

09 January 2024

# REITs

## Mall Galore in Klang Valley

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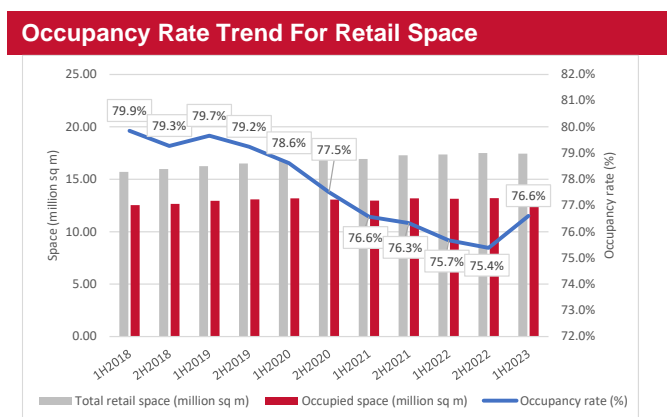
# NEUTRAL



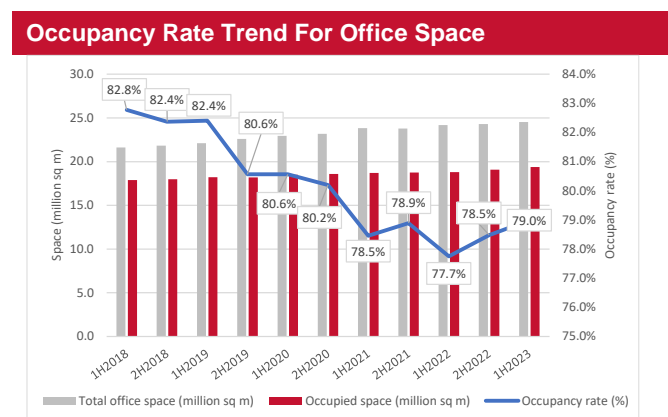
We reaffirm our NEUTRAL sector call on REITs. Despite the persistent supply-demand imbalance impacting the office and industrial sectors, specific REITs with niche exposure in the retail segment in prime locations will continue to derive consistent rental income streams against the challenging industry landscape. That said, we remain cautious of the medium-term prospects, considering potential drags on consumer sentiment due to inflation and cautious spending, coupled with an oversupply of office and industrial spaces. Our top picks are PAVREIT (OP; TP: RM1.47) and SUNREIT (OP; TP: RM1.63).

**A potential for a sustained occupancy rate.** Based on National Property Information Centre's (NAPIC) 1HCY23 Property Market Report, occupancy rates are gradually rising with the retail space in shopping complexes coming in at 76.6% (Dec 2022: 75.4%) from an occupied space of 13.2m sqm on a total retail space of 17.5m sqm. Meanwhile, purpose-built office spaces stood at 79.0% (Dec 2022: 78.5%) from an occupied space of 19.1m sqm against a total office space of 24.3m sqm with the progressive reversion to working-in-office arrangements. We anticipate a sustained healthy occupancy rate in the upcoming quarters as the economy regains vitality and stabilizes.

**Growth amid challenges.** Against a broadly subdued economic climate, we believe that the growing interest in in-person retail transactions, particularly in prime locations, could benefit commercial REITs. With increased footfall from both locals and international tourists, an associated rise in spending is anticipated. Simultaneously, the gradual return to in-office work arrangements will offer some support to office demand, which may lead to a rise in overall occupancy for office assets that may have been depressed from remote working arrangements. Similar to the industrial space, we foresee growth as it becomes a prevailing trend in certain regions thanks to the influx of foreign manufacturing demand paired with an anticipated rise of general exports.



