MREITs

NEUTRAL
↔

Tepid Outlook, CMMT Our Preferred Pick

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Maintain NEUTRAL. 2Q18 results continued to meet expectations, consistent since the 3Q17 results season. Meanwhile, share prices are recovering slowly since the unwarranted sell down in March-April 2018, at +7% to -22% YTD (from -7% to -31% lows in March-April 2018). Fundamentally, MREITs' outlook is clouded by the oversupply of office and retail spaces in the Klang Valley, which is putting a dampener on the sector prospects, limiting our reversion outlook at mildly negative to single-digit reversions for MREITs assets under our coverage. All in, MREITs under coverage are seen maintaining mildly positive DPU growth YoY of 3-2% in FY18-19 as the saving grace is quality landmark assets and/or locations, which can weather oversupply conditions better being able to attract higher footfall traffic. Maintain 10-year MGS target of 4.20%, which is slightly more conservative than current levels of 4.00-4.10%. MREITs' earnings are unchanged, but we rolled forward our valuation base to FY19E, increasing our TPs by 0-8%. Reiterate NEUTRAL call with CMMT (OP; TP: RM1.25) as our preferred pick as its 7.3% gross yield (vs. MREITs' average of 6.1%), post pricing in potential risk to earnings and valuations, appears to have absorbed the necessary risks.

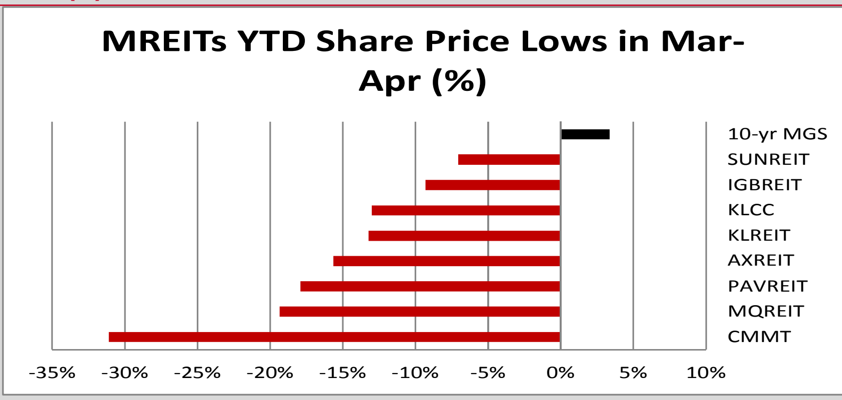
Results have been consistently within expectations. All MREITs' results were in-line, a consistent trait over the past four quarters. YoY-Ytd, top-line growth was mostly positive (2-11%), save for CMMT and MQREIT, which were marginally lower by 4%. This resulted in positive bottom-line growth for most (4-13%), save for CMMT (-3%) and MQREIT (-7%), which were within our expectations. QoQ, bottom-line was mostly flattish to mildly negative (-1% to -15%) due to 2Q18 generally being a marginally weaker quarter for retail REITs due to softer sales while office REITs such as AXREIT and MQREIT saw marginal growth. All in, we made no changes to our earnings estimates, TPs and calls under this latest results review.

