REITs

Onslaught of Supply, Retail to Hold Up Better

NEUTRAL

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We reiterate our NEUTRAL sector call on REITs. We expect the implied target yields for Malaysia REITs to remain stable throughout CY24 on our assumption that the overnight policy rate (OPR) of Bank Negara Malaysia (BNM) to stay at 3.00%. We prefer retail REITs with malls in strategic locations while being mindful of the excess supply in the office segment. That said, we exercise caution on the medium-term prospects, considering potential drags on consumer spending due to elevated inflation, a higher Sales and Service Tax (SST) and the impending fuel subsidiary rationalisation. Our top picks are KLCC (OP; TP: RM8.00) and SUNREIT (OP; TP: RM1.72).

Stable OPR. We expect the implied target yields for Malaysia REITs to remain stable throughout CY24 on our assumption that BNM's OPR to stay at 3.00% and the next move by BNM (beyond CY24) is more likely to be a rate cut rather than a rate hike. This should augur well for REIT valuations. Meanwhile, the 10-year Malaysian Government Securities (MGS) yield – the risk-free rate benchmark we use in REIT valuation has consistently stayed below 4.00% since coming off its peak of 4.57% in Oct 2022. We assume a 4% risk-free in our REIT valuation.

1. Retail

Two more gigantic malls to open this year. While we are positive on REITs with malls in strategic locations, we are mindful of competition for footfall posed by new sizeable high-profile malls in an already highly saturated market. Two new malls within Kuala Lumpur with a collective retail space of c.1.5m sq. ft, are scheduled for openings this year, i.e. 118 Mall and Pavilion Damansara Heights (Phase 2). These will be on the heels of the onslaught of the Exchange TRX and Pavilion Damansara Heights (Phase 1) malls in 2HCY23. Situated in the heart of the city and home to over 500 experiential stores, we believe the potential impacts of The Exchange TRX to the retail market could not be avoided especially to malls in close proximity such as Pavilion KL and Suria KLCC. The crowded market could be partially cushioned by the relaxation on visas application for several neighbouring countries, coupled with a cheaper MYR, we believe tourism will be on the rise in coming quarters, benefiting the retail segment.

Mall occupancy rates improved slightly in 2HCY23. Based on National Property Information Centre's (NAPIC) 2HCY23 Property Market Report, occupancy rates of retail space in shopping complexes came in at 77.4% (Jun 2023: 76.6%) from an occupied space of 13.7m sqm on a total retail space of 17.7m sqm. This supported higher rental income from improved tenant sales amid rising footfall and sustained occupancy levels especially in prime shopping centres in Klang Valley.

Potential dent on consumer spending. We are mindful that the performance of retail malls could be weighed down by weakened consumer spending on elevated inflation, the increase in the SST to 8% (from 6%), and the introduction of a luxury tax ranging from 5% to 10% and the impending fuel subsidy rationalisation. On the flip side, tourist arrivals and their spending may be boosted by a weak MYR.

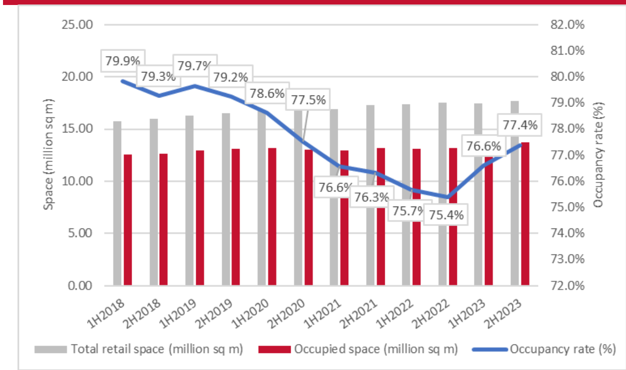
2. Office

More office space to hit the market. Five new office buildings are pending completion in 1HCY24 which will contribute another c.1.4m sq ft to Klang Valley's existing cumulative office stock, two of which are located in KL City, namely Felcra Tower, and The Exchange TRX Office by Lendlease. These will be on the heels of the recent completion of four new office developments, namely Merdeka 118 tower, PNB 1194 office building, Aspire Tower, and Pavilion Damansara Heights Corporate Tower, which contributed to a drop in overall purpose-built office occupancy rate to 78.6% (Jun 2023: 79.0%) from an occupied space of 19.6m sqm against a total office space of 24.9m sqm.

