

MRCB-Quill REIT (MQREIT MK)

Menara Shell: Long-term positive

But short-term blip on dilutive impact; D/G to HOLD

MQREIT's proposed funding for the Menara Shell acquisition via new unit placement is EPU and DPU dilutive, based on our initial assumptions. We raise FY17-18 net profit forecasts by 45% each but lower DPU by 4-5%. Downgrade to HOLD with a lower DCF-based TP of MYR1.10 (-5sen; WACC: 6.6%, terminal yield: 7.0%) as total return is <10%.

Sizeable new units placement

To fund its purchase of Menara Shell for MYR656m (including exercise expenses of MYR16m), MQREIT has proposed to place out up to 406.7m new units to: 1) its largest unitholder for an amount \geq MYR110m but \leq MYR152m, 2) Employees Provident Fund (EPF) for up to 7% of MQREIT's enlarged units (up to 1,068m units), and 3) other institutional investors; by way of a book building exercise at an issue price to be determined later. MQREIT has also proposed for payments of management fees of up to 32.0m new units on a progressive basis for FY17-19.

Higher earnings but lower EPU and DPU

We raise FY17-18 net profit forecasts by ~45% following the inclusion of Menara Shell's contribution from 1 Jan 2017 onwards. However, based on the assumptions of a maximum placement of 407m new units and MYR1.10 issue price (5% discount from closing price), our FY17/18 EPU and DPU forecasts are lower by 10.1/10.5% and 4.4/4.7% respectively. The exercise is expected to be EPU and DPU dilutive as our estimated FY17 net property yield of 6.1% is marginally lower than the estimated funding cost of 6.2%. We also raise FY17-18 net profit payout assumptions to 98% (from 95%) as we understand that management targets to maintain a neutral DPU yield, if not higher.

Earnings to remain resilient

Despite the expected near-term EPU and DPU dilution, we remain positive on Menara Shell's earnings contribution. Going forward, we expect MQREIT's earnings to remain resilient, largely backed by sizeable office assets with tenants on long-term lease agreements (i.e. Platinum Sentral and Menara Shell).

FYE Dec (MYR m)	FY14A	FY15A	FY16E	FY17E	FY18E
Revenue	70	115	124	186	192
Net property income	53	90	100	145	150
Core net profit	34	54	57	88	93
Core EPU (sen)	8.8	8.2	8.6	8.2	8.7
Core EPU growth (%)	(1.1)	(6.7)	5.3	(4.3)	5.3
Net DPU (sen)	7.5	6.9	7.0	7.1	7.5
Net DPU growth (%)	0.0	(8.1)	0.8	1.8	5.3
P/NAV (x)	0.8	0.8	0.8	0.9	0.9
Net DPU yield (%)	6.5	6.0	6.0	6.1	6.5
ROAE (%)	6.4	7.5	6.3	7.8	6.8
ROAA (%)	4.0	4.3	3.5	4.4	4.0
Debt/Assets (x)	0.35	0.42	0.42	0.39	0.39
Consensus Net DPU	-	-	7.4	7.7	8.1
MKE vs. Consensus (%)	-	-	(5.6)	(7.6)	(7.4)

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HOLD

[Prior:BUY]

Share Price MYR 1.16
 12m Price Target MYR 1.10 (-5%)
 Previous Price Target MYR 1.15

Company Description

MRCB-Quill REIT engages in the investment in commercial properties which are mainly located in the Klang Valley.

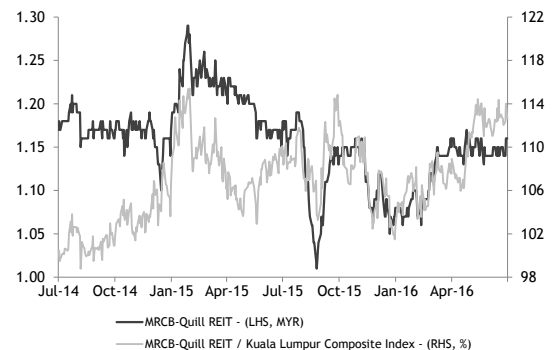
Statistics

52w high/low (MYR) 1.19/1.01
 3m avg turnover (USDm) 0.1
 Free float (%) 27.6
 Issued shares (m) 661
 Market capitalisation MYR767.2M
 USD190M

Major shareholders:

