REITS

Overweight (from Neutral)

A More Attractive Yield Play; U/G To OVERWEIGHT

Stocks Covered	7
Rating (Buy/Neutral/Sell):	5 / 2 / 0
Last 12m Earnings Revision Trend:	Positive

- **Upgrade to OVERWEIGHT from Neutral; Top Picks: Sunway REIT (SREIT), Axis REIT (AXRB).** With the US Federal Reserve (US Fed) beginning to cut interest rates in September – generally favourable for REITs – we think this is the catalyst needed to attract attention back to Malaysian REITs. The sector may become more vibrant with more REIT listings and new asset acquisitions. Overall, with limited downside risks for REITs under our coverage (M-REITs), we prefer those with inorganic growth prospects to drive DPU growth – SREIT and AXRB.
- **Upside from wider yield spread.** While we expect Bank Negara Malaysia (BNM) to keep the overnight policy rate (OPR) at 3%, we think M-REITs would still benefit from the expected interest rate cuts globally. Due to the narrowing rate differential between Malaysia and other countries, this would drive capital into Malaysian bonds, exerting downward pressure into Malaysia bond yields. Currently, despite the 9% YTD appreciation of the KL REIT Index, the yield spread is at +1SD from its the historical mean (220 bps). Backed by solid fundamentals, we think this affords M-REITs further upside potential.
- **More conducive environment for asset acquisitions.** Over the medium term with lower cost of borrowings, M-REITs may see more inorganic growth opportunities ahead. KLCCP Stapled (KLCCSS), the largest REIT in the country, has expressed its intention to acquire more buildings, a strategy similarly shared by Sunway REIT as part of its Transcend 2027 target. We also keep an eye out on IGB REIT potentially acquiring Mid Valley Southkey Mall as the mall is well into its second rental cycle, on top of the long-term growth prospects in Iskandar Malaysia with strong SGD spending power to fuel consumption in the state.
- **New REIT listings could garner interest in the sector.** The proposed injection of c.MYR2.4bn of assets into a newly formed REIT for its upcoming listing is a positive for the sector. We think the trend should continue as more companies with a pool of investment properties consider monetising their assets in a lower interest rate environment. IOIPG (IOIPG MK, NEUTRAL, TP: MYR2.15) and SP Setia (SPSB MK, BUY, TP: MYR1.72) are the developers that have shared their intention to the market to list their investment properties as REITs.
- **Top Picks: SREIT, AXRB.** Both REITs will likely see better growth outlook. Besides the solid backing from its sponsor Sunway (SWB MK, BUY, TP: MYR5.00) that could ensure a sustainable asset pipeline, we like SREIT for its robust earnings outlook, underpinned by a diversified portfolio and active acquisition strategy. We also like AXRB as a proxy to the resilient industrial property segment, especially as the REIT has picked up the pace in new acquisitions this year. Both REITs are likely to own data centre assets in the future.

Top Picks	Target Price
Sunway REIT (SREIT MK) – BUY	MYR1.92
Axis REIT (AXRB MK) – BUY	MYR2.11

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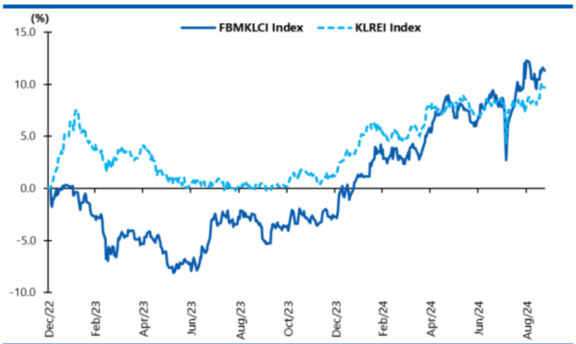
FBM KLCI vs KLREI Index



