

18 June 2020

Property | REITS

MRCB-Quill REIT (MQREIT MK)

Buy (from Neutral)

Starting The Year On a Good Note; U/G To BUY

Target Price (Return): MYR0.78 (13.0%)
 Price: MYR0.69
 Market Cap: USD173m
 Avg Daily Turnover (MYR/USD) 0.31m/0.07m

- **Upgrade to BUY from Neutral with an unchanged MYR0.78 TP, implying 13% upside and c.9% FY20F yield.** 1Q20 earnings exceeded market's expectations as a couple of MRCB-Quill REIT's assets reported higher occupancy rates during the quarter. Although we note that the numbers have not yet truly reflected the volatility that 2Q20 promises, we turn mildly optimistic on MQREIT's outlook considering the less-than-significant impact COVID-19 may still have on MQREIT in comparison to its retail peers.

- **Earnings above expectations.** 1Q20 core profit of MYR19.8m (+6% QoQ, +2% YoY) was above expectations at 31% and 27% of our and market's full-year estimates. MQREIT demonstrated flattish growth in its topline of -0.6% QoQ and +0.8% YoY. This represents an improvement from the past couple of quarters where growth in revenue was negative due to lower rental contribution from Platinum Sentral, Wisma Technip and Quill Building 5. This quarter's better-than-expected performance was attributed to the higher revenue coming from Menara Shell, Wisma Technip and Tesco. The distributable income per unit for 1Q20 was 1.85 sen (vs 1.81 sen in 1Q19).

- **19% of NLA up for renewal in FY20.** The blended occupancy is at 90.5% (from 90% in FY19). The occupancy rates for Menara Shell, Platinum Sentral and Wisma Technip improved, standing at 99%, 94% and 90% respectively (from 94%, 88% and 74% previously). As of 1Q20, less than 1% of leases up for expiry this year were renewed. The bulk of the 19% up for expiry are concentrated at QB1 and QB4, and management confirmed that they are in talks of renewing. MQREIT has taken on a co-working space operator at Platinum Sentral (c.70,000 sqf), which should be able to mitigate any non-renewal risks. Regardless, co-working space operators command lower rental rates, so we view it only mildly positively.

- **We turn slightly optimistic on MQREIT, albeit cautiously.** The better-than-expected performance for the quarter is encouraging. We believe the upcoming quarters should be only marginally impacted by COVID-19, seeing that no rental assistance was offered to office tenants at large. However, rental assistance was given out to the co-working space operator in Platinum Sentral and retail tenants at Plaza Mont Kiara (c.4% of total income) in the month of April, but we believe the impact would not be significant. Note that QB5 remained 100% vacant.

- **Increase earnings, maintain TP.** We increase our FY21-22F earnings by 6-8%, but leave our MYR0.78 TP unchanged. As such, we upgrade MQREIT to BUY from Neutral.

- **Downside risks** to our call include non-renewal risk and a second COVID-19 wave which would exert pressure on rental rates.

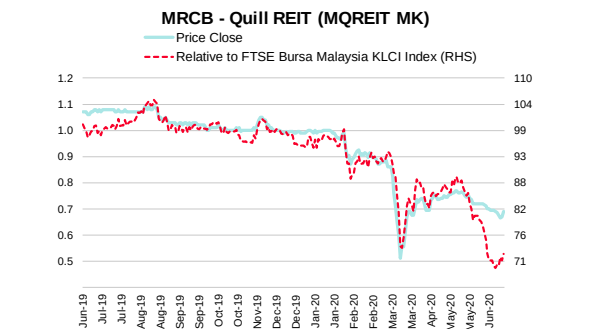
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(31.0)	(7.4)	6.2	(30.7)	(35.5)
Relative	(27.1)	(16.2)	(15.3)	(27.5)	(28.6)
52-wk Price low/high (MYR)				0.51 – 1.09	



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (MYRm)	173	162	138	138	139
Net property income (MYRm)	134	123	106	106	107
Reported net profit (MYRm)	82.5	72.1	63.5	64.0	64.7
Total distributable income (MYRm)	82.5	72.1	63.5	64.0	64.7
DPS (MYR)	0.08	0.07	0.06	0.06	0.06
DPS growth (%)	(3.1)	(16.2)	(13.9)	0.8	1.1
P/B (x)	0.54	0.56	0.56	0.56	0.56
Dividend Yield (%)	11.8	9.9	8.5	8.6	8.7
Return on average equity (%)	6.0	5.3	4.8	4.8	4.9
Return on average assets (%)	3.6	3.2	2.9	2.9	2.9

