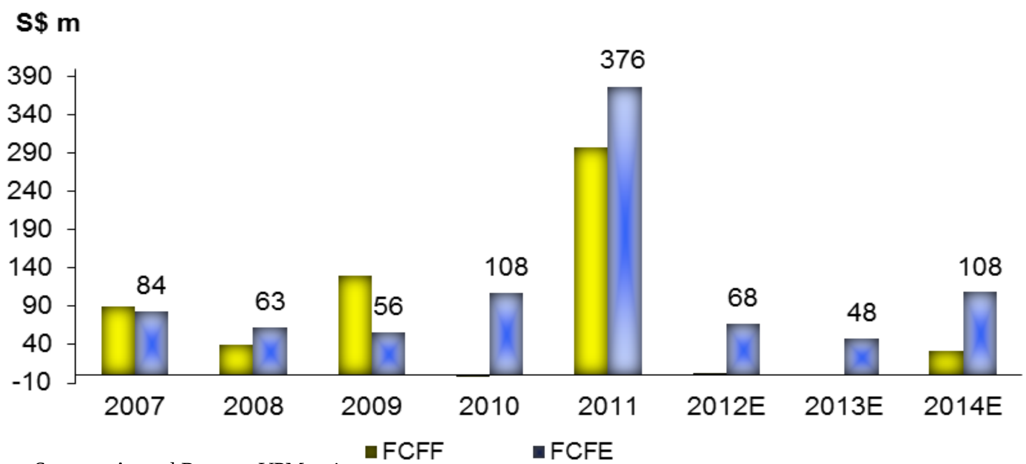
Improvement in capital turnover underlines management's commitment to streamline efficiency by implementing cost control.[8] A cause for concern is the stability of financial

[8] AR 2011

leverage factor as the company takes on higher debt structure [D/ (D+E)] from 31% in FY2009 to 38% in FY2011. As the debt structure increases, the management may be motivated to reduce leverage by increasing equity via issuance of shares from FY2014 onwards. Until then, my pro forma income statements project stronger core revenue with continuing cost control to generate a ROE of 13.4% for shareholders.

Chart 4 below shows that FCFE, except FY2009, has been consistently higher than FCFF, courtesy of more borrowings to finance its operations. In FY2012, pro forma estimation is that FCFF would be negative but FCFE would be positive, supported by debt borrowings. In FY2014, we should see higher FCFE as DBSS project Adora Green and Paya Lebar Square completion would be less demanding on working capital requirement. As the Group realizes its investments in the coming years, coupled with steady but not aggressive acquisitions, it is likely that the Group maintains its historical dividend payout.

Chart 4: Cash Flow Analysis



Sources: Annual Reports, VPM estimates

6. Ratios Analysis

Net margin increased exponentially from 2009 to 2011 without corresponding increase in gross margin is evident of unsustainable fair value gains of its existing properties. However, pro forma projections put net margin to be at a sustainable level of about 34%, absent of extraordinary fair value gains.

Guthrie's outstanding profit margin in FY2011 led to flattering efficiency measurement. With engineering segment operating in tough environment and macro concerns of a global economy slowdown affecting its leisure operations overseas, cost control is crucial to driving healthy margin for shareholders. Overall efficiency metrics, as shown in Table 1, should stabilize at close to FY2010 level on modest revenue.

Table 1:	Profitability and Efficiency							
	2007	2008	2009	2010	2011	2012E	2013E	2014E
Gross Margin	26.3%	23.0%	23.2%	34.6%	38.1%	40.0%	40.0%	40.0%
Net Margin	21.0%	19.1%	16.3%	39.5%	84.3%	34.3%	34.2%	27.9%
ROA	6.3%	8.0%	7.5%	9.6%	16.2%	6.2%	6.1%	7.9%
ROE	12.8%	11.7%	11.1%	16.4%	28.1%	10.9%	10.8%	13.4%
Asset Turnover	30.0%	42.0%	46.0%	24.2%	19.2%	18.1%	18.0%	28.3%
Profit per $cost	1.39	1.94	1.53	2.57	3.97	2.12	2.11	1.71
WC Efficiency	1.13	-0.84	0.91	0.67	0.88	0.73	0.76	1.25

Sources: Annual Reports, VPM estimates

Leverage metrics, as exhibited in Table 2, have been fairly constant with strong cash flow to cover for both debt and capitalized interest expenses.

Table 2:	Leverages							
	2007	2008	2009	2010	2011	2012E	2013E	2014E
Financial Leverage	2.03	1.46	1.47	1.72	1.73	1.76	1.75	1.70
Debt/Equity	0.59	0.60	0.45	0.54	0.62	0.68	0.68	0.68
CF Interest Coverage	8.05	4.61	13.90	-20.64	14.41	6.67	6.50	7.82

Sources: Annual Reports, VPM estimates

As a significant proportion of its revenue derives from property management, it is appropriate to use similar property management firms for comparison. Table 3 shows Guthrie's cheap valuation based on price multiples. In retrospect, P/FCFE valuation was extremely cheap at 1.3x in FY2011 when Guthrie's stocks were oversold. A one-off special dividend of $0.00425 added to normal dividend of $0.00125 explained the significant dividend yield in 2011. At current price of $0.575, the stock is almost half the P/B of its competitors. Moreover, it makes an attractive buy when STI is trading at P/E of 12.38x while Guthrie is at 5.88x.