Source: Company data, RHB

Company Name	Rating	Target (MYR)	% Upside (Downside)	P/E (x) Dec-25F	P/B (x) Dec-25F	ROAE (%) Dec-25F	Yield (%) Dec-25F
AME REIT	Buy	1.53	7.7	18.8	1.3	6.9	5.8
Axis REIT	Buy	2.11	14.7	17.4	1.1	6.6	5.7
IGB REIT	Neutral	2.12	(0.5)	18.8	1.9	10.1	5.6
KLCCP Stapled	Neutral	8.20	4.3	16.5	1.1	6.4	5.7
Pavilion REIT	Buy	1.63	13.2	15.3	1.0	6.7	6.7
Sentral REIT	Buy	0.91	17.4	10.7	0.7	6.4	9.0
Sunway REIT	Buy	1.92	9.7	15.4	1.1	7.1	6.2

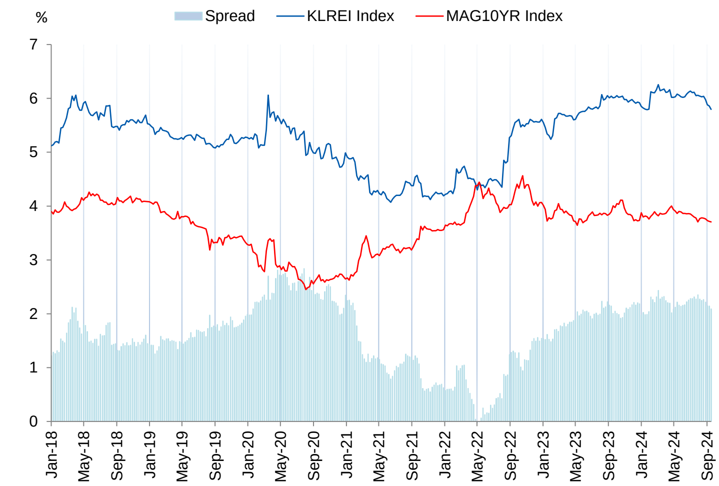
Source: Company data, RHB

Upside from wider yield spread

With the US Fed beginning to cut interest rates in September – generally favourable for REITs – given wider yield spreads, we think this is the catalyst needed to attract attention back to Malaysian REITs. The 10-year US bond yield has dropped c.100bps from 4.7% in April to 3.7%, in line with the 1-year Malaysia Government Securities (MGS) yield – RHB Economics is expecting the US bond yield to drop further to 2.80-2.90% in 2H25.

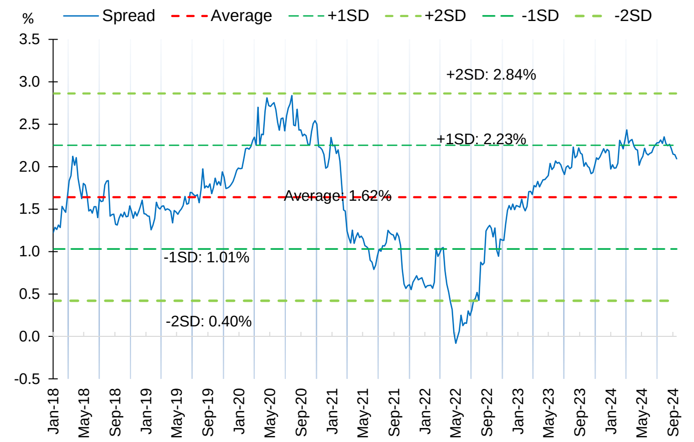
While we expect BNM to keep the OPR at 3%, we think M-REITs would still benefit from the expected interest rate cuts globally. Due to the narrowing rate differential between Malaysia and other countries, this would drive capital into Malaysian bonds, exerting downward pressure into the Malaysia bond yields. In this lower interest rate environment, we think the sector provides an attractive alternative to yield-seeking investors. Currently, despite the 8% YTD appreciation of the KL REIT Index, the yield spread is at +1SD from its the historical mean (220 bps). Since 2023, M-REITs have appreciated by 11%, outperforming S-REITs, which contracted by up to -13% in Jul 2024 before recovering.

