

29 March 2016 | Sector Update

REITs

MGS yield expectation lowered

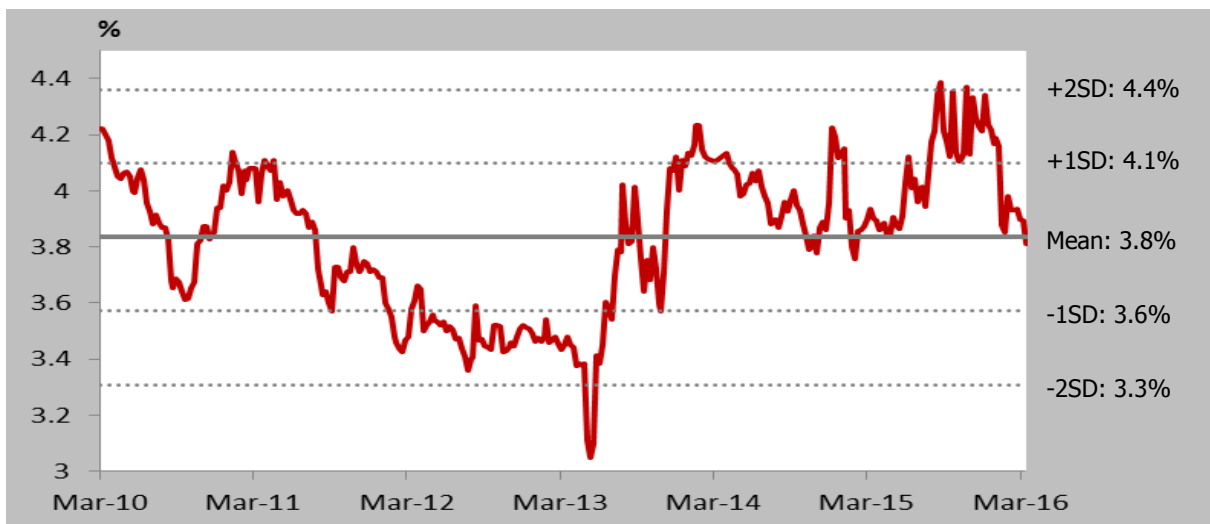
Maintain NEUTRAL

KEY HIGHLIGHTS

- **10-Year MGS yield has tapered off**
- **Lower our MGS yield assumption to 4.00% (from 4.45%)**
- **The decline in MGS yield improves the attractiveness of REITs with the increase in spread between M-REITs and 10 Year MGS Yield**
- **Target prices for REITs revised higher as we tweak our MGS yield assumption lower**
- **We remain NEUTRAL on the sector with Top Picks being IGBREIT (BUY; TP: RM1.63) and CMMT (BUY; TP: RM1.69)**

10-Year MGS yield tapered off - Our earlier expectation of higher volatility for MGS yield due to U.S. interest rate hike had somewhat materialised as MGS yield spiked to 4.37% in December following the hike in U.S. Fed rate in December. Recall that we expect greater volatility in MGS yield in 2016 due to mixed views on the frequency of interest rate hikes by US Fed Reserve in 2016. Nevertheless, MGS yield has tapered off lately and has stabilised at 3.80% level following the return of funds to Malaysia's bond market.

