

Malaysia REITs

OVERWEIGHT (Upgrade)

Switching on defensive mode

- M-REITs' 2QCY15 earnings largely in-line, except for IGB REIT (above) and Axis REIT (below).
- Sector risks remain on the weak ringgit and a surge in bond yields but strong domestic liquidity should cushion.
- Lift to OVERWEIGHT. Top pick is KLCCP.

What's New

M-REITs' reported 2QCY15 core net profits were largely within our expectations except for IGB REIT (above; lower-than-expected opex) and Axis REIT (below; steeper finance costs and non-property expenses). The sector's 2QCY15 core net profit grew 13% YoY, largely contributed by new assets (Axis REIT, MQREIT) and organic growth via positive rental reversions (KLCCP, IGB REIT, PavREIT).

Elsewhere, 10-year MGS yield has been on the rise since Jan 2015 to 4.24% end-Aug 2015 (+16bps; high at 4.447%) triggered by foreign sell off of domestic bonds due to the weakening ringgit (-21.8% YTD) and crude oil price (-10.4% YTD). The narrowing yield gap between M-REITs and 10-year MGS has affected the appeal of the M-REIT sector and led to a sell-down in M-REITs. Unit prices of M-REITs under our coverage have remained flat at -0.1% YTD on average. Currently, the average yield of M-REITs under our coverage is 6.1%, or +185bps above the 10-year MGS yield of 4.24%.

What's Our View

While the re-pricing of M-REITs could continue in the current volatile yield environment due to the weak MYR and foreign sell off of domestic bonds, we see some room for re-rating in 4Q15 once uncertainty over the US Fed's interest rate hike and the MYR volatility subside. Also, strong domestic liquidity should provide a support for M-REITs, which are defensive in nature. We upgrade the M-REIT sector to OVERWEIGHT (from NEUTRAL).

M-REITs' fundamentals are backed by steady organic earnings growth (positive rental reversions, space reconfiguration and stable occupancy rates) and healthy balance sheets of 0.14-0.44x gearing ratio. Our preference is for REITs good valuation buffers to cushion the impact of a sudden surge in bond yields. We upgrade MRCB-Quill to BUY. Stock picks in sequence: KLCCP, IGB REIT and MRCB-Quill.

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Stock	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	Price/DPU (x)		P/B (x)		Dividend yld (%)	
						15E	16E	15E	16E	15E	16E
KLCCP Stapled Group	2,988.7	Buy	7.05	7.80	11	19.4	18.8	1.2	1.4	5.2	5.3
IGB REIT	1,057.9	Buy	1.30	1.50	15	17.0	16.3	1.2	1.2	6.5	6.8
Pavilion REIT	1,034.6	Buy	1.46	1.70	16	20.7	19.4	1.1	1.1	5.4	5.7
Sunway REIT	1,014.9	Hold	1.47	1.55	5	19.3	16.8	1.1	1.0	5.8	6.6
CapitaMalls Msia Trust	622.9	Buy	1.31	1.55	18	14.1	14.1	1.1	1.1	7.9	7.9
Axis REIT	427.0	Hold	0.83	0.83	(1)	13.5	18.9	1.4	1.4	8.3	5.9
MRCB-Quill REIT	164.6	Buy	1.06	1.17	10	14.2	13.7	0.8	0.8	7.8	8.1

2QCY15 results round-up

Largely within expectations

M-REITs' (under our coverage) combined core net profit grew 12.5% YoY to MYR435.4m in 2QCY15, mainly attributed to stronger rental income growth (KLCCP and IGB REIT) and new assets which have contributed additional rental income (MQREIT and Axis REIT). Against our full-year net profit estimates, most of the M-REITs reported core net profits which were in-line (five out of seven) except for IGB REIT (above; due to lower-than-expected opex) and Axis REIT (below; attributed to higher finance costs and non-property expenses).

DPU growths led by IGB REIT and PavREIT

Distributions for the quarter/1HFY15 were mainly in-line as well, with IGB REIT recorded the strongest YoY gross DPU growth of 14.9% to 4.47sen (1HFY15) on the back of better 1HFY15 earnings (+16.8% YoY). This was followed by PavREIT's 1HFY15 gross DPU of 4.09 sen which grew 6.5% YoY, also in tandem with its 6.7% YoY earnings growth (1HFY15).

M-REIT's CY15-17 earnings growth at +3%-7%

Our full-year earnings forecasts for M-REITs were largely intact, with some minor earnings revisions within the range of -4.7% to +6.3% for FY15-17. The sector's CY15/16/17 YoY earnings growth remains decent at +7.3%/+6.6%/+3.4%.

Post individual result releases, we have upgraded IGB REIT and CMMT to BUY (previously HOLD for both). IGB REIT and CMMT now offer total return of 26% and 28%, respectively.

