

22 January 2018

Property | REITS

## MRCB-Quill REIT

**Neutral** (Maintained)

### Cautious On Tenant Retention

**MRCB-Quill's FY17 core net profit came within our expectations. Nevertheless, we remain cautious on the REIT's ability to retain tenants, as 28% of the total NLA will be up for renewal this year. This includes the Menara Technip building, which is due for renewal on 31 Dec 2018. We remain NEUTRAL on the stock, but lower our DDM-based TP to MYR1.24 (from MYR1.28, 1% upside).**

**Earnings within expectations.** MRCB-Quill's FY17 core net profit of MYR88m (excluding losses in the fair value of investment properties, which totalled MYR18.18m) was within our and market expectations, making up 102% of our full-year estimate. Revenue increased by 37% YoY, mainly due to the additional contribution from Menara Shell that was acquired in late FY16, as well as positive rental reversion of 3-5% on Quill Building 2 - HSBC, Quill Building 3 - BMW and Wisma Technip.

Although core net profit grew 49% YoY, core net earnings per unit (EPU) dropped by 6.4% YoY due to the increase in the number of units pursuant to the placement exercise for the acquisition of Menara Shell.

**Valuation of properties.** Meanwhile, the valuation of properties fell MYR18m (or 0.8% of the REIT's total value), mainly due to lower valuations on Platinum Sentral. The asset is now valued at MYR725m (vs MYR750m previously), as a result of the rebate offered to some of its anchor tenants.

**Occupancy rate down 1.7%.** The occupancy rate of all MRCB-Quill's assets as at Dec 2017 dropped to 96.3%, from 98% in Dec 2016. The overall tenancy for 11% of the total NLA was renewed in FY17, while 3% was not renewed. Key tenants that did not renew leases include Tradewinds Corp and GLT Asia - which previously occupied c.30,000 sqf and 16,000 sqf respectively in Menara Shell - as well as Prema Bonanza SB, which previously occupied c.9,000 sqf in Platinum Sentral. As such, Menara Shell's overall occupancy rate declined to 94% in Dec 2017, from 99% in Dec 2016.

**Tenant retention risk.** We remain cautious on the REIT's ability to retain tenants, given that 28% of the total NLA will be up for renewal in FY18. These include three main buildings of the REITs - all of Wisma Technip, which is due for renewal by 31 Dec 2018 with a total NLA of 230,000 sqf, AmGeneral which occupied 140,000 sqf in Menara Shell and some smaller tenants in Platinum Sentral.

**Rate hike impact.** With the expectation of a rate hike by Bank Negara Malaysia in FY18, we believe the impact might not be significant to the REIT's earnings - since 76% of its borrowings are already locked in at fixed rates.

**Maintain NEUTRAL.** We make no changes to our FY18-19 earnings forecasts, and introduce our FY20F net profit of MYR142m in this report. We maintain our NEUTRAL call, but dial down our DDM-based TP to MYR1.24 after updating our CoE assumption due to the expectation of a rate hike. The expected dividend yield is now at around 6.4%.

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (MYRm)	132	180	177	180	185
Net property income (MYRm)	102	140	135	138	142
Reported net profit (MYRm)	59.2	69.9	89.0	92.0	95.4
Total distributable income (MYRm)	59.2	92.1	89.0	92.0	95.4
DPS (MYR)	0.08	0.08	0.08	0.08	0.08
DPS growth (%)	(1.1)	0.1	(7.0)	4.9	3.7
Recurring P/E (x)	13.6	14.8	14.9	14.2	13.7
P/B (x)	0.96	0.94	0.94	0.93	0.93
Dividend Yield (%)	6.9	6.9	6.4	6.7	7.0
Return on average equity (%)	5.2	5.1	6.4	6.6	6.8
Return on average assets (%)	3.0	3.0	3.9	4.0	4.2
Interest cover (x)	2.72	3.09	3.39	3.47	3.57
Our vs consensus EPS (adjusted) (%)			(6.7)	(6.3)	(2.9)

Source: Company data, RHB

Target Price:	MYR1.24
Price:	MYR1.22
Market Cap:	USD331m
Bloomberg Ticker:	MQREIT MK

