MREITs

Live, Work, Shop! Things Are Looking Up

OVERWEIGHT

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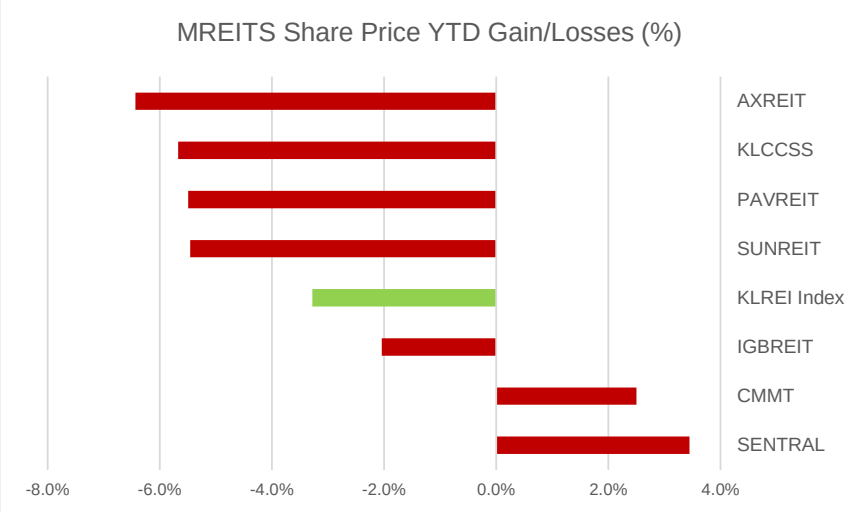
Maintain OVERWEIGHT. 2QCY21 results were mostly within as we already expected a weak quarter in light of the Covid-19 lockdowns. The worsening Covid-19 situation during the May-August 2021 period weakened FY21 earnings prospects and precipitates a partially weak 3QCY21 which has already been accounted for. Positively, the economy has begun opening up in August and September 2021 with most malls currently operating at 80-90% of NLA (vs. 15-25% in 2QCY21). The hospitality segment can resume operating local stays and the office segment will see more employees returning to the premises on a rotational basis. The quick roll-out of vaccinations (61% of the Malaysian population is fully vaccinated in September vs. 46% in August) and resumption of most economic activities are well within our expectation of a 4QCY21 earnings rebound and investors should be looking ahead to normalised FY22 earnings. Maintain our risk spread to 10-year MGS target of 3.60% at average SD for industrial based AXREIT, and at +0.5SD to +1.0SD for other MREITs under coverage. Our preferred picks are AXREIT (OP; TP: RM2.15) and KLCC (OP; TP: RM7.35) on stable to positive earnings outlook despite the pandemic and decent dividend yields of 5.2% and 5.3%, respectively.

2QCY21 largely within expectations as we expected weak 2QCY21 earnings due to the MCO which affected the months of May and June. YoY-YTD, top-line was down by 12% on average for MREITs under coverage, declining for all MREITs due to lower rental during the MCO, except for industrial AXREIT (+3.6%). However, the negative impact to MREITs bottom-line was partially negated (-14%) due to benefits from lower financing cost for some REITs (PAVREIT and SENTRAL). Our calls and TPs are maintained as we expect the Covid-19 situation to improve from 4QCY21 onward and in FY22, and as such, our valuations which are based on FY22E numbers remain unchanged for now.

SENTRAL REIT was the top performer YTD, up 3.4%, on decent results and attractive yields of c.8% while CMMT was up by 2.5%. KLCC and AXREIT declined by 5.7% and 6.4%, respectively, likely due to profit taking post dividends going ex in August (AXREIT) and September (KLCC). KLCC's share price may have also declined partly due to its exclusion from the FTSE4Good index in end-June as a result of low trading liquidity. PAVREIT and SUNREIT were also down by 5.5% each, likely post dividend payouts and due to a challenging retail sector. All in, the KLREIT Index was down by 3.3% due to the volatile Covid-19 situation.

YTD MREITs Share Prices Gains/ Losses YTDCY21 (%)



Source: Bloomberg, Kenanga Research

Economy opening up in 3QCY21. The strict lockdown restrictions from May till July 2021 saw most malls operating at 15-25% of NLA. However, the easing up of lockdown restrictions in August and September 2021 saw increased mall operations to c.80-90% of NLA. Local travel is allowed which would then increase the local shopper's propensity to sightsee and take on more local

holidays. Offices even saw employees slowly returning to work but on a rotation basis. This opening up was made possible with the quick and effective roll-out of vaccinations. As at end September 2021, 61% of the Malaysian population has been fully vaccinated (from 46% in August).

4QCY21 retail segment poised for a comeback and FY22E earnings remain intact. We believe 4QCY21 should see a significant improvement for the retail segment's earnings in the form of revenge shopping, and hospitality segment from an uptick in local holiday stays (i.e. Cuti-Cuti Malaysia). Do note that the office and industrial segments under our coverage have been fairly stable during this period. As a result, our FY22E earnings for MREITs under our coverage are expected to remain intact as we anticipate a gradual opening up of the economy towards year end, while our valuations are based on a more stable FY22.

Office segment stable for now, but we are long term cautious. Most office assets under our coverage did not see significant drops in rental during the pandemic period (in FY20-21) as businesses were able to operate effectively on a work from home (WFH) basis without significant disruptions to business operations. We believe this is to the detriment of the office segment over the long run as **offices may see a decline in demand**, either from shorter lease terms or tenants requiring smaller office space (NLA) as the WFH policy may be here to stay and is cost effective. This is further exacerbated by the pre-existing oversupply of offices in the Klang Valley which will continue to put downward pressure on office prices. That said, **this situation does not apply to KLCC** which operates heavily in the office segment as most of its leases are already secured on long term basis (>10 years vs. retail of 2-3 years) and with easy to manage triple-net-lease (TNL) structure.