Figure 1: 10-Year MGS Yield

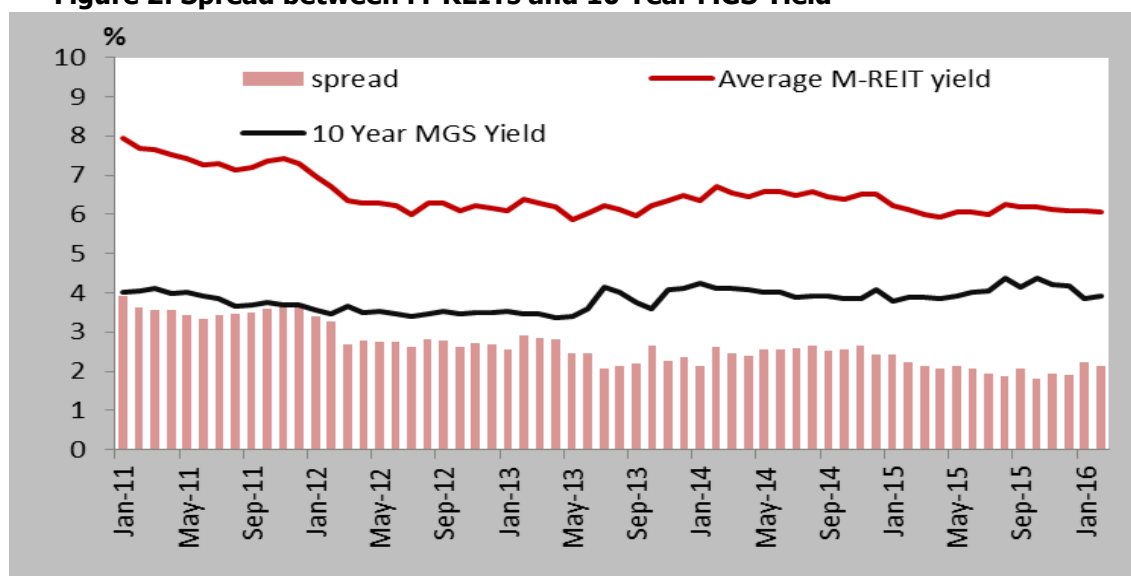


Source: Bloomberg, MIDFR

Our MGS yield assumption is now lower at 4.0% - In view of the stabilising MGS yield, we are revising our MGS yield assumption to 4.00% from 4.45%. We expect MGS yield to be less volatile going forward based on the latest Federal Open Market Committee (FOMC) statement by Federal Reserve which highlighted that the rate hike will be twice this year instead of four rounds as mentioned earlier in last December.

Lower MGS yield improves attractiveness of REITs - Lower MGS yield is positive to REITs as the spread between dividend yield of REITs and MGS yield has widened.

Figure 2: Spread between M-REITs and 10 Year MGS Yield



Source: Bloomberg, MIDFR

Target prices for REITs revised higher - We increase 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 1.8% to RM1.71 (from RM1.68); CMMT TP revised upwards by 1.8% to RM1.69 (from RM1.66); IGB REIT TP revised upwards by 1.9% to RM1.63 (from RM1.60); KLCCP Stapled Group TP increased by 2.3% to RM7.10 (from RM6.94); Pavilion REIT TP revised upwards by 2.5% to RM1.67 (from RM1.63); and Sunway REIT TP raised by 2.5% to RM1.62 from RM1.58. Overall, the increase in Target Prices has been minimal and our recommendations remain intact.

Table 1: Changes to Target Price (TP) after MGS yield assumption revised to 4.0%

No	Stock	Previous MGS Assumption	Previous TP (RM)	New MGS assumption	New TP (RM)	Changes in TP (%)
1	AXREIT	4.45%	1.68	4.00%	1.71	+1.8%
2	CMMT	4.45%	1.66	4.00%	1.69	+1.8%
3	IGBREIT	4.45%	1.60	4.00%	1.63	+1.9%
4	KLCCP	4.45%	6.94	4.00%	7.10	+2.3%
5	PAVREIT	4.45%	1.63	4.00%	1.67	+2.5%
6	SUNREIT	4.45%	1.58	4.00%	1.62	+2.5%

Source: MIDFR

Maintain Neutral on REITs sector - We maintain our Neutral rating on REITs sector as outlook for retail and office segment of Malaysian property market remains unexciting. However, rental reversion for retail segment is expected to stay positive with a marginal increase due to the slow recovery in consumer sentiment. Outlook for office segment looks to remain challenging due to oversupply of office space which is expected to cause a compression in rental rates. Nevertheless, the decline MGS yield is positive for the REITs sector as it improves the appeal of REITs.


Top Picks for REITs sector: IGB REIT (BUY; revised TP: RM1.63) and CMMT (BUY; revised TP: RM1.69) - Despite of the cautious consumer sentiment, we are still expecting positive rental reversions for IGBREIT (+3.0%) and CMMT (+1.8%). We expect the good location of Mid Valley Megamall to be supportive to IGBREIT rental reversion. As for CMMT, we expect positive rental reversion from three malls (East Coast Mall, Gurney Plaza, The Mines and Tropicana) while the new full year rental contributions from Tropicana City asset is expected to more than sufficient to offset the negative rental reversion from Sungei Wang Plaza. Portfolio occupancy rate for IGBREIT and CMMT is still strong at 99.3% and 96.0% respectively. We also expect CMMT and IGBREIT to deliver decent dividend yields of 5.7% and 5.2% respectively which will be above peers' average of 5.1%. We are NEUTRAL on KLCCP Stapled Group (TP: RM7.10), Axis REIT (TP: RM1.71), Pavilion REIT (TP: RM1.67) and Sunway REIT (TP: RM1.62). 

Table 2: Peers Comparison

Stock	FYE	Rec.	Price @ 28-March	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	1.55	1.71	8.3	9.2	9.5	16.8	16.2	8.1	8.4	5.3	5.4
CMMT	Dec	BUY	1.44	1.69	8.2	8.7	8.8	16.6	16.3	8.3	8.4	5.7	5.9
IGBREIT	Dec	BUY	1.52	1.63	7.4	7.8	8.4	19.5	18.2	7.9	8.5	5.2	5.6
PAVREIT	Dec	NEUTRAL	1.69	1.67	8.0	8.4	9.6	20.1	17.6	7.8	8.8	4.6	5.2
SUNREIT	Jun	NEUTRAL	1.57	1.62	8.2	8.6	9.0	18.3	17.4	8.0	8.4	5.1	5.4
KLCC	Dec	NEUTRAL	7.16	7.1	32.4	33.8	34.9	21.2	20.5	34.9	35.2	4.9	4.9
Average												5.13	5.40

Source: MIDFR

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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.