12 September 2018 | 2QCY18 Earnings Wrap

REITs Sector

Green is the in thing

***Maintain* NEUTRAL**

KEY HIGHLIGHTS

- **No surprises for 2QCY18 earnings of REITs**
- **Greenfield and brownfield projects are getting more common**
- **MGS yield averages at about 4.05%**
- **We remain NEUTRAL on the sector with SUNWAY REIT (BUY; TP: RM1.93) as Top Pick. We also have a BUY call on AmanahRaya REIT (TP: RM0.94)**

No surprises for 2QCY18 earnings of REITs. Core net income (CNI) of the six out of the seven REITs under our coverage were in-line with our full year forecasts. Among them, Pavilion REIT's CNI for the quarter was slightly above our expectation due to higher than expected rental income, recording 11.8% yoy growth. For 2QCY18, five REITs under our coverage registered positive CNI growth except for KLCCP, which was flat and CMMT at -16.0%yoy. Overall, most REITs recorded higher earnings for the cumulative period except for CMMT due to the negative rental reversion from its Klang Valley malls.

Figure 1: Summary of REITs earnings in 2QCY18

No	Stock	Date of earnings released	Period Under Review	Cumulative Qtr Core Net Income (RM m)	Core Net Income % of our estimate	Earnings growth (yoy)	Against Estimates	Comment
1	CMMT	25-Jul	2QFY18	70.7	44.4%	-12.0%	Within	Weaker earnings due to lower net property income from Sungei Wang Plaza (rental reversion of -12.0%), The Mines (-5.0%) and 3 Damansara (-4.0%)
2	Axis REIT	6-Aug	2QFY18	50.9	45.5%	10.0%	Within	Earnings contribution from Scomi Facility in Rawang and Kerr warehouse cushioned loss of income from Axis Eureka (sold in March 2017). New assets to boost 2H18 income.
3	Pavilion REIT	26-Jul	2QFY18	126.2	50.0%	13.2%	Slightly above	Higher 1H18 gross revenue from Pavilion KL (+8.1%yoy) and The Intermark Mall (+17.9% yoy). Pavilion Elite has also started to contribute to its income. These had offset the drop in revenue from da:mén USJ mall (-18.1%). We expect a stronger 2H18
4	IGB REIT	13-Jul	2QFY18	152.4	50.0%	6.5%	Within	Earnings growth driven by positive rental reversion and write-back of step-up interest rate
5	Sunway REIT	9-Aug	4QFY18	284.5	100.0%	5.2%	Within	Earnings growth mainly supported by higher NPI from Sunway Pyramid, Sunway Pyramid Hotel, Sunway Putra Hotel and Shah Alam industrial asset.
6	KLCCP Stapled Group	15-Aug	2QFY18	359.8	49.0%	1.4%	Within	Stable earnings supported by steady office and retail divisions
7	AmanahRaya REIT	30-Aug	2QFY18	17.5	47.0%	5.9%	Within	Maiden contribution from Vista Tower. Sold off Silverbird factory.

Source: MIDF Research

Greenfield and brownfield projects are getting more common. Besides the ongoing look out for yield accretive assets, REITs are expected to participate in greenfield and brownfield projects more actively. Notably, Axis has handed over Axis Mega Distribution Centre to Nestle and is working on the Axis Aerotech Center@Subang with a development cost of RM74.2m, which is expected to be completed by 4QCY18. Meanwhile, Sunway REIT is expanding Sunway Carnival's NLA by 330,000 sq ft or 66% over three years. Completion of the RM353m development is expected in 3Q21. In August, Pavilion REIT announced that it was invited by Malton Bhd to participate in the on-going development of Pavilion Bukit Jalil. No indicative value was mentioned. We believe that REITs will look into greenfield or brownfield development as another way of adding value to their portfolios on top of outright purchases of completed assets.

Revised REITs guidelines by Malaysia's Securities Commission that took effect on 9th April 2018 could be one of the reasons to spur the participation of REITs in development projects going forward. Recall that the revised guidelines since the previous version released on 28th December 2012, now allows for REITs to undertake property development activities that caps the investment value at 15% of the REIT's total asset value. We believe that this revision provides an additional option for REITs to seek yield accretive investments on top of purchasing and refurbishing properties.

Earnings estimates largely intact. We retain most of our assumptions as most of the earnings for REITs under our coverage are in-line. That said, we have increased our target price (TP) for Pavilion REIT from RM1.40 to RM1.60 as we assumed higher rental income going forward. We have also increase the TP for Sunway REIT from RM1.90 to RM1.93 as we roll over our base year. We maintain our calls for REITs under our coverage except for IGB REIT from "Buy" to "Neutral" due to the limited upside since the recovery in unit price. However, TP for IGB REIT is unchanged.

