10 January 2024

Property | REITS

REITS

Neutral (Maintained)

Growth To Normalise In FY24F

Stocks Covered	6
Rating (Buy/Neutral/Sell):	3 / 3 / 0
Last 12m Earnings Revision Trend:	Positive

- **After a strong recovery in rental rates for retail REITs in FY23** coming off a lower base post-pandemic, we expect M-REITs' growth to normalise in FY24F as the sector lacks any fresh catalysts to uplift earnings. As such, we prefer industrial REITs for better growth prospects – underpinned by an improving manufacturing sector. That said, we are keeping an eye out on any potential interest rate cuts that could boost sentiment for M-REITs. Maintain NEUTRAL; Top Picks: Axis REIT and IGB REIT.
- **Stability for retail.** Occupancy rates for retail M-REITs have mostly improved across the board, although KLCCP Stapled's (KLCCSS) and PREIT's rates are still below 2019 levels. This should help offset the downside risk to retail spending from the subsidy rationalisation measures and High Value Goods Tax (HVGT). The improving tourism industry should help offset any slowdown in spending from domestic consumers. However, we think rental reversions should normalise to mid-single digit following the strong recovery in FY23.
- **More pressure on rental rates.** 4Q23 saw the opening of The Exchange TRX bringing in a NLA of 1.3m sqf which is comparable to Suria KLCC (1.1m sqf) and Pavilion KL (1.3m sqf). 2024 should also see the opening of Warisan Merdeka Mall @ 118 with a reported NLA of 900k sqf and Pavilion Damansara Phase 2 (529k sqf). While the supply of new retail space is expected to lead to more pressure on rental rates over the near term, in the long term, the competition would also mean that major retail players will likely be more aggressive and active in their marketing activities and tenant remixing/refreshing exercise for long-term sustainability.
- **Flight to quality offices.** According to Knight Frank, the more active transactions involved new office buildings with comprehensive green features – indicative of the continued flight-to-quality trend. As such, we remain cautious on REITs with older office assets such as Sentral REIT which may need to lower rental rates to maintain occupancy rates – especially for buildings with single tenants as they typically have higher bargaining power.
- **Positive on industrial REITs.** We maintain our BUY calls on AME REIT and Axis REIT. Although the pace of acquisition slowed in FY23 following the sharp rise in valuations as asset owners placed a premium on their properties, industrial REITs should continue to record healthy rental reversions each year with minimal risk of non-renewals.
- **Top Picks: Axis REIT and IGB REIT.** We like Axis REIT for its earnings recovery prospects driven by higher occupancy levels and the completion of major asset redevelopments. IGB REIT is our pick for the retail segment, as we think its fully occupied buildings and 6% dividend yield provide a strong defensive play.

Top Picks	**Target Price**
Axis REIT (AXRB MK) – BUY	MYR2.04
IGB REIT (IGBREIT MK) – BUY	MYR1.93

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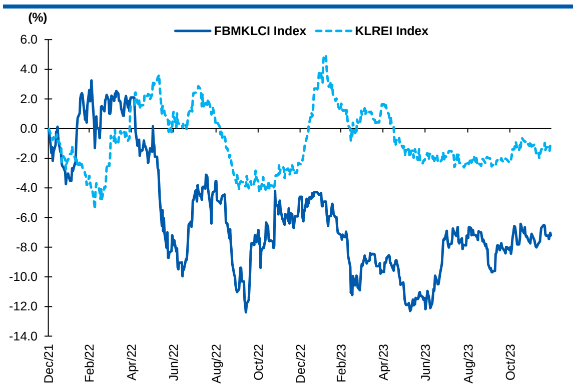
FBM KLCI vs KLREI Index



