

Malaysia

**Neutral** (no change)

**Highlighted Companies**

**Axis REIT**

**ADD, TP RM2.34, RM1.85 close**

We see minimal negative risks affecting its rental income outlook, earnings, tenants, and assets for 2022F. Its portfolio occupancy rate remains above 90%. Axis REIT's logistics/ industrial asset acquisition strategy is well ahead of its peers. FY22F dividend yield is 4.9%.

**IGB REIT**

**ADD, TP RM1.90, RM1.58 close**

IGB REIT is benefitting earlier than most other retail mall operators from the expected retail recovery in 2022F. Its key advantage is its well-established flagship malls (Mid Valley Megamall and The Gardens Mall). Occupancy rates are healthy at over 90%. FY22F dividend yield is 4.9%.

**Sentral REIT**

**HOLD, TP RM0.955, RM0.865 close**

Office space remains oversupplied in FY22F while tenants' space reconfiguration remains an ongoing risk. Sentral REIT's strategy is tenant retention, which may offer minimal growth for rental rates but this is offset by a high dividend yield of 7.0%.

**Summary Valuation Metrics**

P/E (x)	Dec-22F	Dec-23F	Dec-24F
Axis REIT	19.37	17.31	17.09
IGB REIT	19.90	17.14	16.30
Sentral REIT	13.50	13.25	12.03

P/BV (x)	Dec-22F	Dec-23F	Dec-24F
Axis REIT	1.21	1.21	1.21
IGB REIT	1.49	1.50	1.51
Sentral REIT	0.70	0.70	0.70

Dividend Yield	Dec-22F	Dec-23F	Dec-24F
Axis REIT	5.11%	5.72%	5.79%
IGB REIT	5.15%	6.01%	6.30%
Sentral REIT	6.83%	6.96%	7.67%

**Analyst(s)**



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# REIT

## Recovery expectations intact

- We expect MREITs to report weaker post-1H22 retail activity in the upcoming 3Q22F reporting season but this should be offset by still-high NPI margins.
- Our 15.6% sector core net profit growth forecast for FY22F is intact, driven by minimal rental assistance and supported by 5.3% dividend yield.
- Maintain sector Neutral rating; Axis REIT and IGB REIT are top picks.

### Recovery expectations intact going in 2H; more cautious on office

Ahead of the upcoming 3QFY22 results period for M-REITs, our expectation of a gradual U-shaped recovery in the operating environment for retail and hospitality REITs is intact; we expect the effect of weaker retail activity had spilled over into M-REITs 3Q22F earnings. However, we have turned more cautious on the prospects for office REITs due to tenanted space reconfiguration risks, high rate of non-renewal of leases and the oversupplied state in the Klang Valley region (30% vacancy rate as at end-Jun 22). We remain upbeat on the industrial warehousing/logistics space given the strong pipeline of potential asset acquisitions and positive rental reversions.

### Qoq revenue growth for retail assets in 3QFY22 likely to moderate

In line with Retail Group Malaysia's (RGM) 3.4% yoy retail sales growth forecast for 3QFY22F (vs. a robust 25.7% yoy growth rate in 2QFY22 due to festivities and pent-up consumer spending – see Figure 7), we expect M-REITs under our coverage to report a flattish-to-single-digit qoq revenue growth in 3QFY22F for their retail assets (CLMT, KLCCP, IGB REIT, Sunway REIT, Pavilion REIT). While 1HFY22 core net profit growth was a robust 65% yoy on average for M-REITs under our coverage, we expect the growth rate to moderate hoh in 2HFY22F, but supported by recovering NPI margins due to diminishing rental assistance for retail tenants. A slight concern at this juncture is for office REITs – Sentral REIT's 2HFY22F revenue and earnings could be more subdued hoh due to low occupancy rates and the absence of replacement tenants for selected tenancies that were not renewed in 1HFY22.

### 15.6% sector core net profit growth in FY22F; 5.3% dividend yield

We expect any negative impact from potentially weaker consumer spending (due to hikes in the overnight policy rate, OPR, and inflationary pressures) and limited tourist arrivals in 2HFY22F to be mitigated by improvement in NPI margins (due to minimal rental assistance). Our forecasts of 8.1% revenue growth and 15.6% core net profit growth for FY22F are fuelled by improvements in NPI margin from 66.1% in FY21 to 71-72% in FY22-23F. We project 5.3% sector dividend yield in FY22F.