Despite increased supply, Grade A buildings in decentralized locations with strong connectivity and green certifications are expected to remain relatively resilient for its strong and growing demand. Also, there is demand for office spaces from high-growth sectors such as technology, finance, and professional services.

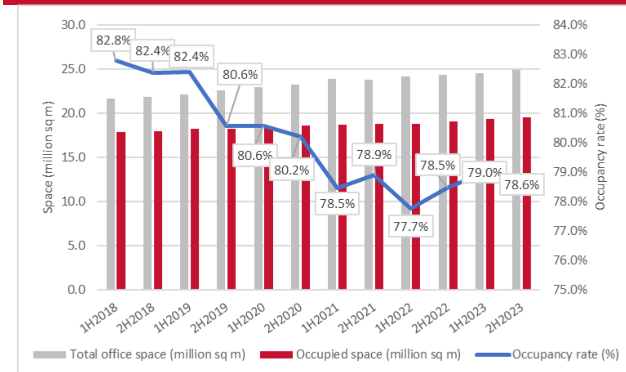
Sector top picks. They are: (i) **KLCC** for its stronger perceived appeal to foreign shoppers and the advantage of having a higher income customer group who may only be minimally affected by the proposed tax hike, and (ii) **SUNREIT** on the view that it will experience milder impact from the entry of TRX mall given its landmark assets' distance to the mall, coupled with being the landlord for numerous Grade A office buildings in prime locations.

Occupancy Rate Trend For Retail Space



Source: NAPIC, Kenanga Research

Occupancy Rate Trend For Office Space



Source: NAPIC, Kenanga Research

10-Year MGS Yield Movement (since March 2023)

Source: Bloomberg

Target Yield at a Glance

REIT	Stock Call	Target Price (RM)	Target Yield (%)
AXREIT	MP	1.62	5.5
CLMT	MP	0.580	7.5
IGBREIT	MP	1.68	6.5
KLCC	OP	8.00	5.5
PAVREIT	OP	1.51	6.0
SUNREIT	OP	1.72	6.5

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

Peer Table Comparison

Name	Rating	Last Price (RM)	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.
REITS																	
Axis REIT	MP	1.84	1.62	-12.0%	3,215.4	Y	12/2024	9.3	10.2	16.6%	0.6%	19.0	18.8	1.2	6.0%	8.7	4.7%
Capitaland Malaysia Mall Trust	MP	0.610	0.580	-4.9%	1,723.6	N	12/2024	3.9	4.0	-284.4%	-19.5%	N.A.	10.1	0.7	5.0%	4.3	7.0%
IGB REIT	MP	1.75	1.68	-4.0%	6,309.5	N	12/2024	10.1	10.4	-2.5%	2.3%	16.7	16.4	1.7	9.8%	9.7	5.5%
KLCCP Stapled Group	OP	7.38	8.00	8.4%	13,323.4	Y	12/2024	40.2	41.6	13.6%	3.7%	16.5	15.9	1.0	5.2%	42.5	5.8%
Pavilion REIT	OP	1.27	1.51	18.9%	4,644.2	N	12/2024	8.0	8.5	20.6%	4.3%	13.1	12.6	1.0	7.2%	8.7	6.9%
SUNWAY REIT	OP	1.52	1.72	13.2%	5,205.7	N	12/2024	10.2	10.9	13.9%	6.3%	14.4	13.5	1.0	6.9%	10.6	7.0%
SECTOR AGGREGATE					**34,421.7**					**-5.1%**	**24.0%**	**18.5**	**14.9**	**1.1**	**6.7%**		**6.2%**

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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