

22 January 2018 | Sector Update

REITs

Maintain NEUTRAL

Minor earnings impact from potential rate hike

KEY HIGHLIGHTS

- **Potential earnings impact of -0.2% to -2.1% for REITs from higher borrowing costs**
- **Price movements of REITs mixed from previous rate hike**
- **Maintaining our estimates until actual announcement of the rate hike**
- **We remain NEUTRAL on the sector with SUNWAY REIT (BUY; TP: RM1.91) as our Top Pick.**

Potential earnings impact of -0.2% to -2.1% for REITs from higher borrowing costs. Market is expecting an announcement of a 25bps increase in overnight policy rate (OPR) to be announced later this Thursday. Some had even predicted the possibility of two rate hikes of 25 bps each for 2018 while our house expects only one rate hike this year. Based on our sensitivity analysis, EPU of REITs under our coverage are limited to -0.2% to -2.1% if there is one rate hike of 25bps. REITs with higher floating rate loans are more likely to be affected by the increase in interest rate. Among the REITs that we cover, Amanahraya REIT's loans are all based on floating rates. Conversely, IGB REIT's floating rate loans was only kept at 1%. We gather that REIT managers are working on converting part of their floating rate loans to fixed rate loans to mitigate the risk of potentially higher interest costs.

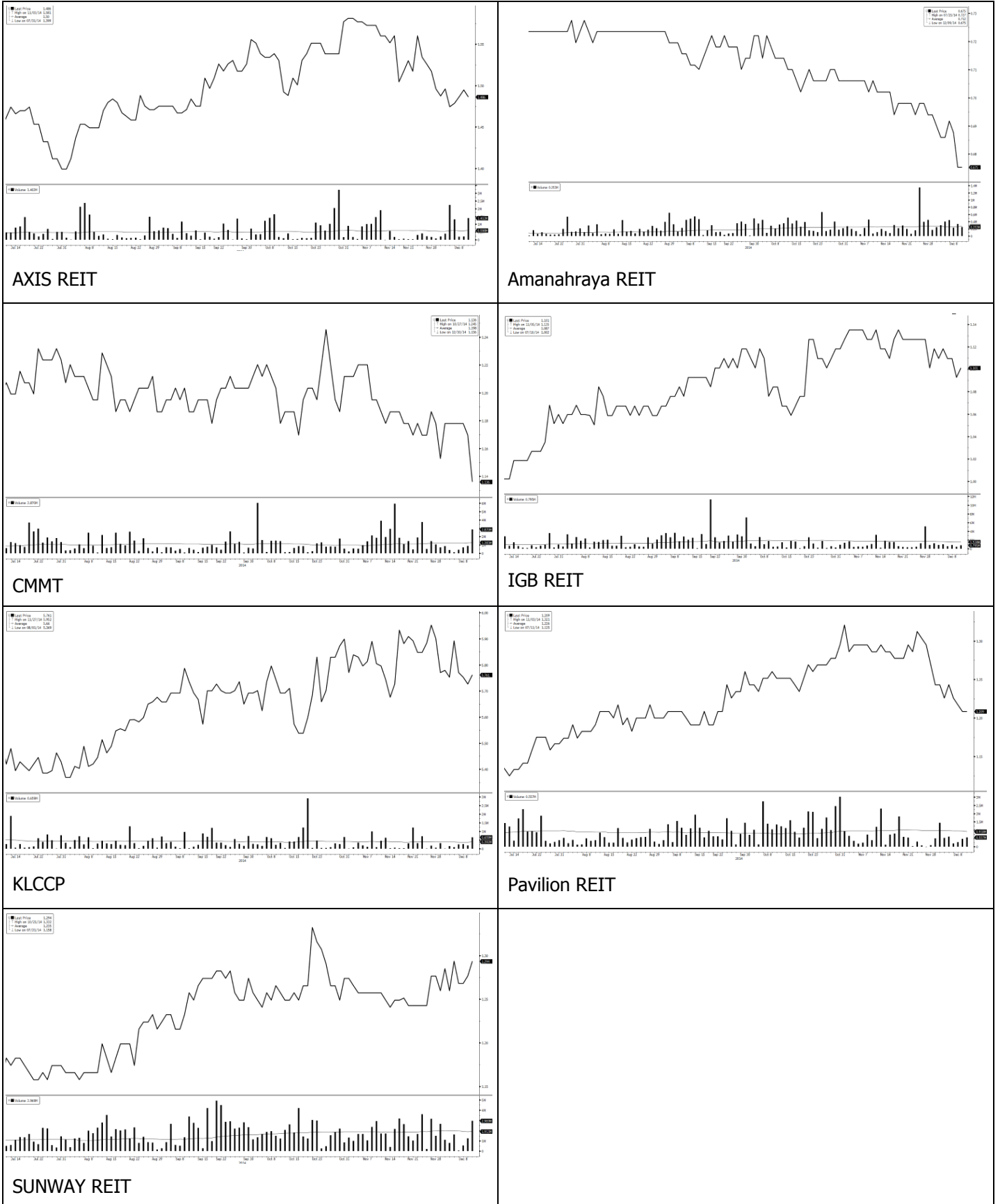
Exhibit 1: Ratio of floating rate loans among REITs

