

31 May 2016

Property | REITS

MRCB-Quill REIT

Buy (from Neutral)

Bucking The Trend In The Office Segment

We anticipate a challenging outlook ahead for the Kuala Lumpur office market given the challenging economic environment this year and the impending future supply of office space. Still, we expect MRCB-Quill REIT to perform relatively better than its office properties-focused peers, as:

1. Most of its tenants are on long-term leases (>5 years);
2. High relocation costs for some tenants ensure tenants' "stickiness";
3. Inorganic growth opportunities could arise from MRCB and Quill Group.

Upgrade to BUY with a higher DDM-based TP of MYR1.29.

High and stable occupancy rate. Amidst the highly challenging office properties market currently, MRCB-Quill REIT has managed to sustain the performance of its portfolio. We expect its portfolio occupancy rate, which stands at 97.1% currently, to remain stable moving forward as most of the tenants are on long-term leases. 43% of its tenants' lease renewals will be due from 2020-2032, and another 37% in 2018-2019. This should provide stability in the current economic environment, especially with new supply of office space coming into the market.

Shell Tower injection to spur inorganic growth. We expect the proposed injection of Menara Shell to provide a jump in growth of the portfolio size and its revenue and earnings. To recap, MRCB-Quill REIT has proposed to acquire the office tower from its sponsor for MYR640m, which would be satisfied through a combination of cash and consideration units. The acquisition would increase the REIT's total property value by 41% to MYR2.2bn. The cut-off date for the sales and purchase agreement (SPA) execution of the proposed acquisition was automatically extended for a further 30 business days from 30 May. As the tower is almost 100% occupied, we expect the acquisition to be yield-accretive.

Office market expected to remain challenging. With approximately 9m sq ft of office space set to enter the market within the next two years, the Kuala Lumpur office property market is expected to remain challenging due to the oversupply situation. We expect this to lead to continued pressure on rental rates and occupancy rates, requiring proactive measures by landlords to offer attractive incentives to retain tenants and attract new ones. Nonetheless, we expect MRCB-Quill REIT to perform relatively better than its office properties-focused peers, as most of its tenants are on long-term leases (>5 years), while high relocation costs for some tenants ensure tenants' "stickiness".

Upgrade to BUY. We make no changes to our EPS forecasts, but lift our DDM-based TP to MYR1.29 (from MYR1.23), as we use a lower risk-free rate of 3.7% (from 4.3%) due to the expected delay in US interest rate hikes and the possibility of an interest rate cut in Malaysia. Our new assumption is consistent with the average 10-year Malaysian Government Securities (MGS) yield between May 2011 and May 2015 when the overnight policy rate (OPR) stood at 3.0%. The key downside risk to our call would be prolonged weak domestic consumer sentiment.

Forecasts and Valuations	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover (MYRm)	70	110	124	126	128
Net property income (MYRm)	53.3	86.6	93.6	95.2	98.9
Reported net profit (MYRm)	34.1	53.9	60.5	59.7	63.1
Total distributable income (MYRm)	34.1	53.9	60.5	59.7	63.1
DPS (MYR)	0.08	0.08	0.09	0.09	0.09
DPS growth (%)	0.0	(1.3)	4.1	1.2	4.0
Recurring P/E (x)	13.0	12.6	12.5	12.6	12.0
P/B (x)	0.82	0.83	0.82	0.82	0.82
Dividend Yield (%)	7.4	7.3	7.5	7.6	7.9
Return on average equity (%)	6.3	7.4	6.6	6.5	6.9
Return on average assets (%)	3.9	4.3	3.7	3.6	3.8
Interest cover (x)	3.38	2.95	3.20	3.00	3.11
Our vs consensus EPS (adjusted) (%)			(1.6)	(6.0)	(0.7)

Source: Company data, RHB

Target Price:	MYR1.29
Price:	MYR1.14
Market Cap:	USD185m
Bloomberg Ticker:	MQREIT MK

Share Data

Avg Daily Turnover (MYR/USD)	0.25m/0.06m
52-wk Price low/high (MYR)	1.01 - 1.19
Free Float (%)	40
Shares outstanding (m)	661
Estimated Return	13%