2QCY15 results summary

Trust	Rec*	TP* (MYR)	Reported period	Vs. MKE estimates	Core net profit			Distribution		EPU revision FY15/16/17
					2QCY15 (MYR'm)	YoY (%)	QoQ (%)	Gross DPU (sen)	YoY (%)	
KLCCP Stapled	BUY	7.80 (+15sen)	2QFY15	In line	179.9	+19.2	+0.8	8.34	+3.6	+6.3%/+4.6%/+3.7%
Sunway REIT	HOLD	1.55 (-5sen)	4QFY15	In line	56.7	+1.1	-3.8	2.05	+1.0	FY16/17: -2.0%/-2.3%
IGB REIT	BUY (from HOLD)	1.50 (+5sen)	2QFY15	Above	65.8	+12.5	-5.8	4.47#	+14.9	+3.7%/+3.7%/+3.6%
Pavilion REIT	BUY	1.70	2QFY15	In line	59.3	+6.6	-2.0	4.09#	+6.5	-
CapitaMalls M'sia	BUY (from HOLD)	1.55	2QFY15	In line	36.5	-0.4	-4.5	4.61#	+1.8	FY15: +5.3%
Axis REIT	HOLD	3.35 (-5sen)	2QFY15	Below	23.6	+13.5	+4.7	4.3	-18.9	-4.7%/-4.0%/-3.3%
MRCB-Quill	HOLD	1.17	2QFY15	In line	13.6	+59.2	+64.7	2.22	+10.4	-

* As at 2QCY15 results review

Bi-annual distribution

Source: Trusts, Bloomberg, Maybank KE

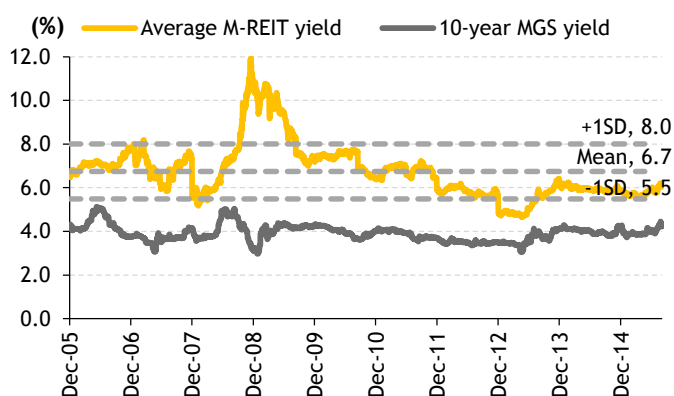
Near-term outlook

Bond yield volatility to retreat; demand on yield stocks should return

The 10-year MGS yield has been on the rise since Jan 2015 to 4.24% presently (+16bps; high was 4.447% in end-Aug 2015) triggered by foreign sell off of domestic bonds due to the weakening ringgit (-21.8% YTD) and falling crude oil price (-10.4% YTD). The narrowing yield gap between the M-REITs and 10-year MGS has affected the appeal of the M-REIT sector and led to a sell-down in M-REITs. Unit prices of five out of seven M-REITs under our coverage have retraced by 0.3-9.4% YTD.

However, we see a re-rating for M-REITs as bond yield volatility is expected to retreat in 4Q15. Our fixed income research team expects foreign holdings of MGS to find a base at the 45% level after the upcoming MGS redemptions on 30 Sep and 15 Oct, as strong domestic liquidity should be able to moderate the selloff. Also, uncertainties over the US Fed's interest rate hikes should subside by then. We have turned tactically constructive on MGS and expect the 10-year MGS yield to be around 4.2% by end-3Q15 and 4.25% by end-4Q15. At the equities end, we think that demand on M-REITs should return when the bond market/yields stabilize.

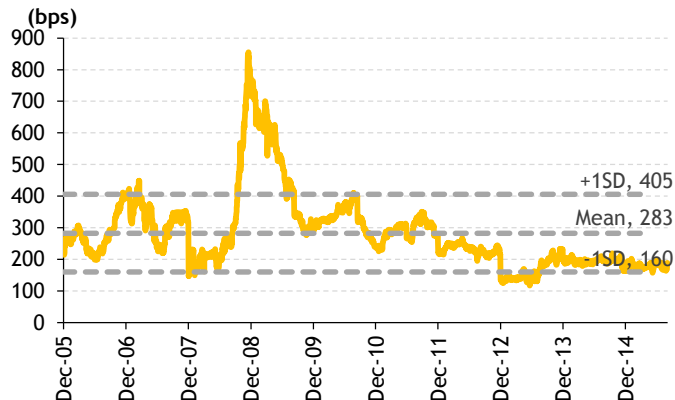
Average M-REIT yield (1-year forward) and 10-year MGS yield



Note: Average M-REIT yield (1-year forward) derived from M-REITs within MKE coverage; Mean,+1SD and -1SD bands are pegged to average M-REIT yield

Sources: Bloomberg, Maybank KE

Yield spread between average M-REIT yield and 10-year MGS yield



Note: Average M-REIT yield (1-year forward) derived from M-REITs within MKE coverage

Sources: Bloomberg, Maybank KE

Valuations and recommendations

M-REITs' fundamentals remain solid, backed by steady organic earnings growth (positive rental reversions, space reconfiguration and stable occupancy rates) and healthy balance sheets of 0.15-0.44x gearing ratio. We like M-REITs with strategically located prime retail assets, such as KLCCP's Suria KLCC, PavREIT's Pavilion KL Mall, IGB REIT's MidValley Megamall and SunREIT's Sunway Pyramid Shopping Mall, which have relatively stronger holding power for rental hikes.