Figure 1: Yield spread between KL REIT Index and 10-year MGS



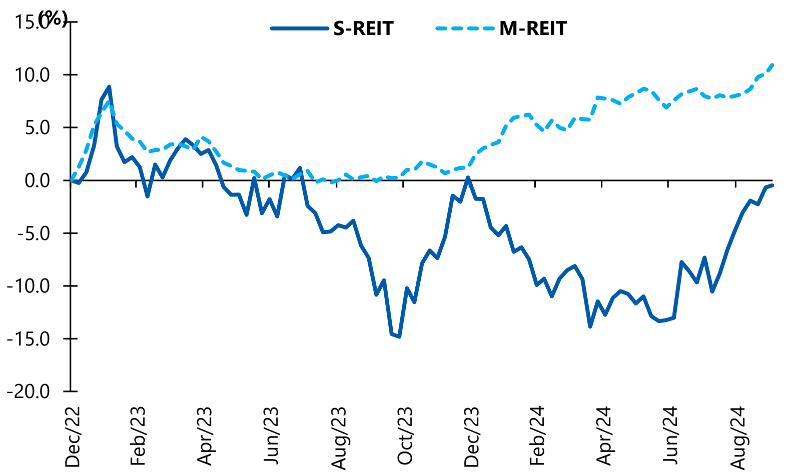
Source: Bloomberg, RHB

Figure 2: Yield spread currently at c.220bps



Source: Bloomberg, RHB

Figure 3: S-REITs index vs M-REITs index



Source: Bloomberg, RHB

Conducive environment for asset acquisitions

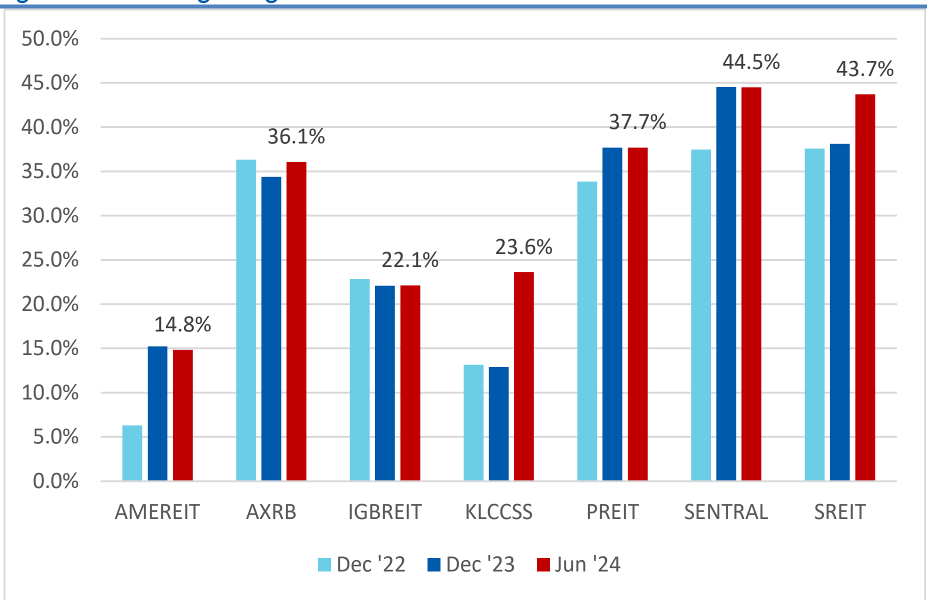
We also think that over the medium term the lower interest rate environment would bode well for asset acquisitions. Currently, the average gearing ratio of M-REITs is at 31.8%. As borrowing cost may potentially get cheaper (coupled with a more favourable equity environment for REITs), more REITs will be able to acquire assets via a combination of debt and equity with less dilutive effects. The recent sale of AirTrunk, the largest DC group in the Asia-Pacific, for an enterprise value of AUD24bn in early Sep 2024 is said to be the largest private equity deal this year. This well indicates that regional capital is starting to be deployed back to the real estate sector given the lower global interest rate environment ahead.

