MREITs

Coming Out of the Woods

OVERWEIGHT ↑

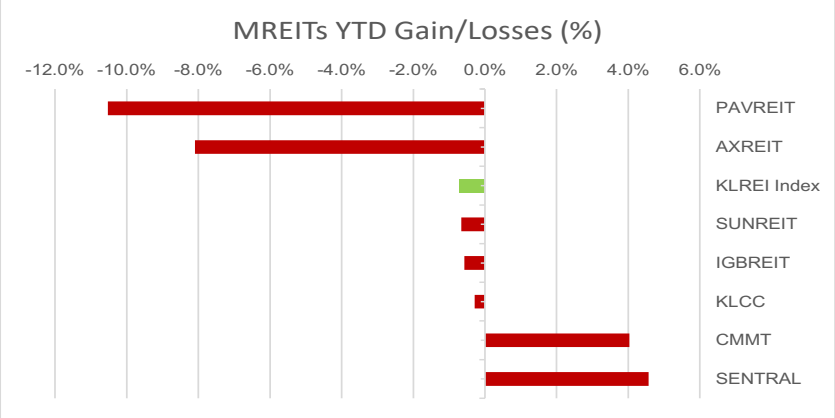
By Marie Vaz / msvaz@kenanga.com.my

Upgrade to OVERWEIGHT (from NEUTRAL). 4QCY20 results season was better than expected as pure retail players PAVREIT, IGBREIT and CMMT outshined expectations as the 4QCY20 MCO restrictions' impact was not as severe as expected. YTD, most MREITs' share prices performed negatively (-0.3% to -10.5%) likely on profit taking post dividend payments, while SENTRAL REIT was the top performer YTD, up 4.6%, on decent results and attractive yields of c.7.9%. Going forward, we expect FY21 to see better earnings YoY for MREITs all around as lockdown restrictions have eased despite the rise in new Covid-19 cases, and upon the proper roll-out of the national vaccination plan. We believe that 1QCY21 may see some form of rental assistance to struggling tenants due to the short MCO, but with noticeable shopper traffic returning to most malls, we expect 2HCY21 to see improved earnings upon further opening of the economy, which has been priced into estimates. That said, we take this opportunity to increase valuations by lowering our spreads (to average to +0.5SD levels, from +0.5SD to +1.5SD) to the 10-year MGS new target of 3.30% (from 3.10%) in anticipation of the gradual normalisation of the retail and hospitality segments. As a result, our MREITs' target prices are increased by 3-16%. Our Top Picks are AXREIT (OP; TP: RM2.25) and KLCC (OP; TP: RM7.55) on stable to positive earnings outlook, and both are also institutional favourites being Shariah-compliant MREITs with decent dividend yields of 5.0% and 4.5%, respectively.

Better-than-expected results from pure retail players, with PAVREIT, IGBREIT and CMMT coming in above estimates, SUNREIT, SENTRAL and AXREIT within, while KLCC came in below due to weakness from hospitality as well as retail. 4QCY20 results season was not as bad as expected as some malls managed to capture better-than-expected sales despite MCO restrictions, and boosted by year-end holiday season shopping. Industrial and office continued to remain stable for now. YoY-Ytd, CNP was down for MREITs by 24-60% due to the various MCOs that affected shopper and tourist traffic. The only MREITs that were steady were industrial REIT AXREIT (CNP +9% YoY), and SENTRAL (CNP +12% YoY) reporting stable top-lines and lower financing costs. All in, we trimmed FY21E CNP for MREIT that may struggle namely CMMT (-17%), KLCC (-11%) and PAVREIT (-22%) due to weakness of specific assets.

SENTRAL REIT was the top performer YTD, up 4.6%, on decent results and attractive yields of c.7.9%. That said, most MREITs under our coverage performed negatively (-0.3% to -10.5%) likely on profit taking post dividend payments. All in, the KLREIT index was also down by 0.7% in line with the majority of MREITs due to similar reasons as mentioned.

YTD MREITs Share Prices Gains/ Losses in CY21 (%)



Source: Bloomberg, Kenanga Research

The crowd is back. During 1QCY21, the Movement Control Order (MCO) in Selangor, Kuala Lumpur, Johor and Penang was reimposed on 13th Jan 2021, while Covid-19 infections continued escalating to a record daily high of 5,728 cases on 30th Jan 2020. The Health director-general Tan Sri Dr Noor Hisham Abdullah forecasted then that daily cases could potentially reach 8,000 by March 2021 if the spread of the virus was not contained. However, the MCO was lifted and replaced with the Conditional Movement Control Order or CMCO on 5th March 2021, enabling the opening of more businesses and the tourism sector while inter-district travel has been reinstated in all states except Sabah.