Source: Company data, RHB

Company Name	Rating	Target (MYR)	% Upside (Downside)	P/E (x) Dec-24F	P/B (x) Dec-24F	ROAE (%) Dec-24F	Yield (%) Dec-24F
AME REIT	Buy	1.42	10.9	18.8	1.2	6.4	5.8
Axis REIT	Buy	2.04	13.8	17.3	1.2	6.9	5.8
IGB REIT	Buy	1.93	11.5	16.5	1.6	9.8	6.3
KLCCP Stapled	Neutral	7.37	2.3	16.1	1.0	7.1	5.8
Pavilion REIT	Neutral	1.29	2.4	14.9	0.9	6.3	6.9
Sentral REIT	Neutral	0.87	10.1	10.6	0.7	6.2	9.2

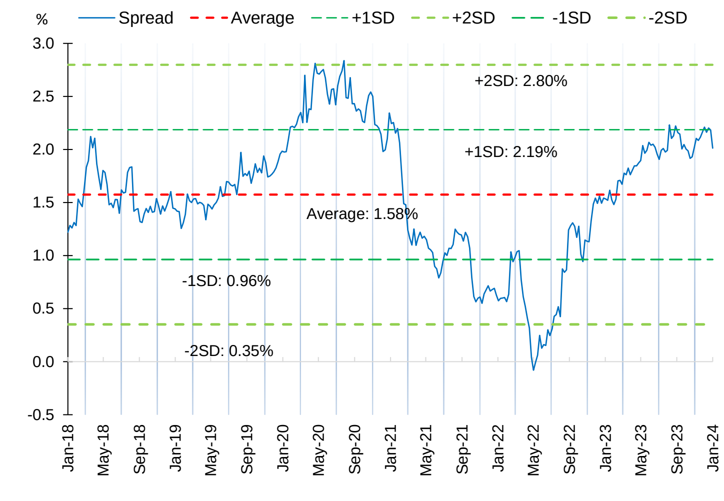
Source: Company data, RHB

Yield spread hovering over +1SD

The M-REIT sector was relatively stable in 2023, rising 2.6% and outperforming the KLCI which declined 2.7%, while the 10-year Malaysia Government Securities (MGS10) yield has hovered between 3.7-4.2%. Consequently, the spread between the KL REIT Index (KLREI) and MGS10 yield is at +1SD from the historical mean. We think the yield spread may hover around current levels as the sector lacks any fresh catalysts to boost REITs earnings and dividends. At the same time, we also do not expect a cut in the overnight policy rate (OPR) over the near term (which would result in lowering bond yield), as RHB Economics expects the OPR to stay at 3% for 2024.

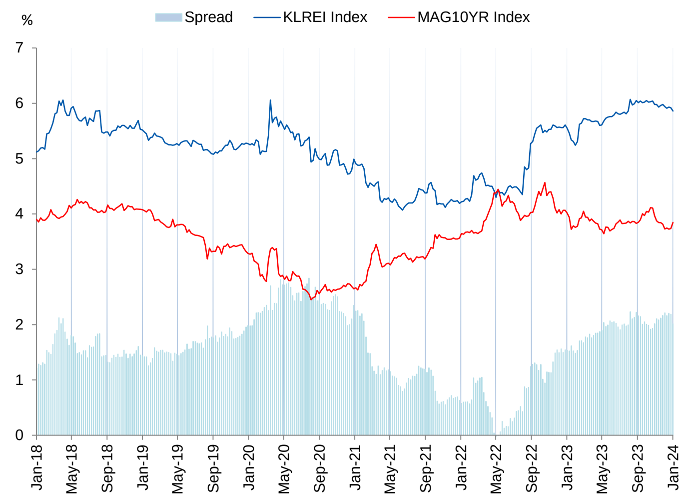
That said, we are keeping an eye out on developments in the foreign market. The US Federal Reserve's recent signal to cut or maintain interest rates this year may have an impact on our bond yields.

Figure 1: Yield spread between KLREI and MGS10



Source: Bloomberg, RHB

Figure 2: Yield spread currently at c.201bps



Source: Bloomberg, RHB

Stability for retail

With easing inflationary pressures, a robust domestic economy coupled with improving tourism industry (also supported by a weak MYR) should see retail REITs continue to be stable in 2024. The occupancy levels across the sector have mostly recovered – although Suria KLCC's and Pavilion KL's occupancy levels are still below its 2019 levels when they were at almost full occupancy. Consumer spending in the malls under our coverage should also be supported by the relatively resilient demand from consumers in the higher income group, as well as higher spending from the recovering tourism industry. The healthy momentum in retail trade should help to offset the downward pressure from the upcoming government subsidy rationalisation efforts and impending implementation of HVGT.