KLCCSS, the largest REIT in the country, has expressed its intention to pursue more acquisitions as part of its growth strategy. It completed the acquisition of the remaining 40% stake in Suria KLCC for MYR1.95bn in April, raising its gearing ratio to 23.6% from 13%. At this level, considering its size, there is still significant room for further acquisitions, although management remains tight lipped on any specific targets.

Meanwhile, SREIT is also actively pursuing new acquisitions as part of its Transcend 2027 target to grow its asset under management (AUM) to MYR14-15bn (from the current MYR9.7bn), although new acquisitions may need to be funded via equity as its gearing ratio is already high at 43.7%. We also keep an eye out on IGB REIT potentially acquiring Mid Valley Southkey Mall as the mall is well into its second rental cycle (opened in 2019), on top of the long-term growth prospects in Iskandar Malaysia with strong SGD spending power to fuel consumption in the state.

We are also optimistic on the outlook for industrial REIT's asset acquisitions. While 2023 was a slow year for acquisitions due to compressed yields, the pace of acquisitions has picked up in 2024 with MYR685m and MYR120m of new acquisitions announced for AXRB and AME REIT. AME REIT's prospects should be supported by its sponsor, which is developing new industrial parks in Johor and Penang, while AXRB has shown that on top of acquisitions, it is capable of redeveloping buildings such as Bukit Raja Distribution Centre 2 which now hosts its fourth largest tenant.

Figure 4: M-REITs' gearing levels as at Jun 2024



Source: Company data, RHB

Figure 5: Proportion of fixed:floating debt as at Jun 2024

	AMEREIT	AXRB	IGBREIT	KLCCSS	PREIT	SENTRAL	SREIT
Fixed	0%	55%	100%	91%	13%	24%	23%
Floating	100%	45%	0%	9%	88%	76%	77%

Source: Company data, RHB

New REIT listings could garner interest

We think the proposed injection of c.MYR2.4bn of assets into a newly formed REIT for its upcoming listing is positive as it could garner interest in the sector. We think the trend should continue as more companies with a pool of investment properties consider monetising their assets as REITs become more favourable in a lower interest rate environment. IOIPG and SP Setia are developers that have shared their intention to the market to list their investment properties as REITs. IOIPG has a solid portfolio that comprises retail, hospitality and office assets (estimated value of over MYR20bn, including assets in Singapore, while SP Setia also has a combination of retail and office assets (estimated value of above MYR1bn). We also think that Sime Darby Property (SDPR MK, BUY, TP: MYR2.00) would be a good candidate for a REIT listing given its growing investment property portfolio.

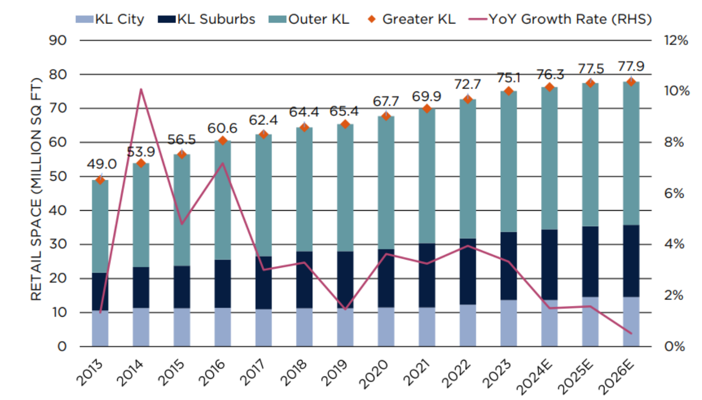
While we are hopeful that the size of the potential REIT listings could be big enough (to ensure good liquidity), assuming they are of high-quality assets, the exercise would be viewed positively by shareholders. Over the past 10-years, aside from IGB Commercial REIT (IGBCR MK, NR) which was listed in 2021 with a market cap of MYR2.3bn, M-REITs have only seen listings with market caps under MYR600m ie AME REIT (2022), KIP REIT (KIP MK, NR) (2017), and Al Salam REIT (SALAM MK, NR) (2015).

