

26 October 2016

Buy

Price
RM1.27

Target price
RM1.45

Bloomberg ticker
MQREIT MK

Equity | Malaysia | Real Estate Investment Trust

Flashnote

MRCB-Quill REIT

Resilient performance

Financial Highlights

| Year to Dec (RMm) | 2014 | 2015 | 2016F | 2017F | 2018F |
|-----------------------|------|-------|-------|-------|-------|
| Revenue | 70.2 | 115.2 | 127.6 | 181.0 | 186.3 |
| Reported net profit | 40.3 | 60.7 | 60.1 | 87.4 | 91.3 |
| Normalised net profit | 34.2 | 53.4 | 60.1 | 87.4 | 91.3 |
| EPS (sen) | 10.3 | 9.2 | 9.1 | 8.2 | 8.5 |
| DPS (sen) | 8.4 | 8.5 | 8.7 | 7.8 | 8.1 |
| P/E (x) | 12.4 | 13.9 | 14.1 | 15.6 | 15.0 |
| ROE (%) | 7.5 | 8.4 | 6.6 | 7.8 | 6.8 |
| Dividend yield (%) | 6.5 | 6.6 | 6.8 | 6.1 | 6.4 |
| Net gearing (%) | 35.1 | 42.4 | 42.3 | 40.0 | 39.9 |
| PBV (x) | 0.9 | 0.9 | 0.9 | 1.0 | 1.0 |

Source: Company, KAF

- We have a Buy rating on MRCB-Quill REIT (MQREIT) with a RM1.45 TP. The stock offers an attractive FY16F dividend yield of 6.8% (based on a 95% distribution rate), which is the highest within our sector coverage, and provides a comfortable spread of 319bps against the 10-year MGS.
- Revenue was flat qoq and up 2% yoy, mainly due to better income from Platinum Sentral and positive rental reversions from Quill Buildings 2, 3 and Wisma Technip. Normalised net profit fell 1% qoq due to flat revenues, but grew 1% yoy on the back of higher interest income and lower borrowing costs.
- For the nine-month period, revenue jumped 18% from the same period last year following the acquisition of Platinum Sentral in 2Q15. Interest cost climbed 19% due to additional borrowings taken up to fund the acquisition, and normalised net profit increased 24%. Overall, the result was in line with our full-year FY16F forecast at 76%.
- The acquisition of Menara Shell for RM640m is set to conclude in 4Q16. Based on an earlier announcement, the acquisition is expected to be funded via placements and borrowings, with a ratio of 65:35. MRCB will take up about 23% of the enlarged share base, while EPF has expressed interest to take up 7%.
- We expect FY17 earnings to jump 43% after the inclusion of Menara Shell, and subsequently earnings should be driven by stable rental increases at ~3% p.a. Management also guided that Menara Celcom in PJ Sentral may be next to be injected into the REIT, followed by Ascott Sentral for a combined RM548m. The inclusion of these two buildings as well as Menara Shell would push up MQREIT's TAV to RM2.8bn.
- MQREIT has demonstrated stable financial performance, underpinned by quality assets in prime locations. The tenancies have long leases of 5-10 years, and despite the current oversupply of offices, its occupancy rates have consistently been strong at an average of 98%, compared to the industry's office segment average of ~70-80%. This is largely due to its build-to-suit profile, which enables MQREIT to lock in tenants for longer periods.

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Important disclosures can be found in the Disclosure Appendix

Table 1 : Quarterly trends

| (RM m) | Quarterly | | | | | | Change | | Cumulative | | | KAF | |
|------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|------------|------------|-------------|-------------|-----------|--------------|-----------|
| FYE 31 Dec | Jun-15 | Sep-15 | Dec-15 | Mar-16 | Jun-16 | Sep-16 | % qoq | % yoy | 9MFY15 | 9MFY16 | % chg | 2016F | 9M/F |
| Revenue | 32.2 | 31.8 | 32.6 | 32.7 | 32.6 | 32.5 | (0) | 2 | 82.6 | 97.7 | 18 | 127.6 | 77 |
| Property operating expenses | (7.9) | (6.3) | (5.8) | (7.2) | (6.9) | (7.0) | 2 | 10 | (19.1) | (21.0) | 10 | (27.6) | 76 |
| Net property income | 24.3 | 25.5 | 26.8 | 25.4 | 25.7 | 25.5 | (1) | 0 | 63.5 | 76.7 | 21 | 100.0 | 77 |
| Interest income | 0.1 | 0.4 | 0.3 | 0.4 | 0.4 | 0.5 | 25 | 35 | 0.6 | 1.2 | 101 | 1.3 | 98 |
| Trust expenses | (2.6) | (2.4) | (2.8) | (2.7) | (2.7) | (2.7) | (2) | 12 | (7.0) | (8.1) | 16 | (10.8) | 75 |
| Borrowing costs | (8.2) | (8.3) | (7.9) | (7.9) | (8.0) | (8.1) | 2 | (3) | (20.0) | (23.9) | 19 | (30.3) | 79 |
| Exceptional items | - | 0.6 | 6.7 | - | - | - | | | 0.6 | - | | - | |
| Profit before tax | 13.6 | 15.7 | 23.1 | 15.2 | 15.4 | 15.2 | (1) | (3) | 37.6 | 45.9 | 22 | 60.1 | 76 |
| Tax | - | - | - | - | - | - | - | - | | | | - | |
| Net profit | 13.6 | 15.7 | 23.1 | 15.2 | 15.4 | 15.2 | (1) | (3) | 37.6 | 45.9 | 22 | 60.1 | 76 |
| Normalized net profit | 13.6 | 15.1 | 16.4 | 15.2 | 15.4 | 15.2 | (1) | 1 | 37.1 | 45.9 | 24 | 60.1 | 76 |

Source: Company, KAF

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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