

HLIB Research

PP 9484/12/2012 (031413)

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HOLD (from Buy)

Target Price: **RM1.09**
Previously: **RM1.15**
Current Price: **RM1.07**

Capital upside	1.9%
Dividend yield	6.6%
Expected total return	8.5%

Sector coverage: REIT

Company description: MRCB-Quill REIT invests in office and retail buildings, business/technology parks, data processing centers, and car parking facilities primarily in Malaysia.

Share price


Historical return (%)	1M	3M	12M
Absolute	-0.9	-2.7	-5.3
Relative	3.9	-0.6	5.7

Stock information

Bloomberg ticker	MQREITMK
Bursa code	5123
Issued shares (m)	1,072
Market capitalisation (RM m)	1,147
3-mth average volume ('000)	306
SC Shariah compliant	No

Major shareholders

MRCB	27.8%
EPF	12.1%
Capita Commercial Trust	10.9%

Earnings summary

	FY18	FY19f	FY20f
FYE (Dec)			
PAT – core	84.7	76.3	77.9
EPU – core (sen)	7.9	7.1	7.3
P/E (x)	13.7	15.2	14.9

MRCB-Quill REIT

Softer than expected 2Q

MQREIT's 2Q19 core net profit of RM16.5m (-15.2% QoQ, -22.7% YoY) translated to 1H19 core net profit of RM35.9m (-15.2% YoY). The result was below both ours and consensus estimates due to lower than expected revenue contribution. Declared dividend of 3.43 sen per unit. Overall, we cut FY19/20/21 earnings forecasts by -7.3%/-5.9%/-5.8% respectively after factoring in lower revenue. We downgrade to HOLD with lower TP of RM1.09 (from RM1.15) based on targeted yield of 6.7%. That said, we note that MQREIT still has an attractive dividend yield offering of >6% (highest among REITs in our universe).

Falling below expectations. 2Q19 core net profit of RM16.5m (-15.2% QoQ, -22.7% YoY) translated into 1H19 core earnings of RM35.9m (-15.2% YoY). The results were below both ours and consensus expectations; at 44% and 43% of full year forecast respectively. The deviation was due to lower than expected revenue.

Dividend. Declared semi-annual dividend of 3.43 sen per unit (1H18: 4.23 sen) going ex on 22nd August 2019.

QoQ. Total gross revenue decreased by 6.3% to RM38.8m, which then led to a fall in core net profit to RM16.5m. The cutback was caused by poorer revenue contribution by Platinum Sentral (SPAD downsized & MyHSR moved out in May), Wisma Technip (tenant downsized) and QB5 (IBM moved out in April). However, this was slightly cushioned by the decline in administrative expenses.

YoY. Core net profit fell by 22.7% to RM16.5m. The drop was driven by lower revenue contribution; mainly from Platinum Sentral, Wisma Technip and QB5. However, the fall was marginally mitigated by the reduction in property operating expense (-3.4%) owing to cost efficiency, lower finance costs as well as lower manager's fees.

YTD. Revenue for 1H19 decreased by 8.3% to RM80.2m. Likewise, core net profit of RM35.9m showed a decrement of 15.2%. The lower revenue was due to (i) loss of revenue from QB8 (disposed in April 2018); (ii) lower occupancy rate from Platinum Sentral (SPAD downsized & MyHSR moved out), Wisma Technip (tenant downsized) and QB5 (IBM moved out). Nevertheless, it was cushioned by (i) lower property expenses (-3.8%) and (ii) lower finance costs (-0.2%).

Occupancy and gearing. Occupancy rate stayed at 89% (1Q19: 89%). The average debt to maturity decreased to 2.07 years from 2.32 years (1Q19), while average cost of financing was kept at 4.5%. As for gearing level, it tapered to 37.1% (1Q19: 37.5%), with a majority of its total borrowings being charged a fixed interest rate (76%).

Outlook. The lacklustre overall office market has dragged MQREIT's showing. Going forward, management will focus on cost discipline and tenant retention. We believe MQREIT will continue to sustain, despite the moving out of tenants in a few assets. While there are tenants moving out, new tenancies for approximately 89k sf of NLA have been executed which includes a co-working space. We expect income contribution from these new leases by 3Q/4Q19. However we do acknowledge that finding a tenant replacement in QB5 will take some time, as demand for office spaces in Cyberjaya is not as vibrant compared to areas in the KL fringes.

Forecast. We reduce our FY19/20/21 earnings forecasts by -7.3%/-5.9%/-5.8% respectively after factoring in lower rental income.

Downgrade to HOLD, TP: RM1.09. We cut our rating to HOLD with lower TP of RM1.09 (from RM1.15) based on targeted yield of 6.7%. Our valuation is based on the 2-year historical average yield spread between dividend yield and 10 year MGS.

