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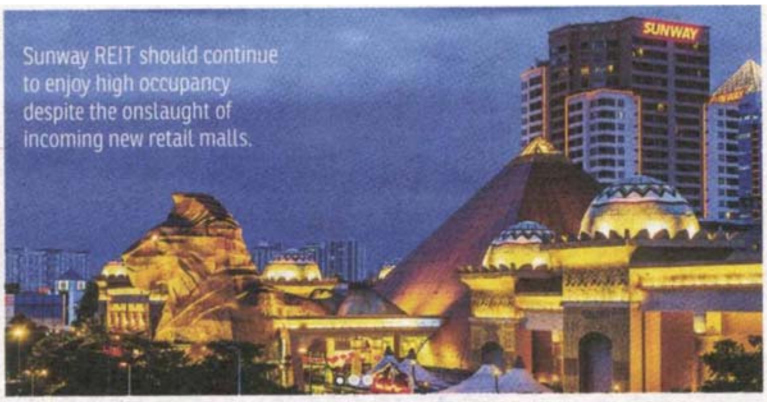

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Real estate investment trust sector

Initiate neutral: We initiate coverage of the real estate investment trust (REIT) sector with a "neutral" recommendation. We believe that while the counters are supported by defensive earnings quality with an attractive average distribution per unit of 4.9%, the yield spread of 150 basis points (bps) against the 10-year Malaysian Government Securities' (MGS) yield of 3.4% is among (if not) the lowest yield spread vis-à-vis other major REIT markets around the world. In light of a dovish-sounding US Federal Reserve, we believe that Bank Negara Malaysia (BNM) could be on the same path of maintaining low interest rates, which should be good for REITs. However, the price run of some counters by as much as 20% year to date suggests that risk-reward is not attractive for now. We like prime shopping mall owners given their sustainable earnings but believe that most positives have been priced in. We initiate coverage of IGB REIT, Axis REIT and Sunway REIT with "neutral" recommendations.

For the near term, we expect the demand-supply dynamics of commercial and retail space in Malaysia to continue to be lacklustre given oversupply concerns. That said, we believe selected REITS' rental earnings should remain resilient given their long-term leases and well-established matured assets. Integrated prime retail mall owners like IGB REIT, Sunway REIT and Pavilion REIT should continue to enjoy high occupancy despite the onslaught of incoming new retail malls.

Commercial space, both retail and office, faces oversupply issues in the near term. According to the Valuation and Property Services Department, the average rate of unoccupied office space in the region stood at 23.5% in the first quarter of 2019 (1Q19), compared with 22.6% in 1Q18. We understand that there will be more than 21.53 million sq ft of office space in the pipeline. Upon completion, it will inject another 12% to the current existing space. Similarly, retail supply in the Klang Valley is expected to rise to 69.1 million sq ft in 2019, according to Savills Research, following the completion of 4.8 million sq ft of lettable retail space this year. The incoming retail space is expected to grow by 13.5% to 78.4 million sq ft in 2022 if all 18 projects presently under construction are completed on time, which could worsen the glut.

The financial year 2019 average gross yield of Malaysian REITs is at 4.9% against the 10-year MGS' yield of 3.4%, providing a yield spread of 150bps. In comparison, Japan's yield spread is 400bps, while Singapore's is 370bps. — *PublicInvest Research, Nov 7*