

18 July 2016 | Sector Update

## REITs

*Lower MGS yield a boon for REITs*

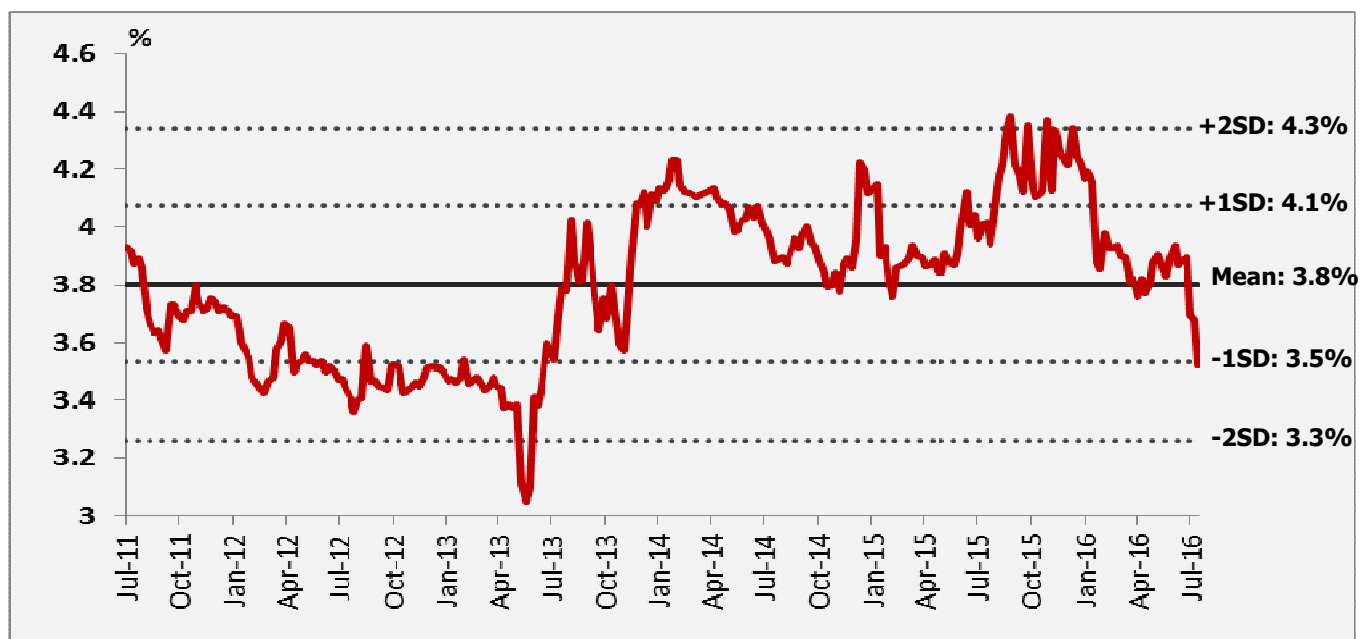
**Maintain NEUTRAL (positive bias)**

### KEY HIGHLIGHTS

- **10-Year MGS yield fell to 2-year low**
- **Lower MGS yield a boon for REITs**
- **Lowering our MGS yield assumption to 3.75%**
- **Target prices for REITs revised higher as we lowered our MGS yield assumption**
- **We remain NEUTRAL (positive bias) on the sector with our top pick being CMMT (BUY; TP: RM1.69)**

**10-Year MGS yield fell to 2-year low.** 10-Year Malaysian Government Securities (MSG) yield came off recently, falling to 2-year low of 3.52% last Thursday before increasing slightly to 3.58% on Friday. The latest decline in MGS yield can be attributed to the surprise Overnight Policy Rate (OPR) cut by Bank Negara Malaysia. The OPR cut boosted demand for yield assets, raising the price for MGS and hence compressing MGS yield further. Earlier on, MGS yield dropped due to heightened demand for safe haven assets during market uncertainties arose by Brexit. It is also noteworthy that the current 10-Year MGS yield of 3.58% is near its 5-year minus 1 standard deviation level of 3.5%.