Malaysian Resources Corp. Bhd. 31.2%
 CapitaLand Commercial Trust 17.7%
 Quill Land Sdn. Bhd. 7.4%

Price Performance



	-1M	-3M	-12M
Absolute (%)	2	1	(1)
Relative to index (%)	0	5	2

Source: FactSet

Other updates

Gearing to improve

Post the placement exercise, the difference between the amount raised from the proposed placements and acquisition cost (MYR656m) will be funded via borrowings. Based on our estimated maximum new units placement scenario with MYR448m to be raised (447m new units and MYR1.10 issue price), we have factored in additional borrowings of MYR209m in FY17. Our revised FY17 gross gearing forecast is 0.39x, an improvement from pre-Menara Shell gross gearing forecast of 0.42x, after considering also the enlarged total asset value base.

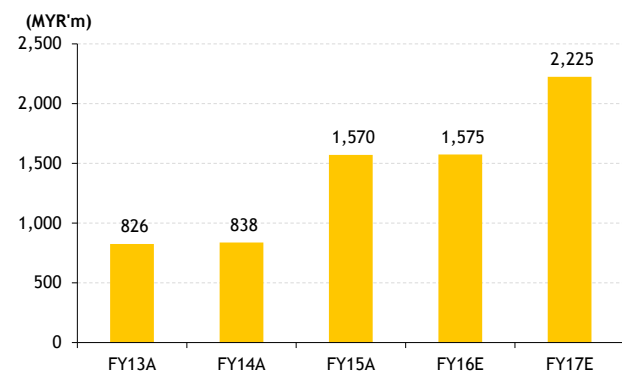
Resilient earnings from Menara Shell

Despite the expected near-term EPU and DPU dilution, we remain positive on Menara Shell's earnings contribution. We understand that Menara Shell is currently 100%-tenanted and backed by two anchor tenants: (i) Shell People Services Asia - 306k NLA (55% of Menara Shell's NLA), and (ii) AmGeneral Insurance - 133k sq.ft. NLA (24%). This would provide a low occupancy risk for MQREIT as both anchor tenants are on 15-year leases and cumulatively occupy 79% of Menara Shell's total NLA.

Value Proposition

- Hands on and experienced management team, backed by its largest unitholder.
- The largest unitholder develops and owns prominent office assets in the Kuala Lumpur city centre, which serve as new asset pipeline for the trust.
- Portfolio dominated by high-quality offices. Assets from MRCB include Platinum Sentral and Menara Shell.
- Portfolio backed by long-term leases of sizeable tenants - provide high occupancy rates and lower occupancy risks.
- Demand for office space, however, has remained soft plus there is an oversupply of office buildings.
- At 0.4x (statutory limit of 0.5x), the total borrowings-to-total asset ratio implies that future sizeable acquisitions would need to raise capital/dispose assets.

Total value of all investment properties

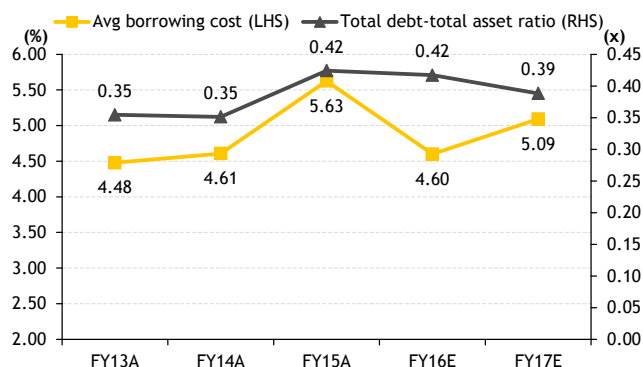


Source: Trust, Maybank Kim Eng

Financial Metrics

- All of MQREIT's long-term borrowings are based on fixed rates. 56% only due for refinancing in 2020.
- Low positive rental reversions across office assets due to long-term leases, but these would lower occupancy risk. Portfolio occupancy expected to remain >95%.
- NPI margin could also be enhanced by lower opex (i.e. utilities) via better property management.
- DPU is stable as recent net income payout p.a. were ~95% (statutory payout of M-REITs is >90%).

