5 May 2017

Property | REITS

MRCB-Quill REIT

Temporary Hiccups For Menara Shell

Neutral (Maintained)

Target Price:	MYR1.32
Price:	MYR1.32
Market Cap:	USD326m
Bloomberg Ticker:	MQREIT MK

MRCB-Quill REIT's 1Q17 core net profit was within our and market expectations, driven by the acquisition of Menara Shell in Dec 2016. Following the acquisition, 1Q revenue increased by 39.5% YoY and core net profit improved by 52% YoY. Menara Shell's occupancy rate has fallen to 95% (2016: 99%), mainly due to non-renewal of the Tradewinds tenancy. Nevertheless, we expect the non-renewal to have a very minimal impact, as it made up only <0.5% of the REIT's total revenue. We keep our FY17-19 forecasts, NEUTRAL call and DDM-based TP of MYR1.32 (0% upside).

1Q17 earnings within expectations. MRCB-Quill's 1Q17 core net profit of MYR23.2m was within our and market expectations, making up 26-27% of our and consensus estimates respectively. Revenue increased by 39.5% YoY, largely due to the acquisition of Menara Shell on 22 Dec 2016. Core net profit grew 52% YoY, as net margin expanded to 50.8% (1Q16: 46.7%), due to a better NPI margin from Menara Shell. Nevertheless, the REIT recorded lower EPU of 2.17 sen (from 2.30 sen), due to the placement exercise of 406.62m units completed in Dec 2016.

Overall occupancy contracted marginally to 97% (from 98%), due to the non-renewal of Tradewinds Corporation's tenancy in Menara Shell. With the non-renewal (Tradewinds previously occupied 4% of Menara Shell's total NLA), the occupancy rate is now 95%, from 99% in 2016. Management is looking for potential new tenants, but we do not expect new tenants in the very short term. Nevertheless, we expect the Tradewinds non-renewal to have a very minimal impact (the tenancy contributed less than 0.5% of the REIT's total revenue) to the REIT's overall performance. Other than that, all the other assets' occupancy rates remained stable.

Menara Shell the key driver. We expect Menara Shell to continue to drive growth for the REIT this year. This 33-storey office building is strategically located in the south-western portion of KL Sentral, which is an integrated transit hub in Kuala Lumpur. It has a total NLA of 557,053 sq ft – about 25% of the REIT's overall portfolio – and has an occupancy rate of >90%, with a good mix of multinational and large conglomerates (Shell Trading Malaysia and AmGeneral are amongst the major tenants). We expect Menara Shell would continue to contribute 28% of the REIT total revenue in FY17 and FY18.

Maintain NEUTRAL. We maintain our FY17-19 earnings forecasts and DDM-based TP of MYR1.32. The potential injection of assets into the REIT from MRCB and Quill Group might be potential catalysts, in our view.

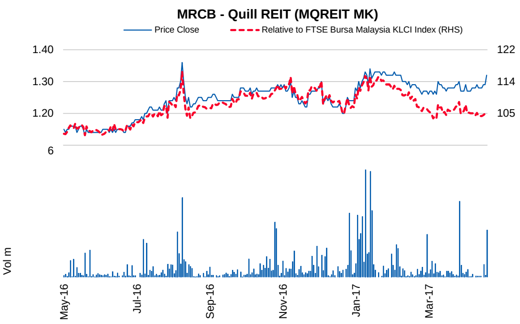
Risks. The key upside risk to our call would be higher-than-expected demand for office space. On the downside, the key risks would include oversupply of office properties, which might affect the portfolio's office property occupancy and rental rates.

Share Data	
Avg Daily Turnover (MYR/USD)	0.48m/0.10m
52-wk Price low/high (MYR)	1.13 - 1.36
Free Float (%)	33
Shares outstanding (m)	390
Estimated Return	0%

Shareholders (%)	
MRCB	27.9
Quill Group	11.0
CapitaCommercial Trust	11.0

Share Performance (%)	YTD	1m	3m	6m	12m
Absolute	10.0	3.1	(0.8)	2.3	14.8
Relative	2.0	1.7	(6.0)	(5.2)	7.9

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (MYRm)	115	132	174	178	181
Net property income (MYRm)	90	102	130	136	140
Reported net profit (MYRm)	53.4	59.2	86.4	91.5	94.9
Total distributable income (MYRm)	53.4	59.2	86.4	91.5	94.9
DPS (MYR)	0.08	0.08	0.08	0.08	0.08
DPS growth (%)	1.1	(1.1)	(6.8)	4.2	3.8
Recurring P/E (x)	14.7	14.7	16.3	15.4	14.9
P/B (x)	0.97	1.04	1.03	1.03	1.03
Dividend Yield (%)	6.4	6.3	5.9	6.2	6.4
Return on average equity (%)	7.4	5.2	6.3	6.7	6.9
Return on average assets (%)	4.3	3.0	3.8	4.0	4.1
Interest cover (x)	2.81	2.72	3.35	3.49	3.59
Our vs consensus EPS (adjusted) (%)			(2.5)	(2.7)	(3.4)

Source: Company data, RHB

Analyst
Muhammad Syafiq Bin Mohd Salam
+603 9280 8867
muhammad.syafiq.mohd@rhbgroup.com

Financial Exhibits

Financial model updated on : 2017-05-04.

