REITS - Widening Yield Spread | I3investor

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RHB Investment Research Reports

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- **With easing government bond yields, stable occupancy rates, and normalising rental reversion, we remain positive on REITs** as a defensive yield play. However, upside to earnings may be limited due to increased competition in the retail sector, and moderate growth in spending due to the higher cost of living. We are selective on REITs that provide more sustainable and higher yields with a stable earnings outlook. Maintain NEUTRAL; Top Pick: IGB REIT.

- **Yield spread at +1SD.** The current yield spread between the KL REIT Index (KLREI) and 10-year Malaysia Government Securities (MGS) is at 230bps, which is +1SD above the historical average. Currently, RHB Economics is expecting the 10-year MGS to drop to 3.75% by year-end from the current 3.85%. We think further upside (in yield spread) could be a matter of timing. YTD, the US government bond yield has increased c.50bps despite the expectations of three interest rate cuts due to persistently high inflation. Therefore, we could see a wider yield spread in 2H24.

- **Limited upside for retail.** With stable occupancy rates, earnings growth for retail REITs would mostly depend on rental reversions, which should normalise to a mid-single digit range following the high single- to double-digit growth recorded in FY23 (from a low base due to the COVID-19 pandemic). This is reflected by the strong 9% growth in Malaysia's retail trade for 2023, and a softer growth forecast of 4% for 2024 by Retail Group Malaysia. Aside from the higher base, higher cost of living remains the main concern for retail spending. In the longer term, we are also cautious on the upside for rental reversions due to the opening of new malls.

- **Recovering tourism sector will be a boost** for retail spending, especially for malls in the city centre such as Suria KLCC and Pavilion KL which typically have a high proportion of foreign shoppers. Meanwhile, the delay in the implementation of High Value Goods Tax should also provide a temporary relief for both malls. For Pavilion REIT however, we are cautious on the performance of Pavilion Bukit Jalil, which should only record higher rental reversions in 4Q23 as it enters a new rental cycle. FY25 should also see a placement for the balance payment for the mall, which will likely dilute earnings growth next year.

- **Room to grow for industrial REITs.** We remain positive on the prospects of the industrial sub-sector premised on its favourable supply-demand dynamics, with certain manufacturing sectors also having benefitted from the US-China trade tensions. Coupled with the influx of investments, and favourable government policies such as the National Industrial Master Plan 2030, the industrial segment should continue to fare better.

- **Top Pick.** We like IGB REIT due to its robust earnings outlook, underpinned by its fully occupied and strategically located malls. While there is no news yet on any indicative timeline, we think that an acquisition of Mid Valley Southkey will be a strong catalyst for the REIT, and be easily funded as its gearing ratio is only at 22%.

Source: RHB Securities Research - 4 Apr 2024