10 April 2018 | Sector Update

REITs

Looking more attractive

Upgrade to **OVERWEIGHT**

(Previously NEUTRAL)

KEY HIGHLIGHTS

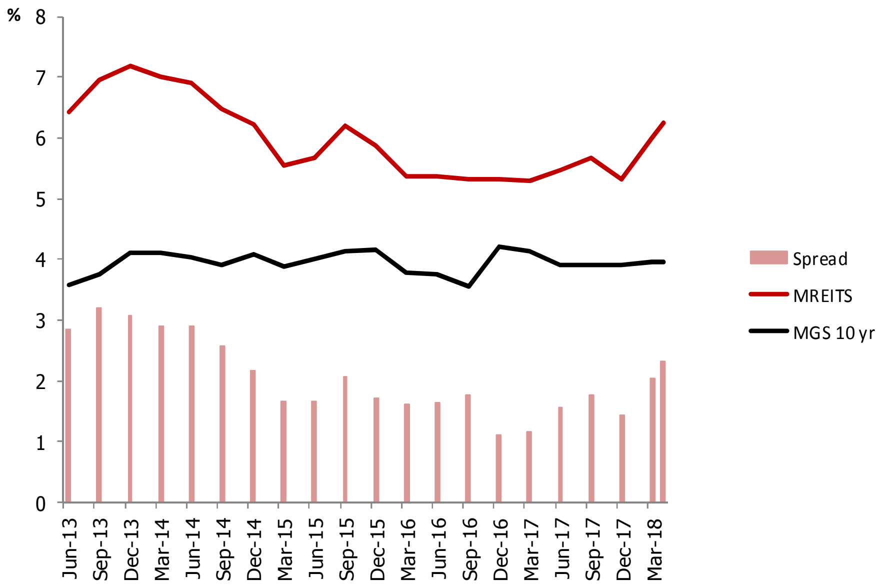
- **Sell-down in REITs presented buying opportunity**
- **Yield spread widening**
- **Near to mid-term fundamentals are intact**
- **We upgrade the sector to OVERWEIGHT with SUNWAY REIT (BUY; TP: RM1.90) as our Top Pick**

Sell-down in REITs presented buying opportunity. REITs listed on Bursa had fallen by 18% year-to-date (YTD). The REITs under our coverage lost between -4.8% to -29.9% in a year, averaging at -12.6%. CMMT recorded the steepest decline at -29.9% while IGB REIT was the more stable one inching down -4.8%. We had factored in the higher borrowing cost from the OPR hike to 3.25% in January and estimated that impact on EPU is limited to -0.2% to -2.1%. Our house economist expects only one rate hike this year.

Value starts to emerge from price weakness. Following the retracement in unit prices, REITs are looking more attractive. Some of them are trading closer to their mean PER, with KLCCP trading -0.77x standard deviation below its 5-year mean PER. This is followed by Axis at -0.07x, Amanah Raya REIT at 0.23x and CMMT at 0.34x. Besides that, price to NAV is also looking more compelling with Amanahraya REIT at 0.6x, CMMT at 0.8x, KLCCP at 0.9x, Axis REIT at 1.0x and Pavilion REIT at 1.1x.

Yield spread widening. More importantly, the spread between dividend yield between MREITs and the 10-year Malaysian Government Securities (MGS) yield has widened to 2.3 percentage points. In comparison, the spread between REITs under our coverage versus that of the MGS yield is 2.1 ppt. This is higher than the 1.7 ppt for MREIT's three-year mean.

Exhibit 1: Yield spread between MGS 10 year and MREITS



Source: Companies, MIDF Research

4QCY17 earnings of REITs under coverage met expectations. Results for six out of the seven REITs that we track were largely in-line with our full year forecasts. Sunway REIT, our top pick of the sector, registered highest earnings growth (+12.3%yoy) driven by better performance across segments namely, retail, hotel and industrial. IGB REIT also registered 9.3% increase in earnings growth yoy.