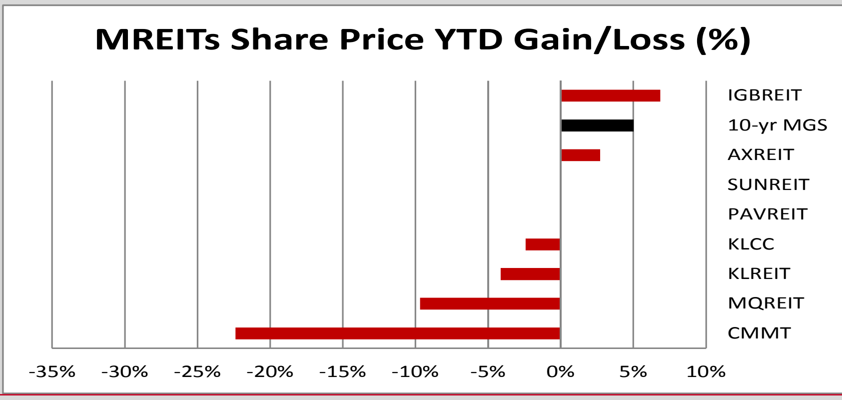
REITs' share prices improving from March-April 2018 lows (of -7% to -31%) to +7% to -22% YTD, with the KLREIT Index recovery (-4% YTD vs. March-April lows of -13%). We postulate that the deep sell-down in March-April may have been due to perceptions of: (i) a growing oversupply of office and retail spaces in the Klang Valley, (ii) expectations of negative impact from an OPR hike, which we believe are unsubstantiated, and (iii) market uncertainties surrounding the local elections. However, we believe the sell-down in March-April were mostly unwarranted while subsequent 1Q18 and 2Q18 results came in within expectations for all MREITs, similar to prior results seasons (note that 3Q17 to 2Q18 results have all met expectations). We believe the slow recovery may have been due to investors gradually gaining some confidence upon the consistent results performance in recent quarters, while investors may also be looking for flights for safety in MREITs in light of market uncertainties.

Unexciting outlook for fundamentals. We are tepid on the outlook for MREITs going forward due to: (i) unexciting reversions, up to mid-single-digit for retail to mildly negative reversions for office assets due to competition from oversupply of office and retail spaces, and (ii) minimal lease expiries (14-30% of NLA for MREITs under our coverage) save for CMMT (45%) in FY18 which we have accounted for. Meanwhile, FY19 will see c. 21-53% leases up for expiry for MREITs under our coverage, but due to the oversupply of both office and retail spaces, we believe strong reversions will remain challenging as tenants will prefer to prioritise occupancy over reversions. As such, we believe we have accounted for most foreseeable near-term risks, on modest FY18-19E average DPU growth of 3-2% YoY.

MREITs with landmark assets will fare better than the market. To recap, considering oversupply fears, we believe MREITs with landmark assets will fare better than the market with above-average occupancy and positive reversions due to well managed assets. REITs such as PAVREIT, IGBREIT, KLCC, SUNREIT will continue to remain stable from higher footfall traffic (vs. neighbourhood malls). This enables such assets to retain close to maximum occupancy of 95-100% vs. domestic retail occupancy of c.80% and command positive reversions, albeit at a slower growth rate which we have accounted for. This is similar for landmark office assets (i.e. KLCC and MQREIT) which fare better than the industry average with close to full occupancy of 96-100% vs. the Klang Valley's average of c.80%. Additionally, according to Bank Negara's Financial Stability Review for 1H18, banks will be more cautious when lending to the office space and shopping complex segments going forward. Although this may not help near-term reversion rates, we believe it is a long-term positive as it helps address the oversupply situation which bodes well for MREITs.

MREITs YTD Gains/Losses (%)





Source: Bloomberg, Kenanga Research

MREITs earnings unchanged, but we rolled forward our valuation base to FY19E. All in, we made no changes to earnings estimates but have rolled forward our valuation base to FY19E, increasing MREITs' TPs by 2-8%, save for CMMT,SUNREIT and MQREIT, which were left unchanged *(refer to table below)*. Additionally, we: (i) increased our spread for CMMT to 2.4ppt, +1SD above its historical average, (from +0.5SD), closer to other retail MREITs and to account for investors' concerns of its negative reversions which we believe we have accounted for in our estimates, and (ii) lowered our spread for IGBREIT to +2.1ppt, average SD (from +2.4ppt, +0.5SD) on stable asset profile and quality.