Retail and hospitality supported by tourists

The improving tourism industry will be a wild card for retail M-REITs. In 1H24, Tourism Malaysia revealed that 11.8m tourists arrived, a 29% increase YoY – boosted by the 30-day visa exemption for Chinese and Indian visitors. This has helped hotel players such as KLCCSS and SREIT record higher than pre-pandemic room rates. We believe the high room rates are sustainable in the medium term, with minimal downside risks to occupancy rates. We also think that the higher tourist numbers are one of the reasons Suria KLCC's and Pavilion Kuala Lumpur's continued to deliver YoY growth despite the opening of The Exchange TRX providing new competition. This trend should continue, as the country looks forward to Visit Malaysia 2026 when it aims to attract 36m tourists.

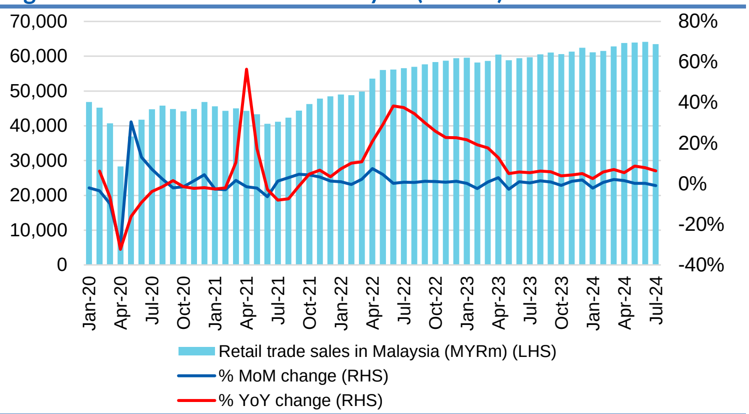
According to Savills, the occupancy rate of malls in Greater KL have shown a gradual improvement since 2023. This is a contrast to the decline recorded over 2013-2019, and this downtrend was further compounded during the pandemic. The growth rate of new supply of retail space in Kuala Lumpur is expected to slow down over the next two years. The key malls under our coverage such as Suria KLCC, Pavilion Kuala Lumpur, Mid Valley Megamall, and Sunway Pyramid all have occupancy rates of above 95%. As such, REITs' managements are generally guiding for mid-single digit rental reversions.

Figure 6: Greater Kuala Lumpur's retail supply and vacancy rate



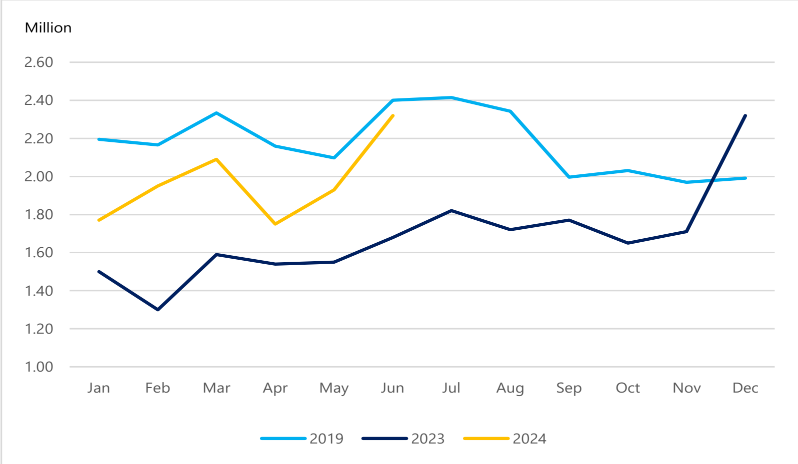
Source: Savills

Figure 7: Retail trade sales in Malaysia (MYRm)