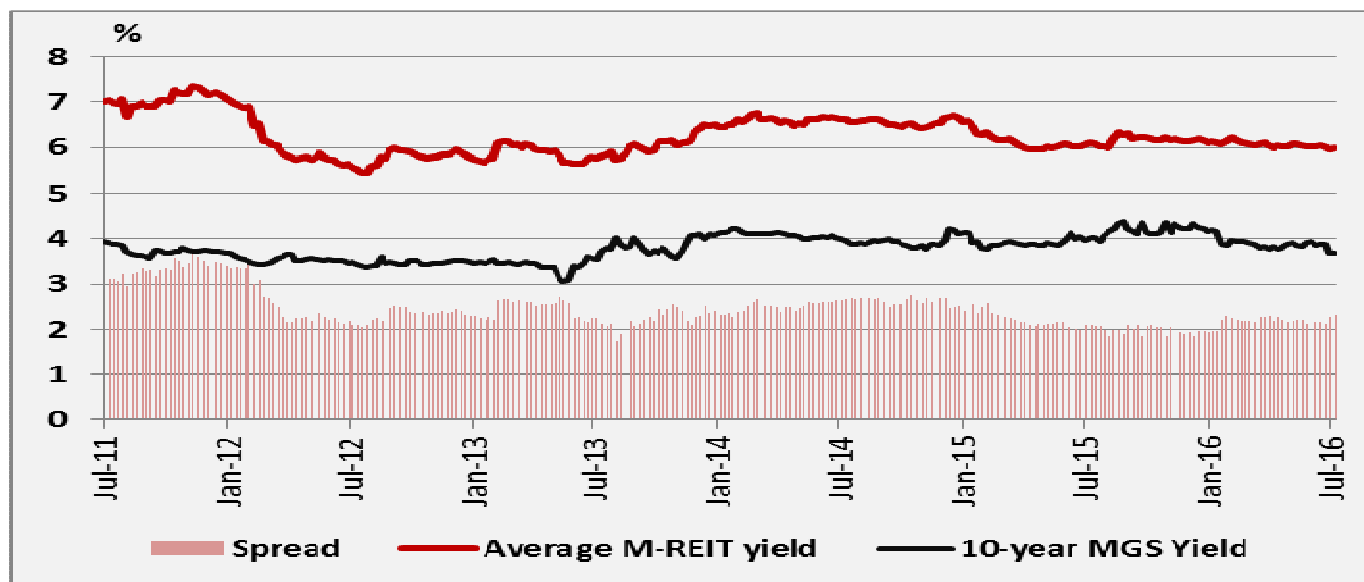
**Figure 1: 10-Year MGS Yield**



Source: Bloomberg, MIDF Research

**Lower MGS yield a boon for REITs.** Lower MGS yield following Brexit and OPR cut is a boon for REITs as lower MGS yield widened the spread between MGS yield and REIT yield and hence improves the attractiveness of REIT which is now commanding higher yield premium.

**Figure 2: Spread between 10-Year MGS yield and M-REIT yield**



Source: Bloomberg, MIDF Research


**Lowering our MGS yield assumption to 3.75%.** We are keeping our view that short-term demand for MGS will remain underpinned by flight to safety amid market uncertainties, hence we do not expect MGS yield to bounce back sharply in the short term. Thus, we are revising our MGS yield assumption by 25 basis points to 3.75% from 4.0%. We also expect MGS yield to be less volatile going forward as frequency of rate hikes by U.S. Federal Reserve may be lower than earlier expected.