MREITs Valuations

MREIT	Last Price as at 21/9/18	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)	Old Call	Old TP (RM)	Share price upside (%)	Total Returns (%)
KLCC	7.72	0.39	FYDec18E	5.0%	5.6%	1.4%	4.20%	UP	6.90	UP	6.80	-11%	-6%
SUNREIT	1.70	0.10	FYJun19E	6.0%	6.4%	2.2%	4.20%	MP	1.60	MP	1.60	-6%	-1%
CMMT	1.11	0.08	FYDec18E	7.3%	6.6%	2.4%	4.20%	OP	1.25	MP	1.25	13%	19%
AXREIT	1.51	0.09	FYDec18E	6.0%	6.6%	2.4%	4.20%	UP	1.35	UP	1.25	-11%	-5%
IGBREIT	1.72	0.10	FYDec18E	5.7%	6.3%	2.1%	4.20%	UP	1.55	UP	1.45	-10%	-5%
PAVREIT	1.62	0.09	FYDec18E	5.6%	5.8%	1.6%	4.20%	MP	1.55	MP	1.50	-4%	1%
MQREIT	1.12	0.08	FYDec18E	7.3%	7.5%	3.3%	4.20%	MP	1.10	MP	1.10	-2%	5%

Source: Bloomberg, Kenanga Research

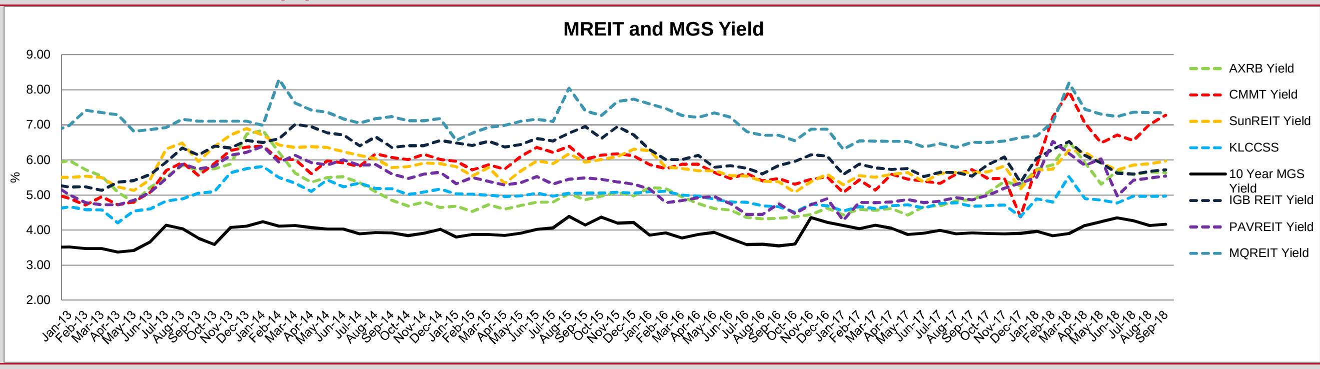
Scenario Analysis: Impact of an Increased 10-yr MGS to 4.40% to MREITs Valuations

MREIT	Last Price as at 21/9/18	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)	Old Call	Old TP (RM)	Share price upside (%)	Total Returns (%)
KLCC	7.72	0.39	FYDec19E	5.0%	5.8%	1.4%	4.40%	UP	6.65	UP	6.90	-14%	-9%
SUNREIT	1.70	0.10	FYJun19E	6.0%	6.6%	2.2%	4.40%	MP	1.55	MP	1.60	-9%	-3%
CMMT	1.11	0.08	FYDec19E	7.3%	6.8%	2.4%	4.40%	OP	1.20	OP	1.25	8%	15%
AXREIT	1.51	0.09	FYDec19E	6.0%	6.8%	2.4%	4.40%	UP	1.35	UP	1.35	-11%	-5%
IGBREIT	1.72	0.10	FYDec19E	5.7%	6.8%	2.4%	4.40%	UP	1.45	UP	1.50	-16%	-11%
PAVREIT	1.62	0.09	FYDec19E	5.6%	6.0%	1.6%	4.40%	MP	1.50	MP	1.55	-7%	-2%
MQREIT	1.12	0.08	FYDec19E	7.3%	7.7%	3.3%	4.40%	MP	1.05	MP	1.10	-6%	0%