Source: Department of Statistics Malaysia

Figure 8: Number of tourist arrivals in Malaysia



Source: Tourism Malaysia

Bright outlook for industrials

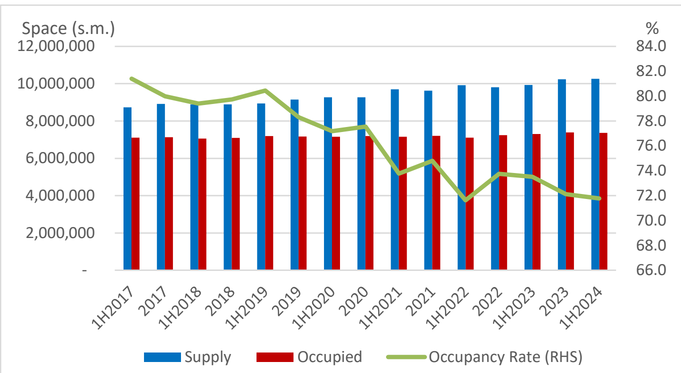
The industrial subsector should continue to perform well with minimal occupancy rate risks and stable rental reversions. This is supported by the influx of investments and favourable government policies such as the National Industrial Master Plan 2030. The positive outlook is reflected by the Industrial Production Index (IPI) which expanded by 5.3% in July, driven by a surge in manufacturing output and export-oriented industries. Following the aforementioned acquisitions, we expect AXRB's and AME REIT's earnings to pick up in FY25 after their recent acquisitions are completed.

Status quo for offices

According to Savills, the total strata office space in Kuala Lumpur grew in 2023 at the fastest rate YoY since 2017, at 6.9% with the addition of 1.7m sqf, which includes buildings such as Pavilion Damansara Heights, Aspire Tower, and The Met Corporate Towers. Even so, the average rental rate has increased, driven by the high rates observed in newer office buildings with built-in sustainability features. Moving forward, an expected 1.5m sqf of supply is expected between 2024 and 2027.

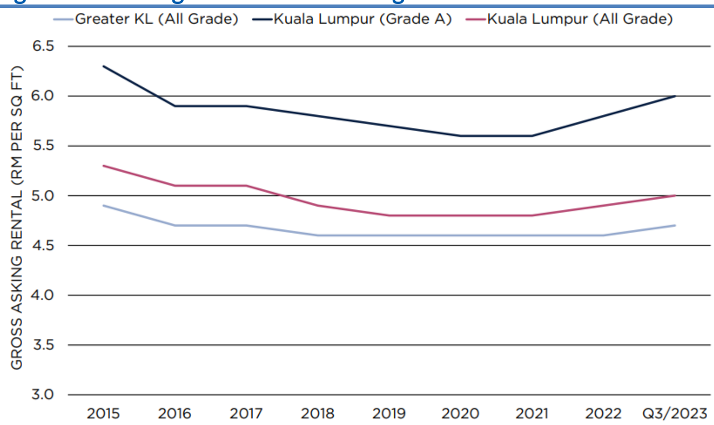
With new high-quality supply in the market, the ongoing flight-to-quality trend will continue to place downward pressure on older office buildings lacking sustainable features to attract and retain tenants. In this subsector, we continue to like Sentral REIT for its attractive high dividend yield. While occupancy rates may fluctuate as tenants move around, we think earnings would be sufficiently supported by its stronger office assets, especially following the acquisition of Menara CelcomDigi in Dec 2023. We also highlight the upside risk from a potential disposal of the vacant Wisma Sentral Inai which would further increase its DPU from interest savings.

