

MRCB-Quill REIT (BUY ↔, EPS ↔)

INDUSTRY: OVERWEIGHT
EARNINGS EVALUATION
3 August 2016
Target Price: RM1.34 (↔)
Share Price: RM1.20

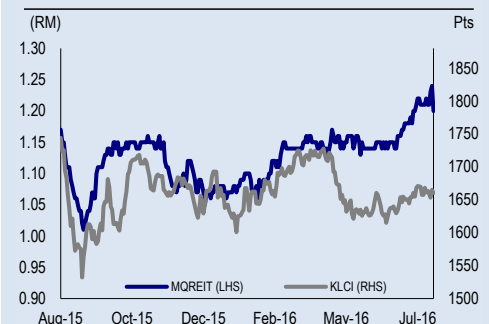
6MFY16 Results

Results	<ul style="list-style-type: none"> 6MFY16 gross revenue of RM65.2m (+28.4% yoy) was translated into normalised net profit of RM30.6m (+39.7% yoy), accounting for 51.9% and 53.4% of HLIB and consensus FY forecasts, respectively.
Deviations	<ul style="list-style-type: none"> None.
Dividends	<ul style="list-style-type: none"> Declared 1HFY16 dividend of 4.23 sen (1H2015: 4.10 sen), going ex on 16 Aug 2016, representing an annualized yield of 7.05%, at a payout ratio of circa 91.4%.
Highlights	<ul style="list-style-type: none"> Resilient revenue growth (+28.4% yoy) in 1HFY16 was due to additional income from Platinum Sentral and step-up rent adjustments; while bottom-line grew higher by 39.7% given lower repairs and maintenance cost this year, mitigated by higher financial costs due to loan drawdown for acquisition. Overall occupancy rate was healthy at 97.2% with 87% of renewal rate achieved for lease expiry in 1HFY16. Major AEIs planned for this year involve energy saving and carbon footprint reduction at both Quill Building 1-DHL and Quill Building 4-DHL as part of the negotiation during renewals. Despite the lacklustre office market overall, we are less concerned on the office spaces owned by MQREIT given its high occupancy rate and long lease term. Beside, its NLA expiry is well-spread with circa 13% and 26% expiring in FY17 and FY18. Following the acquisition of Menara Shell, asset size now stands at RM2.27bn. With additional income from Menara Shell from FY17 onwards, management is then able to achieve greater scale and raise the payout and with the proposed partial payment of management via units. Consequently, distributable income will be lifted. The potential yield accretive assets injection is expected to be funded via placement exercises with equity/debt ratio of circa 65/35 and gearing ratio is expected to improve to around 40% (from 42%) post exercise.
Risks	<ul style="list-style-type: none"> High gearing compare to industry average. Slower rental reversion rate for office market.
Forecasts	<ul style="list-style-type: none"> Unchanged.
Rating	BUY ↔, TP: RM1.34 ↔ <ul style="list-style-type: none"> Positives: (1) Huge pipeline of asset injections from MRCB, Quill and EPF; (2) Resilient earnings with sustainable DPU. Negatives: (1) High gearing; (2) Major assets in challenging office market.
Valuation	<ul style="list-style-type: none"> Maintain BUY recommendation with unchanged TP of RM1.34 based on targeted yield of 6.5% (2SD below 1 year historical average yield spread of MRCB-Quill REIT and 10-year government bond).

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KLCI	1672.7
Expected share price return	6.9%
Expected dividend return	7.3%
Expected total return	14.2%

Share price



Information

Bloomberg Ticker	MQREIT MK
Bursa Code	5123
Issued Shares (m)	661
Market cap (RM m)	794
3-mth avg. volume ('000)	245
SC Shariah-compliant	No

Price Performance	1M	3M	12M
Absolute	2.6	3.4	1.7
Relative	1.7	4.2	5.5

Major Shareholders

MRCB	31.2%
Capita Commercial Trust	17.7%
Quill Group	17.7%

Summary Earnings Table

FYE Dec (RMm)	2015A	2016A	2017E	2018E
Revenue	115.2	132.6	185.9	189.6
NPI	90.3	98.8	139.2	142.0
Net invest income	98.5	100.2	140.7	143.6
PAT	60.7	58.9	85.1	88.7
EPU (sen)	10.2	8.9	7.9	8.2
Norm. PER (x)	13.4	13.5	15.2	14.7
FD PER (x)	13.4	13.5	15.2	14.7
EV/ EBITDA (x)	16.7	16.0	17.2	16.9
Net DPU (sen)	8.5	8.4	8.7	9.0
Distrib. yield (%)	7.1	7.0	7.2	7.5
BVPS (RM)	1.5	1.4	1.2	1.2
P/B (x)	0.8	0.9	1.0	1.0

