MRCB-Quill REIT

1H17 Within Expectations

OUTPERFORM ↔

Price: **RM1.32**
Target Price: **RM1.41 ↔**

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1H17 realised net income (RNI) of RM45.2m was well within our and market expectations at 49% and 50%, respectively. 1H17 dividends of 4.23 sen was also within (50%). Maintain FY17-18E earnings of RM92.0-95.5m. Rating maintained at OUTPERFORM along with TP of RM1.41, based on FY18E GDPS of 8.40 sen and a +2.00ppt spread to our 10-year MGS target of 4.00%.

1H17 realised net income (RNI) of RM45.2m came in well within our and consensus expectations at 49% and 50%, respectively. 1H17 GDPU of 4.23 sen per unit (which includes a non-taxable portion of 0.08 sen) was also within expectations at 50% of our FY17E GDPU of 8.4 sen (6.4% gross yield).

Results Highlights. YoY-Ytd, RNI was up by 48%, spearheaded by top-line growth (+39%) from: (i) the acquisition of Menara Shell in Dec 2016, and (ii) positive reversions from QB3, WismaTechnip and QB2. This was despite higher financing cost (+24%) to part finance the acquisition of Menara Shell. Although RNI saw strong growth, EPU was slightly lower due to dilution post the completion of the placement in end FY16, while DPU was flattish at 4.23 sen. **QoQ,** top-line was down mildly by 1% likely due to slightly lower occupancy on tenant renewals, while RNI margins declined (-1.9ppt) due to higher property operating expense (+8%) likely on repairs and maintenance, causing RNI to decline by 5%.

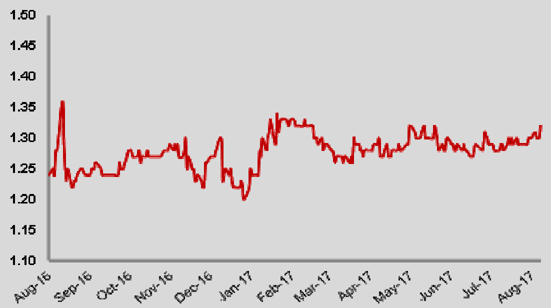
Outlook. FY17-18E leases up for expiry are minimal at 14.0-26.0% of net lettable assets (NLA) which are preferable in current times where the office market is facing an oversupply situation, given the risk of tenant attrition. As such, we are expecting low single-digit reversions. Additionally, we expect minimal capex in FY17-18 of RM10-12m for maintenance. The acquisition of Menara Shell was completed in Dec 2016 and is expected to accrete fully in FY17 which we have accounted for in our earnings model.

Maintain FY17-18E earnings of RM92.0-95.5m. Our FY17-18EGDPU of 8.4-8.4 sen (NDPU of 7.6-7.6 sen), suggests gross yields of 6.4-6.4% (net yields of 5.7-5.7%).

Maintain OUTPERFORM and TP of RM1.41 based on FY18E GDPS of 8.40 sen**.**Post rolling forward our valuation to FY18E (from FY17E), we make no changes to our TP as we expect flattish DPU YoY. To recap, we expect a slightly lower dividend pay-out of 96% in FY18 (vs. 98% in FY17), which is closer to historical pay-out ratios of 94-96%. Our TP is based on a +2.00ppt spread to the 10-year MGS target of 4.00%, implying a target yield of 6.0% vs. MREITs (>RM1b) under our coverage with an average of 5.5%. Our applied spread is above large cap MREITs (>RM1b) under our coverage (between +0.8ppt to +1.70ppt) as MQREIT is slightly smaller than large cap REITs, while the office segment may not be perceived well compared to retail and industrial assets due to oversupply issue. However, despite our conservative valuations, we are comfortable with our OUTPERFORM call as MQREIT is commanding attractive gross yields of 6.5% vs MREIT peers (>RM1b) under our coverage average of 5.8%.

Risks to our call include bond yield expansions or compressions and weaker-than-expected rental reversions.

Share Price Performance



KLCI	1,766.96
YTD KLCI chg	7.6%
YTD stock price chg	10.0%

Stock Information

Shariah Compliant	No
Bloomberg Ticker	MQREIT MK Equity
Market Cap (RM m)	1,409.8
Issued shares	1,068.0
52-week range (H)	1.35
52-week range (L)	1.18
3-mth avg daily vol:	319,789
Free Float	54%
Beta	0.6

Major Shareholders

Malaysian Resources Corporation Berhad	27.9%
Capitaland Limited	11.0%
Employees Provident Fund	7.3%

Summary Earnings Table

FY Dec (RM'm)	2016A	2017E	2018E
Turnover	131.8	182.9	193.7
EBIT	102.3	125.5	133.5
PBT	62.8	92.0	95.5
Net Profit	**62.8**	**92.0**	**95.5**
Core NP*	**59.2**	**92.0**	**95.5**
Consensus (CNP)	n.a.	90.1	93.8
Earnings Revision	n.a.	n.a.	n.a.
Core EPS (sen)	8.8	8.6	8.8
Core EPS growth (%)	-2%	-3%	3%
NDPS (sen)	7.5	7.6	7.6
BVPS (RM)	1.27	1.28	1.28
Core PER	15.0	15.4	15.0
Price/BV (x)	1.0	1.0	1.0
Net Gearing (x)	0.37	0.39	0.39
Net Div. Yield (%)	5.7	5.7	5.7