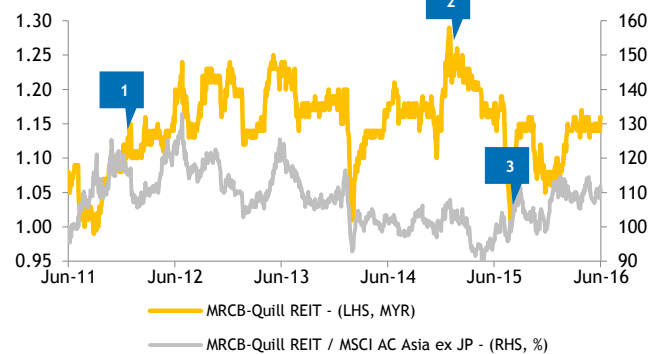
Average borrowing costs and gross gearing



Source: Trust, Maybank Kim Eng

Price Drivers

Historical share price trend



Source: Trust, Maybank Kim Eng

1. Share price uptrend was a combination of improved organic growth and anticipation of more office asset acquisitions.
2. Pre-completion of the purchase of Platinum Sentral, a sizeable addition to its portfolio, which also entails the entrance of its largest unit holder, MRCB.
3. Sharp decline in share price due to fluctuation in 10-year MGS yield, which ranged between 3.9%-4.5% in 2H15.

Swing Factors

Upside

- Yield-accretive acquisitions of high-quality assets.
- Higher-than-expected positive rental reversions.
- Disposal of asset with an attractive price tag.

Downside

- Zero or negative rental reversions.
- Sizeable tenants vacating/downsizing space required. This more apparent for single-tenanted office buildings.
- Decline in asset value.
- Acquisition of less desirable new assets (low occupancy rates, less favourable locations, expensive acquisition costs etc).

FYE 31 Dec	FY14A	FY15A	FY16E	FY17E	FY18E
Key Metrics					
Price/DPU(x)	15.4	16.7	16.6	16.3	15.5
P/BV (x)	0.8	0.8	0.8	0.9	0.9
P/NTA (x)	0.8	0.8	0.8	0.9	0.9
DPU yield (%)	7.2	6.6	6.7	6.8	7.2
FCF yield (%)	8.9	9.2	10.7	7.2	8.8
INCOME STATEMENT (MYR m)					
Revenue	70.2	115.2	124.4	186.1	192.1
Net property income	53.3	90.3	100.3	145.3	150.0
Management and trustee fees	(5.8)	(9.8)	(12.9)	(18.8)	(19.1)
Net financing costs	(13.3)	(26.5)	(30.6)	(38.6)	(38.3)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income/expenses	0.0	0.0	0.0	0.0	0.0
Pretax profit	34.2	54.0	56.9	87.9	92.5
Income tax	0.0	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Net profit	34.2	54.0	56.9	87.9	92.5
Distributable inc to unitholders	34.2	54.0	56.9	87.9	92.5
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	23.3	44.9	73.1	83.2	91.1
Accounts receivable	6.1	5.7	5.7	5.7	5.7
Property, Plant & Equip (net)	0.0	0.0	0.0	0.0	0.0
Investment properties	837.7	1,569.8	1,574.8	2,224.8	2,234.8
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	1.2	4.9	0.0	0.0	0.0
Total assets	868.4	1,625.3	1,653.6	2,313.7	2,331.6
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	12.2	13.6	13.6	13.6	13.6
LT interest bearing debt	305.1	689.7	689.7	898.4	898.4
Other liabilities	9.8	18.1	43.5	45.1	61.1
Total Liabilities	327.1	721.5	746.9	957.1	973.2
Shareholders Equity	541.3	903.9	906.7	1,356.6	1,358.5
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	541.3	903.9	906.7	1,356.6	1,358.5
Total liabilities and equity	868.4	1,625.3	1,653.6	2,313.7	2,331.6
CASH FLOW (MYR m)					
Cash flow from operations	40.1	70.6	82.3	89.4	108.6
Capex	0.0	0.0	0.0	0.0	0.0
Acquisitions & investments	(12.1)	(732.1)	(5.0)	(650.0)	(10.0)
Disposal of FA & investments	0.0	0.0	0.0	0.0	0.0
Dividend income from associates	0.0	0.0	0.0	0.0	0.0
Other investing cash flow	0.0	0.0	0.0	0.0	0.0
CF from investing activities	(12.1)	(732.1)	(5.0)	(650.0)	(10.0)
Dividends paid	(32.7)	(50.9)	(54.0)	(86.1)	(90.7)
Interest expense	0.0	0.0	0.0	0.0	0.0
Change in debt	0.2	384.6	0.0	208.7	0.0
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Other financial activities	0.0	361.8	0.0	0.0	0.0
CF from financing activities	(32.5)	695.4	(54.0)	122.6	(90.7)
Effect of exchange rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	(4.5)	33.9	23.3	(438.0)	7.9