Source: Company data, RHB

18 June 2020

Upgrade | REITS

Financial Exhibits

Asia	Financial summary	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Malaysia	Recurring EPS (MYR)	0.08	0.07	0.06	0.06	0.06
Property	EPS (MYR)	0.08	0.07	0.06	0.06	0.06
MRCB-Quill REIT	DPS (MYR)	0.08	0.07	0.06	0.06	0.06
MQREIT MK	BVPS (MYR)	1.28	1.23	1.24	1.24	1.24
Buy	Return on average equity (%)	6.0	5.3	4.8	4.8	4.9
	Weighted avg adjusted shares (m)	1,071.78	1,071.78	1,071.78	1,071.78	1,071.78
Valuation basis	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Dividend discount model	Recurring P/E (x)	9.11	10.26	11.65	11.56	11.42
	P/E (x)	8.96	10.26	11.65	11.56	11.42
	P/B (x)	0.5	0.6	0.6	0.6	0.6
	FCF Yield (%)	10.6	9.2	8.0	8.1	8.1
	Dividend Yield (%)	11.8	9.9	8.5	8.6	8.7
	EV/EBITDA (x)	(5.65)	(5.82)	(6.20)	(6.13)	(6.05)
	EV/EBIT (x)	(5.65)	(5.82)	(6.20)	(6.13)	(6.05)
Key drivers	Income statement (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Higher-than-expected demand for office space and inorganic growth opportunities arising from MRCB and Quill Group.	Total turnover	173	162	138	138	139
	EBITDA	119	108	95	96	97
	Operating profit	119	108	95	96	97
	Net interest	(36)	(36)	(32)	(32)	(32)
	Pre-tax profit	83	72	63	64	65
	Recurring net profit	81	72	63	64	65
Key risks	Cash flow (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Downside risks oversupply of office properties might affect the portfolio's office property occupancy and rental rates.	Change in working capital	(4)	(4)	(4)	(4)	(5)
	Cash flow from operations	81	70	61	62	62
	Capex	(2)	(2)	(2)	(2)	(2)
	Cash flow from investing activities	(1)	(2)	(2)	(2)	(2)
	Dividends paid	(88)	(80)	(68)	(63)	(64)
	Cash flow from financing activities	24	(442)	(68)	(63)	(64)
	Cash at beginning of period	76	86	63	23	19
	Net change in cash	104	(374)	(9)	(4)	(4)
	Ending balance cash	180	(288)	55	19	16
Company Profile	Balance sheet (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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.	Total cash and equivalents	86	63	23	19	16
	Total investments	2,179	2,144	2,144	2,144	2,144
	Total other assets	0	0	0	0	0
	Total assets	2,272	2,214	2,215	2,216	2,217
	Short-term debt	0	333	333	333	333
	Total long-term debt	854	503	503	503	503
	Total liabilities	899	890	891	891	892
	Shareholders' equity	1,372	1,323	1,324	1,325	1,325
	Total equity	1,372	1,323	1,324	1,325	1,325
	Net debt	768	772	813	816	820
	Total liabilities & equity	2,272	2,214	2,215	2,216	2,217
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	(3.7)	(6.5)	(15.0)	0.2	0.3
	Recurrent EPS growth (%)	(8.1)	(11.2)	(12.0)	0.8	1.1
	Operating EBITDA margin (%)	68.5	66.9	69.2	69.5	69.7
	Net profit margin (%)	47.6	44.5	46.1	46.4	46.7
	Dividend payout ratio (%)	105.6	101.2	0.0	0.0	0.0
	Capex/sales (%)	1.2	1.2	1.5	1.4	1.4
	Interest cover (x)	2.93	2.74	2.72	2.73	2.75

Source: Company data, RHB

Results at a Glance

Figure 1: MRCB-Quill REIT's 1Q20 results summary

FYE Dec (MYRm)	1Q19	4Q19	1Q20	QoQ (%)	YoY (%)	Comments
Revenue	41.4	42.0	41.7	(0.6)	0.8	Higher YoY revenue on the back of higher occupancy for its commercial assets.
Net property income (NPI)	32.0	31.5	32.3	2.5	0.8	
Interest expense	(9.9)	(10.3)	(9.5)	(7.0)	(3.1)	
Interest income	0.8	1.1	0.6	(48.5)	(30.0)	
Associates	0.0	0.0	0.0	nm	nm	
EI	0.0	(36.7)	0.0	nm	nm	
Others	(3.6)	(3.8)	(3.5)	(6.2)	(1.9)	
Pretax profit	19.4	(18.1)	19.8	(209.1)	1.9	
Tax	0.0	(6.2)	0.0	nm	nm	
Minority Interest	0.0	(6.2)	0.0	nm	nm	
Net Profit	19.4	(24.4)	19.8	(181.2)	1.9	Above expectations.
Core Profit	19.4	18.6	19.8	6.3	1.9	
Core earnings per unit (sen)	1.81	1.74	1.85	6.3	2.2	
Dividends per unit (sen)	0.00	3.37	0.00	nm	nm	
<i>NPI Margin (%)</i>	<i>77.4</i>	<i>75.0</i>	<i>77.4</i>			
<i>Pretax Margin (%)</i>	<i>46.9</i>	<i>(43.2)</i>	<i>47.4</i>			
<i>Net Margin (%)</i>	<i>46.9</i>	<i>44.3</i>	<i>47.4</i>			

Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-04-06	Neutral	0.78	0.74
2020-01-20	Neutral	0.97	1.00
2019-11-26	Neutral	0.96	1.02
2019-08-08	Neutral	0.97	1.07
2019-05-10	Neutral	1.02	1.09
2019-01-18	Neutral	1.05	1.11
2019-01-10	Neutral	1.10	1.09
2018-11-28	Neutral	1.15	1.07
2018-08-09	Neutral	1.20	1.18

Source: RHB, Bloomberg

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