

20 November 2017

Property | REITS

MRCB-Quill REIT

Neutral (Maintained)

Tenant Retention Is The Priority

MRCB-Quill's core net profit grew YoY on the back of the acquisition of Menara Shell at the end of 2016, but net EPU was down given the increase in number of units. Overall, the core net profit was within our expectation. Occupancy rate for the REIT remained stable. We make no changes to our FY17-18 earnings forecasts and maintain our NEUTRAL call with an unchanged DDM-derived TP of MYR1.35 (6% upside). Tenant retention is key in sustaining its earnings going forward.

Earnings within expectations. MRCB-Quill REIT's (MRCB-Quill) 9M17 core net profit of MYR66.6m was within our and market expectations, making up 77% of our full-year estimates. Revenue increased by 39% YoY, mainly due to the additional contribution from Menara Shell, which was acquired late last year, as well as positive rental reversions of 2-5% on Quill Building 2 (HSBC), Quill Building 3 (BMW), Quill Building 5 (IMB) and Wisma Technip. Although core net profit grew by 45% YoY, core net earnings per unit (EPU) were down by 7.2% YoY. This was due to an increase in the number of units pursuant to the placement exercise for the acquisition of Menara Shell.

NPI margin for 3Q17 dropped to 76.5% (3Q16: 78.6%), mainly due to a lower NPI margin from Menara Shell. This was as the office tower experienced a loss in rental income due to non-renewal of its tenant in 1Q17.

Occupancy rate of all assets of MRCB-Quill remained stable at 96.6% and marginally improved 0.1% QoQ. This was thanks to the higher occupancy rate at Plaza Mont Kiara, Kuala Lumpur. Menara Shell's occupancy remained unchanged at 95%, as management is still negotiating with a potential new tenant. We are cautious on the REIT's occupancy, given that 26% of its total NLA is up for renewal next year (FY17: 16%). In addition, tenant retention remains challenging, in view of the oversupply of office space in the Greater Kuala Lumpur area.

Potential inorganic growth from Menara Celcom. Menara Celcom is currently under construction. It is slated for completion in 2H18. As this is one of the sponsor's assets, we think a potential injection of Menara Celcom, Petaling Jaya, could spur inorganic growth to the REIT. We do not have further details on the new office tower yet, but we think the total NLA of this tower would be around the size of Menara Shell (ie 557,053sqf). The potential acquisition is expected to happen in FY19, at the earliest.

Maintain NEUTRAL. We make no changes to our FY17-18 earnings forecasts and maintain our NEUTRAL call with an unchanged DDM-based TP of MYR1.35 (6% upside). The expected dividend yield is c.6%. The potential injection of assets into the REIT from its sponsors – Malaysian Resources Corp (MRCB) (MRC MK, BUY, TP: MYR1.23) and Quill Group – could be the potential catalysts to spur inorganic growth, in our view.

Target Price:	MYR1.35
Price:	MYR1.27
Market Cap:	USD326m
Bloomberg Ticker:	MQREIT MK

Share Data

Avg Daily Turnover (MYR/USD)	0.40m/0.09m
52-wk Price low/high (MYR)	1.20 - 1.35
Free Float (%)	33
Shares outstanding (m)	390
Estimated Return	6%

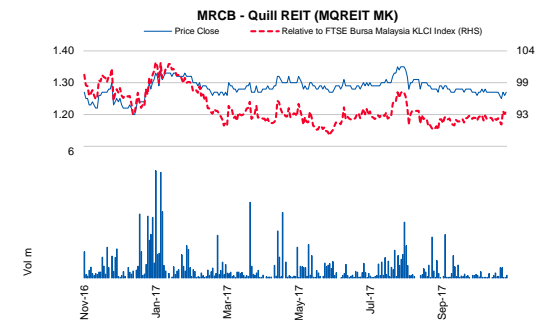
Shareholders (%)

