REIT - Gradual Recovery - HLBank Research Highlights | I3investor

Wednesday, December 22, 2021 10:19 AM

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Leading to 2022, we foresee selective office and industrial REITs to remain stable, while retail and hotel REITs will recover gradually in an endemic reopening. We expect OPR to be raised to 2.00% in 2H22 (from 1.75%), which is still relatively low vs. pre-Covid days of 3.00%. We conservatively increase our MGS assumption to 3.75% (from 3.25%, current: 3.549%) and input in 5 years valuation horizon (from 2 years) of MGS yield spread as we opine this timeline is a fairer one with 2 years of pandemic impact and 3 normalised years. We maintain NEUTRAL on the sector as we expect reopening sentiment to be balanced off by rising rate expectations. Top picks are Axis REIT (TP: RM2.32) and Sentral REIT (TP: RM0.95).

Retail and hotel. We expect a gradual recovery in retail and hotel segment in line with expectations of improving business activities in 2022. Since economic reopening started in mid-Aug, we saw footfall improvement in malls and in hotel occupancy (Figure#4) and thus, we feel this would pave up the momentum for 2022. However, we think the traction is not as rapid due to the absence of foreign tourists. While we expect retail rental assistance to decline, with affected tenants being allowed to start back operations, we are concerned on rental reversion as we foresee muted or negative rental reversion as an attempt to retain tenants. That said, we still like IGB REIT (BUY, TP: RM1.75) for its prime asset location, high occupancy and reliant on domestic footfall, which we believe would experience a faster recovery among other retail REITs.

Office. Oversupply issue will continue to linger in 2022 (+4.0% YoY, Figure #5), also the new supply and completion of new buildings has pushed down the average occupancy rates (-1.3% QoQ, Figure#6) due to the vacancies in new buildings. However, this is an exception to offices under our coverage; Sentral REIT, IGB Commercial REIT, UOA REIT and KLCCSS office buildings, due to their prominent location of assets. Furthermore, office REITs under our coverage managed to maintain strong occupancy of above 80%; this is backed by the longer tenancy in office REITs (vs. retail REITs) paired with resilient rental reversion (especially for prime areas), thus providing dividend certainty. Additionally we anticipate improvement in occupancy, following the economic recovery in an "endemic reopening", with more workers coming back to office leading to increase in demand for office space. We like Sentral REIT (TP: RM0.95) for its stable portfolio occupancy as well as attractive dividend yield of 8.4% (highest among REITs in our universe).

Industrial. Industrial REITs has been steadily strong even during the pandemic, backed by the robust growth of e-commerce which drives up the demand for logistics and fulfilment centres. Average price of industrial land in greater KL continues to increase (Figure #7). We reckon industrial REITs will continue its stable growth trajectory in 2022. We favour Axis REIT (TP: RM2.32) for its strong resiliency throughout the pandemic driven by high occupant tenancy in its diversified portfolio, and also, one of the few Shariah compliant REITs.

OPR hike to 2.00%. Our economics team expects OPR to hike up 25bps to 2.00% (from 1.75%) in 4Q22. Despite expectations of the slight increase, we reckon the quantum is still relatively low when compared to pre-Covid days of 3.00%. Hence, the low level of OPR would remain favourable for REITs, with a low borrowing cost for potential future acquisitions. Also, market has already priced in potential OPR hike of 100bp, looking at the movement of MGS10 yield, suggesting that any OPR increases below this quantum may be a non-event to capital markets and REITs. Furthermore, the temporary uptick in gearing limit set by SC to 60% (from 50%) until Dec 2022 would aid REIT managers to manage their REIT's debt and capital structure which will help support their earnings.

Valuation. To keep abreast with the current MGS10 yield, (now trading at 3.549%), we conservatively increase our assumption to 3.75% (from 3.25%; YTD average: 3.0%). We also took the opportunity to input in 5 year valuation horizon (from 2 years) of MGS yield spread as we opine this timeline is a fairer one with 2 years of pandemic impact and 3 normalised years. New TPs are shown in Figure #9.

Maintain NEUTRAL. We expect selective office and industrial REITs to continue a stable showing in 2022, while retail and hotel REITs will continue to recover gradually driven by the endemic reopening. Maintain **NEUTRAL** as we expect reopening sentiment to be balanced off by rising rate expectations. For top picks, we continue to favour Axis REIT (TP: RM2.32) as a leading player in industrial segment and Sentral REIT (TP: RM0.95) for its high yield (8.4%, highest under our coverage).

Source: Hong Leong Investment Bank Research - 21 Dec 2021