HLIB

Figure #1 Quarterly Results Comparison

FYE Dec (RMm)	2Q15	1Q16	2Q16	YoY (%)	QoQ (%)	Comments
Gross revenue	32.18	32.66	32.57	1.21	(0.28)	Yoy: Higher due to additional revenue from Platinum Sentral, higher rental income due to step up rent adjustment from QB2, QB3 and QB8. Qoq: Lower recoveries of some properties.
Property operating expenses	(7.86)	(7.21)	(6.87)	(12.67)	(4.75)	Lower due to lower repairs & maintenance costs for Platinum Sentral and part of Plaza Mont's Kiara.
Net property income	24.31	25.45	25.70	5.70	0.99	
Interest income	0.14	0.39	0.38	165.13	(2.44)	Higher due to higher bank balances and interest earned on finance lease arrangement.
Gain on divestment	0.00	0.00	0.00	NM	NM	
Net investment income	24.46	25.84	26.08	6.64	0.94	
Finance costs	(8.19)	(7.86)	(7.98)	(2.59)	1.54	Yoy: Lower borrowings after the redemption of RM140 Junior CPs. Qoq: Increase in interest rate for RM110m subordinated secured loan from 4.9% to 5.35% effective 30 Mac 2016.
Valuation fees	(0.05)	(0.04)	(0.08)	73.69	131.91	
Administrative expenses	(0.32)	(0.15)	(0.06)	(81.61)	(61.49)	
Total Expenses	(10.82)	(10.60)	(10.70)	(1.13)	0.96	
Normalised PBT	13.63	15.24	15.38	12.81	0.92	
Normalised PAT	13.63	15.24	15.38	12.81	0.92	As a result of higher revenue, lower operating expenses and finance cost.
EPU (realised)	2.20	2.30	2.33	5.69	0.92	
DPU (sen)	4.10	0.00	4.23	3.17	NM	

Company Data, HLIB

Figure #2 Cumulative Results Comparison

FYE Dec (RMm)	6MFY15	6MFY16	YoY (%)	Comments
Gross revenue	50.78	65.22	28.43	Higher attributable to additional revenue arising from the acquisition of Platinum Sentral on 30 Mac 2015, and higher rental rates for other properties.
Property operating expenses	(12.79)	(14.07)	10.02	Higher due to acquisition of Platinum Sentral.
Net property income	37.99	51.15	34.62	
Interest income	0.27	0.77	186.18	
Gain on divestment	0.00	0.00	NM	
Net investment income	38.26	51.92	35.69	
Finance costs	(11.73)	(15.83)	35.02	Higher due to financial drawdown for acquisition.
Valuation fees	(0.09)	(0.12)	24.29	
Administrative expenses	(0.51)	(0.21)	(58.80)	
Total Expenses	(16.35)	(21.30)	30.28	
Normalised PBT	21.91	30.62	39.73	
Normalised PAT	21.91	30.62	39.73	Higher net property income, net cost and expense.
EPU (realised)	4.29	4.63	7.91	
DPU (sen)	4.10	4.23	3.17	