Source: NAPIC, Kenanga Research



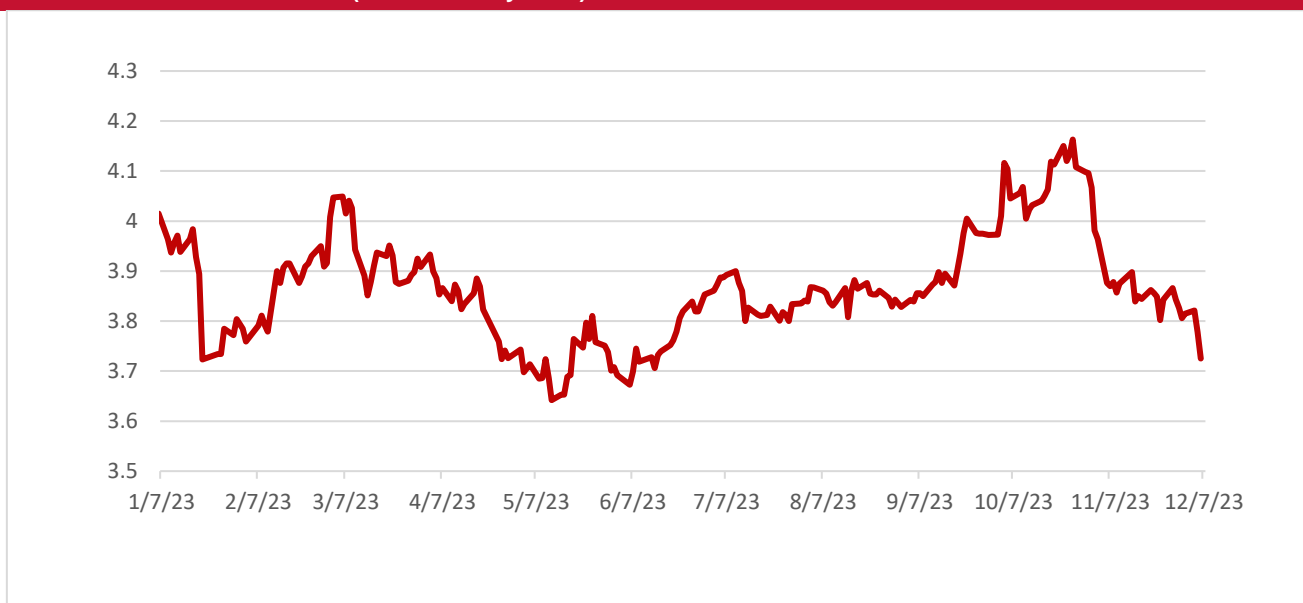
Source: NAPIC, Kenanga Research

**Uncertainty still looms.** On the flipside, we believe that the sector's prospects could face sustained challenges. In the near term, expectations for retail spending appear subdued due to cautious consumer habits and economic concerns. We opine that the implementation of luxury taxes (5%-10% on yet to be detailed goods valued above RM10k) and higher SST rates (8% from 6% on qualified transactions) to be imposed in CY24 may further widen the gap for aspirational spending. Additionally, although the importance of office spaces is on the rise, overall occupancy rates may remain modest, as the influx of new office spaces might outpace the relatively moderate growth in demand and leave older vacant spaces perpetually untenanted. A similar trend is observed in industrial properties, as many developers are venturing into this segment which could spur excess demand.

**MGS yield due to normalise.** The 10-year Malaysian Government Securities (MGS) yield – a risk-free benchmark used by us as a valuation reference to impute the corresponding yield spreads in deriving our individual target prices, has come off from its peak of 4.57% in Oct 2022. Given that inflationary readings appear to be mostly well-contained, we subscribe to a flattish interest rate outlook at least in the near-term and for MGS to sustain closely at 4.00%, which would also be fairly in line with historical averages pre-pandemic.

09 January 2024

## 10-Year MGS Yield Movement (since January 2022)



Source: Bloomberg

## Target Yield at a Glance

REIT	Stock Call	Target Price (RM)	Target Yield (%)
AXREIT	UP	1.58	5.5
CLMT	MP	0.53	7.5
IGBREIT	MP	1.66	6.5
KLCC	MP	7.18	5.5
PAVREIT	OP	1.47	6.0
SUNREIT	OP	1.63	6.5

^ Derived from yield spread above our 10-year MGS yield assumption of 4.0%.