Source: Bloomberg, Kenanga Research

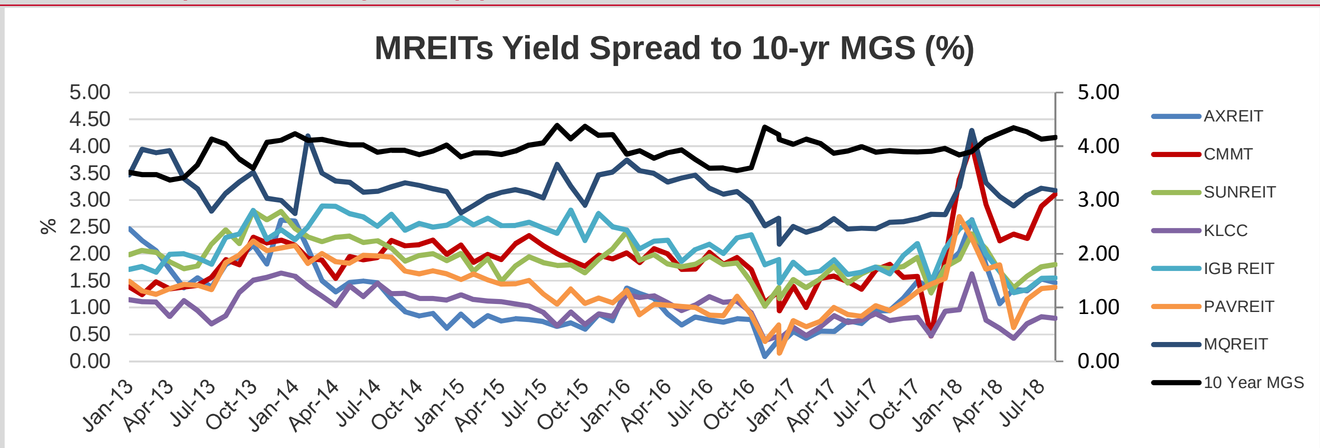
Maintain conservative 10-year MGS target of 4.20%, for now. The 10-year MGS has been hovering close to 4.10% currently (range bound between 4.00% and 4.10% in 3Q18). However, we are more conservative on the outlook of the MGS, targeting 4.20% due to potential interest rate hikes by the US Fed, with the Fed targeting one more rate hike in 2018, and three rate hikes in 2019 which we believe have mostly been priced in. Furthermore, the outlook for the MGS appears gloomy as we continue to monitor investors and market's concerns on Malaysia's credit rating due to the slew of debt-related news post elections, which also pose a downside bias to the MGS. Assuming a 20bps increase to the 10-year MGS to 4.40% (from 4.20%) currently, we do not expect any changes to our calls, while all our TPs will be lowered by 3-4%.

MREITs and MGS Yields (%)



Source: Bloomberg, Kenanga Research

MREITs Yields Spread to the 10-yr MGS (%)



Source: Bloomberg, Kenanga Research

Maintain NEUTRAL on MREITs due to the lacklustre outlook for earnings and fundamentals. Our valuations are based on a **conservative** 10-year MGS target of 4.20% and above-average yield spreads (+0.5 to +1SDSD above historical averages) which will serve as buffers for near-term fluctuations to the MGS and concerns of sector fundamentals (i.e. oversupply of office and retail spaces). Post rolling forward our valuations to FY19E DPU, MREITs are commanding decent yields of 5.0-7.3%, justifying our NEUTRAL call, while CMMT appears slightly more attractive at current levels.

CMMT preferred trading pick on attractive yields of 7.3%. Post rolling forward our valuations to FY19E, we increased our spread for CMMT to 2.4ppt, +1SD above historical average (from 2.1ppt), to account for investors' concerns of its negative reversions, while we believe we have accounted for this in our earnings. Even so, CMMT warrants an upgrade to OUTPERFORM (from MARKET PERFORM) on an unchanged TP of RM1.25 due to attractive yield of 7.3% at current levels vs. other retail MREITs' gross yields of 5.0-5.7%, save for MQREIT. We believe this is due to its overdone share price decline (-22% YTD), retreating close to IPO price of RM1.08 (when it debuted eight years ago), despite results meeting our expectations YTD, and foreseeable downsides already priced in.