FY18 could be a modest year despite the supplies of additional floor area from shopping malls and offices. We believe that shopping malls at strategic locations will continue to command single-digit positive rental reversion while growth for rental reversion for neighbourbood malls may be tepid or flat. We are cautious on growth in 2Q18 due to a lack of major events amid the wait-and-see sentiment prior to GE14. However, we expect better sentiments in 2HFY18 in tandem with World Cup 2018, which may see crowd pulling events in malls. That is also coupled with the year-end holiday, sales and festive seasons.

Near to mid-term fundamentals are intact. Looking ahead, we expect resilient occupancy rates and modest rental reversion growth for strategic retail, commercial and industrial assets. We expect asset owners to prioritise tenant retention to maintain healthy and balance occupancy rates over rental reversion rates for selected properties that face intense competition. That said, we still expect REITs under our coverage to register positive mixed rental reversions for FY18F. We also understand that REIT managers have negotiated with tenants for the expiry of their leasing agreements so that they maintain the ideal tenant mix, which is in-line with the property's positioning.

We revise our TPs for Amanahraya, Axis and CMMT as we adjust their mid-term growth to 2.0%, 2.5% and 3.2% respectively. However, our earnings estimates are unchanged. Following which, the TP prices have been adjust to RM1.57 (previously RM1.68) for Axis REIT, RM1.11 (previously RM1.49) for CMMT and RM0.96 (previously RM1.12) for Amanahraya REIT. Meanwhile, we have recently imputed higher borrowing cost for Pavilion REIT after it announced to cancel its proposed placement to fund Pavilion Elite. Hence, we make no changes to Pavilion REIT.

Exhibit 2: Summary of REITs under coverage

Stock	Rec.	Price @ 9 Apr	Target Price (RM)	Previous TP	Core EPU (sen)			Core PE (sen)		Net DPU		Net Dvd Yield		Price to NAV
					FY17	FY18	FY19	FY18	FY19	FY18	FY19	FY18	FY19	
AXREIT	BUY	1.30	**1.57**	1.64	8.3	9.2	10.5	14.1	12.4	8.1	9.3	6.2	7.2	1.0
CMMT	NEUTRAL	1.09	**1.11**	1.49	7.8	7.9	8.0	13.8	13.6	7.5	7.7	6.9	7.1	0.8
IGBREIT	BUY	1.54	**1.73**	1.73	8.6	8.7	9.2	17.7	16.7	9.4	8.8	6.1	5.7	1.5
PAVREIT	NEUTRAL	1.42	**1.41**	1.41	7.7	8.3	8.4	17.1	16.9	7.7	7.8	5.4	5.5	1.1
KLCC	NEUTRAL	7.05	**7.59**	7.59	40.0	40.7	41.9	17.3	16.8	35.4	36.4	5.0	5.2	1.0
SUNREIT	BUY	1.53	**1.90**	1.90	9.2	9.7	10.3	15.8	14.9	8.7	9.3	5.7	6.1	1.1
ARREIT	BUY	0.83	**0.96**	1.12	5.5	6.8	7.9	12.2	10.5	6.0	6.9	7.2	8.3	0.6
Average												**6.1**	**6.4**	**1.0**

Source: Bloomberg, MIDF Research

Upgrade to OVERWEIGHT from NEUTRAL. We upgrade the sector to OVERWEIGHT on the REITs as we believe that the recent sell down has been overdone. Valuation has become more palatable while the yield spread is getting more attractive. Our top pick for the sector is Sunway REIT (BUY; TP: RM1.90) due to its positive earnings outlook that is backed by positive rental reversion from Sunway Pyramid and growth from its hotel division. We also have a BUY call on AmanahRaya REIT (TP: RM0.96) for its diversified assets base with exposure to education property. We also like IGB REIT (BUY; TP: RM1.73) for its ability to command positive rental reversion for its crown jewel Mid Valley Megamall and Axis REIT (BUY; TP:RM1.57) for its niche in industrial assets, which provides stable income.

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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 *rise* 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 *fall* 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.