AmInvestment Bank

Sector report

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AmInvestment Bank
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REIT

Hopeful ahead of bumpy recovery

OVERWEIGHT

(Maintained)

Rationale for report: Sector update

Investment Highlights

- **Maintain OVERWEIGHT recommendation**. While we continue to believe that the earnings recovery in retail REITs could be bumpy in the immediate term, dragged by the resurgence of Covid-19 cases locally, earnings visibility and associated risks of the sector have now improved compared to last year thanks to the wide rollout of vaccines both locally and globally together with the reopening of domestic economy in stages.

  Based on our estimates, REITs under our coverage provide distribution yields of more than 5% for FY23F and beyond compared to the current low interest rate environment. We like the sector as a recovery play, poised to benefit from an expected rebound in Malaysia's post-pandemic economy.

- **2QCY21 earnings hampered by MCOs.** Out of the 4 companies under our coverage, the results of 3 companies came in below our expectations due to tighter movement control orders (MCO) while YTL Hospitality REIT (YTL REIT) was in line.

  - **IGB REIT, Sunway REIT and Pavilion REIT results missed our expectations**, largely due to higher-than-expected rental support given to their tenants as tighter movement restriction orders were imposed during the quarter following the resurgence of Covid-19 cases locally, as well as lower occupancy rates recorded at the malls. These caused the sector's 1HFY21 revenue to fall 18% YoY and distributable income to drop by 32% YoY.

    Sunway REIT's 12MFY21 revenue decreased by 26% YoY to RM411mil, which led to its distributable income contracting by 48% YoY to RM118mil while IGB REIT's 1HFY21 revenue and distributable income to fell marginally YoY by 1%. Even though Pavilion REIT's 1HFY21 revenue eased by 4% YoY to RM251mil, its 1HFY21's distributable income instead improved by 14% YoY to RM56mil from lower operating expenses and finance costs in 2QFY21.

  - **YTL REIT's results came in within our expectations**. Its FY21 revenue contracted by 24% YoY to RM326mil mainly due to a 41% YoY income drop from the REIT's Australian portfolio, which has been impacted by the various Covid-19-related movement restrictions in the country. This slashed its distributable income by 45% YoY to RM70mil.

  - **Lower QoQ distributable income.** Pavilion REIT, Sunway REIT and YTL REIT recorded lower QoQ distributable income mainly due to the impact of stricter MCOs imposed during the quarter. Additionally, Sunway REIT and YTL REIT's results were dampened by higher property operating expenses. Sunway REIT incurred higher assessment and insurance costs while YTL REIT bore increased finance costs, manager's fees and administration costs. However, lower property maintenance expenses supported IGB REIT's flat QoQ distributable income. All in, the sector's distributable income decreased by 11% QoQ.

- During the MCO/Phase 1 of our National Recovery Plan in 2QCY21, footfall at the malls was only 10–30% of that of the pre-pandemic level vs. above 60% before the tightened lockdown in May this year. Nevertheless, the properties of **REITs under our coverage have observed slightly better footfall at neighborhood malls** during the lockdown compared to malls that are heavily reliant on office crowds or tourists. This is mainly driven by shoppers that are visiting these malls for essential services such as groceries and pharmacies during the lockdown.

- Moreover, these properties also **saw an uptick in footfall** after restrictions and SOPs were relaxed. Nonetheless, the numbers remain volatile as people are still adapting to the new way of living amid the high daily cases locally. Thus, industry players remain conservatively optimistic in the immediate term while restrategising for the post-pandemic new normal to attract the return of visitors. Some of the initiatives include rollouts of special deals and promotions, as well as bringing in more Instagrammable tenants or stores with marketing attractions such as the % Arabica coffee outlet in Pavilion Kuala Lumpur, Japanese chain store Don Don Donki in Lot 10 and BTS pop-up store in 1 Utama. These tenants have proven to be successful in attracting massive crowds and have long queues before the MCO in end-May. On a positive note, despite the lacklustre footfall, the properties also observed higher spending per footfall as shoppers visit the mall with more targeted shopping focus.