The industrial segment is our preferred pick, namely AXREIT (OP; TP: RM2.15). The segment has been faring well during 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 its c.150 tenancies have no legal ground to ask for discounts/rebates. However, the Group was willing to 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 while the group is constantly on a growth trajectory with positive rental reversions (low single-digit) and an active acquisition pipeline of RM135m backed by low gearing of 0.36x. We continue to like AXREIT's Shariah-compliant status, with attractive potential total returns of 17% on decent gross dividend yields of 5.3%

KLCC (OP; TP: RM7.35) our other preferred pick as earnings is bolstered by the stable office segment which makes up c.50% of earnings. KLCC's unique position is due to its highly stable office segment with tenants on longer term leases (>10 years vs. retail of 2-3 years) and easy to manage triple-net-lease (TNL) structure. We continue to like KLCC's premium asset quality and the fact that it is one of the best disclosed companies for ESG under our coverage (Kenanga score of 91%) with priority for Environmental disclosures and advanced Integrated Reporting. KLCC's recent exclusion from the FTSE4Good (June 2021) review was due to low trading liquidity not ESG factors. We also like KLCC's Shariah-compliant status, with attractive potential total returns of 18% on decent gross dividend yields of 5.2%.

Maintain OVERWEIGHT. We maintain our risk spread for MREITs to the 10-year MGS of target of 3.60% at average SD for industrial based AXREIT, and at +0.5SD to +1.0SD for other MREITs under coverage due to the potential volatility in earnings as a result of the pandemic and to remain cautious on the situation despite things looking up. That said, our valuations are based on FY22 which we believe reflects a new normal for earnings as it is poised to be a recovery year for the ailing retail and hospitality segments. Our preferred picks are AXREIT (OP; TP; RM2.15) and KLCC (OP; TP: RM7.35) in light of their rock stable earnings as demonstrated during the harsh MCOs in FY20-21.

MREITs Valuations

MREIT	Last Price as at 24/09/21	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)	Share price upside/ downside (%)	Total Returns (%)
KLCC	6.50	0.35	FYDec22E	5.3%	4.7%	1.1%	3.60%	OP	7.35	13%	18%
SUNREIT	1.44	0.08	FYDec22E	5.2%	5.5%	1.9%	3.60%	MP	1.35	-6%	-2%
CMMT	0.62	0.05	FYDec22E	7.6%	8.1%	4.5%	3.60%	MP	0.580	-6%	1%
AXREIT	1.92	0.10	FYDec22E	5.2%	4.6%	1.0%	3.60%	OP	2.15	12%	17%
PAVREIT	1.41	0.07	FYDec22E	4.9%	5.2%	1.6%	3.60%	MP	1.30	-8%	-3%
IGBREIT	1.68	0.08	FYDec22E	4.9%	4.8%	1.2%	3.60%	MP	1.70	1%	6%
SENTRAL	0.87	0.07	FYDec22E	8.3%	7.7%	4.1%	3.60%	OP	0.935	7%	15%

Source: Bloomberg, Kenanga Research

Preferred Pick is AXREIT (OP; TP: RM2.15). 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 at 18% (of which it has already locked in 32% with 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. We also like AXREIT's Shariah-compliant status, with attractive potential total returns of 15% on decent gross dividend yields of 5%.

Risks to our OW sector call include: (i) weaker-than-expected consumer spending, (ii) weaker-than-expected rental reversions, (iii) U.S. Fed increasing interest rates aggressively, and (iv) weaker-than-expected occupancy rates.

Peer Comparison

Name	Last Price (24/9/21) (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	1.92	2,777.2	Y	12/2021	3.6%	2.5%	11.9%	1.6%	21.3	19.2	19.2	1.5	1.5	6.2%	4.5%	2.15	OP
CAPITALAND MALAYSIA MALL TRUST	0.615	1,308.8	N	12/2021	-12.0%	42.3%	-33.9%	141.6%	20.5	15.4	12.3	0.5	0.5	2.6%	6.1%	0.580	MP
IGB REIT	1.68	5,996.5	N	12/2021	12.6%	1.8%	21.7%	1.7%	24.0	21.0	21.0	1.6	1.6	6.2%	4.4%	1.70	MP
KLCCP STAPLED GROUP	6.50	11,734.7	Y	12/2021	-4.4%	17.4%	-1.0%	20.6%	21.7	21.7	18.1	0.9	0.9	5.4%	4.1%	7.35	OP
SENTRAL REIT	0.870	932.5	N	12/2021	3.0%	2.6%	1.0%	0.7%	10.9	10.9	10.9	0.7	0.7	5.3%	7.5%	0.935	OP
PAVILION REIT	1.41	4,300.6	N	12/2021	-21.5%	50.0%	-20.7%	116.8%	35.3	46.5	21.5	1.1	1.1	2.5%	2.1%	1.30	MP
SUNWAY REIT	1.42	4,863.2	N	12/2021	7.6%	5.0%	-21.3%	21.7%	17.8	28.4	17.8	0.9	0.9	5.4%	3.1%	1.35	MP
Simple Average					**-1.6%**	**17.4%**	**-6.0%**	**43.5%**	**21.6**	**23.3**	**17.2**	**1.0**	**1.0**	**4.8%**	**4.6%**		

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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