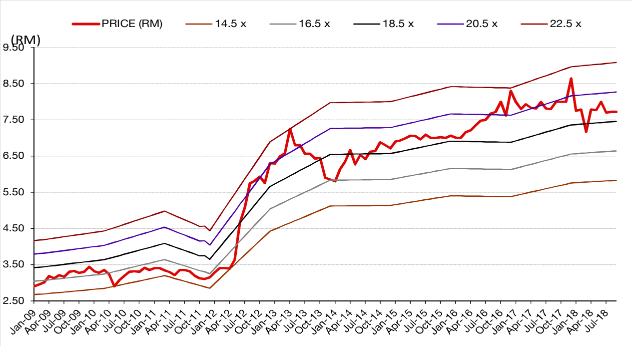
Risks to our call include: (i) worse-than-expected consumer spending, (ii) cost-push factors that result in weaker-than-expected rental reversions, (iii) U.S. Fed increasing interest rates in a more aggressive manner, (iv) weaker-than-expected occupancy rates, and (v) further decline in oil prices and weaker MYR, which may increase pressure on the 10-year MGS.

Peer Comparison

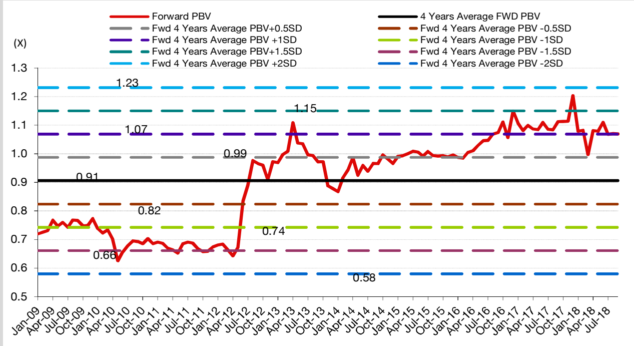
Name	Last Price (21/9/18) (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth 1-Yr. Fwd.	Revenue Growth 2-Yr. Fwd.	Core Earnings Growth 1-Yr. Fwd.	Core Earnings Growth 2-Yr. Fwd.	PER (x) - Core Earnings Hist.	PER (x) - Core Earnings 1-Yr. Fwd.	PER (x) - Core Earnings 2-Yr. Fwd.	PBV (x) 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	1.51	1,860.8	Y	12/2018	15.9%	12.0%	9.8%	11.5%	20.4	18.6	16.7	1.2	1.2	6.3%	4.8%	1.35	UP
CAPITALAND MALAYSIA MALL TRUST	1.11	2,269.0	N	12/2018	-0.3%	2.4%	-1.8%	0.6%	14.2	13.9	13.7	0.9	0.9	6.1%	6.5%	1.25	OP
IGB REIT	1.72	6,071.0	N	12/2018	3.4%	2.6%	0.2%	2.7%	19.8	20.0	19.5	1.6	1.6	8.2%	5.1%	1.55	UP
KLCCP STAPLED GROUP	7.72	13,937.2	Y	12/2018	6.8%	1.6%	7.2%	1.8%	20.8	19.4	19.0	1.1	1.1	6.0%	4.6%	6.90	UP
MRCB-QUILL REIT	1.12	1,200.4	N	12/2018	2.3%	-0.1%	2.7%	0.3%	13.7	13.3	13.5	0.9	0.9	6.6%	6.7%	1.10	MP
PAVILION REIT	1.62	4,919.5	N	12/2018	18.7%	5.7%	8.3%	5.9%	21.1	19.5	18.5	1.2	1.2	6.4%	4.8%	1.55	MP
SUNWAY REIT	1.70	5,006.6	N	06/2019	7.5%	2.7%	5.7%	1.3%	17.7	16.8	16.5	1.1	1.1	7.1%	5.4%	1.60	MP
Simple Average					**7.8%**	**3.8%**	**4.6%**	**3.5%**	**18.2**	**17.4**	**16.8**	**1.1**	**1.1**	**6.7%**	**5.4%**		
** Core NP and Core PER*																	
CONSENSUS NUMBERS																	
YTL HOSPITALITY REIT	1.23	2,096.4	N	06/2019	-0.4%	3.0%	-45.8%	5.7%	8.9	16.3	15.5	0.8	0.9	4.2%	6.7%	1.42	BUY
AL-'AQAR HEALTHCARE REIT	1.23	895.7	Y	12/2018	N.A.	N.A.	N.A.	N.A.	10.6	N.A.	N.A.	1.0	N.A.	N.A.	N.A.	1.70	BUY
AMANAHRAYA REIT	0.840	481.5	N	12/2018	49.1%	34.9%	16.9%	13.5%	15.2	13.0	11.5	0.6	N.A.	3.6%	7.5%	0.940	BUY
AMFIRST REIT	0.595	408.4	N	03/2019	N.A.	N.A.	N.A.	N.A.	36.0	N.A.	N.A.	0.5	N.A.	N.A.	N.A.	N.A.	N.A.
HEKTAR REIT	1.22	563.6	N	12/2018	N.A.	N.A.	N.A.	N.A.	17.2	N.A.	N.A.	0.9	N.A.	N.A.	N.A.	N.A.	N.A.
TOWER REIT	0.960	269.3	N	06/2019	N.A.	N.A.	N.A.	N.A.	13.6	N.A.	N.A.	0.5	N.A.	N.A.	N.A.	N.A.	N.A.
UOA REIT	1.42	600.5	N	12/2018	N.A.	N.A.	N.A.	N.A.	15.9	N.A.	N.A.	0.8	N.A.	N.A.	N.A.	N.A.	N.A.
ATRIUM REIT	1.11	135.2	N	12/2018	N.A.	N.A.	N.A.	N.A.	7.5	N.A.	N.A.	0.8	N.A.	N.A.	N.A.	N.A.	N.A.
AL-SALAM REIT	0.875	507.5	Y	12/2018	3.8%	8.8%	-16.0%	13.5%	12.5	14.9	13.1	0.8	N.A.	4.8%	5.6%	0.900	BUY
KIP REIT	0.820	414.3	N	06/2019	N.A.	N.A.	N.A.	N.A.	11.0	N.A.	N.A.	0.8	N.A.	N.A.	N.A.	N.A.	N.A.

