

REITs

Maintain NEUTRAL

Lack of fresh catalyst in the near-term

KEY INVESTMENT HIGHLIGHTS


- **3QCY19 earnings of REITs largely in-line**
- **Minimal impact seen from OPR rate cut on REITs**
- **Property expenses climbing for some REITs, mitigating the growth in rental income**
- **Maintain NEUTRAL. Top pick is Sunway REIT (TP: RM2.02)**

3QCY19 earnings of REITs largely in-line. Out of the eight REITs in our universe, five met our full year earnings estimates while three missed mainly due to higher than expected property and/or non-property expenses. Five REITs, namely, Axis REIT (+1.0%), IGB REIT (+5.4%), Sunway REIT (+1.0%), KLCC Stapled Group (0.8%) and Amanahraya REIT (+3.6%) registered positive cumulative on-year growth. REITs that registered flat core net income were Pavilion REIT and Al-Aqar Healthcare REIT. CMMT is the only REIT that registered a decline in earnings at 21% lower compared to a year ago.

Minimal impact seen from OPR rate cut on REITs. We note that the impact of the 25bps overnight policy rate (OPR) cut in May on REITs 3QFY19 has been minimal as most REIT managers increase their floating rate loans by less than 6ppt compared to a year ago with most hovering below 60:40 float to fixed ratio. Some REIT managers maintain most of their loans at high fixed ratio. Our house economists expect OPR to maintain at 3.0% this year and one rate cut in 2020, bringing OPR to 2.75% in 2020.

10-year MGS yield averages at 3.75% to-date. The spread between MGS 10-year yield and REITs under our coverage stood at 1.4ppt, which is not very attractive at the moment. MGS average yield to-date is largely unchanged compared to the previous quarter. However, on YTD basis, the KL REITS sector index is sitting at a return of 5.15%, outshining the FBMKLCI's -7.51% decline.

Property expenses climbing for some REITs, mitigating the growth in rental income. During the quarter, we notice that the core net income (CNI) of several REITs did not climb as much as their rental income. Among others, Axis REIT's revenue was up by 12% for 9MFY19 but CNI was only up by 1% due to property expenses that climbed 8.1% and non-property expenses that was up by 5.2%. Pavilion REIT's revenue grew by 7.7%yoy but earnings dipped by 0.3% during the period as property expenses rose by 16.0%yoy.

Maintain NEUTRAL. Top pick is Sunway REIT (TP: RM2.02) We continue to prefer **Sunway REIT (BUY; TP: RM2.02)** among the REITs we cover for its stable income growth from Sunway Pyramid Shopping Mall and more balanced asset portfolio. We have downgraded **Amanahraya REIT to NEUTRAL (previously BUY); TP: RM0.79** as we anticipate a more challenging environment for some of its assets, which may taper its income growth going forward. Meanwhile, we maintain our recommendations for other REITs under our coverage save for adjustments in target prices. 

COMPANY IN FOCUS

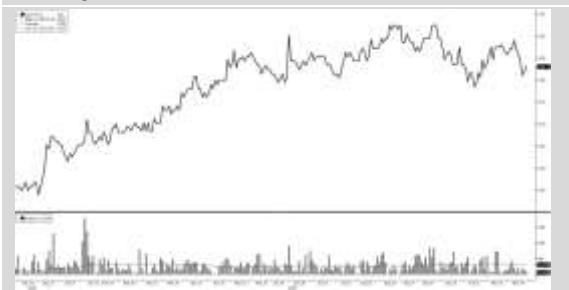
Sunway Real Estate Investment Trust

Maintain **BUY** | Unchanged Target price: RM2.02

Price @ 5th December 2019: RM1.83

- Sunway REIT continues to deliver on-year CNI growth
- The REIT manager looks to expand its portfolio further into the services sector that provides long-term recurring rental income
- Its main rental income contributor, Sunway Pyramid Shopping Mall, is expected to register positive rental reversion

