AmResearch
Sector report
06 Feb 2015

REITS

A volatile MYR and bond yield environment

NEUTRAL
(Maintained)

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Rationale for report: Sector update

Investment Highlights

- **We are NEUTRAL on MREITs** given the weak MYR and volatile bond yield environment. MREITs' yield spread has now narrowed to 200bps and this is in fact tighter than the current SREIT yield spread of 360bps, suggesting high valuation for MREITs. By historical standard, the yield spread between MREITs and 10-year Malaysia Government Securities (MGS) is about 272bps on average between 2012-YTD. MGS yield had risen to 4.15% in end-December, from 3.86% in end-November, and 3.84% in end-October 2014. The increase in MGS yield was due to the impact of weakening oil prices, which affected the local currency and had possibly led to the foreign sell-off in the bond market. The continued volatility in the MGS yield would remain as a drag to MREITs' performance in the near term as higher returns is required given the narrowing yield spread with the MREITs. Against the USD, MYR has weakened to RM3.54 since the collapsed in crude oil prices – the weakest level since 2009.

- **In Singapore, SREITs had a good start for the year,** delivering about 8% returns YTD, given the collapse in the Singapore bond yield and strong appreciation of SGD. We believe SREITs are having a good run due to the attractive distribution yield of 5%-6% compared to the benchmark of Singapore's bond yield which are at YTD lows. Singapore's bond yield has collapsed to 1.92% (-21% YTD) currently from 2.32% since the start of January 2015. Bond yield in Malaysia has however been on an uptrend since mid-2013 at 3.76% currently vs. the historical 3-year average of 3.7%. For comparison, CMMT's sister company, Capitamall Trust Singapore is trading at a more attractive distribution yield of 5% (yield spread of 319bps), despite having a lower Singapore bond yield than Malaysia's.

- **Minimal spillover effect on retail REITs' bottom line despite a challenging retail landscape this year**. This is underpinned by the low composition of turnover rent on sales, which historically constitute about 3%-4% of gross revenue and largely dominated by fixed rental income. Hence, the temporary setback arising from the near-term slowdown in retail sales and post-GST should have minimal impact on the retail REITs' earnings, we opine.

- **Expect no significant changes in the MREITs organic growth.** In the 2015 budget review, the government had postponed the scheduled electricity tariff hike in 2015. We see an unlikelihood of any significant increase in property operating expenses for now. MREITs like PREIT and KLCCSS had raised service charges to cushion the impact from the electricity and assessment hike in 2014. CMMT, however, has been absorbing these hikes while maintaining its service charge, with the exception of The Mines, where service charge had increased by 15% effective January 2015.

- **MREITs have prepared well with conservative balance sheet gearing; they have high proportion of fixed-rated debts** given the proactive capital management. As it is, the fixed-rate debt component for PREIT, CMMT and KLCCSS stand at 99.5%, 70% and 86%, respectively. MREITs' gearing are stable and within the range of 20%-30% - below the 50% threshold.

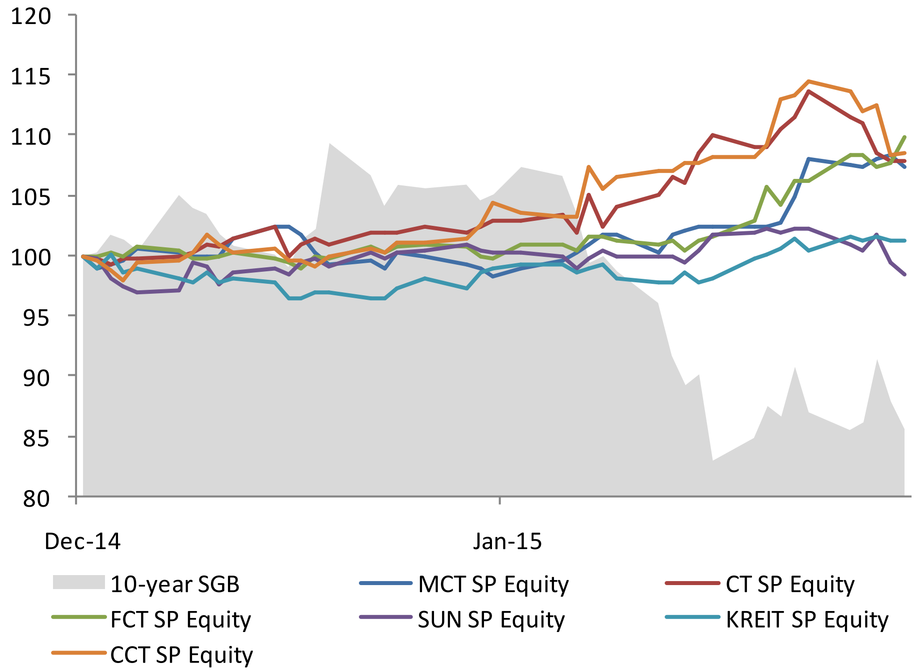
- **We have HOLD calls** on Pavilion REIT (FV: RM1.40/unit), CMMT (FV: RM1.50/unit) and Al'-Aqar Healthcare REIT (FV: RM1.50/unit) until key valuation drivers turns more constructive. We expect no significant growth for MREITs given possible rental pressure during lease renewals due to a challenging retail outlook. GST impact is unlikely to drag the sector's organic growth as GST will be passed on to the tenants. Earnings from 2015 would largely be driven by lease renewals with expectations of a single-digit rental reversion.