MRCB	27.9
Quill Group	11.0
CapitaCommercial Trust	11.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	5.8	(0.8)	(5.2)	(2.3)	1.6
Relative	0.9	0.8	(2.1)	0.8	(4.2)

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (MYRm)	115	132	174	178	181
Net property income (MYRm)	90	102	130	136	140
Reported net profit (MYRm)	53.4	59.2	86.4	91.5	94.9
Total distributable income (MYRm)	53.4	59.2	86.4	91.5	94.9
DPS (MYR)	0.08	0.08	0.08	0.08	0.08
DPS growth (%)	1.1	(1.1)	(6.8)	4.2	3.8
Recurring P/E (x)	14.1	14.2	15.7	14.8	14.3
P/B (x)	0.93	1.00	1.00	0.99	0.99
Dividend Yield (%)	6.7	6.6	6.1	6.4	6.6
Return on average equity (%)	7.4	5.2	6.3	6.7	6.9
Return on average assets (%)	4.3	3.0	3.8	4.0	4.1
Interest cover (x)	2.81	2.72	3.35	3.49	3.59
Our vs consensus EPS (adjusted) (%)			(2.5)	(2.7)	(3.4)

Source: Company data, RHB

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Financial Exhibits

Financial model updated on: 2017-11-18.

Asia	Financial summary	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Malaysia	Recurring EPS (MYR)	0.09	0.09	0.08	0.09	0.09
Property	EPS (MYR)	0.09	0.09	0.08	0.09	0.09
MRCB-Quill REIT	DPS (MYR)	0.08	0.08	0.08	0.08	0.08
Bloomberg MQREIT MK	BVPS (MYR)	1.37	1.27	1.28	1.28	1.28
Neutral	Weighted avg adjusted shares (m)	594	661	1,068	1,068	1,068
Valuation basis	Valuation metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Dividend discount model.	Recurring P/E (x)	14.1	14.2	15.7	14.8	14.3
Key drivers	P/E (x)	14.1	14.2	15.7	14.8	14.3
Higher-than-expected demand of office space and inorganic growth opportunities arising from MRCB and Quill Group.	P/B (x)	0.93	1.00	1.00	0.99	0.99
Key risks	FCF Yield (%)	6.7	(44.0)	6.1	6.5	6.7
Downside risks oversupply of office properties might affect the portfolio's office property occupancy and rental rates.	Dividend Yield (%)	6.7	6.6	6.1	6.4	6.6
Company Profile	EV/EBITDA (x)	(0.99)	(0.49)	(2.31)	(2.23)	(2.19)
MRCB-Quill REIT (MRCB-Quill) is a mid-cap MREIT that focuses on office/commercial assets. Assets are largely concentrated in the Klang Valley and Cyberjaya areas.	EV/EBIT (x)	(0.99)	(0.49)	(2.31)	(2.23)	(2.19)
	Income statement	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
	Total turnover (MYRm)	115	132	174	178	181
	EBITDA (MYRm)	80	90	120	125	128
	Operating profit (MYRm)	80	90	120	125	128
	Net interest (MYRm)	(27)	(31)	(33)	(33)	(33)
	Pre-tax profit (MYRm)	53	59	86	91	95
	Recurring net profit (MYRm)	53	59	86	91	95
	Cash flow (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
	Change in working capital	(3)	(3)	(4)	(4)	(4)
	Cash flow from operations	53	58	85	90	93
	Capex	(2)	(427)	(2)	(2)	(2)
	Cash flow from investing activities	(2)	(427)	(2)	(2)	(2)
	Proceeds from issue of shares	353	448	0	0	0
	Dividends paid	(41)	(53)	(69)	(85)	(89)
	Cash flow from financing activities	507	786	(69)	(85)	(89)
	Cash at beginning of period	23	45	54	259	262
	Net change in cash	558	417	13	2	2
	Ending balance cash	581	462	67	262	264
	Balance sheet (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
	Total cash and equivalents	45	54	259	262	264
	Total investments	1,573	2,225	2,225	2,225	2,225
	Total other assets	0	0	0	0	0
	Total assets	1,625	2,297	2,300	2,305	2,310
	Short-term debt	189	189	189	189	189
	Total long-term debt	501	662	662	662	662
	Other liabilities	15	23	22	23	23
	Total liabilities	721	938	937	938	938
	Shareholders' equity	904	1,360	1,363	1,367	1,372
	Total equity	904	1,360	1,363	1,367	1,372
	Net debt	645	798	592	590	587
	Total liabilities & equity	1,625	2,297	2,300	2,305	2,310
	Key metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
	Revenue growth (%)	64.0	14.4	32.3	2.0	2.0
	Recurrent EPS growth (%)	2.9	(0.5)	(9.6)	5.8	3.8
	Operating EBITDA margin (%)	69.9	68.2	68.7	70.2	70.7
	Net profit margin (%)	46.4	44.9	49.6	51.4	52.3
	Dividend payout ratio (%)	94.1	93.6	93.6	93.6	93.6
	Capex/sales (%)	1.7	324.0	1.1	1.1	1.1
	Interest cover (x)	2.81	2.72	3.35	3.49	3.59