Share price chart



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Figure 1: Summary of REITs earnings in 3QCY19

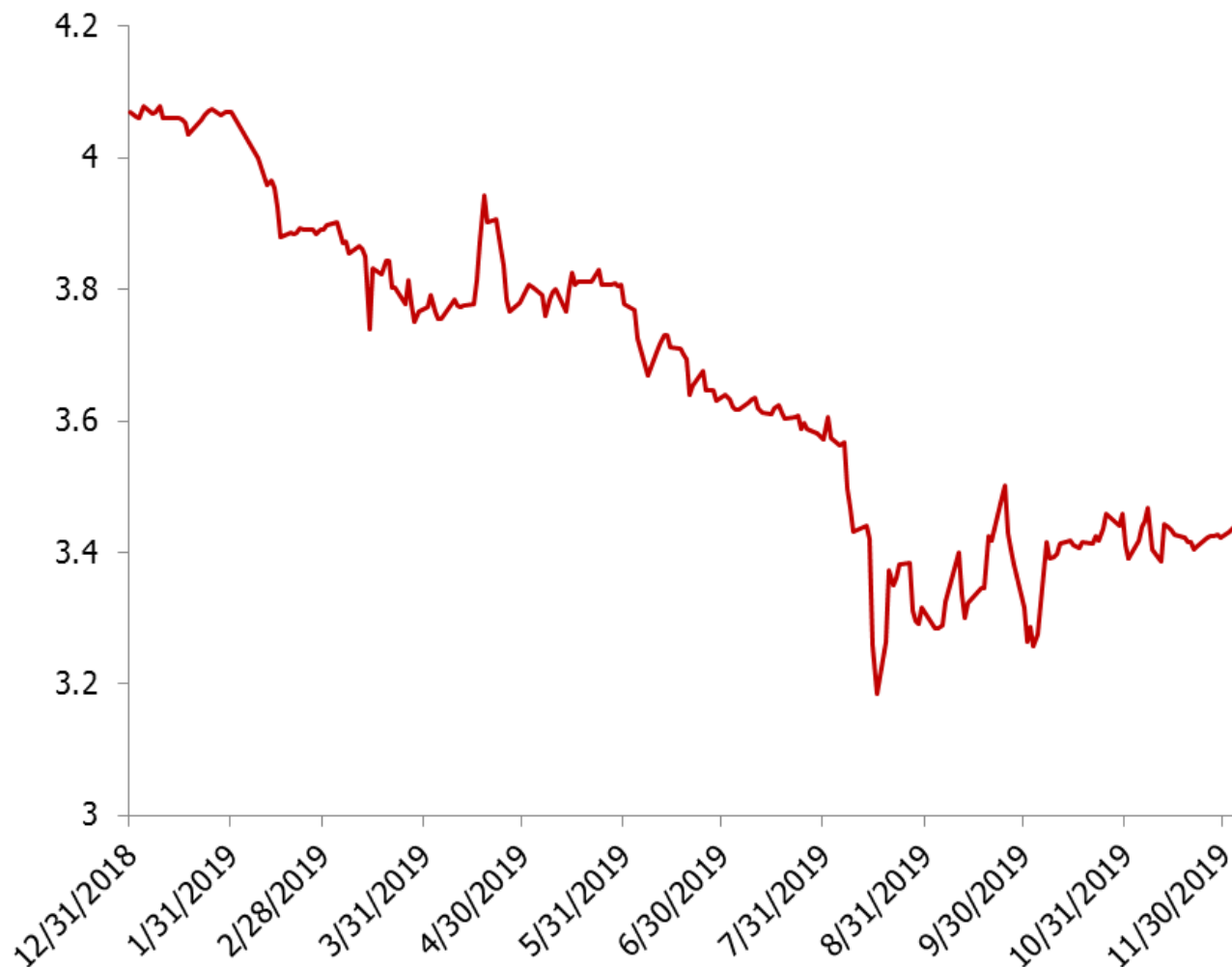
No	Stock	Date of earnings released	Period Under Review	Cumulative Qtr Core Net Income (RM m)	Core Net Income % of our estimate	Earnings growth (yoy)	Against Estimates	Comment
1	CMMT	24-Oct	3QFY19	80.7	73.0%	-21.0%	Within	The lower yoy CNI can be attributed to negative rental reversions at Sungei Wang Plaza (-16.4%), 3 Damansara (-5.5%) and the Mines Shopping Mall (-16.0%)
2	Axis REIT	21-Oct	3QFY19	81.8	67.0%	1.0%	Below	Revenue for the period was up by 12%yoy but CNI improved by only 1% due to higher property and non-property expenses.
3	Pavilion REIT	24-Oct	3QFY19	187.9	67.0%	0.3%	Below	Earnings did not grow in tandem with revenue, which was up by 7%yoy for the period mainly due to higher than expected property expenses that jumped by 16%yoy.
4	IGB REIT	23-Oct	3QFY19	240.6	73.0%	5.4%	Within	Higher rental income from positive rental reversion at Mid Valley Megamall and the Gardens Mall continues to drive growth. Meanwhile, finance costs and operating expenses remain stable.
5	Sunway REIT	5-Nov	1QFY20	73.7	24.0%	1.0%	Within	Net Property income (NPI) for the hotel segment rose by 7% while the office segment NPI jumped by 11%. Sunway University and College, which was acquired earlier this year has also started its contribution.
6	KLCCP Stapled Group	11-Nov	3QFY19	181.4	72.0%	0.8%	Within	Higher rental rate and strong advertising income cushioned loss from retail income due to the reconfiguration exercise. Meanwhile, hotel segment loss has narrowed further.
7	AmanahRaya REIT	25-Nov	3QFY19	27.1	70.0%	3.6%	Below	Holiday Villa Alor Setar and Wisma AIC remain vacant during the quarter, prompting us to take a more cautious view on its rental income prospects. We expect CNI growth rate to taper going forward.
8	Al-'Aqar Healthcare REIT	21-Nov	3QFY19	16.1	77.0%	0.0%	Within	Higher financing cost, higher property maintenance fee and higher administrative expenses offset revenue that grew by 3.5%.

