

06 September 2019 | 2QCY19 Earnings Wrap

## REITs

*Yield spread has narrowed further*

**Maintain NEUTRAL**

### KEY HIGHLIGHTS

- 2QCY19 earnings of REITs within expectation
- Ytd 10-year MGS yield averages at 3.75%
- Yield spread narrowing while valuations climbed
- **Maintain NEUTRAL. BUY calls are on Sunway REIT (TP: RM2.02) and AmanahRaya REIT (TP: RM0.91).**

**2QCY18 earnings of REITs within expectation.** Six out of eight REITs under our coverage recorded core net income (CNI) that were in-line with our full year forecasts. CMMT's core net income was below expectation mainly due to higher-than-expected maintenance and utilities expenses and lower-than-expected rental income from The Mines shopping mall. REITs under our coverage registered growth except for CMMT which recorded a 26% drop in CNI and Al-'Aqar REIT which recorded a slight dip of 3.1%. Other than that, most of the results are within what we had anticipated.

**Figure 1: Summary of REITs earnings in 2QCY19**

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	2QFY19	52.3	38.0%	-26.0%	Below	Due to lower rental income from The Mines shopping mall, higher maintenance expenses and utilities expenses.
2	Axis REIT	24-Jul	2QFY19	55.6	46.0%	9.0%	Within	The better CNI can be attributed to the addition of new assets.
3	Pavilion REIT	25-Jul	2QFY19	128.5	44.0%	1.8%	Slightly below	CNI did not jump as much as revenue, which climbed 10.7% due to higher utility expenses, maintenance expenses, property taxes and other operating expenses.
4	IGB REIT	23-Jul	2QFY19	160.8	49.0%	5.5%	Within	Stable earnings in 1HFY19 supported by the higher rental income from positive rental reversion at Mid Valley Megamall and the Gardens Mall.
5	Sunway REIT	8-Aug	4QFY19	286.5	99.0%	2.0%	Within	The hotel segment (-8%) registered a weaker on-year NPI, which is cushioned by the growth in the retail (+5.0%), office segment (+22%), services (+35%) and industrial segment (+15%). The jump in services segment is due to the newly acquired Sunway University assets.
6	KLCCP Stapled Group	20-Aug	2QFY19	364.3	48.0%	1.3%	Within	Growth in NPI is contributed by the retail and office divisions.
7	AmanahRaya REIT	30-Aug	2QFY19	18.0	47.0%	2.8%	Within	Contribution from Vista Tower more than offset the rental loss at Holiday Villa Alor Setar and Wisma AIC.
8	Al-'Aqar Healthcare REIT	30-Aug	2QFY19	31.2	51.0%	-3.1%	Within	CNI for the period dipped by 3.1% due to maintenance expenses and higher financing costs.

Source: MIDFR

## Earnings forecast largely maintained as earnings are in-line while there are no near-term catalysts.

We maintain most of our earnings assumptions for REITs except for CMMT and Pavilion REIT, which missed our expectation. During the earnings season, we have reduced our CMMT TP from RM1.05 to RM1.01 as we revised our earnings forecast downwards. Elsewhere, we have revised our TP for Axis REIT from RM1.73 to RM1.82, Pavilion REIT from RM1.78 to RM1.79 and IGB REIT from RM1.79 to RM1.90 as we roll over our valuation base year.

