REIT - 2Q22 Report Card: Decent Quarter as Expected | I3investor

Wednesday, September 7, 2022

Clipped from:
https://klse.i3investor.com/web/blog/detail/hleresearch/2022-09-06-story-h1628934172-REIT_2Q22_Report_Card_Decent_Quarter_as_Expected

REITs' 2Q22 results came in largely inline with only 2 out of 8 REITs below our estimates. Sector profit declined 4.4% QoQ but rose 46.8% YoY. Retail REITs showed strength in recovery following the lifting of movement restrictions which spured shopper traffic and tenancy sales. Pure office owners mostly delivered muted performance due to falling occupancy rates arising from challenges brought by oversupply. Industrial REIT continued to register stable growth on the back of robust expansion and acquisition pipeline with stable occupancy rate. Overall, we believe that the sector will continue demonstrating decent recovery on a YoY basis, given the successful transition to endemicity and borders reopening. However, not all REITs are created equal as varying property classes fare differently, as reflected by 2QCY22 results. Maintain NEUTRAL with top picks Axis REIT, Sunway REIT and IGB REIT.

2Q22 results largely inline. The results were largely inline with 6 out of 8 REITs under our coverage raked in profits that met our estimates (Axis REIT, IGB REIT, KLCC REIT, Pavilion REIT, Sunway REIT and UOA REIT) while the remaining 2 were below (IGB Commercial REIT – impacted by elevated operating expenses and Sentral REIT – dampened by declining occupancy rate).

Dividends. Looking at Figure#2, dividends declared for REITs under our coverage were broadly higher in 1HCY22 against SPLY. In line with their performance, retail based players namely, Sunway REIT, Pavilion REIT and IGB REIT delivered significant rebound in dividends declared due to low base last year as retail malls were the hardest hit during lockdowns. Meanwhile, dividends from the rest (office and industrial) remained largely stable.

Retail malls posed impressive recovery. Following the transition to endemicity, malls in prime locations experienced resurgence of shopper traffic and tenancy sales, returning to pre-pandemic levels (if not surpassing), according to managements of REITs that possess flagship shopping malls (Sunway Pyramid Mall, Suria KLCC, Midvalley Megamall, The Gardens Mall, Pavilion Kuala Lumpur). Also, rental rebates of the said malls have diminished to a negligible level with occupancy rates holding steady compared to pre-pandemic levels. This positive backdrop has led to improved performance for Pavilion REIT, Sunway REIT and IGB REIT (see Figure#1).

Oversupply woes continue to bite office owners. Sentral REIT and

UOA REIT registered YoY results decline, mainly due to falling occupancy rates of their properties. Notably, IGBC REIT also posted a marginal QoQ drop, no thanks to higher operating expenses. We opine that the overall tepid performance was attributable to the prevailing office supply glut, which has dampened their ability to source for new tenants, coupled with added pressure to their reversion rates. However, players with properties in prime locations and robust tenancy base have fared fairly resilient. Prominently, KLCC REIT which has displayed a double-digit growth, supported by long-term triple net lease agreements with established MNCs, while also riding on the strong recovery of hotel and retail segment.

Industrial properties remains resilient. Equipped with a proven track record, there was no surprise that Axis REIT had managed to sustain its growth momentum, on the back of 3 newly acquired properties in 1H22. Notably, out of 22% of total NLA due for expiry in 2022, 65% has been renewed with overall positive rental reversions, owing to favourable demand for logistics and warehousing assets.

Outlook. We foresee the positive momentum for retail REITs to persist in 2HFY22 due to: (i) minimal rental support going forward; and (ii) the transition to endemicity where imminent return of foreign tourists will further boost shoppers footfall, especially to malls that previously commanded sizable foreign tourists traffic (Suria KLCC, Pavilion Kuala Lumpur). Retail Group Malaysia (RGM) has also revised the retail industry's growth rate upwards for 2022 to 13.1% from 6.3% (previous estimation in March) in view of the better-than-expected recovery momentum. Nonetheless, we take a pinch of vigilance in view of persistent inflationary pressures and interest rate upcyle that are likely to weaken consumers' purchasing power.

Moving on, we expect office market to remain in the doldrums, attributable to the lack of catalysts and several headwinds such as (i) structural shift in demand dynamics as more companies embrace a hybrid work model and flexible working arrangements, especially MNCs, (ii) worrying uptrend in vacancy rate since 2017 (30% in 2Q22) (see Figure# 3), (iii) incoming supplies amounting to 9.37m sf in KL CBD alone (Figure#4) as well as (iv) stagnant rental growth rates. Notwithstanding, quality and strategically located office buildings with the latest infrastructure will continue to garner favourable take-up rates.

We continue to view positively the industrial REITs – where our optimism is backed by (i) robust expansion and acquisition pipeline with sustained demand for their properties (e.g. Axis REIT is constructing its first built-to-suit facility – Bukit Raja Distribution Centre 2 to be tenanted by Shopee Express Malaysia), (ii) adoption of prudent inventory management system which builds up inventory (transition to Just-In Case from Just-In-Time policy) due to prolonged supply chain disruptions, (iii) investment diversion to Malaysia amidst heightening geopolitical tensions and (iv) anticipated positive rental reversions. However, the elephant in the room is perhaps the slow down of pandemic-fuelled e-commerce activities as people return to physical shopping. Hence, we are cautious on that trend while monitoring the impact on the overall demand for logistics and warehousing assets. On a side note, following the enforcement of Act 446 and consequently the increasing demand for workers accommodation that comply with the standards, REITs with exposure in this space (a soon to be listed industrial REIT) should stand to benefit from this.

Maintain NEUTRAL. On balance, we believe that the sector will continue to demonstrate decent recovery on a YoY basis, given the successful transition to endemicity and ongoing borders reopening of many countries. However, not all REITs are created equal as varying property classes fare differently, as reflected by respective REITs' 2QCY22 results. Therefore, we are selective in names that displayed resiliency over the past 2 years and are best poised to capitalise on the broad recovery in economic activities. We are sanguine on industrial properties as we like Axis REIT for its robust track record and occupant tenancy in its diversified portfolio. For retail REITs, we favour Sunway REIT and IGB REIT for their strategically located prime retail malls and sturdy shopper footfall.

Source: Hong Leong Investment Bank Research - 6 Sept 2022