

Virus outbreak impact on MREITs' profits should be manageable

Real estate investment trust sector

Maintain overweight: Based on our assessment, Axis Real Estate Investment Trust's (Axis REIT) earnings are least exposed to the Wuhan virus outbreak while YTL Hospitality REIT (YTL REIT) is relatively vulnerable. We recommend that investors look beyond the possible near-term earnings weakness and stay invested. The declining Malaysian Government Securities (MGS) yield should drive investor demand for alternative yield plays such as Malaysian REITs (MREITs). Our top picks are Axis REIT and KLCCP Stapled Group (KLCCSS).

Based on our assessments, we believe that Axis REIT's earnings are shielded from the virus outbreak while the impacts on KLCCSS and Sunway REIT are low.

For retail REITs, IGB REIT has a higher earnings sensitivity to the tenants' sales (compared to Pavilion REIT) and hence, is slightly more susceptible to any slowdown in the retail spending. Lastly, YTL REIT's earnings are vulnerable to the outbreak as lower tourist arrivals to Australia — if the epidemic prolongs — may affect its Australian hotels' profitability (accounted for 40% of financial year 2019 net property income).

We maintain our earnings forecasts and stock recommendations for now. In general, we do not expect a significant worsening of the outbreak in Malaysia and hence, the overall impact on MREITs' earnings should be manageable. However, any prolonged or worsening of the outbreak, may trigger a further cut in Bank Negara Malaysia's overnight policy rate, which will in turn support the economy and MREITs' valuations, in our opinion.

All in, we recommend investors look beyond the possible near-term earnings blip and stay invested. The compression in MGS yields should drive investor demand for alternative yield plays such as MREITs, thereby rerating the MREITs' valuations. — *Affin Hwang Capital, Feb 7*