### Likely an indirect beneficiary of Budget 2023

We do not anticipate any stimulus measures from Budget 2023 that will directly benefit M-REITs. If at all, we believe M-REITs will indirectly benefit from potential initiatives/plans that will further boost recovery in the retail and hospitality/domestic tourism sectors, particularly in terms of: 1) sustaining retail mall footfall (remains on average 10-20% below pre-pandemic level) and 2) sustaining the variable rent portion (5-15% of total rental income) derived from tenants' retail sales, although this likely fell in 3Q22F vs. 1Q22 and 2Q22, and 3) potential further improvement in average hotel occupancy rates (c.40-50% currently). The higher 60% gearing limit for M-REITs, which was raised from 50% in CY20 as part of cashflow management assistance, will expire at end-CY22F; this is neutral for M-REITs as their current gearing levels of 29-37% are comfortably below the original 50% threshold.

### Maintain sector Neutral; Axis REIT and IGB REIT as top picks

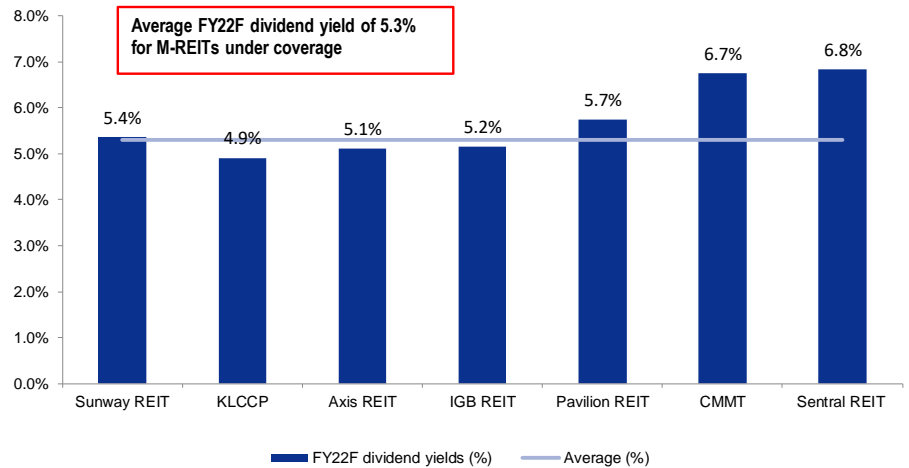
We keep our Neutral sector rating and our two top picks Axis REIT (growth in industrial/logistics assets via acquisitions) and IGB REIT (high occupancy rates for flagship malls). For dividend yield plays, CLMT and Sentral REIT offer highest dividend yields of 6.7-6.8%. Upside risks: positive rental reversion, increased occupancy rates and new asset acquisitions for retail REITs. Downside risk: weaker consumer sentiment.

**Figure 1: Sector comparison**

Company	Bloomberg Ticker	Recom.	Share price (local curr)	Target Price (local curr)	Market Cap (US\$ m)	Core P/E (x)		3-year EPS CAGR (%)	P/BV (x)		Recurring ROE (%)		Dividend Yield (%)	
						CY22F	CY23F		CY22F	CY23F	CY22F	CY23F	CY22F	CY23F
Axis REIT	AXRB MK	Add	1.85	2.34	655	19.4	17.3	5.1%	1.21	1.21	6.3%	7.0%	5.1%	5.7%
CapitaLand Malaysia Trust	CLMT MK	Hold	0.53	0.59	249	13.4	12.8	23.8%	0.45	0.46	3.5%	3.6%	6.7%	7.1%
IGB REIT	IGBREIT MK	Add	1.58	1.90	1,221	19.9	17.1	18.3%	1.49	1.50	7.4%	8.6%	5.2%	6.0%
KLCCP Stapled Group	KLCCSS MK	Hold	6.60	7.24	2,570	18.7	16.7	3.6%	0.92	0.92	4.9%	5.5%	4.9%	5.5%
Sentral REIT	SENTRAL MK	Hold	0.87	0.95	200	13.5	13.3	-4.7%	0.70	0.70	5.2%	5.3%	6.8%	7.0%
Pavilion REIT	PREIT MK	Hold	1.26	1.39	830	18.3	17.8	19.7%	0.99	1.00	5.4%	5.6%	5.7%	5.9%
Sunway REIT	SREIT MK	Hold	1.42	1.60	1,049	16.8	15.7	16.8%	1.00	0.98	6.0%	6.3%	5.4%	5.7%
<b>Average</b>						<b>16.1</b>	<b>14.4</b>	<b>8.5%</b>	<b>0.93</b>	<b>0.93</b>	<b>5.0%</b>	<b>5.6%</b>	<b>4.6%</b>	<b>5.1%</b>

