1 July 2016

Property | REITS

# MRCB-Quill REIT

## Acquiring Menara Shell

**Buy** (Maintained)

| | |
|---|---|
| Target Price: | MYR1.29 |
| Price: | MYR1.16 |
| Market Cap: | USD190m |
| Bloomberg Ticker: | MQREIT MK |

**We were not surprised by MRCB-Quill REIT's proposed Menara Shell acquisition, as the deal has been pending completion for a few months. We deem this acquisition as positive over the long run, enlarging the REIT's asset base and giving it higher exposure to the highly sought-after KL Sentral area. We expect the trust to continue to buck the trend in the challenging office segment and maintain high occupancy rates at its portfolio assets. Maintain BUY and DDM-based MYR1.29 TP (11% upside). This asset injection is a potential re-rating catalyst to the stock.**

**Acquiring Menara Shell from Malaysian Resources Corp (MRCB) (MRC MK, BUY, TP: MYR1.60).** MRCB-Quill REIT entered into a sale & purchase agreement with MRCB on 30 June to acquire Menara Shell at Kuala Lumpur Sentral (KL Sentral) for a purchase consideration of MYR640m. This is to be fully satisfied in cash, funded by a combination of new share placements and borrowings. The acquisition is expected to be completed by end-2016.

**Fully-occupied office tower in KL Sentral.** Menara Shell is a 33-storey office tower in KL Sentral that is erected on a 5-storey podium with a 4-storey basement car park. Its gross built-up area stands at 820,917sqf, with a net lettable area of 557,053sqf. It is currently 99.9% occupied. It generated gross rental income of MYR46.4m in FY15.

**Yield neutral in the short term.** The estimated funding required in undertaking the acquisition is MYR656m, and MRCB-Quill REIT has proposed to fund the acquisition via a combination of new unit placements and additional borrowings. However, the actual funding breakdown has not been determined. Based on an assumed price of MYR1.05/unit and a maximum of 406.7m placement units, the gross proceeds from the placement will be MYR427m, with the remaining MYR229m balance required raised through borrowings. Based on these assumptions, we expect the acquisition to be yield neutral in the short term.

**Positive over the long run.** Post-acquisition, MRCB-Quill REIT's asset size will increase to MYR2.27bn from MYR1.63bn, enhancing its competitive position. With the property almost fully-occupied, the acquisition will improve its overall occupancy rate to 98% from 97%. The addition of Menara Shell will also boost the rental contributions from its KL Sentral assets as a percentage of the portfolio's total gross rental income to 56% (from 39%). We deem this positive, as the area is an integrated transit hub and a prime commercial area within Kuala Lumpur.

**Maintain BUY.** We make no changes to our DDM-based MYR1.29 TP and BUY call. We expect its future growth prospects to remain positive, mainly due to potential further asset injections from its sponsor. This includes Celcom Tower in PJ Sentral, Petaling Jaya. We believe the REIT's relatively high dividend yield is also an attractive investment merit, given the current market uncertainties. The downside risks include prolonged weak domestic consumer sentiment, while stronger demand for its assets (leading to higher occupancy rates) and its assets' rental reversion rates are upside risks.

| Forecasts and Valuations | Dec-14 | Dec-15 | Dec-16F | Dec-17F | Dec-18F |
|---|---|---|---|---|---|
| Total turnover (MYRm) | 70 | 110 | 124 | 174 | 178 |
| Net property income (MYRm) | 53 | 87 | 94 | 132 | 137 |
| Reported net profit (MYRm) | 34.1 | 53.9 | 60.5 | 86.4 | 91.5 |
| Total distributable income (MYRm) | 34.1 | 53.9 | 60.5 | 86.4 | 91.5 |
| DPS (MYR) | 0.08 | 0.08 | 0.09 | 0.08 | 0.08 |
| DPS growth (%) | 0.0 | (1.3) | 4.1 | (9.3) | 4.2 |
| Recurring P/E (x) | 13.3 | 12.8 | 12.7 | 14.3 | 13.5 |
| P/B (x) | 0.84 | 0.84 | 0.92 | 0.92 | 0.92 |
| Dividend Yield (%) | 7.2 | 7.1 | 7.4 | 6.7 | 7.0 |
| Return on average equity (%) | 6.3 | 7.4 | 5.4 | 6.4 | 6.8 |
| Return on average assets (%) | 3.9 | 4.3 | 3.1 | 3.8 | 4.0 |
| Interest cover (x) | 3.38 | 2.95 | 3.20 | 3.19 | 3.32 |
| Our vs consensus EPS (adjusted) (%) | | | (1.6) | (15.7) | (10.8) |