Financial Forecast

All items in (RM m) unless otherwise stated

Balance Sheet

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Cash	76.0	85.8	83.1	92.3	91.4
Receivables	6.0	6.7	6.4	6.5	6.6
Investment properties	2,179.2	2,177.6	2,179.6	2,181.6	2,183.6
PPE	0.2	0.3	0.3	0.2	0.2
Others	27.0	1.3	1.3	1.3	1.3
Assets	2,288.4	2,271.7	2,270.7	2,282.0	2,283.1
Payables	20.3	16.1	15.1	15.4	15.6
Debt	853.5	853.7	853.7	864.7	865.7
Security deposits	29.2	29.2	29.2	29.2	29.2
Derivatives	0.7	0.4	0.4	0.4	0.4
Liabilities	903.7	899.4	898.4	909.7	910.9
Unitholders' capital	1,231.9	1,235.9	1,235.9	1,235.9	1,235.9
Undistributed profit	152.8	136.4	136.4	136.4	136.4
Equity	1,384.7	1,372.3	1,372.3	1,372.3	1,372.3

Income Statement

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Gross rental income	163.5	155.0	146.8	149.4	150.4
Car park income	12.8	13.2	13.9	14.2	14.4
Other revenue	5.2	4.4	5.4	5.6	5.7
Total revenue	181.5	172.5	166.1	169.1	170.5
Property opex	-40.2	-39.7	-37.3	-38.0	-38.3
Net property income	141.3	132.8	128.8	131.1	132.2
Other income	-16.0	1.9	2.7	2.7	3.0
Net invest income	125.4	134.7	131.5	133.8	135.1
Manager's fee	-13.5	-13.3	-13.0	-13.1	-13.2
Trustee's fee	-0.7	-0.7	-0.7	-0.7	-0.7
Finance costs	-40.5	-40.6	-40.6	-41.1	-41.2
Other non opex	-0.8	-0.9	-0.9	-0.9	-0.9
Profit before tax	69.9	79.3	76.3	77.9	79.2
Taxation	0.0	-6.1	0.0	0.0	0.0
Profit after tax	69.9	73.1	76.3	77.9	79.2
Core net profit	88.1	84.7	76.3	77.9	79.2
Distributable income	92.1	87.1	76.3	77.9	79.2
Consensus core net profit			82.8	84.4	85.6
HLIB/ Consensus			92%	92%	93%

Cash Flow Statement

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Profit before taxation	69.9	79.3	76.3	77.9	79.2
Finance costs	40.5	40.6	0.0	0.0	0.0
Depreciation	0.1	0.1	0.1	0.1	0.1
Fair value gain of assets	18.2	5.4	0.0	0.0	0.0
Interest income	-3.6	-4.3	0.0	0.0	0.0
Others	3.8	-14.6	-0.8	0.2	0.1
CFO	128.8	106.5	75.6	78.1	79.3
Capex	-0.4	-3.8	-2.0	-2.0	-2.0
Disposal / (purchase)	0.0	-0.2	0.0	0.0	0.0
Others	2.2	31.7	0.0	0.0	0.0
CFI	1.8	27.6	-2.0	-2.0	-2.0
Distribution paid	-72.6	-89.8	-76.3	-77.9	-79.2
Proceeds frm borrow'g	189.7	117.0	0.0	400.0	165.0
Repayment of borrow'g	-190.0	-117.0	0.0	-389.0	-164.0
Others	-35.7	-34.6	0.0	0.0	0.0
CFF	-108.6	-124.3	-76.3	-66.9	-78.2
Net cash flow	22.0	9.7	-2.7	9.2	-0.9

Valuation & Ratios

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Core EPU (sen)	8.2	7.9	7.1	7.3	7.4
P/E (x)	13.1	13.7	15.2	14.9	14.6
EBITDA	128.7	125.4	117.0	119.1	120.4
EBIT	128.6	125.3	116.9	119.0	120.3
EV	1,930.9	1,925.5	1,928.2	1,929.9	1,931.8
EV/EBITDA (x)	15.0	15.4	16.5	16.2	16.0
DPU (sen)	8.4	8.1	7.1	7.3	7.4
Dividend yield	7.8	7.5	6.6	6.7	6.8
NTA/ share (sen)	129.0	127.3	127.3	127.3	127.3
P/ NTA	0.8	0.8	0.8	0.8	0.8
BVPS (RM)	1.30	1.28	1.28	1.28	1.28
P/B (x)	0.8	0.8	0.8	0.8	0.8
EBITDA margin	70.9%	72.7%	70.4%	70.4%	70.6%
EBIT margin	70.9%	72.6%	70.4%	70.4%	70.6%
PBT margin	38.5%	45.9%	45.9%	46.1%	46.4%
Net margin	48.5%	49.1%	45.9%	46.1%	46.4%
ROE	5.0%	5.3%	5.6%	5.7%	5.8%
ROA	3.8%	3.7%	3.4%	3.4%	3.5%
Net gearing	33.97%	37.70%	33.94%	33.85%	33.91%