Source: Bloomberg, Kenanga Research

KLCC – Fwd PER Band

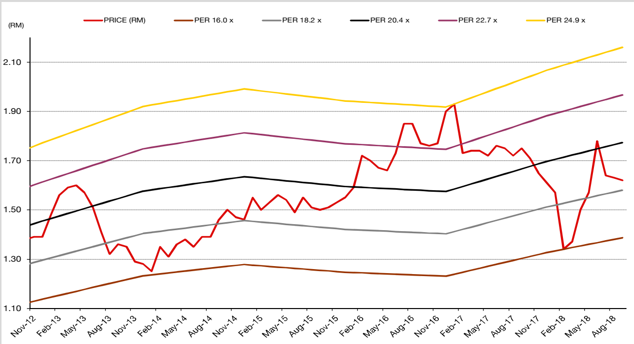


KLCC – Fwd PBV Band

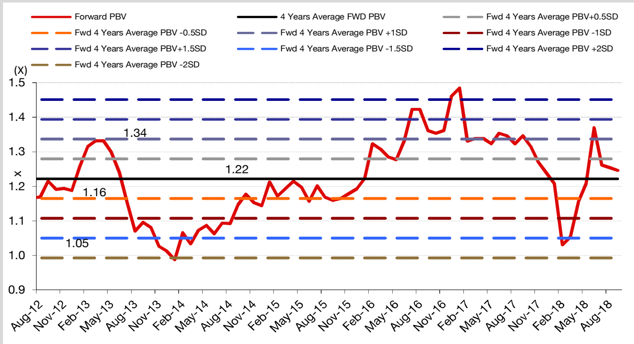


Source: Kenanga Research

PAVREIT – Fwd PER Band

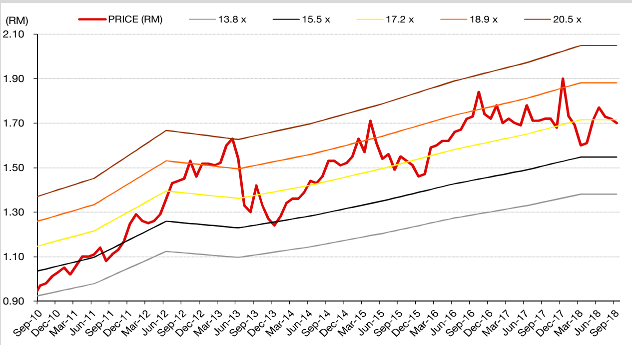


PAVREIT – Fwd PBV Band



Source: Kenanga Research

SUNREIT – Fwd PER Band