- **On the acquisition front,** while CMMT's recent proposed acquisitions of Tropicana City Mall and Tropicana City Office would provide geographical diversification, these properties may not be yield-accretive in the immediate term, we think. While various asset enhancement initiatives would be undertaken to boost rental, it appears challenging for CMMT to lift rentals in the immediate term because:- (1) anchor tenants are locked-in for a long period, unlike specialty store; and (2) possible rental pressure during lease renewals. We are concerned over the further weakening of Sungei Wang's rental reversion (in negative territory now due to ongoing MRT construction works) and footfall traffic disruption. This is because Bukit Bintang Plaza (located next to Sungei Wang) will be demolished and redeveloped into an integrated mixed development. The earliest injection for PREIT is likely to be in 2016, upon the completion of the Pavilion Extension.

- **The REIT-ing of WCT malls could excite the MREITs sector.** The last REIT established, i.e. KLCC Stapled REIT, happened in 2013. Property developer, WCT, intends to REIT its shopping malls on 2016. This includes its existing Paradigm Mall Kelana Jaya, Gateway Mall KLIA2, and Aeon Bandar Bukit Tinggi Mall, with a reported total asset value of about RM2bil. Another two malls currently under construction –Paradigm Mall Johor Bahru and Paradigm Mall OUG –are likely to be injected into the REIT once these assets mature.

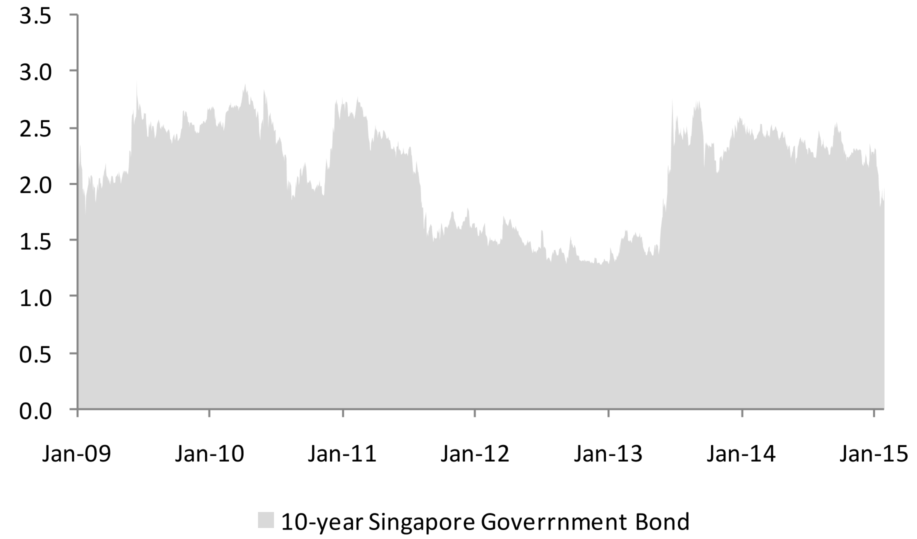
PP 12246/05/2013 (032379)