Figure 9: Supply of purpose-built offices in Kuala Lumpur



Source: National Property Information Centre (NAPIC)

Figure 10: Average strata office asking rents



Source: Savills Research

Upgrade to OVERWEIGHT; Top Picks: SREIT and AXRB

We upgrade the sector – currently trading at an average FY25F yield of 6.4% – to OVERWEIGHT. Besides the solid backing from its sponsor Sunway that could ensure a sustainable asset pipeline, we like SREIT for its robust earnings outlook, underpinned by a diversified portfolio and active acquisition strategy. We also like AXRB as a proxy to the resilient industrial property segment, especially as the REIT has picked up the pace in new acquisitions this year.

In our view, both REITs are also likely candidates to own data centre assets in the future – Sunway has recently sold two parcels of land (total 64 acres) to its existing JV partner Equalbase for data centre development. AXRB, which has proposed a disposal of a vacant steel plant to a DC player in April, can possibly own a DC asset in future given its sizeable exposure to the industrial segment (AUM: MYR4.7bn).

Figure 11: Occupancy rates of buildings of M-REITs

	2018	2019	2020	2021	2022	2023	1H24
Petronas Twin Towers	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Menara 3	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Menara Exxon Mobile	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Menara Dayabumi	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Menara Maxis	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Suria KLCC	98.0	99.0	97.0	93.0	92.0	96.0	98.0
Mid Valley Mall	99.0	99.0	99.7	97.8	99.9	100.0	100.0
The Gardens Mall	97.0	99.0	91.8	90.7	99.9	100.0	100.0
Pavilion Kuala Lumpur	98.7	98.0	96.5	90.2	91.6	95.2	96.4
Intermark Mall	94.4	97.1	85.7	83.6	86.9	89.8	90.2
DA MEN Mall	74.4	71.7	68.9	62.3	64.5	73.4	75.4
Elite Pavilion Mall	96.7	95.0	83.2	86.4	92.3	95.9	95.5
Pavilion Bukit Jalil	-	-	-	-	-	88.1	87.8
Pavilion Tower	94.0	85.8	85.8	79.1	73.0	72.0	75.0
Sunway REIT Offices	61.0	72.0	78.0	84.0	83.0	84.0	84.0
Sunway REIT Retail	96.0	96.0	95.0	97.0	96.0	97.0	97.0
Sunway REIT Hospitality	74.0	69.0	53.0	32.0	54.0	64.0	62.0
Axis REIT*	94.0	92.0	91.0	96.0	95.0	97.0	89.0
Sentral REIT*	93.0	90.0	90.0	90.0	77.0	89.0	84.0
AME REIT*	-	-	-	-	-	100.0	100.0

*Note: * blended portfolio occupancy*
Source: Company data, RHB

Figure 12: Valuations of M-REITs

	FYE	Target	Mkt Cap	P/E (x)		EPS Growth (%)		P/BV (x)	DY (%)	Rec
		(MYR/s)	(MYRm)	FY24F	FY25F	FY24F	FY25F	FY24F	FY24F	
Sunway REIT	Dec	1.92	5,993	16.9	15.4	4.9	9.9	1.1	6.2	Buy
Pavilion REIT	Dec	1.63	5,271	16.0	15.4	7.3	5.0	1.0	6.7	Buy
Axis REIT	Dec	2.11	3,215	19.3	17.4	6.9	11.1	1.1	5.7	Buy
Sentral REIT	Dec	0.91	927	11.0	10.7	2.2	2.6	0.7	9.0	Buy
AME REIT^	Mar	1.53	747	20.2	18.4	8.1	10.0	1.3	5.9	Buy
KLCCP Stapled	Dec	8.20	14,190	17.3	16.5	6.5	4.8	1.1	5.7	Neutral
IGB REIT	Dec	2.12	7,694	19.9	18.8	6.6	5.7	1.9	5.6	Neutral
Sector Avg				**17.7**	**16.6**	**6.4**	**6.3**	**1.2**	**6.4**	

*Note: *FY24F-25F valuations refer to those of FY25F-26F*
Source: Bloomberg, RHB

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