**Core NP refers to RNI*

OTHER POINTS

Result Highlight

FYE 31 Dec (RM'm)	2Q17	1Q17	QoQ	2Q16	YoY	1H16	1H17	YoY-Ytd
Gross revenue	45.1	45.6	-1%	32.6	YoY	65.2	90.6	39%
Prop Opex	-10.2	-9.4	8%	-6.9	48%	-14.1	-19.6	39%
NPI excl unrealised rental income	**33.4**	**36.1**	**-7%**	**24.3**	37%	**49.8**	**69.6**	**40%**
Interest Income	0.6	0.5	44%	0.4	**71%**	0.8	1.1	43%
Gain on divestment prop	0.0	0.0	n.a.	0.0	n.a.	0.0	0.0	n.a.
Surplus on revaluation	0.0	0.0	n.a.	0.0	n.a.	0.0	0.0	n.a.
Total Trust Income	**35.6**	**36.6**	**-3%**	**26.1**	36%	**51.9**	**72.1**	**39%**
Expenditure	-3.7	-3.7	0%	-3.2	**13%**	-6.0	-7.4	23%
Finance Cost	-9.8	-9.7	1%	-8.0	23%	-15.8	-19.6	24%
Total Expenditure	-13.5	-13.4	1%	-11.2	20%	-21.8	-26.9	23%
Income Before Tax	**22.0**	**23.2**	**-5%**	**14.9**	48%	**30.1**	**45.2**	**50%**
Tax	0.0	0.0	n.a.	0.0	**n.a.**	0.0	0.0	n.a.
Net Income	22.0	23.2	-5%	14.9	48%	30.1	45.2	50%
Realised Net income (RNI)	**22.0**	**23.2**	**-5%**	**15.4**	43%	**30.6**	**45.2**	**48%**
EPU (sen)	2.26	2.17	4%	2.33	**-3%**	4.63	4.43	-4%
DPU (sen)	4.23	0	n.a.	4.23	**0%**	4.23	4.23	0%
NAV/unit (RM)	1.32	1.30		1.36		1.36	1.32	
Gearing (x)	0.37	0.37		0.42		0.42	0.37	
NPI Margins	74%	79%		75%		76%	77%	
RNI Margins	49%	51%		47%		47%	50%	

Source: Company, Kenanga Research

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Peer Comparison

NAME	Price (11/8/17) (RM)	Mkt Cap (RMm)	PER (x) FY15/16	PER (x) FY16/17	PER (x) FY17/18	Est. NDiv. Yld. ** (%)	Historical ROE (%)	P/BV (x)	Net Profit (RMm) FY15/16	Net Profit (RMm) FY16/17	Net Profit (RMm) FY17/18	FY16/17 NP Growth (%)	FY17/18 NP Growth (%)	Target Price (RM)	Rating
M-REIT & PROPERTY INVESTMENT UNDER COVERAGE															
KLCCSS *	7.80	14,082	20.9	18.7	18.4	4.8%	9.2%	1.1	674.6	752.2	765.2	11.5%	1.7%	8.30	OUTPERFORM
Pavilion REIT	1.71	5,175	22.0	21.8	19.9	4.3%	8.0%	1.3	235.3	237.0	279.8	0.7%	18.1%	1.85	OUTPERFORM
IGB REIT*	1.74	6,104	21.8	21.3	20.1	4.8%	6.9%	1.6	277.8	286.7	303.9	3.2%	6.0%	1.89	OUTPERFORM
Sunway REIT*	1.74	5,124	19.2	17.4	17.2	4.7%	8.0%	1.2	267.4	294.0	298.0	9.9%	1.4%	1.90	OUTPERFORM
CapitaMalls (M) Trust*	1.48	3,011	18.4	17.3	16.9	5.2%	6.4%	1.1	171.1	173.8	178.4	1.6%	2.6%	1.65	OUTPERFORM
Axis REIT*	1.62	1,790	19.9	22.0	18.9	4.5%	8.9%	1.3	90.2	92.4	119.9	2.4%	29.8%	1.50	MARKET PERFORM
MRCB-Quill REIT	1.32	1,410	15.0	15.4	15.0	5.7%	8.4%	1.6	59.2	92.0	95.5	55.5%	3.8%	1.41	OUTPERFORM
** Core NP and Core PER*															
CONSENSUS NUMBERS															
YTL Hospitality REIT	1.19	2,028	n.a.	15.9	15.1	6.3%	-3.7%	0.8	111.0	131.5	138.0	18.5%	4.9%	1.46	BUY
Al-'Aqar Healthcare REIT	1.52	1,107	17.8	n.a.	n.a.	n.a.	7.1%	1.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
AmanahRaya REIT	0.94	539	13.7	14.9	14.0	5.9%	5.8%	0.8	35.9	38.6	n.a.	7.5%	n.a.	1.15	BUY
AmFIRST REIT	0.72	494	22.2	n.a.	n.a.	n.a.	2.5%	0.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
Hektar REIT	1.30	520.8	12.7	13.0	13.0	6.9%	7.2%	0.9	39.0	43.0	45.0	10.3%	4.7%	1.39	NEUTRAL
Tower REIT	1.20	336.6	17.4	n.a.	n.a.	n.a.	3.7%	0.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
UOA REIT	1.65	697.7	15.6	n.a.	n.a.	n.a.	6.4%	1.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
Atrium REIT	1.14	138.9	24.0	n.a.	n.a.	n.a.	3.3%	0.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
Al-Salam REIT	1.00	580.0	11.9	15.2	14.9	6.0%	8.2%	1.0	38.3	39.2	40.2	2.4%	2.7%	1.16	BUY
KIP REIT	0.94	472	32.2	n.a.	n.a.	n.a.	n.a.	0.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY

Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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