FYE 31 Dec	FY14A	FY15A	FY16E	FY17E	FY18E
Key Ratios					
Growth ratios (%)					
Revenue growth	1.9	64.0	8.0	49.6	3.2
Net property income growth	0.2	69.3	11.2	44.8	3.2
Core net profit growth	(1.1)	58.1	5.3	54.5	5.3
Distributable income growth	(1.1)	58.1	5.3	54.5	5.3
Profitability ratios (%)					
Net property income margin	75.9	78.4	80.6	78.1	78.1
Core net profit margin	48.6	46.9	45.7	47.2	48.2
Payout ratio	86.1	84.8	81.2	86.4	86.4
DuPont analysis					
Total return margin (%)	48.6	46.9	45.7	47.2	48.2
Gross revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.6	1.8	1.8	1.7	1.7
ROAE (%)	6.4	7.5	6.3	7.8	6.8
ROAA (%)	4.0	4.3	3.5	4.4	4.0
Liquidity & Efficiency					
Days receivable outstanding	22.4	18.5	16.5	11.1	10.7
Days payables outstanding	254.1	187.1	203.9	120.4	116.7
Dividend cover (x)	1.2	1.2	1.2	1.2	1.2
Current ratio (x)	2.0	3.2	1.9	2.1	1.6
Leverage & Expense Analysis					
Asset/Liability (x)	2.7	2.3	2.2	2.4	2.4
Net debt/equity (%)	52.1	71.3	68.0	60.1	59.4
Net interest cover (x)	3.6	3.0	2.9	3.3	3.4
Debt/EBITDA (x)	6.4	8.6	7.9	7.2	7.1
Capex/revenue (%)	0.0	0.0	0.0	0.0	0.0
Net debt/ (net cash)	281.8	644.9	616.6	815.2	807.3
Debt/Assets (x)	0.35	0.42	0.42	0.39	0.39

Source: Company; Maybank

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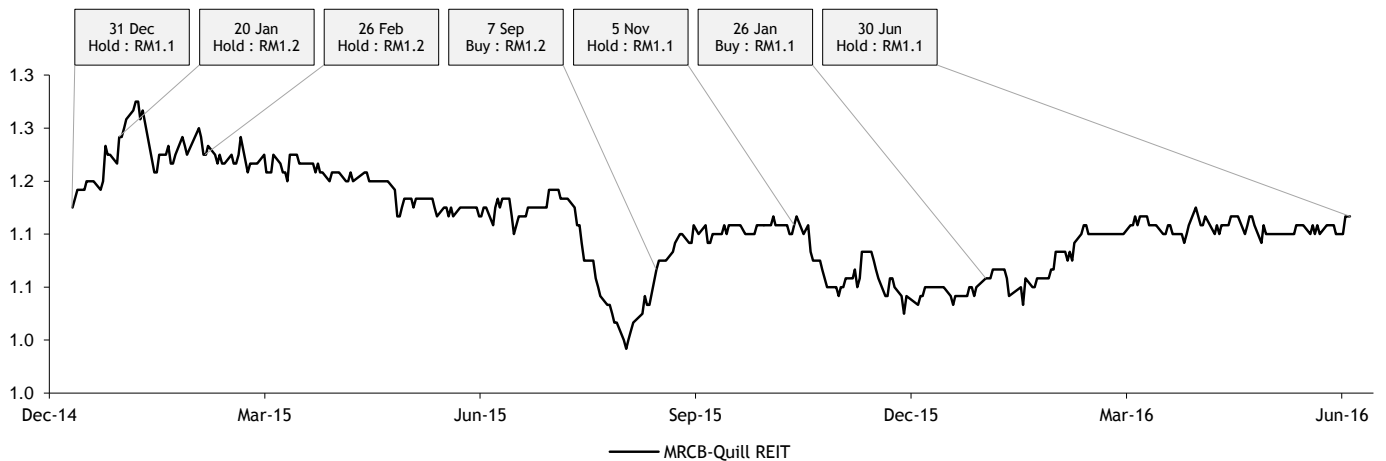
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