

23 August 2016

Overweight

Malaysian REITs

Opening doors for growth

The Malaysian REIT Managers Association (MRMA) held an engagement session with the investment community to exchange ideas and obtain feedback on the proposed amendments to the REIT Guidelines by the Securities Commission (SC). We discuss some of the key highlights from the session below.

Performance

	1M	3M	12M
Absolute (%)	2	7	19
Rel market (%)	(0)	3	11

Source: KAF

Key recommendations & forecasts

Company	Bloomberg	Year end	Rec	Price (RM)	Target (RM)	EPS CY16F	Yield CY16F
Al-'Aqar HC REIT	AQAR MK	Dec-16	Buy	1.63	1.80	0.09	5.5
Axis REIT	AXRB MK	Dec-16	Hold	1.81	1.70	0.08	4.6
IGB REIT	IGBREIT MK	Dec-16	Hold	1.64	1.80	0.08	5.4
Pavilion REIT	PREIT MK	Dec-16	Buy	1.76	1.90	0.09	5.0
MRCB Quill REIT	MQREIT MK	Dec-16	Buy	1.25	1.40	0.08	6.4
Sunway REIT	SREIT MK	Jun-16	Hold	1.73	1.70	0.09	5.2

Source: Bloomberg, Company, KAF

Property development is the way to go

The most talked about issue during the session was property development, where the proposed amendment, should it go through, will allow REITs to undertake property development activities not exceeding 15% of the REIT's TAV. The existing guideline is capped at 10% of TAV, while in Singapore, it is currently set at 25% of TAV.

A challenging acquisition environment due to low cap rates

The panel pointed out that the main challenge faced by REIT managers is finding yield-accretive transactions, which are hard to come by in recent years. This is exacerbated by the fact that there are more REITs now as compared to 10 years ago. Stiff competition for assets means that the balance of negotiation is on the side of the potential sellers. This means low cap rates in the investment market, making yield accretion more difficult.

While the amendment may provide a new avenue for growth from developing vacant land, such a move would be at the expense of lower immediate cash distribution and also, higher risk profile because of the associated uncertainty over building and tenancy. Historically, REITs prefer to buy mature assets with stable cash flows.

Managing development risk

In terms of mitigating risks that come with property development, this is addressed in the proposed amendment in which the gearing limit for REITs will be capped at 50%, without the option for them to increase this limit by obtaining approval of unitholders. The panel also emphasised the track record and expertise of REITs.

A positive move but no rush

We believe the main beneficiaries of the amendments are REITs with strong sponsors and experience in property development, all of which are within our coverage. We remain Overweight on the sector based on the healthy yields on offer, at an average of 5.2%, which translates to a spread of 160bps over the 3.53% 10-year MGS. Our top picks are MRCB-Quill REIT (MQREIT) and Al-'Aqar Healthcare REIT, mainly premised on attractive yields and good pipeline of asset injections backed by strong sponsors – namely MRCB, Quill Group, and EPF for MQREIT; and KPJ Healthcare for Al-'Aqar.

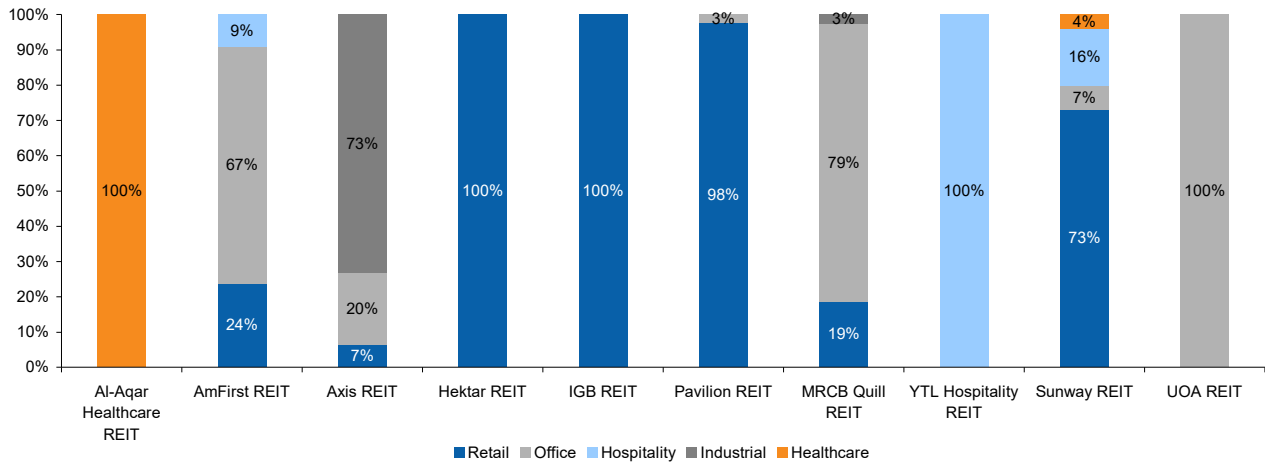
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Important disclosures can be found in the Disclosure Appendix