REITs	Floating rate loan
IGB REIT	1.0%
KLCCP	16.0%
Sunway REIT	18.0%
CMMT	19.0%
Axis REIT	63.0%
Pavilion REIT	79.0%
Amanahraya REIT	100.0%

Source: REITs, MIDF Research

Price movements of REITs mixed from previous rate hike. Although a rate hike may have adverse impact to the bottomlines of REITs notably due to higher borrowing costs and potentially a slightly narrower spread between 10-year MGS yield and dividend yields from REITs, other factors at play may change the dynamic of the unit price movement. For instance, when Bank Negara announced a 25bps rate increase on July 10, 2014, price movements of REITs were mixed. Of the seven REITs under our coverage, only two REITs showed downward price movement of -5.9% (CMMT) and -6.7% (Amanahraya REIT). The rest had showed positive movement from the period of July 10, 2014 until December 10, 2014 (refer to Exhibit 2).

Exhibit 2: Performance of REITs from 10th July 2014 until 10th Dec 2014




Maintaining our estimates until actual announcement of the rate hike. We keep our estimates unchanged until the actual announcement of the rate hike. Based on our estimation, Amanahraya REIT may experience the most change in target price (TP) from the rate hike as all its borrowings are based on floating rates. This is followed by Axis where its target price may be affected by -1.2% with one rate hike, Pavilion REIT by -1.18%, Sunway REIT by -0.52%, KLCCP by -0.1 while there are no changes to the TPs for CMMT and IGB REIT.

Exhibit 3: Potential impact on REITs under our coverage with one or two rate hikes

FY18	As is			One rate hike			Two rate hikes		
	Core EPU	Net DPU	TP	Core EPU	Net DPU	TP	Core EPU	Net DPU	TP
Amanahraya	6.54	5.71	1.11	6.40	5.59	1.09	6.27	5.47	1.07
Axis	9.33	8.22	1.66	9.22	8.13	1.64	9.11	8.03	1.62
Pavilion	8.57	7.94	1.70	8.48	7.86	1.68	8.39	7.77	1.66
Sunway	9.70	8.73	1.91	9.66	8.69	1.90	9.63	8.66	1.89
KLCCP	40.69	35.63	7.60	40.64	35.59	7.59	40.6	35.55	7.58
CMMT	8.45	7.76	1.65	8.42	7.74	1.65	8.39	7.71	1.64
IGB REIT	8.83	8.47	1.73	8.81	8.46	1.73	8.79	8.44	1.73

Source: Bloomberg, MIDF Research

Maintain NEUTRAL on REITs sector. We maintain NEUTRAL on the REITs sector with unchanged earnings and TPs pending the announcement of the upcoming OPR. 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%. We also like **IGB REIT (BUY; TP: RM1.59)** for its ability to command positive rental reversion for its crown jewel Mid Valley Megamall and **Axis REIT (BUY; TP:RM1.46)** for its niche in industrial assets, which provide stable income. 

Ng Bei Shan
ng.bs@midf.com.my
 03-21738461
 Jessica Low
jessica.low@midf.com.my
 03-21738391

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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.