EXHIBIT 1: RELATIVE PERFORMANCE OF SREIT



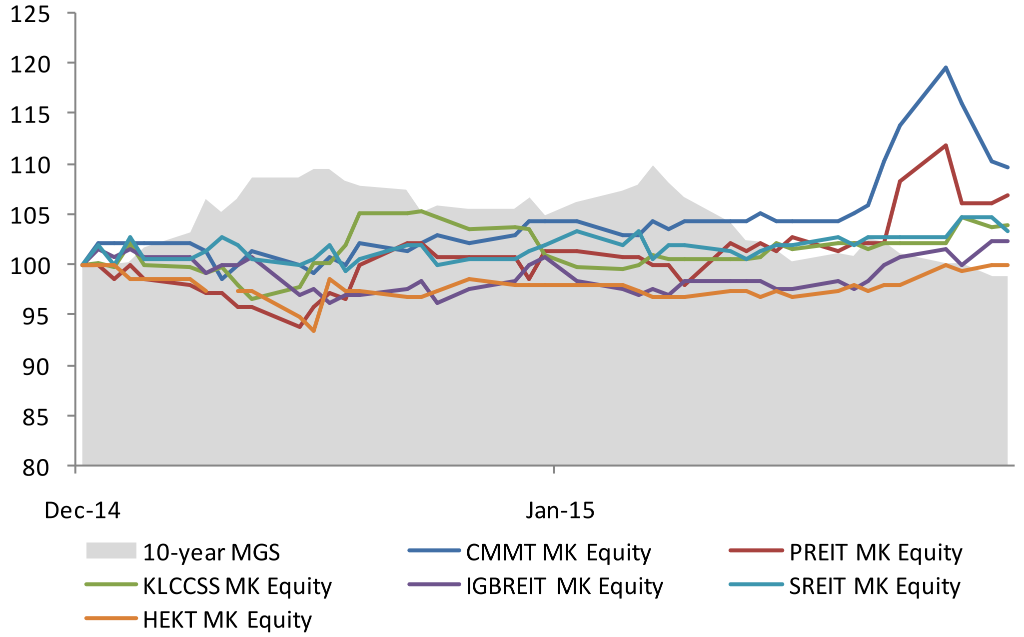
Source: Company, AmResearch

EXHIBIT 2: 10-YEAR SINGAPORE GOVERNMENT BOND TREND



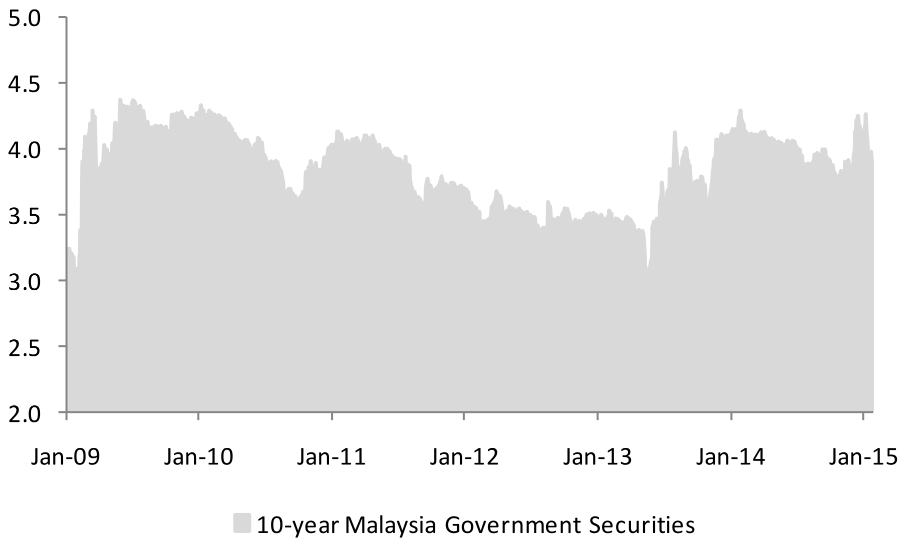
Source: Company, AmResearch

EXHIBIT 3: RELATIVE PERFORMANCE OF MREIT



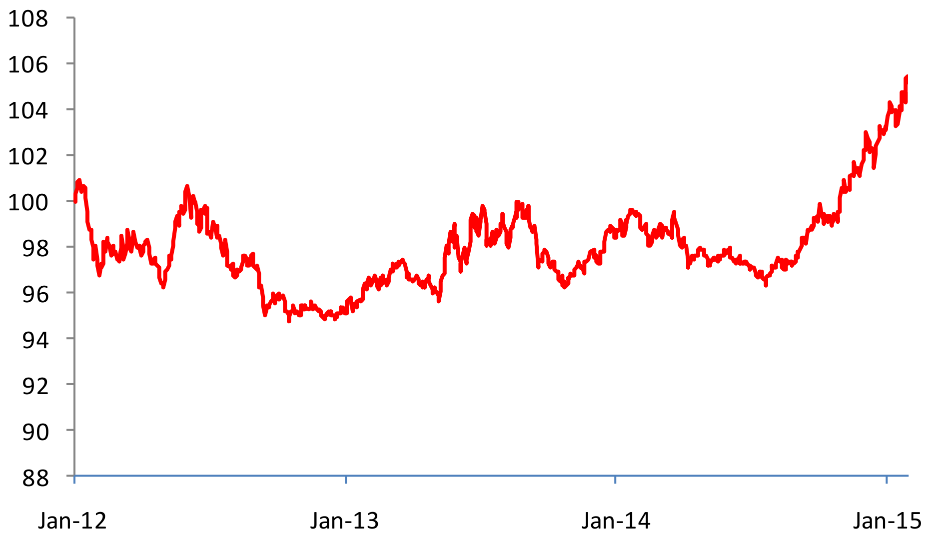
Source: Company, AmResearch

EXHIBIT 4: 10-YEAR MALAYSIA GOVERNMENT SECURITIES



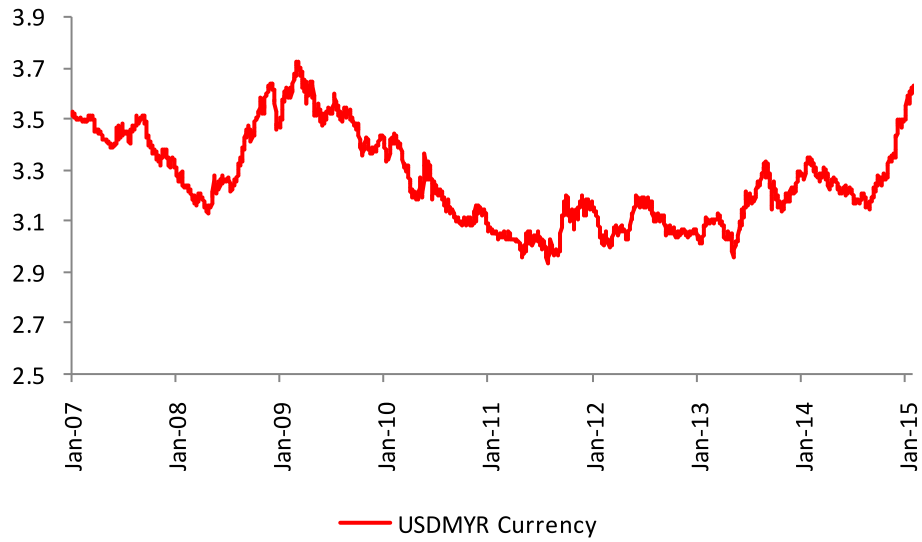
Source: Company, AmResearch

EXHIBIT 5: RELATIVE PERFORMANCE OF SGD