Assumptions

FYE Dec	FY19f	FY20f	FY21f
Gross rental income			
Quill Building 1 - DHL 1	5.0	5.1	5.2
Quill Building 4 - DHL 2	5.4	5.5	5.6
Quill Building 2 - HSBC	9.9	10.1	10.2
Quill Building 3 - BMW	5.8	5.9	6.0
Wisma Technip	8.7	9.5	9.6
Part of Plaza Mont' Kiara	3.7	3.8	3.9
Quill Building 5 - IBM	0.1	0.0	0.1
Tesco Building - Penang	14.7	14.9	15.2
Platinum Sentral	50.0	51.1	51.1
Menara Shell	43.5	43.5	43.5
Total:	146.8	149.4	150.4

Quarterly financial summary

FYE Dec	2Q18	1Q19	2Q19	QoQ (%)	YoY (%)
Gross revenue	43.4	41.4	38.8	-6.3	-10.7
Property opex	-10.0	-9.3	-9.7	-3.8	3.4
Net property income	33.4	32.0	29.1	-9.2	-12.8
Interest income	0.9	0.8	0.6	-31.7	-35.5
Revaluation gains	0.0	0.0	0.0	0.0	0.0
Net investment income	36.4	32.9	29.6	-9.8	-18.6
Finance costs	-9.9	-9.9	-9.7	1.3	2.1
Valuation fees	-0.1	-0.1	-0.1	0.0	-57.5
Administrative expenses	0.6	-0.1	0.0	>100	104.7
TOTAL EXPENSES	-12.9	-13.5	-13.2	2.0	-1.9
Normalised PBT	21.3	19.4	16.5	-15.2	-22.7
Normalised PAT	21.3	19.4	16.5	-15.2	-22.7
EPU (realised)	2.0	1.8	1.5	-15.2	-22.7
DPU (sen)	4.2	0.0	3.4	NM	NM

Figure #1 **Quarterly results comparison**

FYE Dec (RM m)	2Q18	1Q19	2Q19	QoQ	YoY	1H18	1H19	YoY (%)
Gross revenue	43.4	41.4	38.8	-6.3%	-10.7%	87.5	80.2	-8.3%
Property operating expenses	-10.0	-9.3	-9.7	3.8%	-3.4%	-19.8	-19.0	-3.8%
Net property income	33.4	32.0	29.1	-9.2%	-12.8%	67.6	61.1	-9.6%
Interest income	0.9	0.8	0.6	-31.7%	-35.5%	1.6	1.4	-13.2%
Gain on divestment	2.2	0.0	0.0	NM	NM	2.2	0.0	100.0%
Net investment income	36.4	32.9	29.6	-9.8%	-18.6%	71.5	62.5	-12.5%
Finance costs	-9.9	-9.9	-9.7	-1.3%	-2.1%	-19.6	-19.6	-0.2%
Valuation fees	-0.1	-0.1	-0.1	0.0%	-57.2%	-0.2	-0.2	5.9%
Administrative expenses	0.6	-0.1	-0.0	-54.0%	-104.7%	-0.1	-0.1	-1.3%
Total expenses	-12.9	-13.5	-13.2	-2.0%	1.9%	-27.0	-26.7	-1.1%
Core PBT	21.3	19.4	16.5	-15.2%	-22.7%	42.3	35.9	-15.2%
Core PAT	21.3	19.4	16.5	-15.2%	-22.7%	42.3	35.9	-15.2%
Distributable adjustments	1.0	0.0	0.9	>100%	-10.0%	2.4	0.9	-62.3%
Distributable income	22.3	19.4	17.4	-10.6%	-22.1%	44.7	36.8	-17.7%
Core EPU (sen)	2.0	1.8	1.5	-15.2%	-22.7%	3.9	3.3	-15.2%
DPU (sen)	4.2	0.0	3.4	NM	NM	4.2	3.4	-18.9%

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Published & printed by:

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BUY	Expected absolute return of +10% or more over the next 12 months.
HOLD	Expected absolute return of -10% to +10% over the next 12 months.
SELL	Expected absolute return of -10% or less over the next 12 months.
UNDER REVIEW	Rating on the stock is temporarily under review which may or may not result in a change from the previous rating.
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