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

**Figure 2: FY22F dividend yields of M-REITs under coverage**



SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

**Figure 3: Sector forecast assumptions**

Sector average growth assumptions	FY21	FY22F	FY23F	Notes
Revenue growth (% , yoy)	-1.9%	8.1%	4.9%	Minimal rental assistance; higher variable rent
Core net profit growth (% , yoy)	-2.6%	15.6%	10.1%	Improving NPI margin vs FY21 on diminishing rental assistance
DPS growth (% , yoy)	2.8%	7.9%	9.7%	Assuming 95-99% average payout ratio
Average NPI margin (%)	66.1%	71.5%	71.7%	In line with gradual recovery in rental income
Retail portfolio occupancy rates (range)	60% to 95%	60% to 99%	60% to 99%	Higher occupancy rates expected for flagship malls
Hotel portfolio occupancy rates (range)	20% to 25%	40% to 60%	40% to 60%	Driven by domestic tourism; limited tourist arrivals

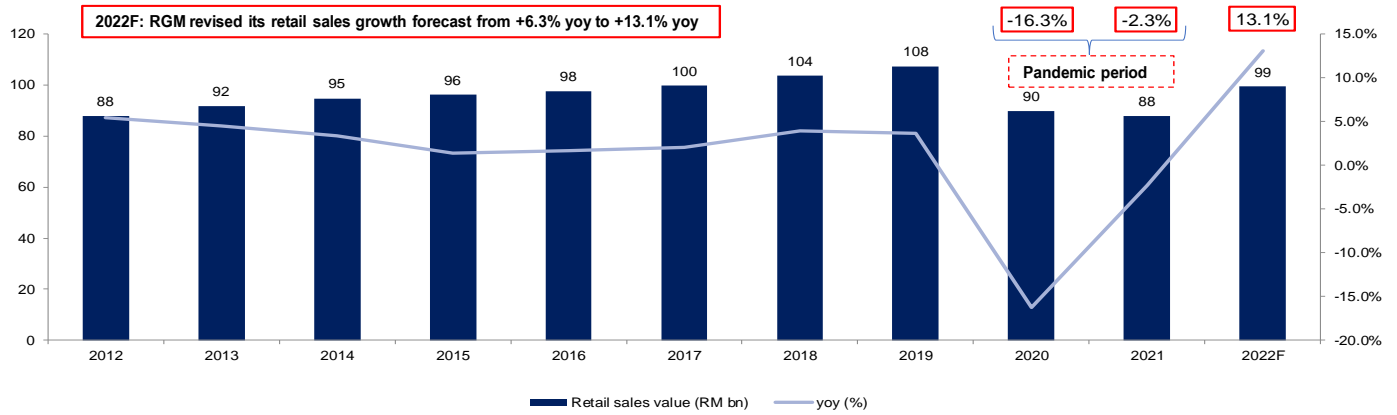
SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

**Figure 4: Forecasting improvement in NPI margins in FY22-23F**

Companies	FY21	FY22F	FY23F
Axis REIT	87.7%	88.3%	88.0%
CMMT	46.0%	53.0%	53.0%
IGB REIT	68.9%	73.1%	74.1%
Pavilion REIT	48.4%	63.4%	63.9%
KLCCP (*EBITDA margin)	67.0%	70.0%	70.0%
Sentral REIT	76.8%	77.8%	77.6%
Sunway REIT	67.7%	75.2%	75.1%
<b>Average</b>	<b>66.1%</b>	<b>71.5%</b>	<b>71.7%</b>

