

07 Aug 2019

Hold

Price
RM1.07

Target Price
RM1.05

Market Data

Bloomberg Code	MQREIT MK
No. of shares (m)	1,071.8
Market cap (RMm)	1,146.8
52-week high/low (RM)	1.19 / 1.04
Avg daily turnover (RMm)	0.3
KLCI (pts)	1,611.8

Source: Bloomberg, KAF

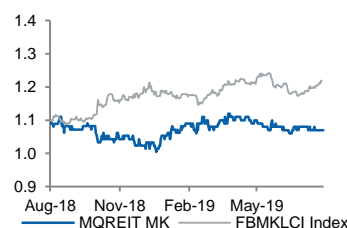
Major Shareholder (%)

MRCB	(27.8%)
KWSP	(12.1%)
CapitalLand Ltd	(10.9%)
Free Float	329.2

Source: Bloomberg, KAF

Performance

	3M	6M	12M
Absolute (%)	(2.7)	(1.8)	(5.3)
Rel Market (%)	(1.5)	2.5	4.6



Source: Bloomberg, KAF

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MRCB-Quill REIT

Below expectations; downgrade to Hold

We downgrade our rating on MRCB-Quill REIT (MQREIT) from Buy to Hold with a DDM-derived target price of RM1.05. 1H19 normalised earnings were down 15% yoy on lower revenue, and made up only 43% of our forecast. We cut FY19-20F earnings by 12-16%, as we fine-tune our rental assumptions. We do not think there would be a sequential pick-up in MQREIT's earnings over the next few quarters, given the office oversupply situation with less robust rental reversions. At the current price level, MQREIT offers FY19F yield of 6.5%, a yield spread of 290 bps against the 10-year MGS of 3.6%.

Financial Highlights

FYE Dec	2016	2017	2018	2019F	2020F
Revenue (RM mil)	131.8	180.1	173.4	162.6	160.6
Net Property Income	102.3	140.0	133.7	125.4	123.8
Realised Net profit (RM mil)	58.5	87.0	82.5	74.1	72.7
EPU (sen)	5.5	8.1	7.7	6.9	6.8
EPU Growth (%)	(32.2)	48.7	(5.5)	(10.2)	(1.9)
DPU (sen)	8.4	8.4	8.1	6.9	6.8
PE (x)	19.5	13.1	13.9	15.5	15.8
Div yield (%)	7.8	7.8	7.6	6.5	6.3
ROE (%)	5.5	5.0	5.3	5.4	5.3
Gearing (%)	37.1	37.3	37.6	37.6	37.6

Source: Company, KAF

1H19 results below expectations

MQREIT reported 2Q19 core earnings of RM16.9m, bringing 1H19 earnings to RM36.3m (-15% yoy). This made up only 43% of our previous full-year forecast, and 44% of consensus. The weaker-than-expected earnings was mainly due to lower rental revenue from Platinum Sentral, Wisma Technip and Quill Building 5, as well as the loss of income from Quill Building 8, after the disposal took place in April 2018. The group declared a DPU of 3.43 sen during the period, down 19% yoy (vs. 1H18: 4.23 sen).

Minimal leases to be renewed for the remainder of FY19; but at an unexciting rate

About 19% of MQREIT's total net lettable area (NLA) is due for renewal in FY19, of which c.11% has been renewed. However, we expect rental reversions to be unexciting as management continues to focus on tenant retention. In terms of renewals over the next few years, around 18% and 19% of leases by NLA are up for renegotiations in FY20 and FY21, respectively.

Tenant downtime

Major vacancies are at Platinum Sentral due to non-renewals of MyHSR and MCMC (>50k sq ft) and downsizing of a tenant at Wisma Technip (c.59k sq ft). We also learn that the key tenant at Quill Building 5, IBM, has moved out from the office building. While active negotiations are currently in progress to fill up the vacant spaces, there would likely be some earnings hiccup during the transition period, before management secures replacement tenants.

Downgrade to Hold; TP cut to RM1.05

We lower our core earnings by 12-16% for FY19-20F, as we fine-tune our rental assumptions post results. Consequently, our DPU estimates were revised downward to 6.8-6.9 sen over the period between FY19-20F. We do not think there would be a sequential pick-up in MQREIT's earnings over the next few quarters, given the office oversupply situation with less robust rental reversions. Furthermore, we do not expect Menara Celcom, which the group has ROFR from sponsor, to be injected any time soon.

All in, we downgrade our rating on MQREIT from a Buy to a Hold with a reduced TP of RM1.05 (from RM1.25), based on DDM valuation. At the current price level, MQREIT offers FY19F yield of 6.5%, a yield spread of 290 bps against the 10-year MGS of 3.6%.

