07 December 2017 | 3QCY17 Earnings Wrap

REITs

***Maintain* NEUTRAL**

Still holding on well

KEY HIGHLIGHTS

- **3QCY17 earnings of most REITs under coverage met expectations**
- **Unwavering appetite for new assets**
- **Fine-tuning our assumptions**
- **MGS yield continues to tread under 4.0%**
- **We remain NEUTRAL on the sector with SUNWAY REIT (BUY; TP: RM1.91) as Top Pick. We also have BUY call on AmanahRaya REIT (TP: RM1.11)**

3QCY17 earnings of REITs under coverage met expectations. Results for five out of the seven REITs that we track were largely in-line with our full year forecasts. Sunway REIT, our top pick of the sector, registered highest earnings growth (+18%yoy) driven by better performance across segments namely, retail, hotel and industrial. On the other hand, Amanahraya REIT (ARREIT) registered 9MFY17 earnings that were below expectation, making up 68% of our forecast due to higher property and non-property expenses.

Sunway REIT is our sector top pick. Sunway Pyramid is still Sunway REIT's main CNI driver, followed by Sunway Pyramid Hotel which had opened its doors to guests since completion of refurbishment in June 2017. Meanwhile, Sunway Putra Mall benefited from the SEA Games and ASEAN Para Games which took place in August and September as occupancy rates and average daily rates increased. The industrial asset in Shah Alam has also started its earnings contribution.

Higher expenses a drag for some. Pavillion REIT and ARREIT saw earnings declined on-year by -7.5% each due to higher property costs. As for CMMT, the shrinking earnings were mainly attributed to lower net property income (NPI) mainly from Sungei Wang Plaza and The Mines. Meanwhile, KLCCP 9MFY17 earnings slipped marginally -1.2%yoy as a result of lower retail contribution.

Strategic retail malls should see a better 4QCY17. Results for REITs under our portfolio were generally mixed due to their asset portfolio and expansion strategies. Three REITs recorded earnings growth while NPI for four REITs were lower on-year. We expect the retail segment to see a better sequential quarter due to the school holiday and year-end sales and festive season. A higher quarter-on-quarter income is expected for Sunway REIT, IGB REIT, Pavillion REIT and KLCCP. Although CMMT is also highly exposed to the retail segment, we only expect a flattish to slightly positive on-quarter growth due to higher advertising and promotional expenses to attract shoppers as well as lower occupancy rate at Tropicana Office Tower.

Figure 1: Summary of REITs earnings in 3QCY17

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-Oct	3QFY17	120.2	72.0%	-2.0%	Slightly below	Weaker earnings due to lower net property income from Sungei Wang Plaza (rental reversion of -23.2%) and The Mines (loss of an anchor tenant and rental reversion of -5.4%)
2	Axis REIT	23-Oct	3QFY17	68.6	74.0%	1.0%	Within	Earnings contribution from Scomi Facility in Rawang and Kerry warehouse cushioned loss of income from Axis Eureka (sold in March 2017)
3	Pavilion REIT	26-Oct	3QFY17	166.8	72.0%	-7.5%	Within	Lower earnings due to higher property expenses, higher borrowing cost higher maintenance cost incurred for Pavilion KL shopping mall
4	IGB REIT	8-Nov	3QFY17	226.2	77.9%	9.0%	Within	Earnings growth driven by positive rental reversion and write-back of step-up interest rate
5	Sunway REIT	31-Oct	1QFY18	78.7	27.5%	18.0%	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	13-Nov	3QFY17	532.4	74.0%	-1.2%	Within	Marginally lower earnings were due to slightly weaker contribution from retail division."
7	AmanahRaya REIT	24-Nov	3QFY17	25.0	67.9%	-7.5%	Below	Topline growth of 5.2%yoy was offset by higher property operating expenses and higher manager's fees

Source: MIDF Research

Unwavering appetite for new assets. Notably, ARREIT has announced one of its landmark deals, i.e. the RM455m acquisition of Vista Tower at Intermark. This marks its largest purchase to-date and will catapult its total assets value to the top 10 among listed REITs on Bursa (excluding KLCCP) from number 12 currently. Meanwhile, Axis REIT is also on a roll, announcing its second green field project, which is a build-to-suit manufacturing facility for its existing tenant Upeca in this quarter. The RM73.2m plant is expected to be completed by end-2018. Recall that Axis REIT has announced to buy a pipe-coating factory in Kuantan on 24th July for RM155m and the deal has been completed, bringing its total number of assets to 40. We believe that the appetite for industrial assets will still be healthy as REIT managers continue their quest to hunt for yield accretive assets and industrial assets generally provide relatively stable medium to longer term income.

Fine-tuning our assumptions. We have made several minor changes to our assumptions, which resulted in adjustments of our target price for a few REITS during the quarter. Among others, target price for Sunway REIT was revised from RM1.93 to RM1.91 due to housekeeping. As for ARREIT, we lowered its TP from RM1.15 to RM1.11 to incorporate higher than expected property and non-property expenses. We have also revised CMMT's TP from RM1.69 to RM1.65 to factor in lower than expected rental reversion. At the meantime, Axis REIT's EPU and DPU assumptions were lowered after the recent private placement, which has increased its share base by 11% to 1.23 billion. The dilution effect is partially offset by higher interest savings estimated at 7.5%.

Changes in recommendations. We have made some changes to our calls in the latest reporting season to reflect the change in our stock recommendation percentage thresholds (from +15%/-15% to +10%/-10%). Following the thresholds change, we have upgraded Axis REIT and IGB REIT to BUY from NEUTRAL previously.