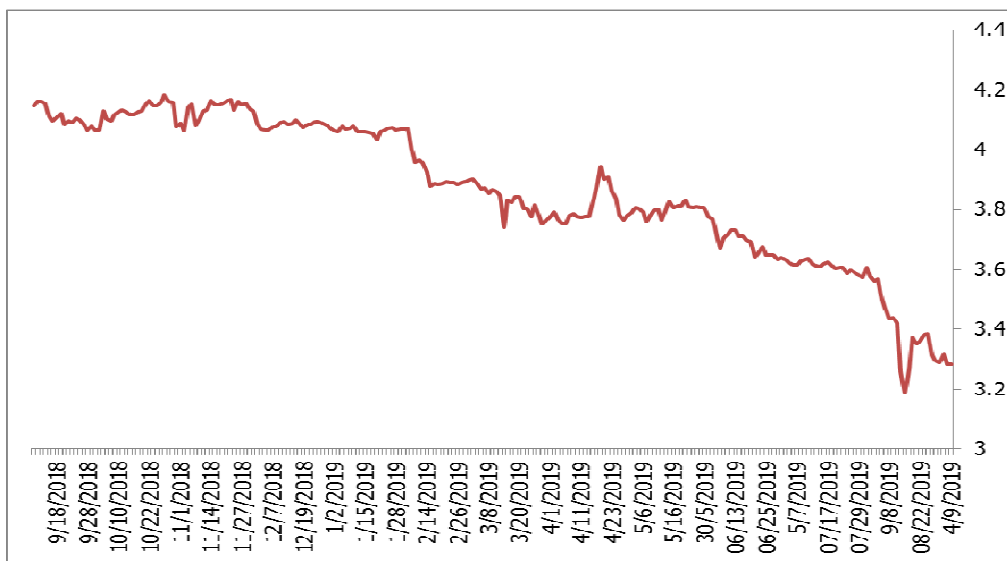
**Figure 2: Peers comparison**

Stock	FYE	Rec.	Price @ 4 Sep	Target Price (RM)	Core EPU (sen)			Core PE (x)		Net DPU		Net Dvd Yield	
					FY18	FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20
AXREIT	Dec	NEUTRAL	1.87	1.83	9.1	9.9	10.4	18.9	18.0	8.7	9.2	4.7	4.9
CMMT	Dec	NEUTRAL	1.03	1.01	6.6	5.4	6.3	18.9	16.2	5.7	6.5	5.5	6.3
IGBREIT	Dec	NEUTRAL	2.07	1.9	8.6	9.3	9.8	22.2	21.1	8.6	9.0	4.1	4.3
PAVREIT	Dec	NEUTRAL	1.87	1.79	8.4	9.2	9.4	20.3	19.9	8.5	8.7	4.6	4.6
KLCC	Dec	NEUTRAL	8.25	7.78	40.3	40.8	42.1	20.2	19.6	35.4	37.6	4.3	4.6
SUNREIT	Jun	BUY	1.95	2.02	9.6	9.7	10.6	20.1	18.4	8.6	9.6	4.4	4.9
ARREIT	Dec	BUY	0.82	0.91	6.3	6.8	6.9	12.1	11.9	5.9	6.0	7.2	7.4
AL-'AQAR	Dec	BUY	1.54	1.49	8.4	8.3	8.6	18.5	17.9	7.0	7.2	4.6	4.7
<b>Average</b>												<b>5.0</b>	<b>5.3</b>


Source: MIDF Research

**10-year MGS yield averages at 3.75% to-date from 3.88% in the previous quarter.** MGS yield has eased by -0.13 ppt during the period. We maintain our 10-year MGS yield assumption of 4.0% for now premised on our house of no further rate cut for 2019. Based on the current year-to-date (ytd) average of 10-year MGS yield, yield spread compared to the average dividend yield of REITs under our coverage has narrowed to 1.25ppt for CY19 and 1.55ppt for CY20, which is not very appealing.

**Figure 3: 10-Year MGS yield**



Source: Bloomberg, MIDFR

**Maintain NEUTRAL as positives are largely priced-in.** We maintain NEUTRAL on the REIT sector as we believe that most of the near-term positives are largely priced in, leaving limited room for unit price appreciation. Based on REITs under our coverage, they have advanced by an average of 11.7% ytd. Among the top gainers that saw unit prices jumping ~20% to-date are Axis REIT, IGB REIT and Al-'Aqar, which also lifted their core PE as a result. Meanwhile, the average yield spread compared to 10-year MGS is not very appealing at 1.35ppt. Our top pick for the sector is **Sunway REIT (BUY; TP: RM2.02)** due to the stable income growth from Sunway Pyramid and more balanced portfolio. We also have a BUY recommendation on **Amanahraya REIT (TP:RM0.91)** due to its exposure to the education asset, diversified asset base and an attractive yield of about 7%. 

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#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> 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 <i>fall</i> 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.