Overall, we expect rental reversions to normalise at mid-single digit in FY24 following the higher-than-expected rental reversions in FY23. Note that despite the economic reopening in FY22, retail REITs mostly put off rental reversions in that year to allow its tenants more time to fully recover from the pandemic.

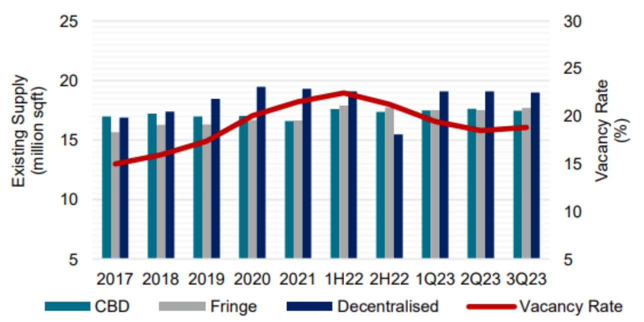
The opening of new malls such as The Exchange TRX (1.3m sqf) and Pavilion Damansara Heights Phase 1 (533k sqf) in late 2023, and the upcoming opening of Warisan Merdeka Mall @ 118 with a reported NLA of 900k sqf and Pavilion Damansara Phase 2 (529k sqf) may take away some footfall from established malls in the short term due to its novelty – we think footfall will gradually return to the older malls due to familiarity of these existing malls, especially those that continuously refresh their retail offerings. However, there is no denying that the increasing supply of malls will only amplify the already tenant-driven market in their favour, considering most malls typically offer similar flagship brands as part of their offerings.

Figure 3: Occupancy rates of buildings of M-REITs under our coverage

Name	2017	2018	2019	2020	2021	2022	1H23	9M23
Petronas Twin Towers	100.0	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	100.0
Menara Exxon Mobile	100.0	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	100.0
Menara Maxis	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Suria KLCC	97.0	98.0	99.0	97.0	93.0	92.0	96.0	96.0
Mid Valley Mall	99.0	99.0	99.0	99.7	97.8	99.9	99.9	99.9
The Gardens Mall	98.0	97.0	99.0	91.8	90.7	99.9	100.0	100.0
Pavilion Kuala Lumpur	98.9	98.7	98.0	96.5	90.2	91.6	93.9	-
Intermark Mall	90.0	94.4	97.1	85.7	83.6	86.9	86.9	-
DA MEN Mall	86.3	74.4	71.7	68.9	62.3	64.5	72.2	-
Elite Pavilion Mall	-	96.7	95.0	83.2	86.4	92.3	93.6	-
Pavilion Bukit Jalil	-	-	-	-	-	-	83.6	-
Pavilion Tower	98.5	94.0	85.8	85.8	79.1	73.0	66.0	-
Axis REIT*	91.0	94.0	92.0	91.0	96.0	95.0	89.0	92.0
Sentral REIT*	96.3	93.0	90.0	90.0	90.0	77.0	77.0	86.0

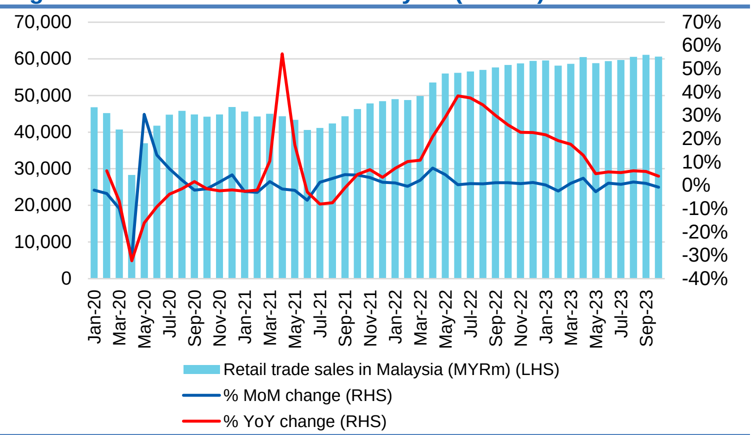
*Note: * blended portfolio occupancy*
Note 2: PREIT building occupancy disclosed semiannually
Source: Company data, RHB