Exhibit 1: Quarterly trend (previous full-year forecast)

(RM m)	2Q18	3Q18	4Q18	1Q19	2Q19	Change		Cumulative			KAF	
FYE 31 Dec	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	% qoq	% yoy	6M18	6M19	% chg	2019F	6M/F
Revenue	43.7	43.6	42.7	41.4	39.2	(5)	(10)	87.7	80.6	(8)	176.7	46
Property operating expenses	(10.0)	(9.9)	(10.0)	(9.3)	(9.7)	4	(3)	(19.8)	(19.0)	(4)	(40.5)	47
Net property income	33.6	33.7	32.7	32.0	29.5	(8)	(12)	67.9	61.5	(9)	136.2	45
Interest income	0.9	1.0	1.7	0.8	0.6	(32)	(36)	1.6	1.4	(13)	3.5	40
Trust expenses	(3.0)	(3.7)	(3.9)	(3.6)	(3.2)	(11)	7	(7.3)	(6.8)	(7)	(15.2)	45
Borrowing costs	(9.9)	(10.1)	(10.9)	(9.9)	(10.0)	1	0	(19.6)	(19.8)	1	(40.6)	49
Exceptional items	2.2	-	(5.4)	-	-			2.2	-	-		
Profit before tax	23.8	20.9	14.2	19.4	16.9	(13)	(29)	44.8	36.3	(19)	84.0	43
Tax	-	-	(6.1)	-	-			-	-		-	
Net profit	23.8	20.9	8.0	19.4	16.9	(13)	(29)	44.8	36.3	(19)	84.0	43
Normalized net profit	21.6	20.9	19.6	19.4	16.9	(13)	(22)	42.6	36.3	(15)	84.0	43

Source: Company, KAF

Exhibit 2: Earnings revision

	Original		Revised		Change	
	FY19F	FY20F	FY19F	FY20F	FY19F	FY20F
Revenue	176.7	180.3	162.6	160.6	-7.9%	-10.9%
NPI	136.2	139.0	125.4	123.8	-7.9%	-10.9%
Pretax profit	84.0	86.4	74.1	72.7	-11.8%	-15.8%
Net profit	84.0	86.4	74.1	72.7	-11.8%	-15.8%

Source: Company, KAF

Exhibit 3: PB Band chart



Source: Company, KAF, Bloomberg

Exhibit 4: PE Band chart



Source: Company, KAF, Bloomberg

MRCB-Quill REIT

Income Statement

FYE Dec (RMm)	2016	2017	2018	2019F	2020F
Gross rental income	131.8	180.1	173.4	162.6	160.6
Property operating expenses	(29.5)	(40.2)	(39.7)	(37.3)	(36.8)
Net property income	102.3	140.0	133.7	125.4	123.8
Non-property expenses	(12.4)	(14.9)	(14.9)	(14.0)	(13.8)
PBITDA	89.9	125.0	118.8	111.4	110.0
PBIT	89.9	125.0	118.8	111.4	110.0
Interest expense	(33.0)	(40.5)	(40.6)	(40.6)	(40.6)
Exceptional item	3.5	(18.2)	(3.2)	-	-
PBT	62.0	68.8	79.3	74.1	72.7
Tax	-	-	(6.1)	-	-
Distributable Income	62.0	68.8	73.1	74.1	72.7
Core Net Profit	58.5	87.0	82.5	74.1	72.7

Balance Sheet

FYE Dec (RMm)	2016	2017	2018	2019F	2020F
Investment Properties	2,225.0	2,181.4	2,179.3	2,179.3	2,179.3
Trade and other receivables	18.3	31.0	6.7	6.2	6.2
Cash and cash equivalents	54.1	76.0	85.8	85.2	85.1
Inventories	-	-	-	-	-
Total Assets	2,297.3	2,288.4	2,271.7	2,270.7	2,270.5
Payables and accruals	63.1	33.1	26.2	25.2	25.0
Short-term Borrowings	189.1	116.9	-	-	-
Long-term Borrowings	662.5	736.6	853.7	853.7	853.7
Payables and accruals	22.9	17.1	19.6	19.6	19.6
Unit holder's capital	1,231.9	1,231.9	1,235.9	1,235.9	1,235.9
Undistributed income to Reserves	127.8	152.8	136.4	136.4	136.4
Total unit holder's fund	1,359.7	1,384.7	1,372.3	1,372.3	1,372.3
Total liabilities and shareholder's fund	2,297.3	2,288.4	2,271.7	2,270.7	2,270.5

Cash flow Statement

FYE Dec (RMm)	2016	2017	2018	2019F	2020F
Pretax profit	62.0	68.8	79.3	74.1	72.7
Working Capital	90.2	124.8	119.6	111.4	110.0
Others	nm	nm	nm	nm	nm
Operating cash flows	105.9	128.2	105.7	110.8	109.9
Acquisitions	(648.7)	(0.4)	(3.8)	-	-
Enhancement exp.	1.6	2.1	3.9	3.2	3.2
Others	(0.9)	(6.6)	(33.9)	-	-
Investing cash flows	(647.9)	(4.8)	(33.8)	3.2	3.2
Issue of shares	487.9	-	4.0	-	-
Dividend paid	(56.9)	(72.6)	(89.8)	(74.1)	(72.7)
Borrowings	161.0	(0.3)	-	-	-
Others	(40.7)	(35.7)	(38.5)	(40.6)	(40.6)
Financing cash flow	551.4	(108.6)	(124.3)	(114.7)	(113.2)
Net inflows/(outflows)	9.3	14.7	(52.4)	(0.6)	(0.1)
Change in receivables	(12.1)	13.5	(1.0)	0.4	0.1
Change in payables	27.7	(10.1)	(12.9)	(1.0)	(0.2)

Source: Bloomberg, 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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