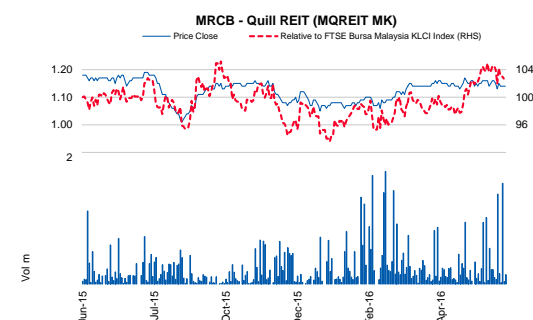
Shareholders (%)

CapitaCommercial Trust	30.0
Quill Group	30.0

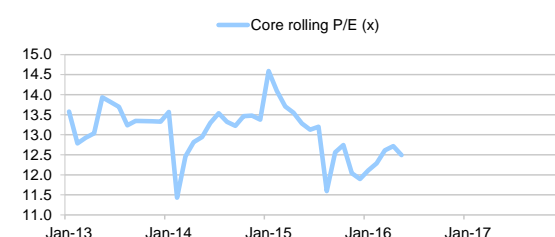
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	5.6	(1.7)	1.8	4.6	(3.4)
Relative	8.9	0.4	2.9	6.7	2.9

Source: Bloomberg



Source: Bloomberg



Source: Bloomberg

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Financial Exhibits

Financial model updated on 2016-05-30.

Asia
Malaysia
Property
MRCB-Quill REIT
Bloomberg MQREIT MK
Buy

Valuation basis

Dividend discount model

Key drivers

Improvement in domestic consumer sentiment leading to strong consumer spending.

Key risks

Downside risks include prolonged weak domestic consumer sentiment, while the upside risk would be stronger demand for its assets, leading to higher occupancy rates and rental reversion rates at its assets.

Company Profile

MRCB-Quill REIT is a mid-cap MREIT that focuses on office/commercial assets. Assets are largely concentrated in the Klang Valley and Cyberjaya areas.

Financial summary	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Recurring EPS (MYR)	0.09	0.09	0.09	0.09	0.10
EPS (MYR)	0.09	0.09	0.09	0.09	0.10
DPS (MYR)	0.08	0.08	0.09	0.09	0.09
BVPS (MYR)	1.39	1.38	1.38	1.39	1.39
Weighted avg adjusted shares (m)	390	594	661	661	661

Valuation metrics	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Recurring P/E (x)	13.0	12.6	12.5	12.6	12.0
P/E (x)	13.0	12.6	12.5	12.6	12.0
P/B (x)	0.82	0.83	0.82	0.82	0.82
FCF Yield (%)	5.6	7.5	7.8	7.4	7.9
Dividend Yield (%)	7.4	7.3	7.5	7.6	7.9
EV/EBITDA (x)	(2.37)	(1.74)	(1.54)	(1.51)	(1.45)
EV/EBIT (x)	(2.37)	(1.74)	(1.54)	(1.51)	(1.45)

Income statement (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover	70	110	124	126	128
EBITDA	47	80	87	88	92
Operating profit	47	80	87	88	92
Net interest	(13)	(26)	(26)	(29)	(29)
Pre-tax profit	34	54	61	60	63
Recurring net profit	34	54	61	60	63