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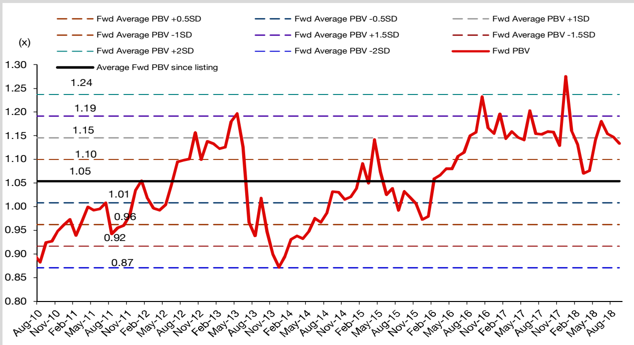
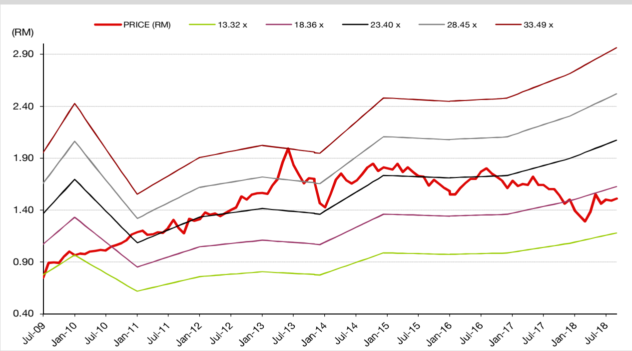


Source: Kenanga Research

AXREIT – Fwd PER Band



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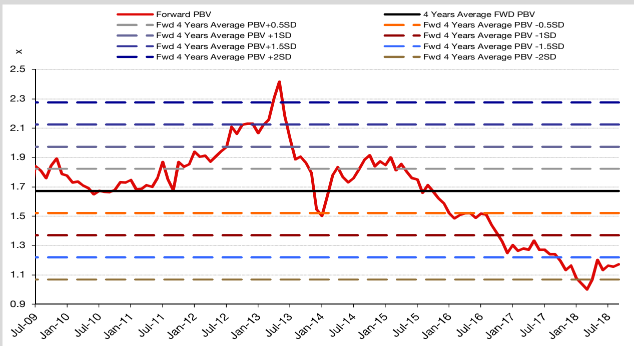
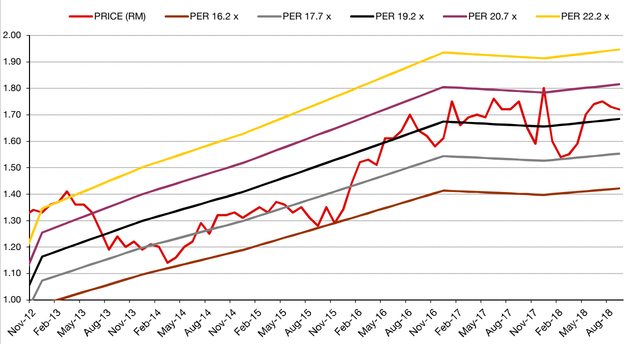
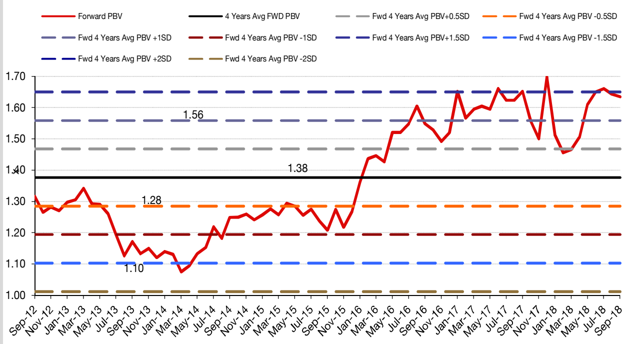