Figure 4: Greater KL's existing supply and vacancy rate



Source: Cushman & Wakefield

Figure 5: Retail trade sales in Malaysia (MYRm)



Source: Department of Statistics Malaysia, RHB

Positive outlook for industrial properties

We remain positive on the prospects of the industrial sub-sector premised on its favourable supply-demand dynamics, and an improvement in the external environment which should support the manufacturing and export-oriented segments, and favourable government policies such as the National Industrial Master Plan 2030.

However, we think the positive outlook could be a double-edged sword for M-REITs. While existing assets should see high rental reversions and stable occupancy rates, this would also limit the pace of acquisitions as property owners place high valuations on their assets. To ensure acquisitions are accretive, we believe the two industrial REITs will look to acquire properties with a 6-6.5% yield, but lower yielding properties may also be considered for high quality, well-located assets with strong long-term prospects.

We prefer Axis REIT in this sub-sector. The REIT underperformed in FY23 after its tenant for Axis Steel Centre defaulted on its rent, resulting in a loss of revenue and one-off costs for provisions for doubtful debts. The pace of acquisition had also grinded to a halt, as the proposed acquisition of a logistics warehouse in Kulim for MYR92m was shelved. However, FY24F will include the full-year earnings contribution from the newly redeveloped Bukit Raja

Distribution Centre 2, and Axis Mega Distribution Centre 2 – another major redevelopment set to be completed in 1Q24.

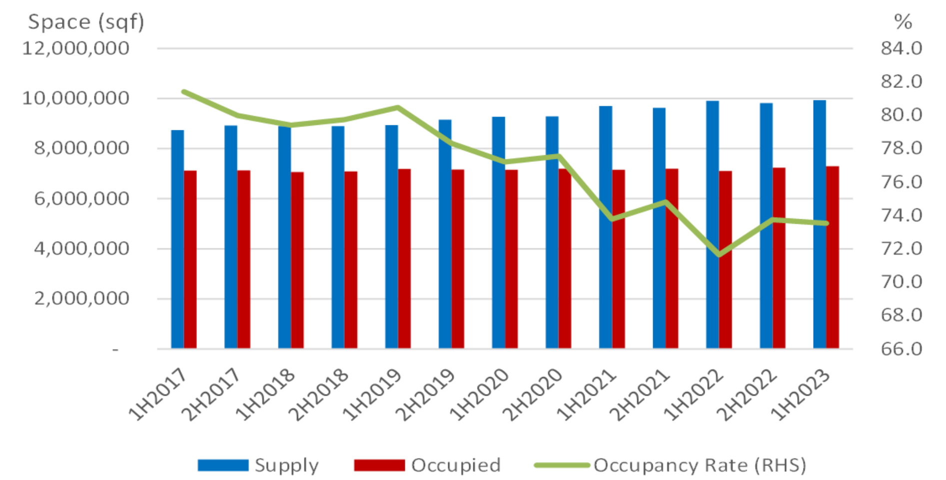
Meanwhile, AME REIT's share price has performed well with an appreciation of 10% over the past year. Although we like the REIT for its fully occupied and good quality assets, we await more news on acquisitions that can further drive inorganic growth.

Higher demand only for newer office buildings

Across the Greater KL region, the average occupancy rates for offices have improved along with an increase in rental rates – but the pickup in demand was seen mostly for newer office buildings with the latest ESG specifications built in. The lateral move by companies from older office buildings to newer ones increases the pressure on landlords to maintain occupancy levels by lowering rental rates.