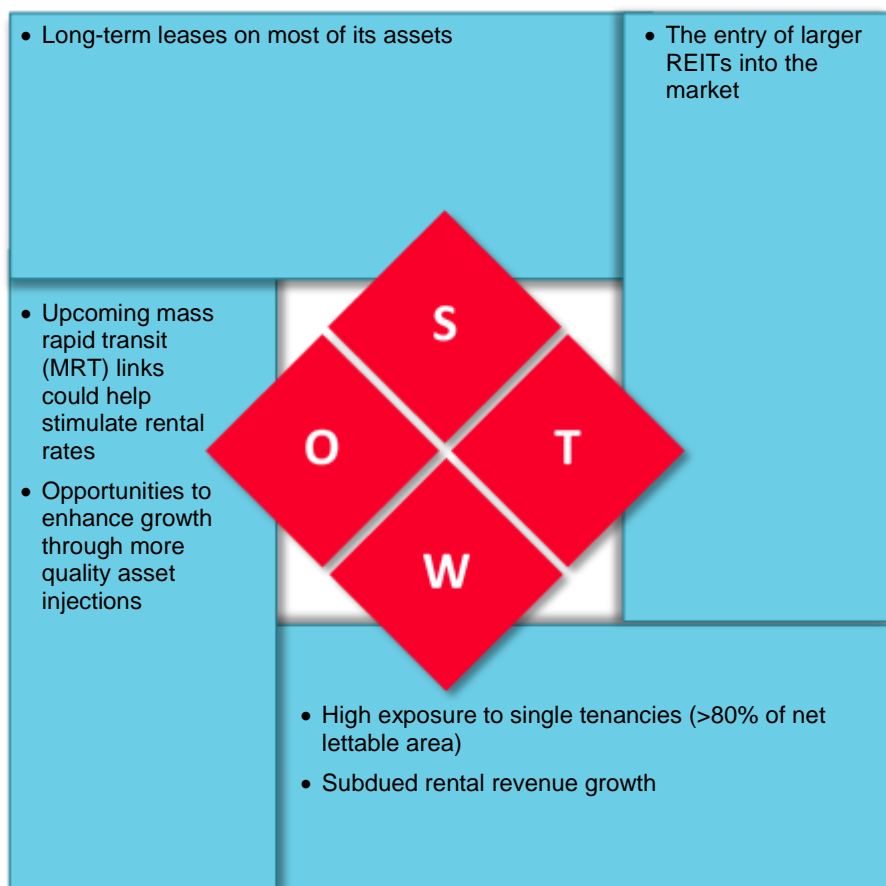
Source: Company data, RHB

Figure 1: MRCB-Quill's results comparison

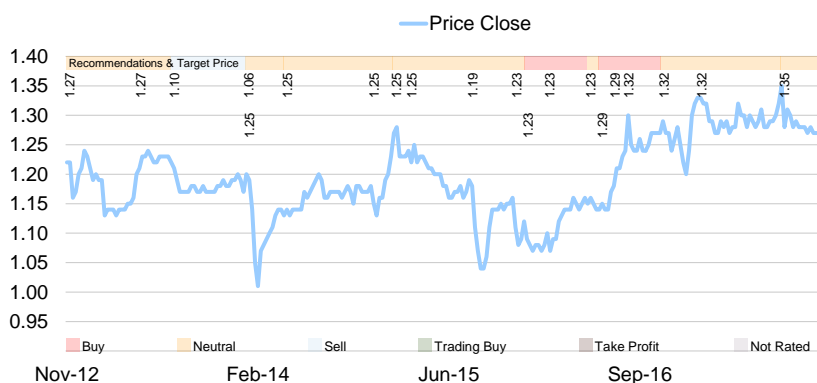
FYE Dec (MYRm)	3Q16	2Q17	3Q17	QoQ (%)	YoY (%)	9M16	9M17	YoY (%)	Comments
Revenue	32.5	45.1	44.8	(0.6)	37.9	97.7	135.5	38.6	Higher YoY revenue growth due to the additional contribution from Menara Shell which was acquired on 22 Dec 2016 and positive rental reversions of its assets.
Net property income (NPI)	25.5	34.9	34.3	(1.8)	34.3	76.7	105.3	37.4	Higher operating expenses due to the acquisition of Menara Shell.
Interest expense	(8.1)	(9.8)	(10.0)	1.1	22.8	(23.9)	(29.5)	23.3	Higher interest expense due to interest on additional borrowings to finance part of the acquisition of Menara Shell.
Interest income	0.5	0.6	0.7	15.1	57.3	1.2	1.8	48.6	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Others	(2.7)	(3.7)	(3.7)	0.7	38.3	(8.1)	(11.1)	35.9	
Pretax profit	15.2	22.0	21.4	(3.0)	40.4	45.9	66.6	45.2	
Tax	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Minority Interest	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Net Profit	15.2	22.0	21.4	(3.0)	40.4	45.9	66.6	45.2	