*Source: Company data, RHB*

**Share Data**

| | |
|---|---|
| Avg Daily Turnover (MYR/USD) | 0.22m/0.05m |
| 52-wk Price low/high (MYR) | 1.01 - 1.19 |
| Free Float (%) | 40 |
| Shares outstanding (m) | 661 |
| Estimated Return | 11% |

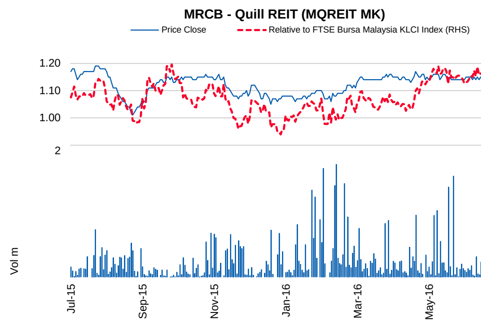
**Shareholders (%)**

| | |
|---|---|
| CapitaCommercial Trust | 30.0 |
| Quill Group | 30.0 |

**Share Performance (%)**

| | YTD | 1m | 3m | 6m | 12m |
|---|---|---|---|---|---|
| Absolute | 7.4 | 1.8 | 0.0 | 8.4 | (0.9) |
| Relative | 9.7 | 0.3 | 3.7 | 10.7 | 2.2 |

*Source: Bloomberg*




*Source: Bloomberg*

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# Financial Exhibits

Financial model updated on: 2016-07-01.

Asia
Malaysia
Property
**MRCB-Quill REIT**
Bloomberg MQREIT MK
**Buy**

**Valuation basis**

DDM-based.

**Key drivers**

Improvement in domestic consumer sentiment leading to strong consumer spending.

**Key risks**

Downside risks include prolonged weak domestic consumer sentiment, while upside risks include:

i. Stronger demand for its assets leading to higher occupancy rates;
ii. Rental reversion rates at its assets.

**Company Profile**

MRCB-Quill REIT is a mid-cap MREIT that focuses on office/commercial assets. These 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 | 0.08 | 0.09 |
| EPS (MYR) | 0.09 | 0.09 | 0.09 | 0.08 | 0.09 |
| DPS (MYR) | 0.08 | 0.08 | 0.09 | 0.08 | 0.08 |
| BVPS (MYR) | 1.39 | 1.38 | 1.26 | 1.26 | 1.26 |
| Weighted avg adjusted shares (m) | 390 | 594 | 661 | 1,068 | 1,068 |

| Valuation metrics | Dec-14 | Dec-15 | Dec-16F | Dec-17F | Dec-18F |
|---|---|---|---|---|---|
| Recurring P/E (x) | 13.3 | 12.8 | 12.7 | 14.3 | 13.5 |
| P/E (x) | 13.3 | 12.8 | 12.7 | 14.3 | 13.5 |
| P/B (x) | 0.84 | 0.84 | 0.92 | 0.92 | 0.92 |
| FCF Yield (%) | 5.5 | 7.4 | (48.0) | 6.7 | 7.1 |
| Dividend Yield (%) | 7.2 | 7.1 | 7.4 | 6.7 | 7.0 |
| EV/EBITDA (x) | (2.20) | (1.59) | (1.91) | (2.26) | (2.19) |
| EV/EBIT (x) | (2.20) | (1.59) | (1.91) | (2.26) | (2.19) |

| Income statement | Dec-14 | Dec-15 | Dec-16F | Dec-17F | Dec-18F |
|---|---|---|---|---|---|
| Total turnover (MYRm) | 70.2 | 109.6 | 123.9 | 174.3 | 177.8 |
| EBITDA (MYRm) | 47.4 | 80.4 | 87.0 | 124.8 | 129.9 |
| Operating profit (MYRm) | 47.4 | 80.4 | 87.0 | 124.8 | 129.9 |
| Net interest (MYRm) | (13.3) | (26.5) | (26.5) | (38.4) | (38.4) |
| Pre-tax profit (MYRm) | 34.1 | 53.9 | 60.5 | 86.4 | 91.5 |
| Recurring net profit (MYRm) | 34.1 | 53.9 | 60.5 | 86.4 | 91.5 |