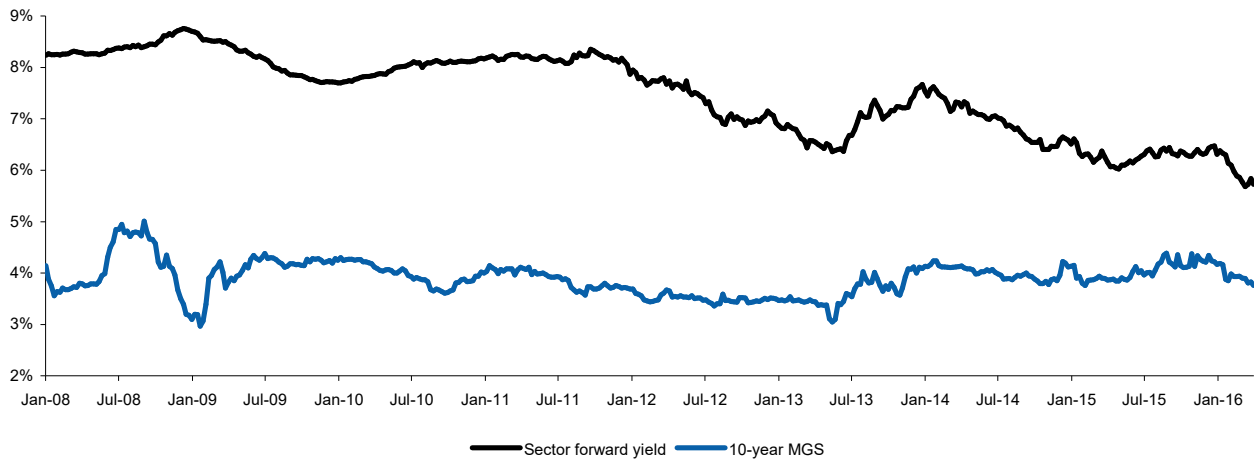
Relevant charts and tables

Chart 1 : Asset portfolio segmentation by revenues



Source: Company, KAF

Chart 2 : REIT sector forward yield vs the 10 year MGS



Source: Bloomberg, KAF

Table 1 : Peer comparison

Company	Rec	Mkt Cap (RMm)	Price (RM)	TP (RM)	PER (x)		PBV (x)		ROE (%)		Yield (%)	
					2016F	2017F	2016F	2017F	2016F	2017F	2016F	2017F
Al-Aqar Healthcare REIT	BUY	1,187	1.63	1.80	18.3	18.0	1.3	1.3	7.4	7.5	5.5	5.5
Axis REIT	HOLD	2,000	1.81	1.70	21.7	21.5	1.5	1.5	6.8	6.8	4.6	4.6
IGB REIT	HOLD	5,721	1.64	1.80	20.7	19.3	1.6	1.6	7.5	8.0	5.4	5.8
Pavilion REIT	BUY	5,320	1.76	1.90	20.0	18.6	1.4	1.4	6.9	7.4	5.0	5.4
MRCB-Quill REIT	BUY	827	1.25	1.40	15.0	14.2	0.9	0.9	6.1	6.4	6.4	6.7
Sunway REIT	HOLD	5,090	1.73	1.70	19.4	18.3	1.3	1.3	6.6	7.0	5.2	5.5
REITs	Overweight	20,145			19.9	18.8	1.4	1.4	6.9	7.3	5.2	5.5

Source: Company, KAF, Bloomberg

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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