IGB REIT - Near-full occupancy rates for malls; positive rental reversions close to pre-pandemic levels | I3investor

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Investment Highlights

- We maintain **BUY** on IGB REIT with an unchanged **fair value (FV) of RM1.92/unit** based on dividend discount model (DDM) and a neutral 3-star ESG rating (Exhibits 7, 8).

- The FV implies a FY24F distribution yield of 6%, at parity to its 5-year median.

- We maintain our earnings forecast following our recent meet up with IGB REIT's management for updates.

- IGB REIT's share price has recovered since the decline on 11 May 2023 following the stock's removal from the MSCI Small Cap Index.

- Despite a 6% rebound in the share price following the bottoming out of share price coinciding with the effective date of IGB REIT's removal from MSCI Small Cap Index on 31 May 2023, we believe that there is still room for share price upside. This is premised on its improving earnings prospects, which will be supported by favorable rental reversions, resilient tenant sales and near-full occupancy rates of its retail assets.

- We understand that the financial impact on IGB REIT resulting from the recent fire incident was negligible. It has only affected the external Tenaga Nasional substation. The losses incurred could be mitigated by an insurance claim.

- Historically, IGB REIT has consistently achieved a stable rental reversion rate ranging from 4% to 6% annually for both Mid Valley Megamall and The Garden Mall.

- IGBREIT has completed the renewal of a majority of leases expiring in FY23 at a rate of 4% to 6%, supported by an improvement in retail sales (Exhibit 1).

- IGB REIT adopts a proactive approach to rental renewals, typically finalising 9-12 months ahead of lease expirations. With the continued positive sales momentum, we are confident that the majority of leases set to expire in FY24F (Exhibit 4) will be successfully renewed in 2HFY23, with positive rental reversions close to pre-pandemic levels.

- Meanwhile, we expect the turnover rent derived from tenant sales to remain resilient in 2HFY23, buoyed by robust footfall traffic from domestic shoppers and an uptick in retail sales. Our projection of stronger retail sales is underpinned by the forecast of our in-house economic team of a retail sales growth rate of 6.4% YoY in 2HFY23 vs. 5.2% YoY in 1HFY23. The positive outlook is backed by improving consumer sentiment on the back of expectations of no further interest rate hikes and improvement in the labour market.

- Additionally, IGB REIT has effectively mitigated the impact from interest rate hike through the utilisation of fixedrate medium-term notes (MTN) with an interest rate of 4.49% per annum. It is worth highlighting that these MTNs will mature only on 20 September 2027, thus ensuring stability in financial cost for the next 4 years.

- Considering the maximum utilisation of net lettable area and consistent base rent growth, we anticipate that the potential acquisition of Mid Valley Southkey mall in Johor to be the key growth catalyst for IGB REIT in the long term. To recap, IGB REIT has secured the right of first refusal from main shareholder, IGB, for the acquisition of the mall.

- We expect that the acquisition of Southkey Mall to materialise once the mall has achieved a satisfactory yield. This should take at least 2 full rental cycles (3 years each) from its first operating year in FY19, taking into consideration the time needed for tenants to mature. As such, we foresee the acquisition to occur earliest in FY25F.

- Our in-house economist anticipates the Fed fund rate to peak between 5.5%-5.75% by 3QCY23. With the expectation of the end of global monetary policy tightening, our economist forecasts 10-year MGS to be lower at 3.75% in 4QCY23 from 3.9% currently with a gradual decline to 3.5% by 4Q2024. However, we do not rule out the possibility that the 10-year MGS yield could be lower than our projection of 3.75% by end-2023 should there be a change in Fed's hawkishness on rate hikes.

- We anticipate the yield spread from FY23F onwards to widen to 2% vs. 5-year median of 1%. Hence, we expect IGB REIT to be appealing to yield-seeking investors with its higher distribution yield spread against 10-year MGS (Exhibit 5).

- IGB REIT's FY24F distribution yield of 6% is compelling vs. 10-year MGS yield of 3.9%.

- We like IGB REIT due to its resilient long-term outlook underpinned by the group's strategically located assets in the heart of Klang Valley. In addition, it has a better-balanced footfall profile comparatively with moderate exposure to foreign tourists. This positions the group to be able to better capitalise on domestic consumption recovery while international tourist arrivals gradually regain momentum.

Source: AmInvest Research - 6 Jul 2023