The MCO and CMCO in 2021 appears more relaxed compared to 2020, while the general public appear more comfortable going out despite higher YoY number of Covid-19 cases, implying that the sentiment of fear surrounding the pandemic is ebbing. This has been apparent with noticeable traffic jams on roads, and increased shopper traffic at most malls while channel checks also reported long lines at various shopping mall outlets/restaurants. This is a far cry from the empty malls witnessed in 1QFY20 when the pandemic first surfaced.

Rebound poised for 2HCY21. Given the challenges in FY20 brought by the Covid-19 pandemic, we believe FY21 will certainly be a better year with the absence of strict MCOs, and the recovery brought about by the proper roll out of vaccines which should intensify from Feb 2021 to March 2022. As such, we expect 2HCY21 to see gradual improvements to shopper traffic and increasing tenant sales, as well as improvements in hotel occupancy which we have priced into our earnings assumptions. **All in, we expect FY21-22E DPU growth of 7.8-7.9%.**

The industrial segment remains a safe haven and has been faring well during the MCO and post MCO as most manufacturing tenants remained in operations. AXREIT, the only industrial MREIT which has no force majeure clause, implying that all of AXREIT's c.150 tenancies have no allowance for tenants asking for discount. However, the Group will consider rental deferment on a case-to-case basis for struggling tenants, but the percentage of rental deferment even during the peak of the pandemic during the March-May 2020 MCO phase was minimal. Meanwhile the office segment will continue to remain stable, namely KLCC and SENTRAL as tenants have resumed working at offices or have the option to utilise work-from-home arrangement, ensuring businesses continuity.

MREITs Valuations

MREIT	Last Price as at 19/03/21	GDPS (RM)	FY	Gross Yield based on last price	Target Gross Yield	Gross yield spread to 10-yr MGS	10-yr MGS target	New Call	New TP (RM)	Old Call	Old TP (RM)	Share price upside/ downside (%)	Total Returns (%)
KLCC	7.01	0.31	FYDec21E	4.5%	4.2%	0.9%	3.30%	OP	7.55	MP	7.30	8%	12%
SUNREIT	1.50	0.08	FY22	5.0%	4.9%	1.6%	3.30%	MP	1.55	UP	1.10	3%	8%
CMMT	0.65	0.05	FYDec21E	7.2%	7.8%	4.5%	3.30%	MP	0.590	MP	0.57	-9%	-2%
AXREIT	1.93	0.10	FYDec21E	5.0%	4.3%	1.0%	3.30%	OP	2.25	OP	2.15	17%	21%
PAVREIT	1.36	0.06	FYDec21E	4.5%	4.7%	1.4%	3.30%	MP	1.30	UP	1.15	-4%	0%
IGBREIT	1.74	0.08	FYDec21E	4.8%	4.5%	1.2%	3.30%	OP	1.85	MP	1.60	6%	11%
SENTRAL	0.92	0.07	FYDec21E	7.9%	7.4%	4.1%	3.30%	OP	0.975	OP	0.94	7%	14%

Source: Bloomberg, Kenanga Research

Upgrade to OVERWEIGHT (from NEUTRAL). We are optimistic that FY21 will be a better year for MREITs given that lock-down restrictions have eased somewhat. As a result, we lower our risk spread for MREITs to the 10-year MGS average to +0.5SD levels (from +0.5Sd to +1.5SD) in anticipation of further opening of the economy and proper roll-out of the national vaccination programme, that will result in more steady shopper traffic flow to malls and increased occupancy in the hospitality sector. We make no changes to earnings as we have already priced in better YoY earnings to our estimates. Additionally, we also increased our 10-year MGS target to 3.30% (from 3.10%) in line with our internal strategy and steepening of the yield curve. As a result, MREITs' target prices are increased by 3-16%, save for SUNREIT (+41%) which we have rolled forward to FY22 as it reflects a more normalised earnings level for the Group as it is an inflection year in light of the ailing retail and hospitality segments in FY20-21. We have also upgraded our call for KLCC and IGBREIT to OP (from MP), and SUNREIT to MP (from UP). At current levels, MREITS under our coverage are commanding yields of between 4-8%.