Company Data, HLIB

Figure #3 FY15 Results vs. HLIB's Estimates and Consensus

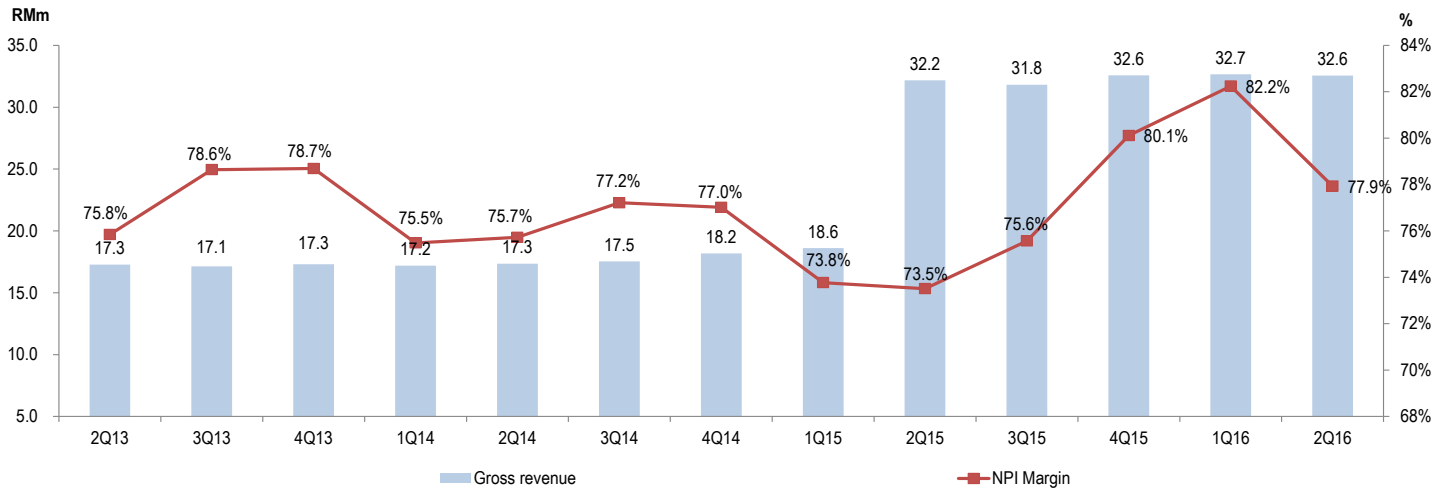
	Actual FY16	HLIB FY16	Actual vs. HLIB (%)	Consensus FY16	Actual vs. Consensus (%)	Comments
Revenue	65.2	132.6	49.2	125.0	52.2	In line.
Normalised PAT	30.6	58.9	51.9	57.3	53.4	In line.
EPU (sen)	4.6	8.9	51.9	8.6	53.8	In line.
DPU (sen)	4.2	8.4	50.2	8.2	51.6	In line.

Company Data, HLIB, Bloomberg

Figure #4 HLIB Forecasts vs. Consensus

RMm	FY17E			FY18E		
	HLIB	Consensus	%	HLIB	Consensus	%
Normalised PAT	85.1	70.1	21.3	88.7	73.9	20.0
DPU (sen)	8.7	7.9	10.0	9.0	8.3	7.9

HLIB, Bloomberg

Figure #5 Gross Revenue & NPI Margin

HLIB, Bloomberg

Figure #6 Peers Comparison

Company	FYE	Price		Market Cap (m)	P/E (x)		P/B (x)		Gross DY (%)
					2016	2017	2016	2017	2016
Amanah Harta Tanah PNB	Dec	MYR	1.02	102.0	NM	NM	NM	NM	NM
Al-'Aqar Healthcare REIT	Dec	MYR	1.61	1,172.4	18.5	18.3	1.3	1.3	5.3
AmFIRST Real Estate Investment Trust	Mar	MYR	0.77	528.5	19.3	19.3	0.6	0.6	5.2
Amanahraya Real Estate Investment Trust	Dec	MYR	0.92	527.4	14.2	13.7	NM	NM	7.2
Atrium Real Estate Investment Trust	Dec	MYR	1.08	131.5	NM	NM	NM	NM	NM
Axis Real Estate Investment Trust	Dec	MYR	1.74	1,923.0	18.9	18.7	1.4	1.4	5.1
CapitaMalls Malaysia Trust	Dec	MYR	1.52	3,083.0	17.7	16.5	1.2	1.2	5.7
Hektar Real Estate Investment Trust	Dec	MYR	1.56	625.0	13.6	13.0	1.0	1.0	7.1
IGB Real Estate Investment Trust	Dec	MYR	1.64	5,712.7	20.8	20.2	1.5	1.5	5.2
KLCCP Stapled Group	Dec	MYR	7.50	13,540.0	18.4	17.5	0.9	0.9	4.8
MRCB-Quill Real Estate Investment Trust	Dec	MYR	1.20	793.7	13.5	15.0	0.9	1.0	7.0
Pavilion Real Estate Investment Trust	Dec	MYR	1.84	5,556.4	21.6	19.2	1.4	1.4	4.6
Al-Salam Real Estate Investment Trust	Mar	MYR	1.03	597.4	18.7	15.8	NM	NM	4.8
Sunway Real Estate Investment Trust	Jun	MYR	1.67	4,913.8	19.0	17.8	1.3	1.3	5.4
Tower Real Estate Investment Trust	Dec	MYR	1.23	345.0	10.3	10.3	0.7	0.7	9.8
UOA Real Estate Investment Trust	Dec	MYR	1.70	718.9	15.5	15.5	1.0	1.0	6.5
YTL Hospitality REIT	Jun	MYR	1.11	1,470.1	13.9	15.9	0.7	0.9	5.4
Average					16.9	16.4	1.1	1.1	5.9