#### Share Data

Avg Daily Turnover (MYR/USD)	0.44m/0.11m
52-wk Price low/high (MYR)	1.20 - 1.35
Free Float (%)	33
Shares outstanding (m)	390
Estimated Return	1%

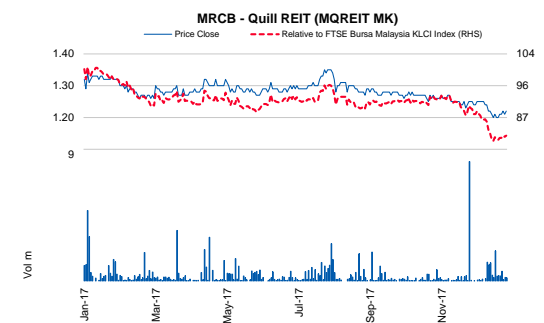
#### Shareholders (%)

Malaysian Resources Corp (MRCB)	27.9
Quill Group	11.0
CapitaCommercial Trust	11.0

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(2.4)	(2.4)	(3.9)	(5.4)	(8.3)
Relative	(4.2)	(7.7)	(8.8)	(9.5)	(18.0)

Source: Bloomberg



Source: Bloomberg

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## Financial Exhibits

Financial model updated on : 2018-01-20.

Asia	<b>Financial summary</b>	<b>Dec-16</b>	<b>Dec-17</b>	<b>Dec-18F</b>	<b>Dec-19F</b>	<b>Dec-20F</b>
Malaysia	Recurring EPS (MYR)	0.09	0.08	0.08	0.09	0.09
Property	EPS (MYR)	0.09	0.07	0.08	0.09	0.09
<b>MRCB-Quill REIT</b>	DPS (MYR)	0.08	0.08	0.08	0.08	0.08
Bloomberg MQREIT MK	BVPS (MYR)	1.27	1.30	1.30	1.31	1.31
<b>Neutral</b>	Weighted avg adjusted shares (m)	661	1,068	1,068	1,068	1,068
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-16</b>	<b>Dec-17</b>	<b>Dec-18F</b>	<b>Dec-19F</b>	<b>Dec-20F</b>
DDM	Recurring P/E (x)	13.6	14.8	14.9	14.2	13.7
	P/E (x)	13.6	18.6	14.6	14.2	13.7
	P/B (x)	0.96	0.94	0.94	0.93	0.93
	FCF Yield (%)	(45.8)	6.5	6.5	6.8	7.0
	Dividend Yield (%)	6.9	6.9	6.4	6.7	7.0
	EV/EBITDA (x)	(0.86)	(0.81)	(0.44)	(0.46)	(0.48)
	EV/EBIT (x)	(0.86)	(0.81)	(0.44)	(0.46)	(0.48)
<b>Key drivers</b>	<b>Income statement</b>	<b>Dec-16</b>	<b>Dec-17</b>	<b>Dec-18F</b>	<b>Dec-19F</b>	<b>Dec-20F</b>
i. Higher-than-expected demand of office space;	Total turnover (MYRm)	132	180	177	180	185
ii. Inorganic growth opportunities arising from MRCB and Quill Group.	EBITDA (MYRm)	90	125	121	124	128
	Operating profit (MYRm)	90	125	121	124	128
	Net interest (MYRm)	(31)	(37)	(32)	(32)	(32)
	Pre-tax profit (MYRm)	59	70	89	92	95
	Recurring net profit (MYRm)	59	88	88	92	95
<b>Key risks</b>	<b>Cash flow (MYRm)</b>	<b>Dec-16</b>	<b>Dec-17</b>	<b>Dec-18F</b>	<b>Dec-19F</b>	<b>Dec-20F</b>
Downside risks include oversupply of office properties which might affect the occupancy and rental rates of assets in its portfolio. .	Change in working capital	(3)	(4)	(4)	(4)	(4)
	Cash flow from operations	58	86	87	90	93
	Capex	(427)	(2)	(2)	(2)	(2)
	Cash flow from investing activities	(427)	(2)	(1)	(1)	(1)
	Proceeds from issue of shares	448	63	0	0	0
	Dividends paid	(53)	(73)	(86)	(85)	(89)
	Cash flow from financing activities	786	65	(86)	(85)	(89)
	Cash at beginning of period	45	54	76	52	56
	Net change in cash	417	149	(0)	4	3
	Ending balance cash	462	203	76	56	59
<b>Company Profile</b>	<b>Balance sheet (MYRm)</b>	<b>Dec-16</b>	<b>Dec-17</b>	<b>Dec-18F</b>	<b>Dec-19F</b>	<b>Dec-20F</b>
MRCB-Quill REIT is a mid-cap MREIT that focuses on office/commercial assets. Its assets are largely concentrated in the Klang Valley and Cyberjaya areas.	Total cash and equivalents	54	76	52	56	59
	Total investments	2,225	2,181	2,156	2,156	2,156
	Total other assets	0	25	0	0	0
	Total assets	2,297	2,288	2,292	2,297	2,302
	Short-term debt	189	117	117	117	117
	Total long-term debt	662	737	734	734	734
	Other liabilities	23	24	24	25	25
	Total liabilities	938	903	901	902	902
	Shareholders' equity	1,360	1,385	1,390	1,395	1,400
	Total equity	1,360	1,385	1,390	1,395	1,400
	Net debt	798	777	799	795	792
	Total liabilities & equity	2,297	2,288	2,292	2,297	2,302
	<b>Key metrics</b>	<b>Dec-16</b>	<b>Dec-17</b>	<b>Dec-18F</b>	<b>Dec-19F</b>	<b>Dec-20F</b>
	Revenue growth (%)	14.4	36.7	(2.0)	1.8	2.8
	Recurrent EPS growth (%)	(0.5)	(7.9)	(0.4)	4.9	3.7
	Operating EBITDA margin (%)	68.2	69.4	68.6	69.1	69.1
	Net profit margin (%)	44.9	38.8	50.4	51.2	51.7
	Dividend payout ratio (%)	93.6	128.2	128.2	128.2	128.2
	Capex/sales (%)	324.0	1.1	1.1	1.1	1.1
	Interest cover (x)	2.72	3.09	3.39	3.47	3.57