Table 3:	Price Multiples					
	2011	2012	CapitaMall Trust	Frasers Centrepoint	Reits	STI
P/E	2.07	5.88	13.05	7.84	9.59	12.38
P/S	1.76	2.07	9.86	10.07	8.64	1.07
P/FCFE	1.30	9.11	6.42	8.82	n.a.	n.a.
P/B	0.52	0.63	1.18	1.25	1.00	1.39
Dividend Yield	12.088%	6.522%	3.617%	5.483%	5.628%	3.061%

Sources: Annual Reports, Companies' AR, Bloomberg and VPM estimates

7. Valuations

Using CAPM formula to estimate required rate of return on equity, using risk-free rate 1.6% based on 10-year SGS bond yield and an equity beta of 0.9 and market return of 10%, my r_e = 1.6+0.9x(11-1.6) =10.06%. On a conservative stance, I add 3% liquidity premium to make my r_e = 13.06%. Terminal FCFE growth assumed to be at average Singapore inflation rate of 3%. Thus, DCF model valuation shows Guthrie has an intrinsic value of S$0.88 per share.

Table 4: Discounted Cash Flow Valuation

	2012E	2013E	2014E	Terminal Value
FCFE	68,054	47,892	108,441	1,116,942
PV	60,193	37,467	75,035	772,865
Intrinsic Value	S$ 0.877			

With healthy dividend coverage from its operating cash flow, I foresee dividend to increase at $0.00125 per year for the next 5 years before terminal dividend growth of 3%. In particular, upon booking revenue for sales of Adora Green upon TOP, there is a likelihood of a special dividend of $0.00125 for FY2014. Thus, over a 6-year estimation period, intrinsic value based on DDM is S$0.79 per share.

Table 5: Dividend Discount Model Valuation

	2012E	2013E	2014E	2015E	2016E	Terminal Value
Dividend	0.0375	0.05	0.075	0.0875	0.1	1.023247
PV	0.033168	0.039116	0.051896	0.053552	0.054132	0.553905
Intrinsic Value	S$ 0.786					

Frasers Centrepoint Trust has similar in revenue generating units and has numerous malls in the heartlands. Hence, we could use the multiples to find Guthrie's market determined intrinsic value of S$0.94 per share.

Table 6: Price Multiples Valuation:

	Guthrie's Financials	Frasers' Multiples	Guthrie's Price	Allocation	Value
EPS	0.096	7.84	0.749	20%	0.150
Sales	0.278	10.07	2.801	10%	0.280
FCFE	0.063	8.82	0.557	50%	0.278
Book Value	0.906	1.25	1.132	20%	0.226
Intrinsic Value	S$ 0.935				

9. Assumptions and Risks

Revenue: I grew property business revenue at 6% for the next 3 years. Revenue FY2014 is expected to have a one-time increase of about $205 million in revenue, as a result of INT FRS 115 revenue recognition for DBSS Adora Green. Separately for engineering division, I grew revenue at 8%, after considering the order book of Guthrie and upstream revenue to its existing properties. For leisure segment, reopening of Novotel Benoa Bali and of Jakarta mixed-use commercial complex, revenue may grow at 9% for 2 years before reversion to a competitive rate at 5%.

Capital Expenditure: Over the years, Guthrie has steady Capex/Revenue. At CAGR of 9.59%, I continue to project Capex into FY2014 at the current rate.

Net Working Capital: Unless there are extensive acquisitions made, net working capital of existing operations should be constant at inflation rate 3.5%.

Debt Structure: Observing the fairly constant debt structure of about 0.4, mathematical manipulation got me 0.64 for debt/equity leverage. With on-going DBSS Adora Green and Paya Lebar Square to be built, I expect a slightly higher leverage at 0.68x D/E.

Guthrie’s City of Lights Development project at Al-Reem island, Abu Dhabi, practically came to a standstill on weak property sentiment. This has strained on its Engineering resources and cost. As of today, there is no clear indication of the project rolling into steam.

Liquidity is a key investment risk. The counter is thinly traded and hence subjected to great price fluctuation. Financial risk includes significant fair valuation. The valuation metrics, although reliable, carries significant risk should property valuation drop and the Group be compelled to put the losses through P&L statement.

10. Technical Analysis

The chart above shows the daily price return for Guthrie GTS Limited. The green parallel lines are the long-term downtrend lines before it broke out in early Jan 2012 to establish a range trading. After it gapped up high volume, on $0.055 dividend announcement on Mar 1, 2012, it traded above resistance until ex-dividend, whereby it once again touched the long-term support of $0.470. Since then, it has been trading within range (high volume range) of $0.545 and $0.610.

On Aug 17, 2012, Guthrie closed at $0.575, with 50-day and 200-day Moving Averages at $0.5735 and $0.5444 respectively. Traders may wish to stay out until cross-over of these two MAs. Furthermore, RSI at 48 does not suggest strong overselling. At short-term support $0.545, traders may consider taking a small position in the stock. Should Guthrie trade at long-term support $0.470, investors and traders may consider selling house and car for Guthrie, unless fundamentals justify otherwise.

11. Disclosures

I do not hold Guthrie GTS Limited but have intention to long in the next 5 trading days.