HLIB, Bloomberg

MRCB-Quill REIT (BUY, TP: RM1.34, CP: RM1.20)**Income Statement**

FYE Dec (RM m)	2014A	2015A	2016E	2017E	2018E
Gross rental income	59.3	99.5	116.8	166.3	169.7
Car park income	5.2	10.3	10.3	13.9	14.2
Other revenue	5.7	5.4	5.6	5.7	5.8
Total Revenue	32.7	115.2	132.6	185.9	189.6
Assessment & quit rent	(2.8)	(4.5)	(5.5)	(7.8)	(8.0)
Depreciation	0.0	(0.0)	(0.0)	(0.0)	(0.0)
Insurance	(0.4)	(0.7)	(0.9)	(1.2)	(1.3)
Property management fees	(2.0)	(2.2)	(3.5)	(5.0)	(5.1)
Service contracts	(4.7)	(7.3)	(9.3)	(12.6)	(12.9)
Utilities	(7.0)	(10.2)	(14.6)	(20.0)	(20.4)
Total Opex	(7.2)	(24.9)	(33.8)	(46.7)	(47.6)
Net property income	25.4	90.3	98.8	139.2	142.0
Net investment income	25.8	98.5	100.2	140.7	143.6
Pretax profit	15.2	60.7	58.9	85.1	88.7
Taxation	0.0	0.0	0.0	0.0	1.0
Net profit	34.2	53.4	58.9	85.1	88.7
No of units (m)	390.1	596.0	661.4	1,075.8	1,083.6
EPU (sen)	10.3	10.2	8.9	7.9	8.2

Cash Flows

FYE Dec (RM m)	2014A	2015A	2016E	2017E	2018E
PBT	40.3	60.7	58.9	85.1	88.7
Finance costs	14.1	28.0	0.0	0.0	0.0
Depreciation	0.0	0.0	0.0	0.0	0.0
Fair value gain of assets	(6.1)	(7.3)	0.0	0.0	0.0
Interest income	(0.7)	(0.9)	0.0	0.0	0.0
Others	(16.4)	(21.5)	4.0	4.4	0.3
Operating cashflow	31.1	59.0	62.9	89.5	89.0
Capex	(6.0)	(751.9)	(2.0)	(658.0)	(2.0)
Disposal / (purchase)	(0.0)	(0.2)	(0.0)	(0.0)	(0.0)
Others	0.0	24.9	0.0	0.0	0.0
Investing Cashflow	(6.0)	(727.3)	(2.0)	(658.0)	(2.0)
Distribution paid	(32.7)	(38.7)	(55.7)	(84.2)	(87.8)
Proceeds from borrowings	15.0	534.0	190.0	229.0	100.0
Repayment of borrowings	(15.0)	(145.0)	(190.0)	0.0	(117.0)
Financing cashflow	0.0	342.0	0.0	427.0	0.0
Net cash flow	(32.7)	350.3	(55.7)	144.8	(104.8)

Balance Sheet

FYE Dec (RM m)	2014A	2015A	2016E	2017E	2018E
PPE	0.0	0.2	0.2	0.2	0.2
Investment properties	837.7	1,569.8	1,571.8	2,229.8	2,231.8
Derivatives	1.2	1.6	1.6	1.6	1.6
Non-current assets	838.9	1,571.6	1,573.6	2,231.6	2,233.6
Trade receivables	6.1	5.7	6.6	9.3	9.5
Cash	23.3	44.9	50.1	53.3	35.5
Total Current Assets	29.4	51.3	57.4	63.3	45.7
Total assets	868.4	1,622.9	1,631.0	2,294.9	2,279.3
Unitholders' capital	411.7	751.3	751.3	1,178.3	1,178.3
Undistributed profit	129.5	152.6	155.8	156.7	157.6
Total Equity	541.3	903.9	907.1	1,334.9	1,335.8
Borrowings	305.1	689.7	689.7	918.7	901.7
Security Deposits	9.8	18.1	18.1	18.1	18.1
Derivatives	0.0	0.0	0.0	0.0	0.0
Trade payables	12.2	13.6	18.5	25.6	26.1
Total liabilities	327.1	721.5	726.3	962.4	945.9
Total liabilities & equity	868.4	1,625.3	1,633.4	2,297.3	2,281.7