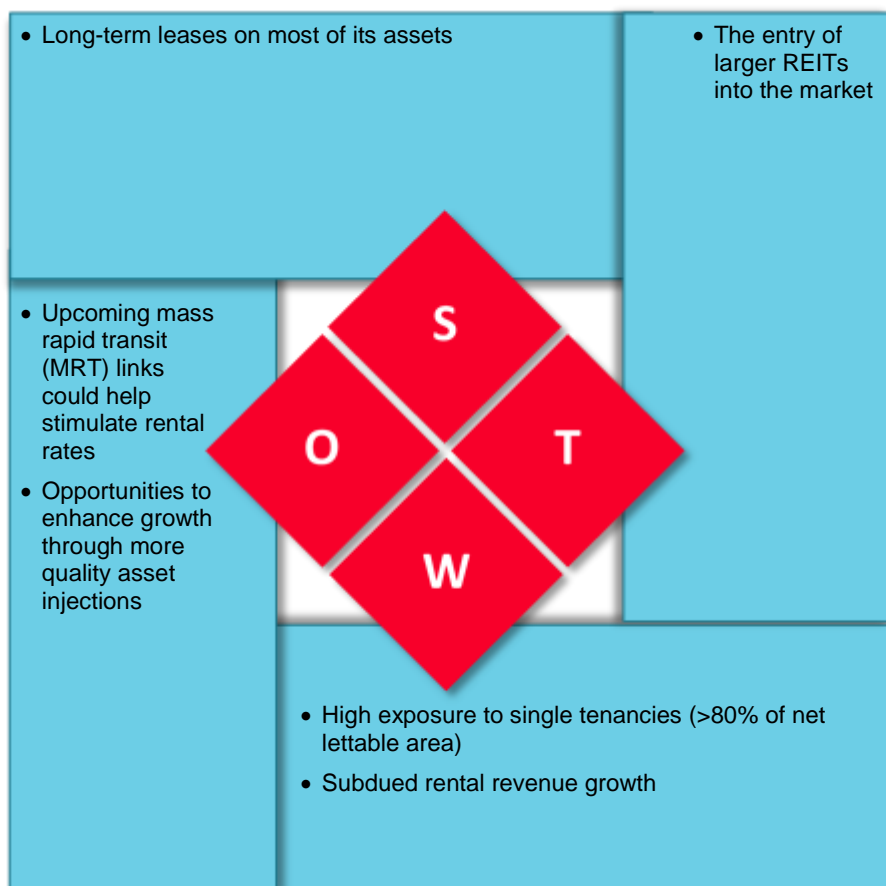
Source: Company data, RHB

Figure 1: MRCB-Quill's results comparison

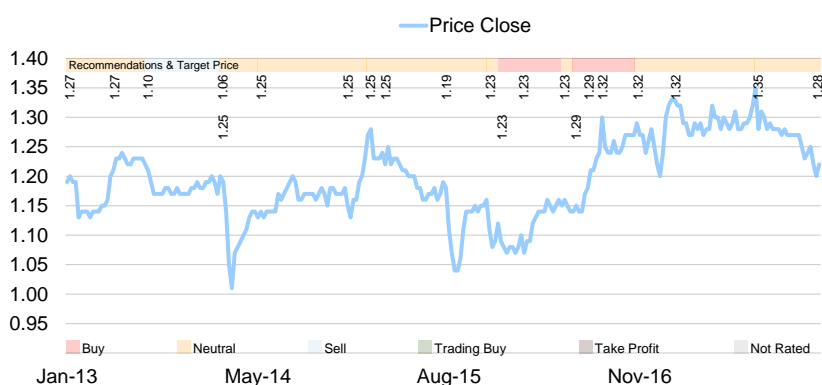
FYE Dec (MYRm)	4Q16	3Q17	4Q17	QoQ (%)	YoY (%)	FY16	FY17	YoY (%)	Comments
Revenue	34.1	44.8	44.7	(0.3)	31.1	131.8	180.1	36.7	Higher YoY revenue growth was due to the additional contribution from Menara Shell, which it acquired on 22 Dec 2016, and positive rental reversions of its assets.
Net property income (NPI)	25.6	34.3	34.6	1.0	35.2	102.3	140.0	36.8	Higher operating expenses due to the acquisition of Menara Shell.
Interest expense	(9.1)	(10.0)	(11.0)	10.4	20.8	(33.0)	(40.5)	22.6	Higher interest expense due to the interest on additional borrowings to finance part of the acquisition of Menara Shell.
Interest income	1.1	0.7	1.7	132.7	52.9	2.4	3.6	50.6	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI	3.5	0.0	(18.2)	nm	(613.2)	3.5	(18.2)	(613.2)	
Others	(4.3)	(3.7)	(3.9)	5.0	(9.4)	(12.4)	(14.9)	20.3	
<b>Pretax profit</b>	<b>16.9</b>	<b>21.4</b>	<b>3.3</b>	<b>(84.5)</b>	<b>(80.4)</b>	<b>62.8</b>	<b>69.9</b>	<b>11.4</b>	