Top Pick AXREIT (OP; TP: RM2.25). We favour AXREIT for its robust resilience during this pandemic. The Group is possibly the only MREIT under our coverage confident of positive reversions, and downsides are limited with minimal expiries of 18% (of which it has already locked in 32% on positive reversions). Fundamentally, the Group is actively acquiring numerous bite-size industrial assets, targeting RM135m for now, supported by its low gearing of 0.33x, which could potentially accrete up to 5% additional earnings in FY21. Essentially, we believe AXREIT's valuations are severely undervalued given its solid growth trajectory vs. MREIT peers that have struggled especially in FY20. As FY21 is poised to be a recovery year, lower spreads are warranted, to 1.0ppt @ historical average levels (from 1.4ppt @ +0.5SD), and we increase our MGS target to 3.3% (from 3.1%) in light of the steepening yield curve. We like AXREIT's Shariah-compliant status, with attractive potential total returns of 21% on decent gross dividend yields of 5%.

Top Pick KLCC (OP; TP: RM7.55). We like KLCC for its premium asset quality, highly stable office segment with tenants on longer term leases (5 years vs. retail of 2-3 years) and easy to manage triple-net-lease (TNL) structure. We believe KLCC is the perfect combo for a retail and hospitality comeback story from 2HCY21 onwards with further opening of the economy upon successful rollout of vaccinations, whilst being well supported by its extremely stable office segment which makes up at least 50% of portfolio EBIT. In anticipation of an improving economy, we lower our spread to historical average levels to 0.9ppt (from 1.2ppt @ +1.0SD) on FY21E, and increase our MGS target to 3.3% (from 3.1%) in light of the steepening yield curve. Downside is limited and we expect KLCC to remain a favourite among institutional investors as it is one of the few Shariah-compliant MREITs. Current yields of 4.5% are decent vs. large cap MREITs of 4.5-5.0%, commanding 12% in total returns.

Risks to our call include: (i) weaker-than-expected consumer spending, (ii) weaker-than-expected rental reversions, (iii) U.S. Fed's move in increasing interest rates in an aggressive manner, and (iv) weaker-than-expected occupancy rates.

Peer Comparison

Name	Last Price (19/3/21) (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth 1-Yr. Fwd.	Revenue Growth 2-Yr. Fwd.	Core Earnings Growth 1-Yr. Fwd.	Core Earnings Growth 2-Yr. Fwd.	PER (x) - Core Earnings Hist.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) Hist.	PBV (x) 1-Yr. Fwd.	ROE (%) 1-Yr. Fwd.	Net Div.Yld. (%) 1-Yr. Fwd.	Target Price (RM)	Rating
STOCKS UNDER COVERAGE																	
AXIS REIT	1.93	2,791.7	Y	12/2021	3.6%	2.5%	11.9%	1.6%	21.4	19.3	19.3	1.5	1.5	6.2%	4.5%	2.25	OP
CAPITALAND MALAYSIA MALL TRUST	0.645	1,331.2	N	12/2021	20.7%	6.0%	56.6%	9.1%	21.5	12.9	12.9	0.5	0.5	2.6%	6.4%	0.590	MP
IGB REIT	1.74	6,201.3	N	12/2021	12.6%	1.8%	21.7%	1.7%	24.9	21.8	21.8	1.6	1.6	6.2%	4.2%	1.85	OP
KLCCP STAPLED GROUP	7.01	12,655.4	Y	12/2021	4.9%	6.9%	8.2%	10.3%	23.4	21.2	19.5	1.0	1.0	5.4%	4.2%	7.55	OP
SENTRAL REIT	0.915	980.7	N	12/2021	3.0%	2.6%	1.0%	0.7%	11.4	13.1	11.4	0.7	0.7	5.3%	6.8%	0.975	OP
PAVILION REIT	1.36	4,144.9	N	12/2021	9.1%	7.9%	51.7%	13.1%	34.0	22.7	19.4	1.1	1.1	2.5%	4.1%	1.30	MP
SUNWAY REIT	1.50	5,137.2	N	12/2021	1.5%	12.2%	-10.5%	24.4%	15.0	16.7	15.0	1.0	0.9	5.4%	4.7%	1.55	MP
Simple Average					**7.9%**	**5.7%**	**20.1%**	**8.7%**	**21.7**	**18.2**	**17.0**	**1.1**	**1.0**	**4.8%**	**5.0%**		

Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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KENANGA INVESTMENT BANK BERHAD (15678-H)
Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my Email: research@kenanga.com.my