Asia
Malaysia
Property
MRCB-Quill REIT
Bloomberg MQREIT MK
Neutral

Valuation basis

Dividend discount model

Key drivers

Higher-than-expected demand of office space and inorganic growth opportunities arising from MRCB and Quill Group.

Key risks

Downside risks oversupply of office properties might affect the portfolio's office property occupancy and rental rates.

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-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Recurring EPS (MYR)	0.09	0.09	0.08	0.09	0.09
EPS (MYR)	0.09	0.09	0.08	0.09	0.09
DPS (MYR)	0.08	0.08	0.08	0.08	0.08
BVPS (MYR)	1.37	1.27	1.28	1.28	1.28
Weighted avg adjusted shares (m)	594	661	1,068	1,068	1,068

Valuation metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Recurring P/E (x)	14.7	14.7	16.3	15.4	14.9
P/E (x)	14.7	14.7	16.3	15.4	14.9
P/B (x)	0.97	1.04	1.03	1.03	1.03
FCF Yield (%)	6.5	(42.3)	5.9	6.2	6.4
Dividend Yield (%)	6.4	6.3	5.9	6.2	6.4
EV/EBITDA (x)	(0.62)	(0.12)	(1.86)	(1.80)	(1.77)
EV/EBIT (x)	(0.62)	(0.12)	(1.86)	(1.80)	(1.77)

Income statement	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (MYRm)	115	132	174	178	181
EBITDA (MYRm)	80	90	120	125	128
Operating profit (MYRm)	80	90	120	125	128
Net interest (MYRm)	(27)	(31)	(33)	(33)	(33)
Pre-tax profit (MYRm)	53	59	86	91	95
Recurring net profit (MYRm)	53	59	86	91	95

Cash flow (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Change in working capital	(3)	(3)	(4)	(4)	(4)
Cash flow from operations	53	58	85	90	93
Capex	(2)	(427)	(2)	(2)	(2)
Cash flow from investing activities	(2)	(427)	(2)	(2)	(2)
Proceeds from issue of shares	353	448	0	0	0
Dividends paid	(41)	(53)	(69)	(85)	(89)
Cash flow from financing activities	507	786	(69)	(85)	(89)
Cash at beginning of period	23	45	54	259	262
Net change in cash	558	417	13	2	2
Ending balance cash	581	462	67	262	264

Balance sheet (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total cash and equivalents	45	54	259	262	264
Total investments	1,573	2,225	2,225	2,225	2,225
Total other assets	0	0	0	0	0
Total assets	1,625	2,297	2,300	2,305	2,310
Short-term debt	189	189	189	189	189
Total long-term debt	501	662	662	662	662
Other liabilities	15	23	22	23	23
Total liabilities	721	938	937	938	938
Shareholders' equity	904	1,360	1,363	1,367	1,372
Total equity	904	1,360	1,363	1,367	1,372
Net debt	645	798	592	590	587
Total liabilities & equity	1,625	2,297	2,300	2,305	2,310

Key metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Revenue growth (%)	64.0	14.4	32.3	2.0	2.0
Recurrent EPS growth (%)	2.9	(0.5)	(9.6)	5.8	3.8
Operating EBITDA margin (%)	69.9	68.2	68.7	70.2	70.7
Net profit margin (%)	46.4	44.9	49.6	51.4	52.3
Dividend payout ratio (%)	94.1	93.6	93.6	93.6	93.6
Capex/sales (%)	1.7	324.0	1.1	1.1	1.1
Interest cover (x)	2.81	2.72	3.35	3.49	3.59

Source: Company data, RHB

Figure 1: MRCB-Quill's results comparison

FYE Dec (MYRm)	1Q16	4Q16	1Q17	QoQ (%)	YoY (%)	Comments
Revenue	**32.7**	**34.1**	**45.6**	**33.7**	**39.5**	Higher YoY revenue growth due to the additional contribution from Menara Shell, which was acquired on 22 Dec 2016; as well as positive rental reversions of its assets.
Net property income (NPI)	**25.4**	**25.6**	**36.1**	**41.0**	**42.0**	Higher operating expenses due to acquisition of Menara Shell.
Interest expense	(7.9)	(9.1)	(9.7)	6.9	23.8	Higher interest expense due to interest on additional borrowings to finance part of the acquisition of Menara Shell.
Interest income	0.4	1.1	0.5	(60.3)	16.1	
Associates	0.0	0.0	0.0	nm	nm	
EI	0.0	3.5	0.0	nm	nm	
Others	(2.7)	(4.3)	(3.7)	(13.9)	34.4	
Pretax profit	**15.2**	**16.9**	**23.2**	**36.9**	**52.0**	
Tax	0.0	0.0	0.0	nm	nm	
Minority Interest	0.0	0.0	0.0	nm	nm	
Net Profit	**15.2**	**16.9**	**23.2**	**36.9**	**52.0**	
Core Profit	**15.2**	**13.3**	**23.2**	**74.1**	**52.0**	Within expectations
Core earnings per unit (sen)	**2.30**	**1.89**	**2.17**	**14.8**	**(5.9)**	Lower due to increase in units pursuant to the placement exercise for acquisition of Menara Shell
Dividends per unit (sen)	**0.00**	**4.15**	**0.00**	**nm**	**nm**	
NPI Margin (%)	*77.9*	*75.2*	*79.3*			
Pretax Margin (%)	*46.7*	*49.7*	*50.8*			
Net Margin (%)	*46.7*	*39.1*	*50.8*			

