

IGB REIT - Minimal rental rebates in FY22F | I3investor

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Investment Highlights

- We upgrade IGB REIT to **BUY** from **HOLD** with a higher **fair value (FV) of RM1.85** (from RM1.74) based on the dividend discount model (DDM). The increase in our FV is based on the lower risk-free rate due to decline in the 10-year Malaysian Government Securities (MGS) to 4% from 4.3%. We also take into account higher rental income and minimal rental rebates from FY22F onwards. No changes to our neutral 3- star ESG rating (Exhibits 5, 6).
- IGB REIT's distributable income of RM182mil in 1HFY22 came in above our and consensus' expectations. It accounted for 62% of ours and 59% of streets' full-year estimates. The variance was mainly due to higher-thanexpected base rent upon the renewal of tenancies as well stronger shopper volume and tenant sales for the festive season which increased the variable portion of rents tied to the sales of retail stores.
- We raise our FY22F/FY23F/FY24F distributable income forecast by 4%/11%/7%. This is to factor in higher rental income from the improving footfall, coupled with minimal rental assistance to tenants.
- Footfall at The Mid Valley Megamall (MVM) and The Gardens Mall (TGM) recovered to almost 90% of pre-Covid levels. Hence lower rental assistance will be required moving forward to retain tenants and attract new ones.
- In 2QFY22, IGB REIT's gross revenue surged 58% YoY while net property income (NPI) climbed 67% YoY. The improvement was driven by higher occupancy rate in TGM from a low 90% in 2QFY21 to 99.7% in 2QFY22, coupled with lower rental rebates offered to tenants.
- QoQ, occupancy rates for both the MVM and TGM remained stable at 99.7% in 2QFY22 (Exhibit 2).
- 15% of its tenancies in MGM and 38% in TGM are set to expire in FY22 (Exhibit 3). We understand from management that more than 80% of lease renewals have been completed with the remaining to be replaced by new tenants.
- We are confident in IGB REIT's ability in maintaining its high occupancy rate due to its malls' strategic location and lower gross monthly rental rates of RM13–15 per sq ft. compared to other shopping malls in Klang Valley, such as Suria KLCC (>RM40 per sq ft.), Pavilion Kuala Lumpur Mall (RM27 per sq ft.) and Sunway Pyramid Shopping Mall (RM16 per sq ft.).
- We expect rental reversion to be flattish upon the renewal of tenancies in FY22F as tenants will still require some time to recover to their pre-pandemic sales level. Nevertheless, we foresee a positive rental reversion in FY23F/FY24F with the assumption of a gradual normalization of economic and social activities following the transition to the endemic phase of Covid-19.
- IGB REIT's net debt-to-asset ratio fell slightly to 18.6%, below the 60% statutory threshold required by the Securities Commission. It has the lowest net debt-to-asset ratio among the REITs under our coverage.
- The group's borrowings are all under medium-term notes (MTN) with a fixed coupon rate of 4.4% per annum. IGB REIT plans to refinance the MTN by September 2022 (expected maturity date) to avoid the stepped-up increase in coupon rates. We expect the new coupon rate to remain low given its high credit rating of AAA/stable MTN rating by RAM Ratings.
- IGB REIT declared its first interim gross DPU of 2.45 sen in 2QFY22 which represented a distribution payout ratio of 98%. It was 8%

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- IGB REIT declared its first interim gross DPU of 2.45 sen in 2QFY22, which represented a distribution payout ratio of 98%. It was 8% higher than the 2.26 sen in 2QFY19 (the pre-pandemic level).
- Since the beginning of 2022, the yield spread between IGB REIT and the 10-year MGS has been narrowing. This was contributed by the surge in the 10-year MGS yield which followed closely the rising trend of the 10-year US Treasury yield (UST). However, we see a stabilisation in the 10-year MGS yield with a decline to 4.0% from the peak of 4.4% following heavy foreign selling in June 2022 and also tapering in inflationary pressure with the retreat in commodity prices from their high levels. FY23F distribution yield is estimated at 6%. We expect IGB REIT to be appealing to yieldseeking investors with its higher yield spread against the 10-year MGS (Exhibit 4).
- IGB REIT currently trades at a compelling FY23F PE of 18x vs. 4-year average of 24x. Meanwhile, distribution yield for FY23F of 6% is attractive vs. 10-year MGS yield of 4%.
- We like IGB REIT given its more resilient long-term outlook underpinned by strategically located assets in the heart of Klang Valley and better balanced footfall profile with moderate exposure to tourists, which position the group to better capitalise the domestic consumption recovery while international tourist arrivals reg

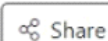
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