Source: Kenanga Research

Given that most of our coverage focuses on the retail segment in the Klang Valley, it's noteworthy to highlight the opening of The Exchange TRX on 29 Nov 2023. This mall is anticipated to intensify competition for retail space within the local REIT sector, potentially impacting malls in the Klang Valley. While we reckon near-term consumer attention may be cornered by its opening, our perspective is that in the longer term, the like of KLCC is likely to remain unaffected due to its iconic status as part of the Twin Towers. Similarly, **SUNREIT** and **IGBREIT** are expected to remain unimpacted, considering its malls' locations which are more than 10 kilometres away from The Exchange TRX. They also cater to a wider mix of consumers which may be inclined to a more modest shopping experience. Meanwhile, the odds of **PAVREIT** experiencing short-term impact are modest, given **PAVREIT**'s main mall, Pavilion KL is at the closest proximity to TRX among the high-end malls within our coverage and the overlapping target market. Despite TRX's advantageous position in garnering attention upon its launch, benefiting from its novelty, especially since the last major mall in Kuala Lumpur, Pavilion KL, was opened in 2007, we hold a positive outlook that Pavilion KL's foot traffic is likely to be sustained by a growing young population, making **PAVREIT** sustainable in the long run.

**NEUTRAL sector view.** Backed by the still challenging industry dynamics, we are keeping our NEUTRAL stance. Within the sector, we still like REITs with the following attributes: (i) niche in the right business segments particularly in retail and office, and/or (ii) own property assets in prime and strategic locations, which will continue to provide resilient rental income streams. From a valuation perspective, **PAVREIT** and **SUNREIT** emerge as our top retail-centric picks, as we believe their risk-to-reward is favourable. We expect **PAVREIT** to remain resilient attributed by its prime locations catering to a diverse range of target markets, not solely concentrated on the high-end segment. On the other hand, **SUNREIT** may have a balance buffer against sector risk exposures thanks to its diversified assets (hospitality and office) and strong brand equity. We maintain a cautious stance on AXREIT, our sole industrial REIT, as its occupancy rates have declined to 92% at end-Sep 2023 (in comparison to 95% by Sep-end 2022). The increased supply of industrial properties may intensify competition, providing potential tenants with a broader range of choices.

09 January 2024

## Peer Table Comparison

Name	Rating	Last Price	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Gross Div. (sen)	Gross Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
<b>REITS</b>																	
AXIS REIT	MP	1.80	1.58	-12.2%	3,145.5	Y	12/2023	9.3	10.2	-12.9%	23.3%	22.8	18.5	1.2	5.4%	7.8	4.3%
CAPITALAND MALAYSIA MALL TRUST	MP	0.570	0.530	-7.0%	1,562.1	N	12/2023	3.9	4.0	11.5%	5.6%	12.3	11.6	0.5	4.1%	3.9	6.8%
IGB REIT	MP	1.72	1.66	-3.5%	6,194.8	N	12/2023	10.1	10.4	7.7%	3.7%	17.0	16.4	1.6	9.4%	10.5	5.6%
KLCCP STAPLED GROUP	MP	7.20	7.18	-0.3%	12,998.4	Y	12/2023	40.2	41.6	-7.7%	3.6%	18.0	17.4	1.0	4.8%	36.3	4.6%
PAVILION REIT	OP	1.25	1.47	17.6%	4,565.4	N	12/2023	8.0	8.5	15.3%	22.1%	13.4	11.0	1.0	7.3%	8.2	6.3%
SUNWAY REIT	OP	1.57	1.63	3.8%	5,376.9	N	12/2023	10.2	10.9	4.8%	13.5%	16.9	14.9	1.0	6.1%	8.8	5.4%
<b>SECTOR AGGREGATE</b>					<b>33,843.1</b>					<b>0.4%</b>	<b>9.5%</b>	<b>17.6</b>	<b>16.1</b>	<b>1.1</b>	<b>6.2%</b>		<b>5.5%</b>

Source: Bloomberg, Kenanga Research

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**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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