Elsewhere, we remain cautious on the over-supplied office market. Demand could remain soft due to the slowdown in business expansions given a weaker economic outlook.

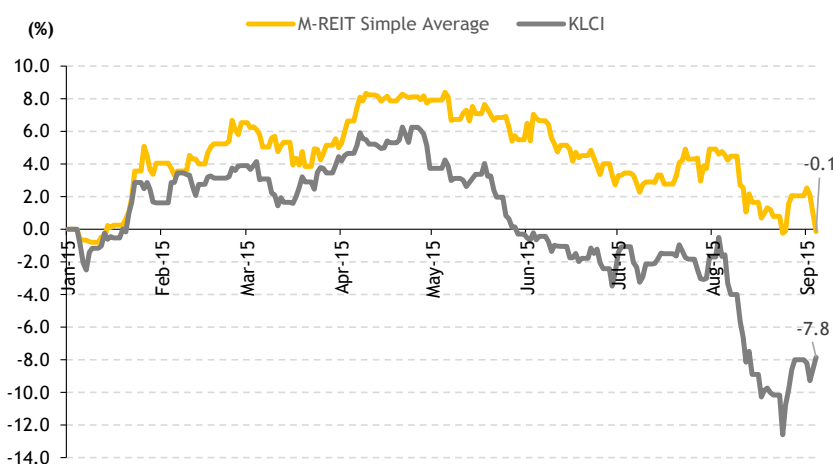
However, we upgrade MRCB-Quill to BUY after the selldown in the trust lately (-5.5% YTD). Despite the oversupply of office spaces in the Klang Valley, MRCB-Quill's average occupancy rate remains stable at 93% thanks to its hands-on management team, strategically located assets and good rapport with its tenants. The trust's occupancy rate is expected to improve to 97% following the sale of Quill Building 10 (QB10; vacant since Apr 2012) which would be completed soon, we understand. The proposed disposal was announced on 25 Feb 2015.

Our top BUY picks in sequence are KLCCP (BUY; MYR7.80 TP), IGB REIT (BUY; MYR1.50 TP) and MRCB-Quill (BUY; MYR1.17 TP).

- We like KLCCP for its stable rental income backed by long triple net office leases. The potential injection of Kompleks Dayabumi into its REIT vehicle could happen post the completion of City Point redevelopment by 2018-2019.
- As for IGB REIT, we like its strong earnings resiliency backed by two prime shopping malls - The Gardens Mall and Mid Valley Megamall.
- Meanwhile, MRCB-Quill's net yield of 7.3% (2016; our estimate) provides good valuation buffers to cushion the impact of a sudden surge in bond yields.

We upgrade the M-REIT sector to **OVERWEIGHT** (from NEUTRAL).

YTD performance



Note: Based on simple average of MKE's M-REITs YTD share price (Base=1-Jan-2015)

Sources: Bloomberg, Maybank KE Sources: Bloomberg, Maybank KE

Sector summary table

Company	Share Price (MYR)	Market Cap (MYR m)	Target Price (MYR)	PE		Div Yield		ROE		P/BV		EPU CAGR CY14-16 (%)
				CY15 (x)	CY16 (x)	CY15 (%)	CY16 (%)	CY15 (%)	CY16 (%)	CY15 (x)	CY16 (x)	
KLCC Stapled	7.05	12,728	7.80	17.9	17.4	5.2	5.3	6.2	7.3	1.1	1.2	2.2
Sunway REIT	1.47	4,322	1.55	15.3	14.2	5.6	6.1	6.8	7.4	1.2	1.1	13.0
IGB REIT	1.30	4,505	1.50	17.7	17.0	5.9	6.1	6.9	7.2	1.2	1.2	6.3
Pavilion REIT	1.46	4,406	1.70	18.7	17.4	4.8	5.2	6.3	6.6	1.2	1.1	4.3
CapitaMalls M'sia	1.31	2,652	1.55	14.4	14.3	7.1	7.1	6.9	7.5	1.0	1.1	4.2
Axis REIT	1.66	1,819	1.65	17.3	16.1	5.0	5.3	7.9	8.4	1.4	1.4	1.0
MRCB-Quill	1.06	701	1.17	12.1	11.7	7.1	7.3	8.0	6.6	0.8	0.8	(6.3)
Simple average				16.2	15.4	5.8	6.1	7.0	7.3	1.1	1.1	3.5

Source: Bloomberg, Maybank KE

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