

30 September 2016

MRCB-Quill REIT

Stable Earnings, Undemanding Valuations

By Marie Vaz | msvaz@kenanga.com.my

INVESTMENT MERIT

MRCB-Quill REIT (MQREIT)'s earnings prospect appears solid due to its stable asset profile as the Group had recently acquired Menara Shell, a fully-tenanted asset with a long-term lease, while existing assets are also on long-term leases (avg. 5 years). Going forward, portfolio occupancy is expected to remain healthy at >97% with minimal lease expiries (6.7-13.0% in FY16-17) capping downside risk, while MQREITs is backed by two sponsors for future acquisitions. TRADING BUY with TP of RM1.35 (14.0% total returns) on a +2.40 ppt spread to our 10-year MGS target.

Moving in with the big boys. Post the placement by 4Q16, MQREIT will move into the large cap MREIT space (>RM1b), increasing its market cap to c.RM1.3b (from RM820m). This implies better trading liquidity and added institutional shareholding from placements to EPF. However, we believe the stock is still trading at a discount to large cap MREITs, at 6.5% on FY17E gross yields vs. 5.1-6.1% for large cap MREITs under our coverage, albeit its stable earnings profile.

Portfolio occupancy remains healthy >97%. The Group has a strong occupancy rate of 97% and had maintained this above 90% historically, higher than its small-mid-cap office-based peers (between 65%-96%). Notably, 7 out of its 11 assets have full occupancy with most tenants locked in for minimum 5 years (vs. retail 2-3 years), providing long-term stability in rental income. Occupancy rates for office assets are generally more stable than retail given the longer contract period.

Office segment's downside risk limited with minimal lease expiries in FY16-17E. MQREIT's FY16E-17E leases up for expiry are minimal at 6.7-13.0% of NLA vs. office-based peers of 16.9-32.0% (FY16) and 16.2%-63.0% (FY17). We believe low lease expiries are preferable in current times when the office market is in oversupply situation, given the risk of attrition of tenants. To date, MQREIT has secured 4.0% of the 6.7% leases up for expiry in FY16.

Recent acquisition of Menara Shell increasing earnings stability. MQREITs recent acquisition of Menara Shell (June 2016) is sizeable (32% of FY17E GRI), on 100% occupancy with a long-term lease of over 15 years for 79% of NLA, ensuring a stable earnings base for MQREIT from FY17 onwards. Although we expect strong earnings growth in FY17 (+63% YoY), mostly from Menara Shell, we expect this acquisition to be DPU neutral in the near term and accretive in the longer run.

Strong asset pipeline secured from MRCB and Quill Group. MQREITs is backed by two sponsors for acquisitions (MRCB and Quill Group), allowing opportunities for yield accretive acquisitions as MRCB targets to dispose at least one asset per year with potential assets being Menara Celcom (est. value RM428m), while other assets include Ascott Sentral, Sooka Sentral, and Kompleks Sentral, and assets from its original sponsor, the Quill Group (i.e. Quill Building 6, Lebu Ampang, Quill Building 9, Section 14, Petaling Jaya, and Quill Building 18, Cyberjaya). Post finalisation of Menara Shell's acquisition and placement, we expect gearing to lower to 0.40x in FY17, which would allow MQREIT to borrow an additional RM450m for an additional asset acquisition before hitting the maximum gearing limit of 0.50x.

Earnings projections of RM56.1-91.6m in FY16-17E mostly from contributions from Menara Shell, Platinum Sentral and stable earnings on all assets. We estimate DPU of 8.1-8.1sen in FY16-17E based on a 95% pay-out ratio (in line with historical trends), suggesting gross yields of 6.5-6.5%.

TRADING BUY with a fair value of RM1.35 based on a target yield of 6.0%, on a +2.40 ppt spread to our 10-year MGS target of 3.60%. Our applied spread is slightly above large cap MREITs (>RM1b) under our coverage (between +0.8ppt to +2.10ppt) as MQREIT is slightly smaller than large cap REITs, while the office segment may not be perceived as well as retail and industrial due to the oversupply issue. Even on our conservative valuations, MQREIT is commanding 14.0% total returns and 6.5% FY17E gross yield.

	Rating	Fair Value
Last Price		RM1.25
Kenanga	Trading Buy	RM1.35
Consensus	-	-

Stock Information

Shariah Compliant	No
Stock Name	MRCB-QUILL REIT
CAT Code	5123
Industry	REITS
Industry Sub-sector	REITS-Office Property
YTD stock price chg	15.74%
Market Cap (RM m)	826.73
Issued shares (m)	661.38
52-week range (Hi)	1.39
52-week range (Low)	1.05
3-mth avg daily vol:	383209.7
Free Float	28%
Beta	0.62
Altman's Z-score	0.85

Major Shareholders

Malaysian Resources Corporation Berhad	31.18%
Capitaland Limited	17.70%
Quill Land Sdn Bhd	7.37%