Source: MIDFR

Figure 2: Peer Comparison Table

Stock	FYE	Rec.	Price @ 30 Nov	Target Price (RM)	Core EPU (sen)			Core PE (x)		Net DPU (sen)		Net Dvd Yield (%)	
					FY18	FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20
AXREIT	Dec	NEUTRAL	1.78	1.83	9.1	9.7	10.5	18.4	17.0	8.6	9.2	4.8	5.2
CMMT	Dec	NEUTRAL	1.04	1.01	6.6	5.4	6.3	19.1	16.4	5.7	6.5	5.5	6.3
IGBREIT	Dec	NEUTRAL	1.92	1.90	8.6	9.3	9.8	20.6	19.6	8.6	9.0	4.5	4.7
PAVREIT	Dec	NEUTRAL	1.80	1.79	8.4	8.7	9.1	20.7	19.9	8.0	8.4	4.4	4.7
KLCC	Dec	NEUTRAL	8.00	7.78	40.3	40.8	42.1	19.6	19.0	35.4	37.6	4.4	4.7
SUNREIT	Jun	BUY	1.86	2.02	9.6	9.7	10.6	19.2	17.5	8.6	9.6	4.6	5.1
ARREIT	Dec	NEUTRAL	0.76	0.91	6.3	6.4	6.6	12.0	11.5	5.5	5.7	7.2	7.5
AL-'AQAR	Dec	NEUTRAL	1.46	1.49	8.4	8.3	8.6	17.5	17.0	7.0	7.2	4.8	4.9
Average												5.1	5.4

Source: Company, MIDFR

Figure 3: Ytd 10-Year MGS yield

Source: Bloomberg

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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 <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.