Core Profit	15.2	22.0	21.4	(3.0)	40.4	45.9	66.6	45.2	Within expectations
Core earnings per unit (sen)	2.30	2.26	2.00	(11.5)	(13.0)	6.93	6.43	(7.2)	Lower, due to an increase in units pursuant to the placement exercise for acquisition of Menara Shell
Dividends per unit (sen)	0.00	4.23	0.00	nm	nm	4.23	4.23	0.0	
<i>NPI Margin (%)</i>	<i>78.6</i>	<i>77.4</i>	<i>76.5</i>			<i>78.5</i>	<i>77.8</i>		
<i>Pretax Margin (%)</i>	<i>46.9</i>	<i>48.9</i>	<i>47.7</i>			<i>46.9</i>	<i>49.2</i>		
<i>Net Margin (%)</i>	<i>46.9</i>	<i>48.9</i>	<i>47.7</i>			<i>46.9</i>	<i>49.2</i>		

Source: Company

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2017-08-13	Neutral	1.35	1.32
2017-05-05	Neutral	1.32	1.32
2017-01-26	Neutral	1.32	1.32
2016-10-27	Neutral	1.32	1.27
2016-08-03	Buy	1.32	1.24
2016-07-01	Buy	1.29	1.17
2016-05-31	Buy	1.29	1.14
2016-05-03	Neutral	1.23	1.14
2016-01-25	Buy	1.23	1.08
2015-12-04	Buy	1.23	1.12

Source: RHB, Bloomberg

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