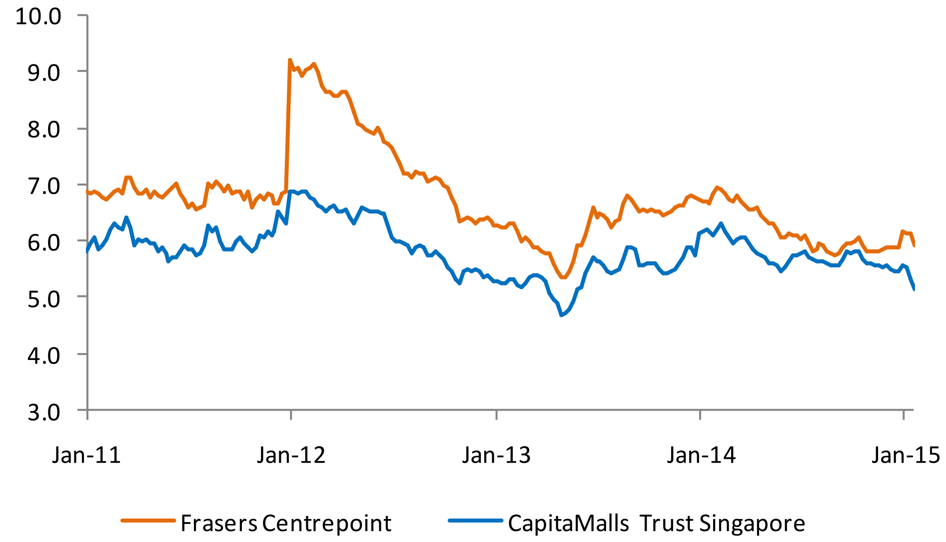
Source: Company, AmResearch

EXHIBIT 6: WEAKENING MYR AGAINST USD



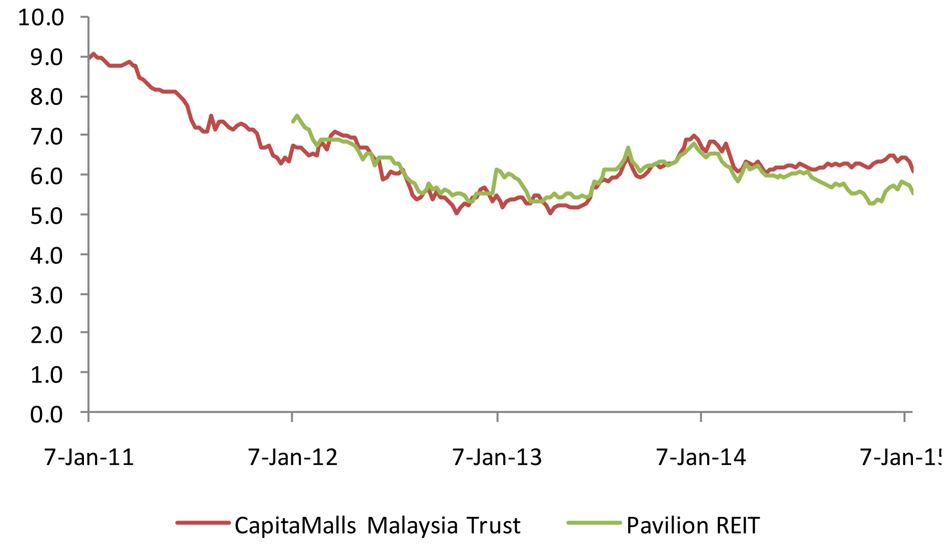
Source: Company, AmResearch

EXHIBIT 7: SREIT DISTRIBUTION YIELD



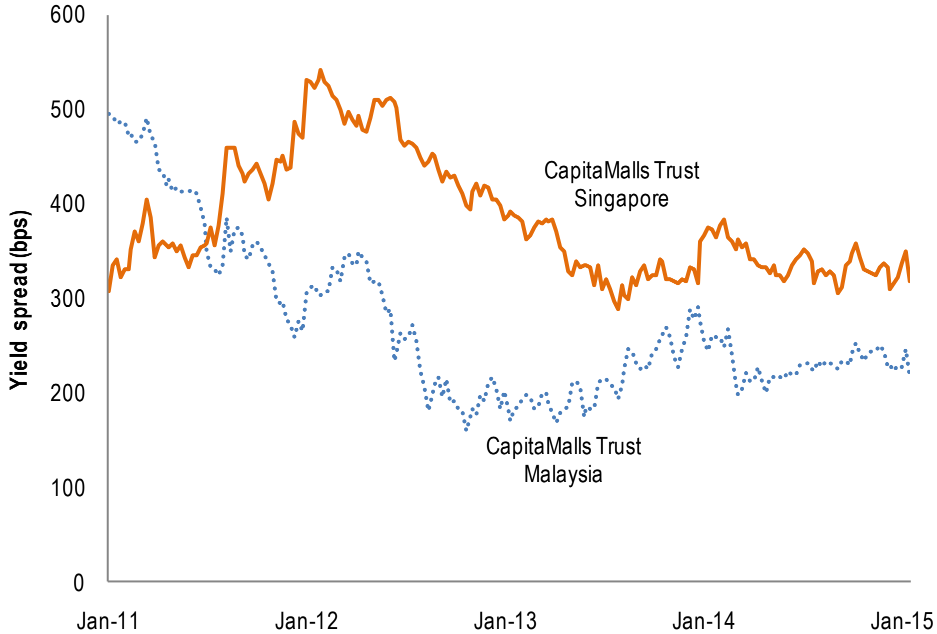
Source: Company, AmResearch

EXHIBIT 8: MREIT DISTRIBUTION YIELD



Source: Company, AmResearch

EXHIBIT 9: COMPARING YIELD SPREAD FOR BETWEEN CMMT MK AND CT SP



Source: Company, AmResearch

EXHIBIT 10: PEER COMPARISON

Company	Share price (RM/share)	EPU growth (%) FY15F	EPU growth (%) FY16F	DPU (sen) FY15F	DPU (sen) FY16F	istribution yield (%)	Gearing (%)	ROE (%)	Fair Value (RM/share)	Call
Capitamall Malaysia Trust	1.43	1.7	3.0	9.1	9.3	6.3	28.3	10.5	1.50	HOLD
Pavilion REIT	1.48	4.6	4.9	8.3	8.7	5.6	15.3	8.7	1.40	HOLD
Al-Aqar Healthcare REIT*	1.40	(24.3)	10.8	8.0	8.6	5.7	42.4	6.8	1.50	HOLD

**represent FY14F and FY15F respectively*

Source: Company, AmResearch *Share price as at 5 February 2015*

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