Lower OPR should lift Malaysian REITs' valuation

Real estate investment trust sector

Maintain overweight: Bank Negara Malaysia (BNM) decided to cut its overnight policy rate (OPR) by 25 basis points (bps) to 2.75%. This is its lowest level since April 2011. The market was expecting the OPR to be unchanged at 3%. BNM guided that its decision to lower the OPR was a "pre-emptive measure to secure the improving growth trajectory amid price stability". Barring unforeseen global events (for example, worsening of the recent coronavirus outbreak), we anticipate BNM to keep the OPR unchanged throughout 2020 as it guided that the current OPR level of 2.75% is appropriate in sustaining economic growth with price stability.

In the long run, the OPR cut should lower Malaysian real estate investment trusts' (REITs) finance cost and lift earnings, but the impact to near-term profit (2020-21 estimates) is likely minimal. Most of the Malaysian REITs under our coverage (Axis REIT, IGB REIT, KLCCP Stapled Group and YTL Hospitality REIT) have the majority (more than 70%) of their borrowings pegged at a fixed rate, while the others (Pavillion REIT, Sunway REIT) have pegged at 43% of their borrowings at a fixed rate.

On Jan 22, 2020, the OPR cut triggered a 12bps decline in the 10-year Malaysia Government Securities (MGS) yield to 3.17%. We anticipate the compression on MGS yields to drive investor demand for alternative yielding assets such as Malaysian REITs, thereby rerating the sector's valuation. We maintain "overweight". For exposure, we like: i) KLCCP Stapled Group ("buy"; target price [TP]: RM8.90) for its highly defensive earnings/sustainable yield; ii) Axis REIT ("buy"; TP: RM1.97) for its industrial/warehouse portfolio and attractive valuation; and iii) IGB REIT ("buy"; TP: RM2.12) for its prime assets, robust earnings track record and strong management.

Key risks: Weak retail spending, lower economic growth, lower tourist arrivals and reversal in the global yield trend. — *Affin Hwang Capital, Jan 23*

Real estate investment trust peer comparison

COMPANY	RATING	SHARE PRICE (RM)	TP (RM)	MKT CAP (RM MIL)	YEAR END	CORE PER (X)		CORE EPU CHG (%)		GEARING (%)	P/NAV (X)	DPU (SEN)		DPU YIELD (%)	
						CY19E	CY20E	CY19E	CY20E			CY19E	CY20E	CY19E	CY20E
Axis REIT	Buy	1.86	1.97	2,669.6	Dec	20.3	19.2	5.7	6.1	28.7	1.3	9.3	9.6	5.0	5.2
IGB REIT	Buy	1.95	2.12	6,920.2	Dec	21.9	21.0	3.5	4.1	23.3	1.8	9.1	9.5	4.7	4.9
KLCC	Buy	7.83	8.90	14,135.8	Dec	19.4	18.4	0.4	5.5	13.0	1.1	38.0	40.1	4.9	5.1
Pavilion REIT	Hold	1.72	1.85	5,227.1	Dec	20.3	19.1	0.5	6.4	34.3	1.3	8.7	9.3	5.1	5.4
Sunway REIT	Buy	1.83	2.00	5,389.5	June	18.8	18.0	1.8	4.2	38.6	1.2	9.7	10.1	5.3	5.5
YTL REIT	Buy	1.36	1.46	2,318.0	June	15.7	14.4	(0.3)	8.4	41.3	0.9	8.2	9.0	6.1	6.6
Average						**19.4**	**18.4**	**1.9**	**5.8**	**29.9**	**1.3**			**5.2**	**5.4**

Prices as of Jan 22, 2020

Sources: Company, Affin Hwang estimates, Bloomberg