

09 December 2015 | Sector Update

**REIT*****MGS yield assumption raised******Maintain NEUTRAL*****KEY HIGHLIGHTS**

- **The latest quarterly results were within expectations with two outperformers**
- **MGS yield assumption raised to 4.45% as we take the view that US interest rate hike is imminent**
- **IGBREIT least affected by MGS yield increase, maintain BUY with TP reduced by only 1.9% to RM1.53**
- **Maximum reduction in Target Price for other REITs at only 2.5%**
- **Expect higher volatility for MGS yield in 2016**
- **We remain NEUTRAL on the sector with Top Picks being IGBREIT (BUY; TP: RM1.53) and CMMT (BUY; TP: RM1.62)**

**The latest quarterly results were within expectations with two outperformers.** In our universe of 6 REIT stocks, earnings of IGB REIT and KLCCP Stapled Group came in above expectations. IGB REIT operating expenses was lower than expected led by decline in utilities expenses (-8.7%yoy) due to cost-cutting measures. On the other hand, KLCCP Stapled Group latest earnings topped expectations due to the lower-than-expected tax rate and minority interest. The remaining 4 REIT stocks with earnings that matched expectations are AXREIT, CMMT, PAVREIT, and SUNREIT.

**MGS yield assumption raised to 4.45% as we take the view that US interest rate hike is imminent.**


Our economist believes that the US Federal Reserve is poised to increase its benchmark interest rate by 25 basis points in the upcoming meeting in mid-Dec. We believe that this could increase the MGS yield as well due to the potential money outflow. As a result, we have now applied a new MGS yield assumption of 4.45% (from 4.20%) and lowered our Target Prices for all six REITs under our coverage.

**IGBREIT least affected by MGS yield increase, Target Price reduced by only 1.9% to RM1.53.** The lowest Target Price reduction is IGBREIT with new Target Price of RM1.53 (down 1.9% from RM1.56). Historically, IGBREIT correlation with MGS yield is also the lowest at -0.041 and this supports our view that IGBREIT share price will be the least affected by increase in MGS yield. Furthermore, the higher required return shall be compensated by its high earnings growth. Note that IGBREIT FY14 Core Net Income grew by 12.4%yoy to RM233m and this was the strongest among all REITs.

**Maximum reduction in Target Price for other REITs at 2.5% only.** We have reduced our Target Price for other REITs as well. **AXREIT TP has been reduced by 2.4% to RM1.66** (from RM1.70); **CMMT TP has been reduced by 2.4% to RM1.62** (from RM1.66); **KLCC Stapled Group TP has been lowered by 2.1% to RM7.44** (from RM7.60); **Pavilion REIT TP lowered by 2.5% to RM1.53** (from RM1.57); and **Sunway REIT TP nudged down by 2.5% to RM1.58** (from RM1.62). Overall, the reduction in Target Prices are minimal and our recommendations are all intact.

**Expect higher volatility for MGS yield in 2016.** The uncertainties in interest rate hike had caused the higher volatility in MGS 10-year yield in 2H2015 against 1H2015. Note that 2H2015 standard deviation (SD) for MGS 10-

year yield has increased by 10% to 0.124 (against 1H2015's 0.113). We believe that the current trend of increased volatility will continue in 2016 due to mixed view on whether US Federal Reserve will continue to raise interest rate after the expected first round in Dec-2015.

**We remain NEUTRAL on the sector with Top Picks: IGBREIT (BUY; TP: RM1.53) and CMMT (BUY; TP: RM1.62).** We like **IGBREIT** due to: (i) improving operating efficiency as evidenced by its improving 9MFY15 net property income margin to 71% from 69% in 9MFY14, (ii) positive rental reversion outlook as its rental rates for Mid Valley Megamall and The Gardens Mall are still relatively low comparing to shopping malls in KL city centre, and (iii) attractive net dividend yield of 6%. Meanwhile, our **BUY call on CMMT** is premised on (i) positive rental reversions outlook for East Coast Mall, (ii) potential recovery in Sungei Wang Plaza occupancy rate from FY17 onwards upon completion of the MRT project, and (iii) attractive net dividend yield of 6.0%. We are NEUTRAL on KLCC (TP: RM7.44), AXREIT (TP: RM1.66), PAVREIT (TP: RM1.53) and SUNREIT (TP: RM1.58). 

**Table 1: Summary of REITS' Quarterly Results**

No	Stock	Period Under Review	Latest Qtr Core Net Income (RM'm)	Expectation (Above/Within/Below)	Gross DPU Growth yoy	Comments
1	AXREIT	3Q15 / 9M15	24.4	Within	4%	Earnings underpinned by contribution from newly acquired assets.
2	CMMT	3Q15 / 9M15	39.8	Within	-2%	9M15 earnings increased 4%yoy however core DPU declined due to dilutive impact from private placement.
3	IGBREIT	3Q15 / 9M15	65.1	Above	15%	Earnings lifted by higher rental income and lower utilities expenses.
4	KLCC	3Q15 / 9M15	182	Above	0%	Earnings driven by higher contribution from office and retail segment. Lower tax rates and minority interest also aided earnings growth.
5	PAVREIT	3Q15 / 9M15	60.5	Within	7%	Earnings underpinned by rental from asset enhancement areas in Pavilion Shopping Mall.
6	SUNREIT	1Q16	64.5	Within	-7%	Higher earnings contribution from retail and hotel segments offset the lower contribution from office segment.