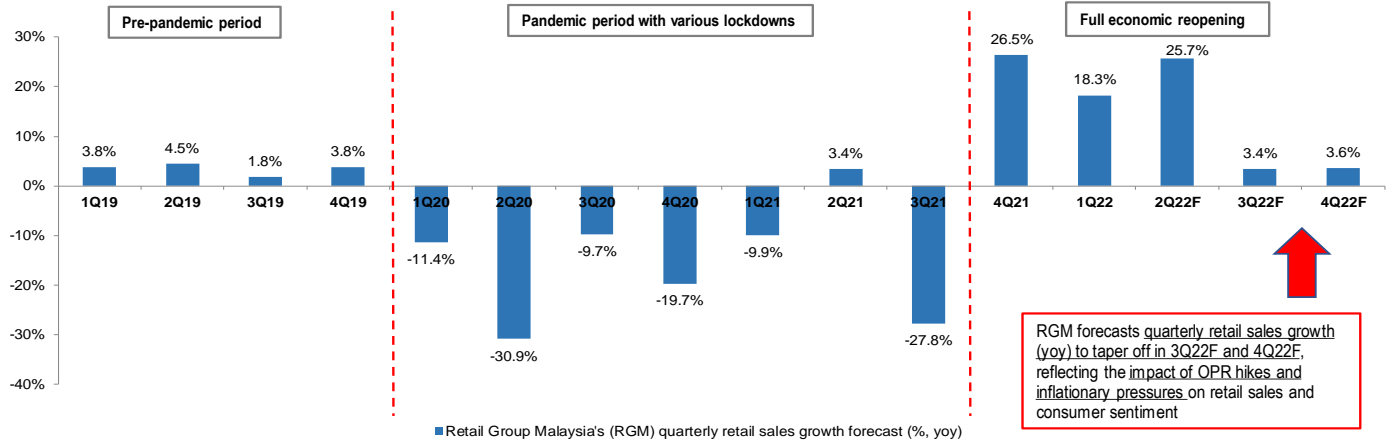
SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

**Figure 5: Retail Group Malaysia's (RGM) retail sales growth forecast in FY22F**



SOURCES: CGS-CIMB RESEARCH, RGM

**Figure 6: RGM's quarterly retail sales growth forecasts**



SOURCES: CGS-CIMB RESEARCH, RGM



## Axis REIT: ESG in a nutshell

Axis REIT practices a holistic ESG approach, covering 15 sustainability issues that it reviews from time to time. It breaks down the 15 issues under three pillars: 1) Economic: economic performance, tenant satisfaction, quality assets and services for existing assets and new acquisitions, business ethics, supply chain management, innovation and technology, and cybersecurity; 2) Environmental: resource management, energy and carbon footprint, waste management, and water management; and 3) Social: occupational health and safety, talent development, employee wellness, and community activity/partnership.

### Keep your eye on

Key deliverables under its economic performance pillar cover, among others: a) a disciplined investment strategy, b) capitalising on acquisition as a growth strategy, c) prioritising portfolio diversification, d) cost discipline and optimisation, and e) efficient management of working capital and liquidity.

### Implications

All these items will be part of key considerations in managing the group's portfolio of assets, taking into consideration the impact of Covid-19.

### ESG highlights

Ongoing efforts to improve and sustain tenant satisfaction, which is an integral part of its business. This covers all that relates to superior services and workspace solutions that are relevant to the requirements of each individual tenant. The group's tenant management portal (Hello Axis) enables it to continuously engage with its tenants.

### Implications

Key initiatives include: 1) regular tenant engagements, 2) understanding tenants' priorities, 3) tenant profile screening, and 4) asset enhancement initiatives (AEI).

### Trends

Pursuing new asset acquisitions with minimal ESG risks. Measures include additional budget allocation for environmental site assessments (ESA) in addition to its existing criteria for asset acquisitions — this is to ensure a proper review of the targeted asset's manufacturing facilities, which contain water tanks and/or underground tanks that have been used for chemical storage in the past. Separately, sustainability features and planning are also incorporated into the development of its build-to-lease assets.