| Cash flow (MYRm) | Dec-14 | Dec-15 | Dec-16F | Dec-17F | Dec-18F |
|---|---|---|---|---|---|
| Change in working capital | (3.1) | (3.3) | (3.5) | (3.6) | (3.8) |
| Cash flow from operations | 31.1 | 52.6 | 59.1 | 84.8 | 89.6 |
| Capex | (6.0) | (2.0) | (427.0) | (2.0) | (2.0) |
| Cash flow from investing activities | (6.0) | (2.0) | (427.0) | (2.0) | (2.0) |
| Proceeds from issue of shares | 0.2 | 365.3 | 0.0 | 0.0 | 0.0 |
| Dividends paid | (32.7) | (40.9) | (53.0) | (70.2) | (85.1) |
| Cash flow from financing activities | (32.2) | 722.4 | 176.0 | (70.2) | (85.1) |

| Balance sheet (MYRm) | Dec-14 | Dec-15 | Dec-16F | Dec-17F | Dec-18F |
|---|---|---|---|---|---|
| Total cash and equivalents | 23 | 60 | 248 | 260 | 263 |
| Total investments | 839 | 1,552 | 2,192 | 2,192 | 2,192 |
| Total other assets | 0 | 0 | 0 | 0 | 0 |
| Total assets | 868 | 1,637 | 2,296 | 2,300 | 2,304 |
| Other liabilities | 8 | 8 | 8 | 8 | 8 |
| Total liabilities | 327 | 725 | 954 | 955 | 955 |
| Shareholders' equity | 541 | 911 | 1,342 | 1,345 | 1,350 |
| Total equity | 541 | 911 | 1,342 | 1,345 | 1,350 |
| Net debt | 282 | 643 | 684 | 672 | 669 |
| Total liabilities & equity | 868 | 1,637 | 2,296 | 2,300 | 2,304 |

| Key metrics | Dec-14 | Dec-15 | Dec-16F | Dec-17F | Dec-18F |
|---|---|---|---|---|---|
| Revenue growth (%) | 1.9 | 56.0 | 13.1 | 40.7 | 2.0 |
| Recurrent EPS growth (%) | (1.2) | 3.8 | 0.8 | (11.6) | 5.8 |
| Operating EBITDA margin (%) | 67.5 | 73.4 | 70.2 | 71.6 | 73.1 |
| Net profit margin (%) | 48.6 | 49.2 | 48.9 | 49.6 | 51.4 |
| Dividend payout ratio (%) | 95.8 | 91.0 | 91.0 | 91.0 | 91.0 |
| Capex/sales (%) | 8.6 | 1.8 | 344.6 | 1.1 | 1.1 |
| Interest cover (x) | 3.38 | 2.95 | 3.20 | 3.19 | 3.32 |

*Source: Company data, RHB*

# SWOT Analysis

- A decent dividend yield of about 7%

- An anticipated oversupply of new office space in the Klang Valley
- The entry of larger REITs into the market

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T

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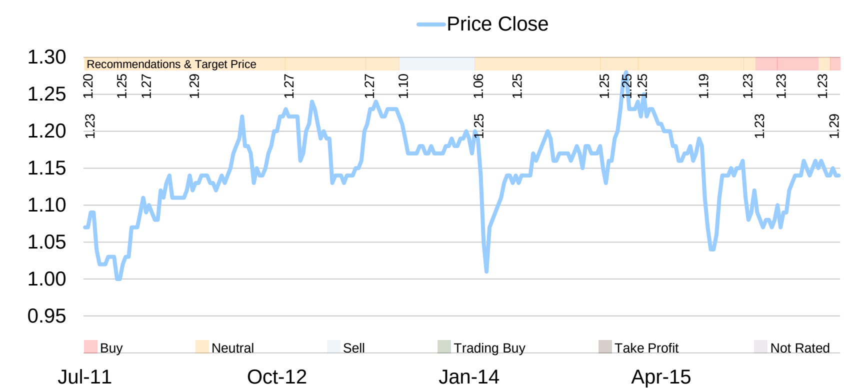
- Upcoming mass rapid transit (MRT) links could help stimulate rental rates
- Opportunities to enhance growth through more quality asset injections from Malaysian Resources Corp (MRCB)

- High exposure to single tenancies (>80% of net lettable area).
- Subdued rental revenue growth

# Recommendation Chart




*Source: RHB, Bloomberg*

| Date | Recommendation | Target Price | Price |
|---|---|---|---|
| 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 |
| 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 |

*Source: RHB, Bloomberg*

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**Not Rated:** Stock is not within regular research coverage

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