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	
<b>Net Profit</b>	<b>16.9</b>	<b>21.4</b>	<b>3.3</b>	<b>(84.5)</b>	<b>(80.4)</b>	<b>62.8</b>	<b>69.9</b>	<b>11.4</b>	
<b>Core Profit</b>	<b>13.3</b>	<b>21.4</b>	<b>21.4</b>	<b>0.2</b>	<b>61.0</b>	<b>59.2</b>	<b>88.0</b>	<b>48.8</b>	Within expectations
<b>Core earnings per unit (sen)</b>	<b>1.89</b>	<b>2.00</b>	<b>2.01</b>	<b>0.5</b>	<b>6.3</b>	<b>8.80</b>	<b>8.24</b>	<b>(6.4)</b>	Lower, due to the increase in units pursuant to the placement exercise for the acquisition of Menara Shell.
<b>Dividends per unit (sen)</b>	<b>4.15</b>	<b>0.00</b>	<b>4.16</b>	<b>nm</b>	<b>0.2</b>	<b>8.38</b>	<b>8.39</b>	<b>0.1</b>	
<i>NPI Margin (%)</i>	75.2	76.5	77.6			77.6	77.7		
<i>Pretax Margin (%)</i>	49.7	47.7	7.4			47.6	38.8		
<i>Net Margin (%)</i>	39.1	47.7	48.0			44.9	48.9		

Source: Company data

## SWOT Analysis



## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-01-08	Neutral	1.28	1.21
2017-11-19	Neutral	1.35	1.27
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

Source: RHB, Bloomberg

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