Source: Company

Figure 2: MRCB-Quill REIT – forecast assumptions

	NLA / GFA (sf)	Average Rental Rates (MYR psf)		
Asset		**FY17F**	**FY18F**	**FY19F**
QB 1 - DHL 1	92,284	4.45	4.54	4.63
QB 4 - DHL 2	99,183	4.45	4.54	4.63
QB 2 - HSBC	184,453	4.45	4.54	4.63
QB 3 - BMW	117,198	4.45	4.54	4.63
QB 5 - IBM	81,602	3.33	3.44	3.56
Plaza MK	73,408	8.53	8.54	8.55
Wisma Technip	233,021	5.85	6.02	6.20
QB 10 - HSBC	68,377	3.33	3.44	3.56
QB 8 - DHL	65,205	3.33	3.44	3.56
Tesco Penang	275,020	3.09	3.16	3.22
Platinum Sentral	475,857	9.04	9.17	9.31
Shell Tower	557,053	7.28	7.46	7.65
DPU (sen)		**7.81**	**8.14**	**8.44**

Source: RHB, Company

SWOT Analysis

S

- Long-term leases on most of its assets

T

- The entry of larger REITs into the market

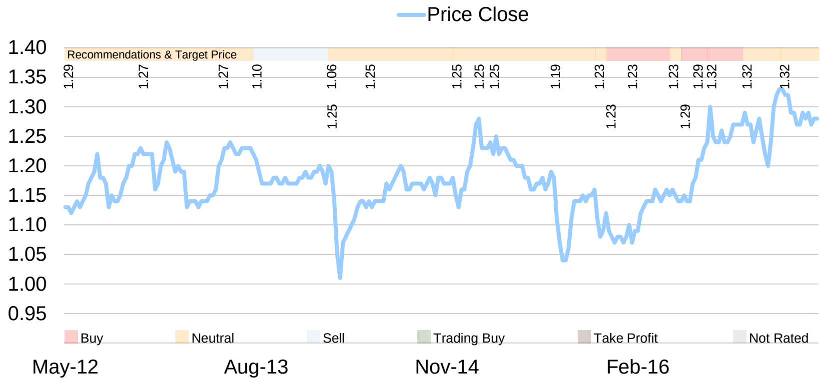
O

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

W

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

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2017-01-26	Neutral	1.32	1.32
2016-10-27	Neutral	1.32	1.27
2016-08-03	Buy	1.32	1.24
2016-07-01	Buy	1.29	1.17
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

Source: RHB, Bloomberg

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Kuala Lumpur	Hong Kong	Singapore
RHB Research Institute Sdn Bhd Level 3A, Tower One, RHB Centre Jalan Tun Razak Kuala Lumpur 50400 Malaysia Tel : +(60) 3 9280 8888 Fax : +(60) 3 9200 2216	**RHB Securities Hong Kong Ltd.** 12th Floor World-Wide House 19 Des Voeux Road Central, Hong Kong Tel : +(852) 2525 1118 Fax : +(852) 2810 0908	**RHB Research Institute Singapore Pte Ltd.** 10 Collyer Quay #09-08 Ocean Financial Centre Singapore 049315 Tel : +(65) 6533 1818 Fax : +(65) 6532 6211
Jakarta	**Shanghai**	**Bangkok**
PT RHB Securities Indonesia Wisma Mulia, 20th Floor Jl. Jenderal Gatot Subroto No. 42 Jakarta 12710, Indonesia Tel : +(6221) 2783 0888 Fax : +(6221) 2783 0777	**RHB (China) Investment Advisory Co. Ltd.** Suite 4005, CITIC Square 1168 Nanjing West Road Shanghai 20041 China Tel : +(8621) 6288 9611 Fax : +(8621) 6288 9633	**RHB Securities (Thailand) PCL** 10th Floor, Sathorn Square Office Tower 98, North Sathorn Road, Silom Bangrak, Bangkok 10500 Thailand Tel: +(66) 2 088 9999 Fax : +(66) 2 088 9799