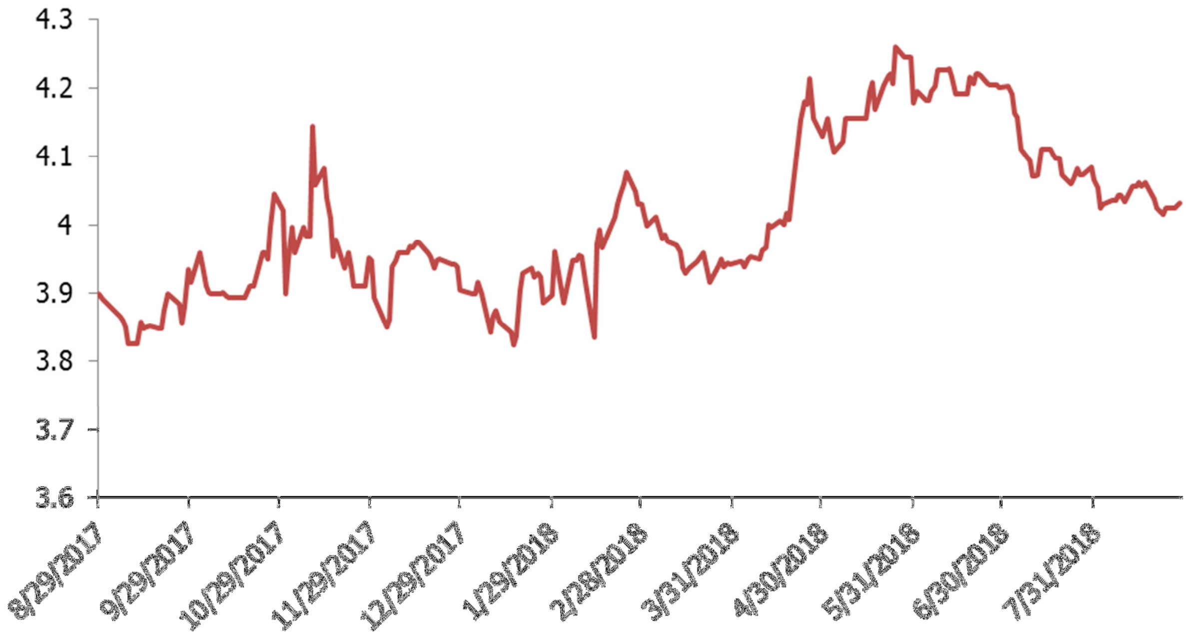
Figure 2: Peers comparison

Stock	FYE	Rec.	Price @ 6-Sept	Target Price (RM)	Core EPU (sen)			Core PE (sen)		Net DPS		Net Dvd Yield	
					FY17	FY18	FY19	FY18	FY19	FY18	FY19	FY18	FY19
AXREIT	Dec	NEUTRAL	1.50	1.55	10.0	9.1	10.0	16.5	15.0	8.0	8.8	5.3	5.9
CMMT	Dec	NEUTRAL	1.14	1.11	7.8	7.9	8.0	14.5	14.3	7.5	7.6	6.6	6.7
IGBREIT	Dec	NEUTRAL	1.72	1.73	8.6	8.7	9.2	19.7	18.7	8.4	8.8	4.9	5.1
PAVREIT	Dec	NEUTRAL	1.63	1.60	7.7	8.7	9.7	18.8	16.9	8.0	8.9	4.9	5.5
KLCC	Dec	NEUTRAL	7.77	7.60	39.9	40.7	41.9	19.1	18.6	35.4	36.4	4.6	4.7
SUNREIT	Jun	BUY	1.73	1.93	9.2	9.6	9.9	17.9	17.4	8.7	8.9	5.0	5.2
ARREIT	Dec	BUY	0.87	0.94	5.5	6.5	7.3	13.4	11.8	5.6	6.4	6.5	7.4
Average												**5.4**	**5.8**

Source: MIDF Research

MGS yield averages at about 4.05%. Current 10-year MGS yield climbs a little compared to the average of 4.0% in the previous quarter but is still considered accommodative. The spread of 1.35 ppt between the average dividend yield of REITs under our coverage and the MGS yield is unexciting at the moment.

Figure 3: 10-Year MGS yield



Maintain Neutral on REITs sector - Maintain Neutral on REITs sector due to the lack of near-term catalysts. Our top pick for the sector is Sunway REIT (BUY; TP: RM1.93) due to its positive earnings outlook. We believe its retail division will continue to spur earnings growth going forward while the office segment may rebound from its previous low. We also have a Buy call on AmanahRaya REIT (TP: RM0.94) for its diversified assets base with exposure to education property and attractive dividend yield of 6.5%.

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.