Source: Respective companies, MIDF Research

**Table 2: Changes to Target Price (TP) after MGS assumption increase of 25 basis points**

No	Stock	Previous MGS Assumption	Previous TP (RM)	New MGS assumption	New TP (RM)	Changes in TP (%)
1	AXREIT	4.20%	1.70	4.45%	1.66	-2.4%
2	CMMT	4.20%	1.66	4.45%	1.62	-2.4%
3	IGBREIT	4.20%	1.56	4.45%	1.53	-1.9%
4	KLCC	4.20%	7.60	4.45%	7.44	-2.1%
5	PAVREIT	4.20%	1.57	4.45%	1.53	-2.5%
6	SUNREIT	4.20%	1.62	4.45%	1.58	-2.5%

Source: MIDF Research

**Table 3: Correlations between REIT with MGS**

Company	Correlation with MGS	FY14 earnings growth (%)	Average 2-yr earnings growth (%)
Pavilion REIT	-0.543	8.5%	9.3%
CMMT	-0.417	0.8%	4.7%
Sunway REIT	-0.336	6.0%	10.5%
Axis REIT	-0.311	-0.3%	2.3%
KLCC Stapled Group	-0.271	5.0%	n/a
IGB REIT	-0.041	12.4%	n/a

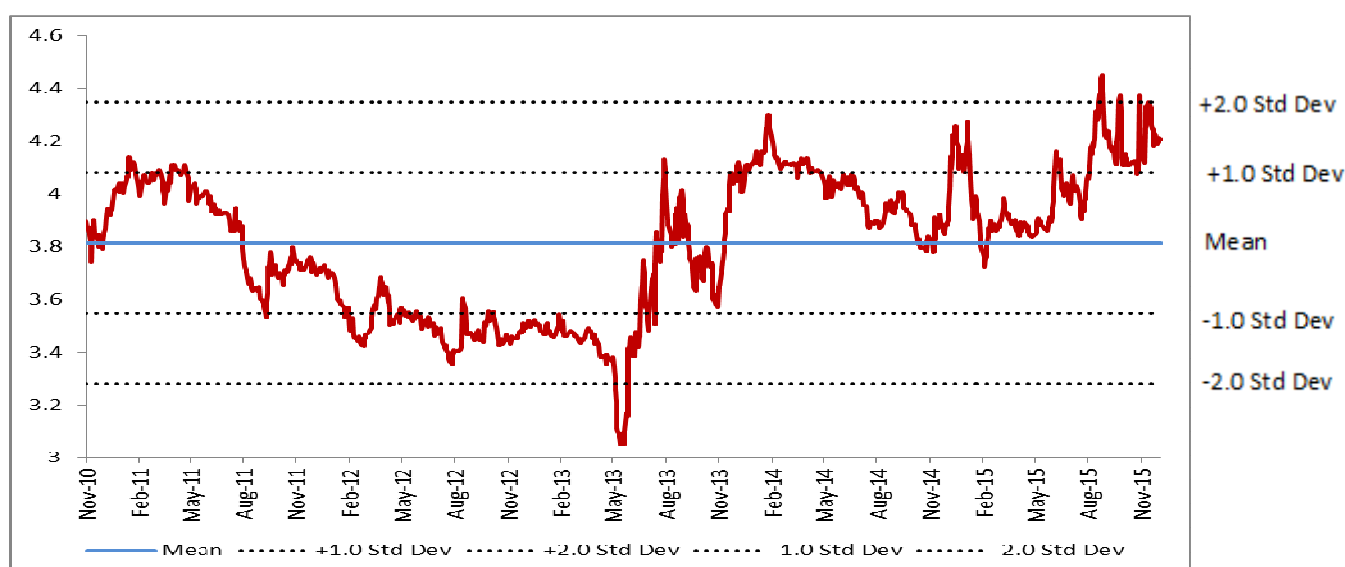
Source: Respective companies, Bloomberg

**Table 4: Peers Comparison**

Stock	FYE	Rec.	Price @ 8-Dec	Target Price (RM)	Core EPU (sen)			Core PE (sen)		Net DPS		Net Dvd Yield (%)	
					FY14	FY15	FY16	FY15	FY16	FY15	FY16	FY15	FY16
AXREIT	Dec	NEUTRAL	1.63	1.66	7.89	8.64	9.06	18.9	18.0	7.63	8.00	4.7	4.9
CMMT	Dec	BUY	1.36	1.62	8.43	8.53	8.69	15.9	15.6	8.13	8.30	6.0	6.1
IGBREIT	Dec	BUY	1.30	1.53	6.77	7.60	7.78	17.1	16.7	7.75	7.93	6.0	6.1
PAVREIT	Dec	NEUTRAL	1.52	1.53	7.74	7.99	8.41	19.0	18.1	7.42	7.80	4.9	5.1
SUNREIT	Jun	NEUTRAL	1.50	1.58	7.94	8.23	8.59	18.2	17.5	7.85	8.21	5.2	5.5
KLCC	Dec	NEUTRAL	7.05	7.44	32.24	37.67	37.93	18.7	18.6	35.46	35.71	5.0	5.1
<b>Average</b>												<b>5.3</b>	<b>5.5</b>

Source: MIDF Research Estimate

**Chart 1: 10yr MGS Yield to Maturity**



Source: Bloomberg

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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.