IGB REIT feeds into thirst for yield

Written by Cindy Yeap

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KUALA LUMPUR: Set to be Malaysia's largest retail-centric real estate investment trust (REIT), IGB REIT is expected to garner healthy interest in its RM838 million offering although it will be marketed at only about 5% yield.

This is some 110 basis points less than the IPO of a similarly large Pavilion REIT nine months back.

The pricing of IGB REIT with a forecast yield of only 5.1% annualised for its remaining six months' results of 2012 and 5.37% for the full year of 2013 is no surprise, given that prices of quality listed REITs have gained substantially in recent months, causing their yields to decline as investors sought stability in predictable dividend income.

In comparison, while Pavilion REIT last November priced its IPO at a forecast yield of 6.51% for its first full year ending December 2012, its unit is now trading at slightly over 4.9% yield. Meanwhile, coupon for risk-free Malaysian Government Securities ranges from 3.2% to 3.6% currently, similar to fixed deposit rates.

Given that IGB REIT is being priced and marketed at a time some analysts — including those at Maybank Investment Research — are beginning to think quality yield offering asset classes are close to their full value, the question is how much upside is left for the REIT from current levels and how much room is there for the yield to move higher. Do tenancy profile, rent outlook, costs and broader economic conditions allow yields to stay attractive?

When Pavilion REIT marketed itself last November, the yield proposition gave it relatively more room to run. At its retail price of 88 sen, also its indicative pricing, Pavilion REIT was priced at 0.94 times its pro forma net asset value (NAV) of 94 sen. Institutions paid 90 sen apiece.

Raising RM710.3 million from its offering, Pavilion REIT gained over 10% from its retail price in its maiden trading day in December last year. Upon listing, its debt levels at RM730.6 million or 20.1% of estimated total asset value (TAV), still gave it enough debt head room for future acquisitions.

Will IGB REIT perform as well upon its debut on the Main Market come Sept 19?

To be sure, IGB REIT too will have the balance sheet for acquisitions. Upon listing, its debt will stand at about RM1.2 billion, or 25.8% of its estimated total assets of RM4.6 billion.

That ratio is about half of the prescribed 50% debt ceiling which all Malaysian REITs (M-REITs) cannot cross without unit holders' prior consent.

At its indicative pricing of RM1.25, which is still subject to finalisation after a book-building exercise that ends on Sept 4, but it is the maximum price retail investors pay — IGB REIT is selling itself at 1.26 times its pro forma NAV per unit of 99.6 sen.

The multiple still falls within the 0.82 times and 1.56 times book that M-REITs were fetching at the time of writing, with the priciest on this measure being another sizeable retail-centric peer CapitaMalls Malaysia Trust (CMMT), Bloomberg data showed.

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Pavilion REIT fetched 1.44 times book at its RM1.37 close on Aug 8, having gained 25.7% year-to-date and 8.7% the past month with analysts raising their earnings forecasts after the REIT's first-half results beat consensus on higher than expected retail turnover and rental hikes. Also stoking interest is the potential acquisition of Fahrenheit88 mall, located opposite its primary asset, the Pavilion Kuala Lumpur mall, which Pavilion REIT has right of first refusal over.

According to its draft listing prospectus, IGB REIT too intends to invest in real estate used primarily for retail purposes in Malaysia and overseas and was granted first right of refusal by its sponsor, IGB Corp Bhd, to all its future retail properties and mixed-used development with retail component.

IGB has commenced work on Mid Valley Southpoint, a mixed office and retail development that is "expected to complete

around 2015". Another potential mall is the planned RM6 billion Southkey Megamall in Johor Baru with 1.5 million sq ft of net lettable area (NLA) in which IGB has a 70% stake following a joint venture agreement signed with Selia Pantai Sdn Bhd in March this year.

Whatever the case, analysts say IGB is coming to the market as retail REITs are in vogue relative to other cash flow generating real estate classes like offices or even hotels. Incidentally, its closest peers — Pavilion REIT, Sunway REIT and CMMT — are also retail-centric and are the largest REITs in Malaysia.

CMMT's implied value was RM3.07 billion on Aug 8, behind Sunway REIT's RM3.99 billion and Pavilion REIT's RM4.11 billion. IGB REIT, which will debut with a 3.4 billion unit base, will have a RM4.25 billion market capitalisation at its RM1.25 indicative price.

A potentially even bigger retail-centric REIT that could come to market is KLCC Property Holdings Bhd (KLCC Prop), whose over RM12 billion real estate portfolio includes the Suria KLCC mall, part of the iconic Petronas Twin Towers.

KLCC Prop had indicated its intention of a REIT, a move that Maybank Investment Research analyst Wong Wei Sum reckoned "would improve the breadth and depth of the sector" and make M-REITs more appealing to international investors.

In a July 12 note downgrading the sector to "neutral", Wong said Malaysian retail REITs are already trading at 4.6% to 5% 2013 gross dividend yield, in contrast to their Singapore peers that fetch 5.7% to 6%. "The next re-rating catalyst [for the sector] could be the REIT-ing of KLCC Prop which may set a new benchmark in cap [capitalisation] rates," Wong wrote.

CIMB Research analyst Foong Wai Mun remains bullish on the M-REIT sector although the larger-cap REITs are already fetching an average premium of 37% over their asset value.

"We believe this premium should be sustained as investors chase high-yielding and defensive stocks with quality earnings, such as the retail REITs, in uncertain market times," Foong wrote in a July 20 note.

Among the larger REITs, the analyst said Pavilion and Sunway REITs have large percentages of tenancies expiring in 2013 — a situation that could be interpreted either way, given that rents could well be revised upward for spaces with strong demand. Tenancy renewals for CMMT and IGB REIT are relatively better spread out. For IGB REIT, some 35.5% of NLA representing 38.7% of gross rental income is up for renewal in 2013, its draft prospectus read.

Foong expects Pavilion REIT to see strong rental reversions when 67% of its NLA is up for renewal next year, as is the case for Sunway Pyramid mall in which 63% of NLA is due for renewal in September 2013. Supporting his forecast is the Malaysian Retail Association's projection for retail sales to grow 6% year-on-year to RM88.2 billion in 2012.

Well-capitalised REITs are expected to continue being a defensive safe haven amid volatile market conditions and a low and stable interest rate environment,according to analysts.

CIMB Investment Bank Bhd is manager, joint managing underwriter, joint global coordinator and a bookrunner for IGB REIT. Maybank Investment Bank is one of four underwriters.

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