Source: Kenanga Research

IGBREIT – Fwd PER Band



IGBREIT – Fwd PBV Band



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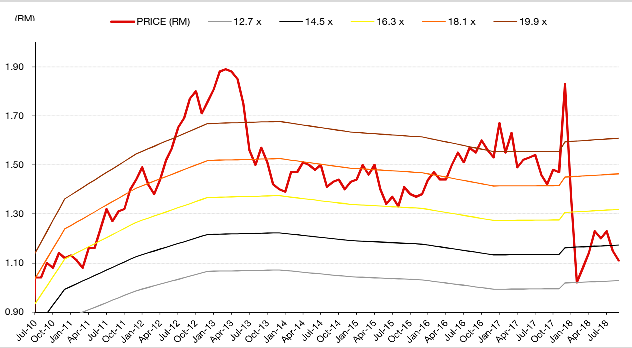
CMMT – Fwd PER Band



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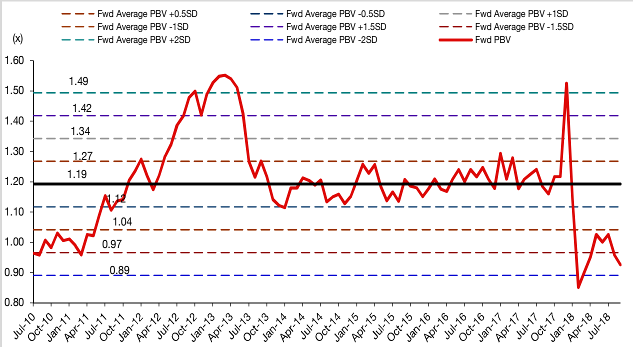
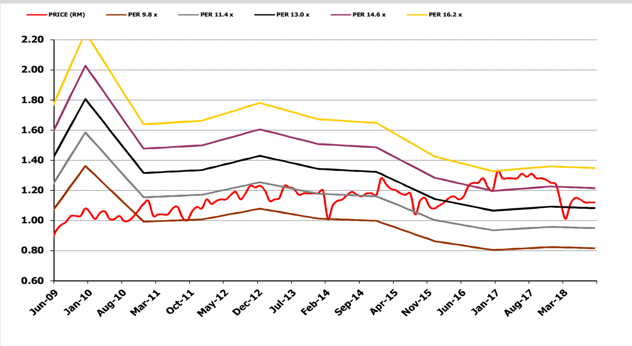
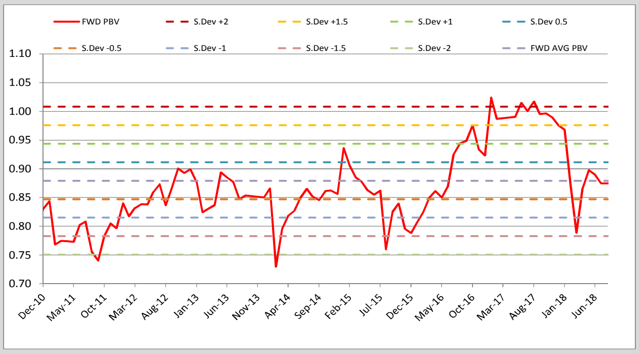


Source: Kenanga Research

MQREIT – Fwd PER Band



MQREIT – Fwd PBV Band



Source: 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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