AmInvestment Bank

Sector report

11 June 2021

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REITS

Mixed 1CFY21 performance

OVERWEIGHT
(Maintained)

Rationale for report: Sector update

Investment Highlights

- **We maintain our OVERWEIGHT recommendation on the REIT sector**. We are cautious that the reimplementation of the lockdown with tighter SOPs will dampen the companies' earnings in 2Q2021 as REITs are most likely be pressured to give another round of rental support to tenants that are not allowed to operate during this period. However, we believe the market has priced in the impact of the latest movement restriction. Looking beyond the lockdown, we believe REITs' recovery remains strong once restrictions are lifted, underpinned by pent-up demand as consumers tend to "revenge spend and gather", similar to what happened in the past. According to the Bumiputera Retailers Organisation, retail sales at malls have recovered to 75–80% of pre-pandemic levels when the previous MCO was lifted towards the end of 2020 and early 2021 (as compared to only 25% retail sales recorded at malls nationwide last year). Apart from that, we also believe that earnings visibility and associated risks of the REITs are more positive compared to last year, thanks to the wide rollout of vaccines both locally and globally.

- **Mixed 1QCY21 results.** Out of the 4 companies under our coverage, 1 exceeded our expectations, 2 were in line while 1 company came in below our expectations.

  - **YTL REIT results came in above our expectations**, thanks to higher-than-expected revenue from the Australian hotels as revenue per available room has gradually increased since the beginning of the pandemic (rising by 37% to A$74 in 3QFY21 from A$54 in 4QFY20), despite a low occupancy rate. In 9MFY21, YTL REIT's revenue and distributable income declined YoY by 34% and 47% respectively.

  - **IGB REIT and Pavilion REIT's results were in line with our expectations**. For 1QFY21, IGB REIT's revenue and distributable income dropped 20% and 35% YoY respectively, mainly due to rental support provided to tenants, lower carpark income and higher allowance for impairment of trade receivables due to the Covid-19 pandemic. Pavilion REIT's revenue and distributable income contracted YoY by 6% and 9% respectively, mainly on lower occupancy rate for malls with the non-renewal of some expired tenancies, as well as weaker marketing events and advertising revenue. This was however partly offset by the lower property operating expenses, largely from electrical cost savings and reduced marketing expenses, as well as decreased management fees and borrowing costs under the low interest rate environment.

  - **Sunway REIT results missed our expectations**, we believe, mainly due to the higher-than-expected rental support given to its tenants, coupled with lower-than-expected income from the hotel segment. This has caused its 9MFY21 revenue and distributable income to shrink YoY by 32% and 57% respectively.

  - **QoQ, the companies also recorded mixed results.** IGB REIT and Pavilion REIT recorded lower revenue and distributable income QoQ, we believe mainly due to the impact of MCO 2.0 as well as the seasonally quieter 1Q after the holiday season in 4Q. Meanwhile, YTL REIT's performance was flat QoQ, thanks to its stabilising master leases for Malaysia and Japan's portfolio, as well as consistent income from the Australian portfolio with its participation in the government's isolation group business. Sunway REIT recorded a stronger quarter thanks to the guaranteed income received from Sunway Clio Property and Sunway Hotel Georgetown, coupled with the full quarterly income contribution by The Pinnacle Sunway. The absence of one-off professional fees for The Pinnacle Sunway's acquisition and consent fee for borrowing facilities, as well as the lower average interest rate have also helped raise its distributable income for the quarter.

- **Retail sales contraction of 9.9% in 1QCY21 was better than expected YoY.** The Retail Group Malaysia (RGM) is forecasting the retail sales to grow by 4.1% for 2021, after declining by 13.4% YoY in 1Q21. On a positive note, the actual data of retail sales in 1Q2021 came in better than expected at a smaller 9.9% contraction. Moving forward, while we believe 2Q2021 retail sales will remain subdued due to the reimplementation of various MCOs and the much tighter lockdown in place, this is partly offset by the much better Hari Raya sales during the quarter. According to Jakel Group, Raya sales for this year increased significantly from last year, sliding by only 20% from pre-pandemic levels, vs. 60% lower sales recorded in 2020. Festive shopping is estimated to account for 18–20% of annual retail sales, according to RGM.

- Moreover, we take comfort that the **occupancy rate at the anchor malls of retail REITs under our coverage remains healthy** at above 90% on average albeit at a slight decline compared to pre-pandemic levels due to the termination of tenancy contracts. While these were quickly replaced by new tenants, the transition period takes slightly longer than usual as renovation work was delayed due to the various movement restrictions in place.

- In terms of financial health, the REITs under our coverage **continue to maintain a healthy debt-to asset ratio** of 22%–42% vs. 60% of the regulatory threshold (temporarily raised from 50% up to 31 December 2022 by the Securities Commission as a Covid-19 relief measure), which allows the REITs to gear up for further acquisitions. We do not rule out potential acquisitions to materialise in the next 12–18 months for the REITs under our coverage with the emergence of yield-accretive assets, which will further drive the REITs' medium to long-term growth despite short-term earnings headwinds.

- We have updated our fair values (FV) for **Sunway REIT (RM1.81), Pavilion REIT (RM1.59)** and **IGB REIT (RM1.89),** having rolled forward our base year to FY23F and applied a target yield of 5%. For **YTL REIT (FV RM1.11),** we apply a higher target yield of 7.5% to reflect higher earnings risks arising from its overseas assets. Our top pick for the sector is **Sunway REIT**. We like **Sunway REIT** for its diversified investment portfolio (which includes retail malls, hotels, offices, university and hospital) and the large pipeline of potential assets for future injection.

- **We maintain our OVERWEIGHT recommendation for the REIT sector**. Based on our estimates, REITs under our coverage provide distribution yields of more than 5.0% for FY22F and beyond compared to the current low interest environment rate. We like the sector as a recovery play, which is poised to benefit from Malaysia's post-pandemic economic growth.

- We may downgrade our stance to NEUTRAL if: (1) footfall recovery is slower than expected; (2) there is a massive decline in the occupancy rate due to increased competition from the oversupply of retail spaces; and (3) consumer spending/sentiment deteriorates further or recovers slower than expected.

EXHIBIT 1: VALUATION MATRIX

	Recomm	Price	Curr FV	Prev FV	Upside	Mkt Cap	FYE	DPU	(sen)	DPU growth (%)		Div Yield (%)		P/B	ROE
		(RM)	(RM)	(RM)	(%)	(RMmil)		FY22F	FY23F	FY22F	FY23F	FY22F	FY23F	(x)	(%)
PREIT	BUY	1.36	1.59	1.75	16.9	4,144.9	Dec	7.0	7.9	34.6	12.9	5.1	5.8	1.1	4.4
YTL REIT	BUY	0.91	1.11	1.28	22.7	1,542.5	Jun	5.2	9.3	23.8	78.8	5.7	10.3	0.6	3.1
SREIT	BUY	1.41	1.81	1.64	28.4	4,829.0	Dec*	7.7	8.8	28.3	14.3	5.5	6.2	1.0	5.0
IGB REIT	BUY	1.72	1.89	2.03	9.9	6,130.1	Dec	9.1	9.5	9.6	4.4	5.3	5.5	1.6	6.6
Simple Average										**24.1**	**27.6**	**5.4**	**7.0**	**1.0**	
Weighted Average										**22.6**	**16.3**	**5.3**	**6.2**	**1.2**	

**FY21 18 months*

Source: AmInvestment Bank

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