Valuation Ratios

FYE Dec (RM m)	2014A	2015A	2016E	2017E	2018E
EPU before mgr's fee	8.8	9.0	8.9	7.9	8.2
EPU after mgr's fee	10.3	10.2	8.9	7.9	8.2
PER (x)	13.7	13.4	13.5	15.2	14.7
No of units	390.1	596.0	661.4	1,075.9	1,083.7
Net DPU	8.4	8.5	8.4	8.7	9.0
Net DY (%)	7.0	7.1	7.0	7.2	7.5
NTA/ share (sen)	137.7	151.0	136.2	123.4	122.5
P/NTA (x)	0.9	0.8	0.9	1.0	1.0
FCF/ share (sen)	17.9	16.2	18.2	16.3	18.1
FCF yield (%)	14.9	13.5	15.2	13.6	15.1
Enterprise value	750.0	1,360.0	1,433.3	2,156.5	2,166.7
EV/ EBITDA (x)	15.6	16.7	16.0	17.2	16.9
ROE (%)	7.4	6.7	6.5	6.4	6.6
Net gearing (x)	0.3	0.4	0.4	0.4	0.4
Total gearing (x)	0.4	0.4	0.4	0.4	0.4
BVPS (RM)	1.4	1.5	1.4	1.2	1.2
P/B (x)	0.9	0.8	0.9	1.0	1.0

Assumption metrics

Gross Rental Income	2016E	2017E	2018E
Quill Building 1 - DHL 1	4.7	4.8	4.9
Quill Building 4 - DHL 2	5.1	5.2	5.3
Quill Building 2 - HSBC	9.4	9.6	9.8
Quill Building 3 - BMW	4.9	5.0	5.1
Wisma Technip	11.9	12.2	12.4
Part of Plaza Mont' Kiara	3.8	3.9	4.0
Quill Building 5 - IBM	3.8	3.9	4.0
Quill Building 6 - DHL XPJ	3.1	3.1	3.2
Tesco Building - Penang	14.1	14.4	14.6
Platinum Sentral	55.9	57.0	58.2
Menara Shell	0.0	47.2	48.1
Total	116.8	166.3	169.7

Quarterly Financial Summary

FYE Dec (RM m)	2Q15	1Q16	2Q16	YoY (%)	QoQ (%)
Gross revenue	32.2	32.7	32.6	1.2	(0.3)
Property operating expenses	(7.9)	(7.2)	(6.9)	(12.7)	(4.7)
Net property income	24.3	25.4	25.7	5.7	1.0
Interest income	0.1	0.4	0.4	165.1	(2.4)
Revaluation gains	0.0	0.0	0.0	NM	NM
Net investment income	24.5	25.8	26.1	6.6	0.9
Finance costs	(8.2)	(7.9)	(8.0)	(2.6)	1.5
Valuation fees	(0.0)	(0.0)	(0.1)	73.7	131.9
Administrative expenses	(0.3)	(0.2)	(0.1)	(81.6)	(61.5)
Total Expenses	(10.8)	(10.6)	(10.7)	(1.1)	1.0
Normalised PBT	13.6	15.2	15.4	12.8	0.9
Normalised PAT	13.6	15.2	15.4	12.8	0.9
EPU after mgmt fee	2.2	2.3	2.3	5.7	0.9
DPU (sen)	4	0	4	3	NM

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2. As of 3 August 2016, the analyst, Lee Meng Horng who prepared this report, has interest in the following securities covered in this report:

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Published & Printed by
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Equity rating definitions

BUY	Positive recommendation of stock under coverage. Expected absolute return of more than +10% over 12-months, with low risk of sustained downside.
TRADING BUY	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between -10% and +10% over 12-months, with low risk of sustained downside.
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NOT RATED	No research coverage, and report is intended purely for informational purposes.

Industry rating definitions

OVERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of more than +5% over 12-months.
NEUTRAL	The sector, based on weighted market capitalization, is expected to have absolute return between -5% and +5% over 12-months.
UNDERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of less than -5% over 12-months.