Financials

FYE Dec (RM'm)	2015A	2016E	2017E
Turnover	115.2	122.0	178.5
EBIT	80.5	85.1	124.9
PBT	60.7	56.1	91.6
Core Net Profit (RNI)	54.0	56.1	91.6
Core EPS (sen)	8.2	8.5	8.5
BV/Share (RM)	1.37	1.37	1.25
Core PER	15.3	14.7	14.7
Price/BV (x)	0.9	0.9	1.0
G. Div. Yield (%)	6.2	6.5	6.5

Quarterly Financial Data (RM'm)

	4Q15	1Q16	2Q16
Revenue	32.6	32.7	32.6
NPI	26.8	25.4	25.7
RNI	16.4	15.2	15.4
EPU (sen)	2.8	2.7	2.7
EPU Growth (QoQ)	4%	-6%	1%
Revenue Growth (QoQ)	2%	0%	0%
RNI Margin	50%	47%	47%

Peers Comparison

	PER (CY16)	Div. Yld (%)	Mkt Cap (RM m)
UOAREIT	15.5	6.5	718.9
AMFIRST	20.9	4.8	573.1
AXREIT	19.9	4.9	1,912.0
Average	18.7	5.4	1,068.0
MQREIT	14.7	6.5	826.7
FBMKLCI	16.7	3.1	999.8B



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Daily Charting – MRCB Quill-REIT



Comment: MQREIT has been consolidating sideways after retracing from its high level of RM1.39 on August 2016. The underlying outlook is neutral-to-positive at this juncture, given that the share price is supported by all its key SMAs. The monotonous form of MACD histogram, RSI and Stochastic are suggesting that the stock is likely to continue trading sideways in the immediate term. Any settlement above RM1.26 (R1) would see the stock seeking a higher high towards RM1.29 (R2) immediately, with the next overhead resistance envisaged at RM1.39 (R3). Meanwhile, any decline further below its key support level of RM1.22 (S1) would see share price retracement towards RM1.19 (S2) and possibly RM1.15 (S3).

About the stock:

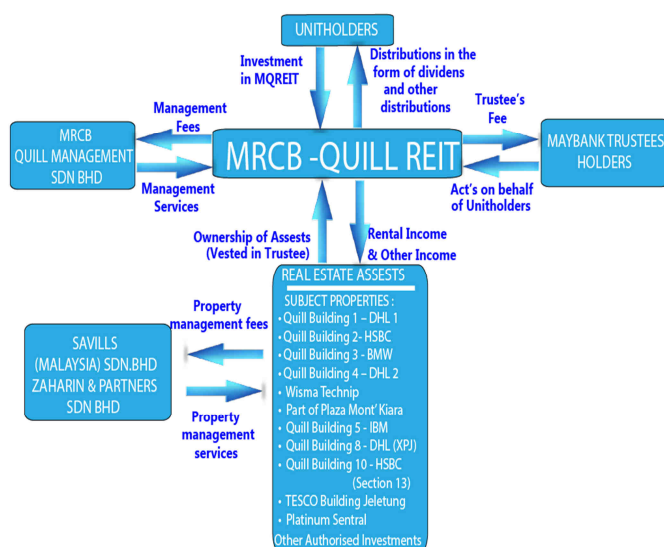
Name : MRCB Quill-REIT
Bursa Code : 5123

Key Support & Resistance level

Resistance	: RM1.26 (R1)	RM1.29 (R2)	RM1.39 (R3)
Support	: RM1.22 (S1)	RM1.19 (S2)	RM1.15 (S3)
Outlook	: Neutral-Positive		

Source: Kenanga Research

CORPORATE STRUCTURE



BUSINESS OVERVIEW

- MRCB-Quill REIT is a Real Estate Investment Trust (REIT) listed in 2007. It is formed to acquire and invest in commercial properties primarily in Malaysia.
- MQREIT is managed by MRCB Quill Management Sdn Bhd which has three shareholders, namely, Quill Resources Holding Sdn Bhd (QRH), a company within the Quill Group of Companies, Malaysian Resources Corporation Bhd (MRCB) and Global Jejaka Sdn Bhd (GJSB).
- The initial portfolio of commercial properties acquired by MQREIT comprises built-to-suit office buildings, data processing centres and business park properties. Majority of the key tenants have committed to initial lease term of five years or more, with agreed step-up rentals.

BUSINESS SEGMENTS

MRCB-Quill REIT is a predominantly office (82% office, 13% retail) based MREIT with 11 assets under its portfolio, with 59% of the assets located in the prime locale of KL (of which 48% is in KL Sentral), 23% in Cyberjaya, 9% in Penang and 7% in Mont Kiara. Assets within the portfolio include DHL Building 1 and 2, HSBC building, BMW, IBM, DHL (XPJ), Plaza Mon't Kiara, Wisma Technip, Tesco Penang, Platinum Sentral, and the latest Menara Shell, with the acquisition to be completed by 4Q16.

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KENANGA INVESTMENT BANK BERHAD (15678-H)

8th Floor, Kenanga International, Jalan Sultan Ismail, 50250 Kuala Lumpur, Malaysia
Telephone: (603) 2166 6822 Facsimile: (603) 2166 6823 Website: www.kenanga.com.my



Chan Ken Yew
Head of Research