- While the occupancy rates for malls of retail REITs under our coverage have shown a slight decline, we are not particularly perturbed by this development as the companies have guided that they are slowing down their discussions in renewing/replacing tenants during the lockdown. This is because landlords are in a less favourable bargaining position in rental rate discussions during this period. Not helping either is the longer transition period between tenant replacements as renovation works were delayed due to the various movement restrictions in place. Having said that, we continue to **take comfort that the occupancy rates at anchor malls of retail REITs under our coverage remain healthy at above 90%**.

- In terms of financial health, the REITs under our coverage **continue to maintain a healthy debt-to asset ratio** of 23%–41% 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. Most of the companies under our coverage have guided that they are actively scouting for quality assets and do not rule out potential acquisitions over the next 12–18 months if any yield-accretive propositions emerge, which could drive the REITs' medium-to-long term growth despite short-term earnings pressure. We note that other non-rated players such as Capital Land Malaysia Mall Trust and KIP REIT have started raising capital for asset acquisitions.

- Our top pick for the sector is **Sunway REIT (fair value RM1.66)** as we like its diversified investment portfolio (which includes retail malls, hotels, offices, plus a university and hospital) and the large pipeline of potential assets for future injection.

- Risks to our **OVERWEIGHT** calls are: (1) footfall recovery is slower than expected; (2) there is a massive decline in occupancy rates due to increased competition from an oversupply of retail spaces; and (3) consumer spending/sentiment deteriorates further or recovers slower than expected from new viral variants or external events.

EXHIBIT 1: VALUATION MATRIX

	Recomm.	Price	FV	Upside	Mkt Cap	FYE	DPU (sen)		DPU growth (%)		Div Yield (%)		P/B	ROE
		(RM)	(RM)	(%)	(RMmil)		FY21F	FY22F	FY21F	FY22F	FY21F	FY22F	(x)	(%)
PREIT	BUY	1.40	1.50	7.1	4,266.8	Dec	4.1	5.9	0.0	43.9	2.9	4.2	1.1	3.0
YTL REIT	BUY	0.94	1.11	18.7	1,593.6	Jun	4.2	5.2	-44.0	23.8	4.5	5.6	0.6	3.2
SREIT	BUY	1.41	1.66	17.7	4,829.0	Dec*	6.0	7.7	-17.8	28.3	4.3	5.5	0.9	4.0
IGB REIT	BUY	1.68	1.85	10.1	5,987.5	Dec	8.3	9.1	13.7	9.6	4.9	5.4	1.5	5.3
Simple Average							**5.7**	**7.0**	**-12.0**	**26.4**	**4.2**	**5.2**	**1.0**	
Weighted Average							**6.2**	**7.5**	**-4.5**	**25.3**	**4.2**	**5.1**	**1.2**	

**FY21 18 months*

Source: AmInvestment Bank, Bloomberg

EXHIBIT 2: EARNINGS COMPARISON

Companies	FYE	Distributable Income (RM mil)			QoQ Chg	YoY Chg	Revenue (RM mil)		YoY Chg	Dist. Inc. (RM mil)		YoY Chg	FY21 Dist. Inc. Forecasts (RM mil)	1HCY21/FY21 Dist. Inc.	Results
		2QCY20	1QCY21	2QCY21	(%)	(%)	1HCY20	1HCY21	(%)	1HCY20	1HCY21	(%)			
IGB REIT	Dec	24.0	48.6	49.3	1.4	>100	187.0	184.4	-1.4	98.5	97.9	-0.6	293.9	33%	Below
Pavilion REIT	Dec	12.2	33.5	22.5	-32.8	84.4	260.7	251.0	-3.7	49.1	56.0	14.1	158.4	35%	Below
Sunway REIT	Dec	21.9	31.9	28.5	-10.7	30.1	#556.9	#410.9	-26.2	#228.9	#118.2	-48.4	*206.2	57%	Below
YTL Hospitality REIT	Jun	27.0	19.0	17.7	-6.8	-34.4	#426.4	#326.3	-23.5	#127.1	#71.0	-44.1	#71.6	99%	Inline
Total		**85.1**	**133.0**	**118.0**	**-11.3**	**38.7**	**1431.0**	**1172.6**	**-18.1**	**503.6**	**343.1**	**-31.9**	**730.1**	**47%**	

**18 Months; #12 Months*

Source: AmInvestment Bank, companies

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