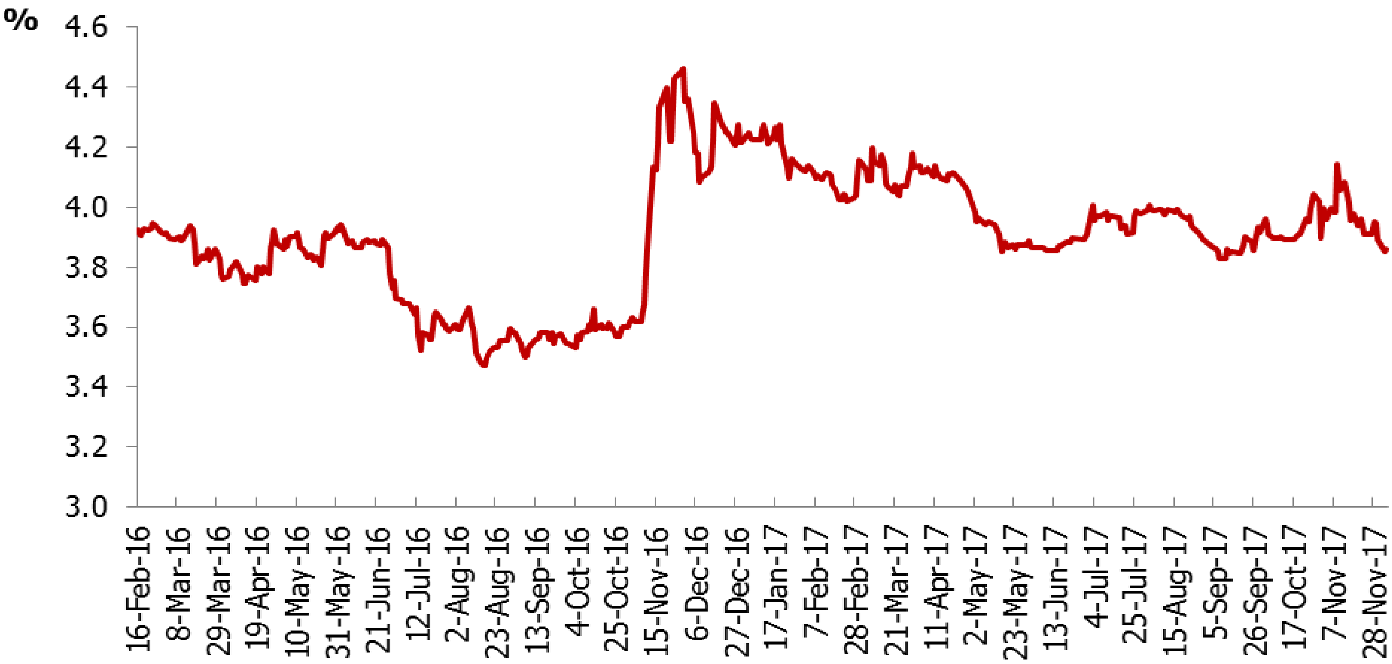
Figure 2: Peers comparison

Stock	FYE	Rec.	Price @ 6-Nov	Target Price (RM)	Core EPU (sen)			Core PE (x)		Net DPU		Net Dvd Yield	
					FY16	FY17	FY18	FY17	FY18	FY17	FY18	FY17	FY18
AXREIT	Dec	BUY	1.46	1.66	8.4	8.3	9.3	17.6	15.7	7.4	8.2	5.1	5.6
CMMT	Dec	NEUTRAL	1.42	1.65	8.1	8.1	8.5	17.5	16.8	7.6	7.8	5.4	5.5
IGBREIT	Dec	BUY	1.59	1.73	8.1	8.3	8.8	19.1	18.0	8.0	8.5	5.0	5.3
PAVREIT	Dec	NEUTRAL	1.64	1.70	7.8	7.7	8.6	21.4	19.1	7.1	7.9	4.3	4.8
KLCC	Dec	NEUTRAL	7.80	7.60	39.8	40.1	40.7	19.5	19.2	35.1	35.6	4.5	4.6
SUNREIT	Jun	BUY	1.65	1.91	8.6	9.2	9.7	18.0	17.0	8.3	8.7	5.0	5.3
ARREIT	Dec	BUY	0.94	1.11	6.2	6.0	6.5	15.6	14.4	5.2	5.7	5.6	6.1
Average												**5.0**	**5.3**

Source: MIDF Research

MGS yield continues to tread under 4.0%. During the quarter, MGS yield averaged at 3.94%. Compared to the previous quarter, MGS yield has decreased marginally by 0.02ppt. We expect that MGS will continue to average at just below 4.0% in the coming quarter. Overall, we maintain our MGS yield assumption at 4.0%. The spread between our anticipated REITs yield and MGS yield are 1.0% and 1.3% for FY17F and FY18F respectively.

Figure 3: 10-Year MGS yield



Source: Bloomberg, MIDF Research

Maintain NEUTRAL on REITs sector. We maintain NEUTRAL on the REITs sector due to the lack of imminent catalyst that will change the outlook of the sector. The spread between our expected REITs yield and MGS yield is also narrow at 1.0% for FY17 and 1.3% for FY18. Our top pick for the sector is Sunway REIT (BUY; TP: RM1.91) due to its positive earnings outlook that is backed by positive rental reversion from Sunway Pyramid and higher contribution from the hotel segment. We also have a BUY call on AmanahRaya REIT (TP: RM1.11) for its diversified assets base with exposure to education property and attractive dividend yield of 5.7%. Furthermore, our two new BUY calls are for IGB REIT and Axis REIT. We like IGB REIT for its ability to command positive rental reversion for its crown jewel Mid Valley Megamall and Axis REIT for its niche in industrial assets, which provide stable income.

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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.