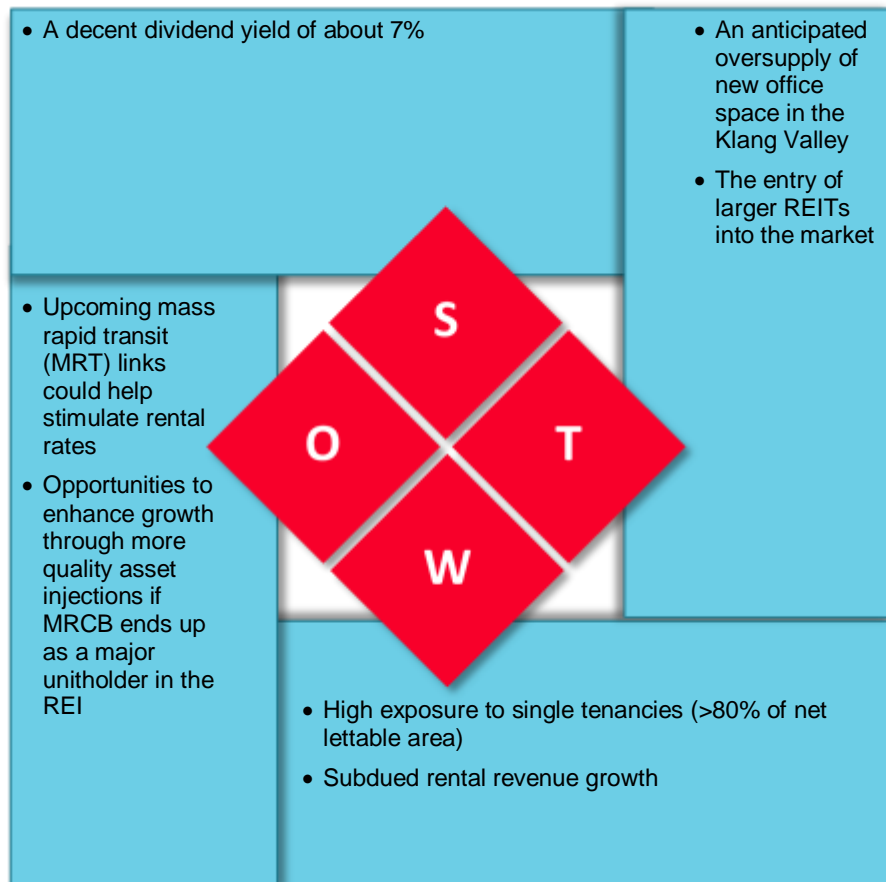
Cash flow (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Change in working capital	(3)	(3)	(3)	(4)	(4)
Cash flow from operations	31	53	59	58	61
Capex	(6)	(2)	0	(2)	(2)
Cash flow from investing activities	(6)	(2)	0	(2)	(2)
Proceeds from issue of shares	0	365	0	0	0
Dividends paid	(33)	(41)	(53)	(57)	(59)
Cash flow from financing activities	(32)	722	(53)	(57)	(59)

Balance sheet (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total cash and equivalents	23	60	39	38	38
Total investments	839	1,552	1,552	1,552	1,552
Total other assets	0	0	0	0	0
Total assets	868	1,637	1,640	1,643	1,646
Other liabilities	8	8	8	8	8
Total liabilities	327	725	725	726	726
Shareholders' equity	541	911	915	917	920
Total equity	541	911	915	917	920
Net debt	282	643	664	665	665
Total liabilities & equity	868	1,637	1,640	1,643	1,646

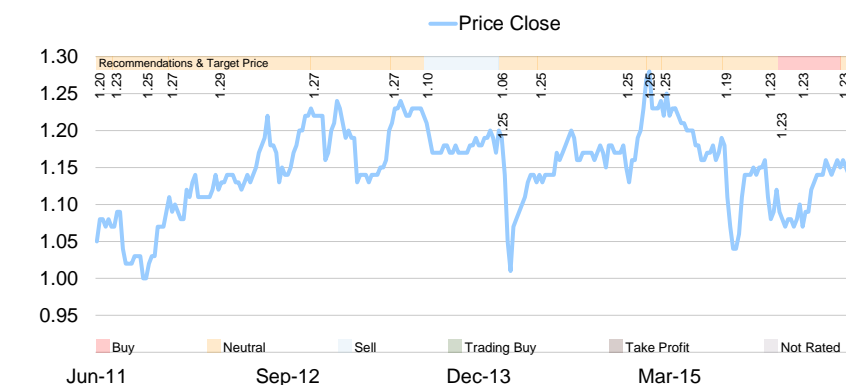
Key metrics	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Revenue growth (%)	1.9	56.0	13.1	1.8	1.8
Recurrent EPS growth (%)	(1.2)	3.8	0.8	(1.4)	5.7
Operating EBITDA margin (%)	67.5	73.4	70.2	70.1	71.5
Net profit margin (%)	48.6	49.2	48.9	47.3	49.1
Dividend payout ratio (%)	95.8	91.0	91.0	91.0	91.0
Capex/sales (%)	8.6	1.8	0.0	1.6	1.6
Interest cover (x)	3.38	2.95	3.20	3.00	3.11

Source: Company data, RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2016-05-03	Neutral	1.23	1.14
2016-01-25	Buy	1.23	1.08
2015-12-04	Buy	1.23	1.12
2015-11-06	Neutral	1.23	1.16
2015-07-23	Neutral	1.19	1.19
2015-02-26	Neutral	1.25	1.23
2015-01-20	Neutral	1.25	1.25
2014-11-27	Neutral	1.25	1.18
2014-05-02	Neutral	1.25	1.13
2014-01-30	Neutral	1.25	1.20

Source: RHB, Bloomberg

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