### Implications

The group's asset growth strategy within its logistics and warehouse space is intact for FY22F, with RM120m worth of acquisitions in the pipeline.

SOURCES: CGS-CIMB RESEARCH, REFINITIV



## IGB REIT: ESG in a nutshell

IGB REIT's ESG efforts revolve around eight main areas covering community enrichment, human capital management, health and safety, engagement with the community, energy conservation, water management, waste management, and security.

### Keep your eye on

The group established a Risk Management and Sustainability Committee (RMSC) to oversee and monitor its ESG-related matters, including feedback and input from business partners, government/authorities, employees, investment community, retail shoppers, and tenants. To ensure that its ESG initiatives are kept in check, the RMSC organises workshops within the group to raise ESG awareness and how the initiatives can be applied across the organisation.

### Implications

IGB REIT's ESG initiatives can be viewed as a relatively generic approach but nonetheless comprehensive, and adaptable to changing market conditions and challenges brought about by the Covid-19 pandemic.

### ESG highlights

Key deliverables that are monitored from time to time include 1) average water consumption, 2) constant monitoring and optimisation of each asset's waste disposal management, 3) energy consumption that reduces carbon emissions being among the key deliverables over the longer term, and 4) health, safety and human capital management, including comprehensive business continuity plan (BCP) and competitive staff benefits.

### Implications

Its energy-saving and waste management may have a positive impact on NPI margins as its property operating expenses could decline over time.

### Trends

Key trends to watch out for in the coming months – signs of a recovery in the retail sector, which will be anchored by the full reopening of economic sectors and the lifting of interstate travel bans.

### Implications

Key ESG efforts that could emerge as a priority would be health/safety and engagement with the community in terms of enhancing its brand awareness and bringing back retail mall visitors/footfall to both MVM and The Gardens.

SOURCES: CGS-CIMB RESEARCH, REFINITIV

## Sentral REIT: ESG in a nutshell



Sentral REIT's sustainability initiatives are focused on 11 key areas: 1) sustainable business growth and financial performance, 2) quality of assets and services, 3) anti-corruption, 4) health and safety, 5) regulatory compliance, 6) employee management, 7) data privacy, 8) energy and carbon footprint, 9) water management, 10) waste management, and 11) community partnerships and activities.

### Keep your eye on

In view of the impact of Covid-19 and greater adoption of work-from-home (WFH) protocols, data privacy has gained importance among Sentral REIT's office tenants. This is in view of the widespread adoption of technology during the pandemic period since early-2020. Some initiatives include protection of all data, information and intellectual property against cyber security breaches and safeguarding the privacy of tenant, organisational and visitor information.

### Implications

Potentially supportive of tenant retention initiatives, on top of ongoing tenancy negotiation, with flattish rental reversion guided for FY22F.

### ESG highlights

Some achievements in 2020 include installing Building Automated Systems – BAS – to allow real-time monitoring of energy consumption. The group achieved a 15% reduction in electricity consumption and carbon emissions and an 11% decline in water consumption. In the technology space, the group has implemented facial recognition readers and temperature scanning at Menara Shell as part of its health and safety initiatives.

### Implications

No major expenditure relating to building automation and technology enhancements expected in the foreseeable future as the group maintains its cash retention strategy due to the Covid-19 pandemic. Asset Enhancement Initiatives (AEI) related capex would also be minimal in FY22F.

### Trends

Under sustainable business growth, the group will continue to practice proactive leasing strategies to ensure stabilisation of portfolio occupancy rates and rental income, ongoing cost management and ensuring quality of all office assets (supply chain management), potentially considering new acquisitions when feasible and when market conditions are accommodative.

### Implications

Leasing strategies remain more oriented towards retaining tenants. Portfolio occupancy rate of 86% at end-1QFY22 remains decent.

SOURCES: CGS-CIMB RESEARCH, REFINITIV



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	Rating Distribution (%)	Investment Banking clients (%)
Add	68.4%	0.8%
Hold	24.6%	0.0%
Reduce	7.0%	0.2%



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- Add** The stock's total return is expected to exceed 10% over the next 12 months.
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*The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.*

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