For Sentral REIT, we are positive on its acquisition of Menara CelcomDigi – completed in Dec 2023 – which makes up 18% of its total asset value, thus reducing its reliance on its older office buildings. As of writing, Sentral Building 3 remains vacant, but the REIT's blended occupancy levels have increased to 86% from 77% as it secured a tenant to fill up its previously vacant Sentral Building 4. For FY24F, the risk of non-renewals is limited as the tenancies due for renewal are mostly for its higher-end office buildings, but we are more conservative on rental reversions due to the increased competition in the sector.

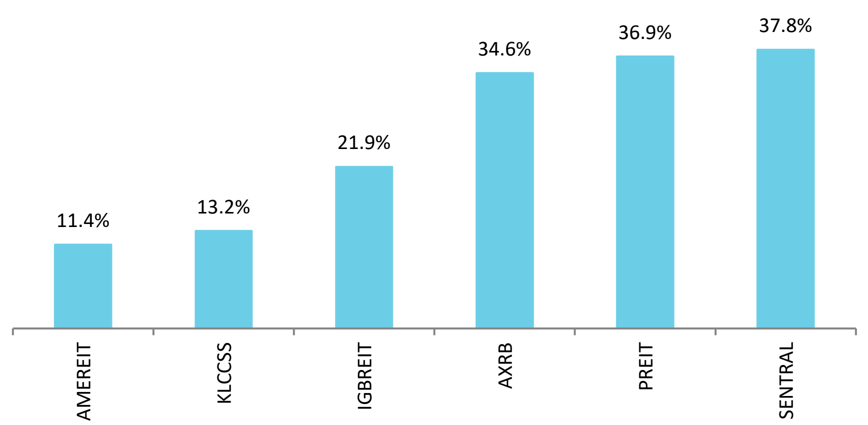
Figure 6: Supply of purpose-built offices in Kuala Lumpur



Source: Department of Statistics Malaysia, RHB

Varying gearing levels

Figure 7: M-REITs' gearing levels as at end-Sep 2023



Source: Company data, RHB

The average gearing level for M-REITs under our coverage as at Sep 2023 is 26%, well below the 50% gearing limit imposed by the Securities Commission. Including the acquisition of Menara CelcomDigi in Dec 2023, we expect Sentral REIT's gearing level to be at 44%

AME REIT and KLCCSS have the lowest gearing levels under our coverage. We hope to see news on acquisitions for the latter as management has previously shared that it plans to expand its core business via an increase in property investments. Although it remains tight lipped on any timeline or property type, the stapled securities' large size and low gearing suggest plenty of room to fund new acquisitions without needing to tap in the equity market. The gearing level for AME REIT also suggests that it should have a strong war chest to support its inorganic growth plans.

Top Picks

We maintain our NEUTRAL call for the sector. We like Axis REIT for its earnings recovery prospects from higher occupancy levels and the completion of major asset redevelopments. IGB REIT is our pick for the retail segment, as we think its fully occupied buildings and 6% dividend yield provide a strong defensive play.

Figure 8: Valuations of M-REITs under our coverage

	FYE	Target	Mkt Cap	P/E (x)		EPS Growth (%)		P/BV (x)	DY (%)	Rec
		(MYR/s)	(MYRm)	FY24F	FY25F	FY24F	FY25F	FY24F	FY24F	
IGB REIT	Dec	1.93	6,231	16.5	15.7	5.7	5.6	1.6	6.3	Buy
Axis REIT	Dec	2.04	3,128	17.3	16.4	22.1	5.5	1.2	5.8	Buy
AME REIT	Mar	1.42	671	18.7	17.3	2.9	8.1	1.2	5.8	Buy
KLCCP Stapled	Dec	7.37	12,998	16.1	15.6	1.0	2.9	1.0	5.8	Neutral
Pavilion REIT	Dec	1.29	4,602	14.9	14.5	1.5	2.9	0.9	6.9	Neutral
Sentral REIT	Dec	0.87	944	10.6	10.6	12.6	0.2	0.7	9.2	Neutral
Sector Avg				**15.0**	**14.3**	**2.7**	**3.4**			

Source: RHB

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