**Target prices for REITs revised higher.** We increased the target prices for REITs under our coverage following the revision of MGS yield assumption which translates into lower discount rate in our Dividend Discount Model (DDM) valuation. Target price (TP) for Axis REIT has been raised by 2.3% to RM1.75 (from RM1.71); CMMT TP revised upward by 1.8% to RM1.72 (from RM1.69); IGB REIT TP revised upward by 2.5% to RM1.67 (from RM1.63); KLCCP Stapled Group TP increased by 2.8% to RM7.30 (from RM7.10); Pavilion REIT TP revised upward by 3.4% to RM1.79 (from RM1.73); and Sunway REIT TP raised by 3% to RM1.67 from RM1.62.

**Table 1: Changes to Target Price (TP) after MGS yield assumption revised to 3.75%**

No	Stock	Previous MGS Assumption	Previous TP (RM)	New MGS assumption	New TP (RM)	Changes in TP (%)
1	AXREIT	4.00%	1.71	3.75%	1.75	+2.3%
2	CMMT	4.00%	1.69	3.75%	1.72	+1.8%
3	IGBREIT	4.00%	1.63	3.75%	1.67	+2.5%
4	KLCCP	4.00%	7.10	3.75%	7.30	+2.8%
5	PAVREIT	4.00%	1.73	3.75%	1.79	+3.4%
6	SUNREIT	4.00%	1.62	3.75%	1.67	+3.0%

Source: MIDF Research

**Maintain Neutral with positive bias on the sector.** We are keeping our Neutral rating but with positive bias on REITs sector. We reiterate our view that REITs would continue to be benefited from flight to safety as it is perceived as a safe haven in time of uncertainty while the recent decline in MGS also improves attractiveness of REIT. Meanwhile, we reckon that retail sales outlook should improve going forward after Malaysian retail industry recorded a 4.4%yoy decrease in sales for 1Q2016 which was owing to high base effect in 1Q2015. Our expectation of improving retail sales is banking on recovery in consumer sentiment. Note that Consumer Sentiment Index in 1Q2016 rebounded to 72.9 from all-time low of 63.8 in 4Q2015, indicating potential recovery in consumer spending. 

**Top pick for REITs sector: CMMT (BUY; revised TP: RM1.72).** We like CMMT for its decent dividend yield of 5.3% while full year rental contribution from Tropicana City asset is expected to more than sufficient to offset the lower contribution from Sungei Wang Plaza. Meanwhile, we **downgrade IGBREIT to Neutral from BUY with a revised TP of RM1.67** following the good run of share price which hit our TP. While we remain in favour of its stable rental incomes from Mid Valley Megamall and The Gardens Mall which translate into minimal earnings risk to unit holders, dividend yield had tapered off to 4.8% following the spike in share price. Meanwhile, we maintain our Neutral call for Axis REIT (revised TP: RM1.75), KLCCP Stapled Group (revised TP: RM7.30), Pavilion REIT (revised TP: RM1.79), and Sunway REIT (revised TP: RM1.67).

**Table 2: Peers Comparison**

Stock	FYE	Rec.	Price @ 15-July	Target Price (RM)	Core EPU (sen)			Core PE (sen)		Net DPS		Net Dvd Yield	
					FY15	FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17
AXREIT	Dec	NEUTRAL	1.76	1.75	8.3	9.2	9.5	19.1	18.4	8.1	8.4	4.6	4.8
CMMT	Dec	BUY	1.55	1.72	8.2	8.7	8.8	17.9	17.5	8.3	8.4	5.3	5.4
IGBREIT	Dec	BUY	1.67	1.67	7.4	7.8	8.4	21.5	20.0	7.9	8.5	4.8	5.1
PAVREIT	Dec	NEUTRAL	1.8	1.79	8.0	8.7	9.8	20.6	18.4	8.1	9.0	4.5	5.0
SUNREIT	Jun	NEUTRAL	1.73	1.67	8.2	8.6	9.0	20.2	19.2	8.0	8.4	4.6	4.9
KLCC	Dec	NEUTRAL	7.56	7.3	38.3	39.8	40.1	19.0	18.9	34.9	35.9	4.6	4.7
<b>Average</b>												<b>4.74</b>	<b>4.99</b>

Source: MIDF Research

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### MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.