

20 January 2020

Property | REITs

MRCB-Quill REIT (MQREIT MK)

Neutral (Maintained)

Less Like Platinum, More Like Gold

Target Price (Return) MYR0.97 (-3%)
 Price: MYR1.00
 Market Cap: USD264m
 Avg Daily Turnover (MYR/USD) 0.18m/0.05m

- **Maintain NEUTRAL with new TP of MYR0.97 from MYR0.96**, 3% downside. FY19 earnings were well within expectations. Lower contribution from commercial assets for yet another quarter dragged its full-year performance. Against the backdrop of an unexciting office segment, we believe MRCB-Quill REIT's outlook remains lukewarm at this juncture – with Platinum Sentral's drop in value to MYR686m from MYR724m in 4Q19 as a testament to that. We foresee rental reversions going into negative territory for tenant-retention.

- **Earnings in line with expectations.** 4Q19 core earnings of MYR18.6m (+5.5% QoQ, -4.9% YoY) brought core net profit for FY19 to MYR72.1m. At 102%/99% of our/consensus full-year estimates, results are deemed in line. The drop in earnings and revenue was due to lower rental contribution from Platinum Sentral, Wisma Technip and Quill Building 5 (QB5), which had all seen a decline in occupancy rates throughout FY19 – in addition to a loss of revenue resulting from the disposal of Quill Building 8 (QB8) in Apr 2018.

4Q19 net loss was due to Platinum Sentral being valued lower at MYR686m from MYR724m after having imputed a more reasonable reversion rate which better reflects the sluggish market and supply glut. Full-year DPU amounted to 6.80 sen vs 8.08 sen in FY18, translating into a yield of 6.8%.

- **Only 2% non-renewal in FY19.** The average occupancy rate across all of MQREIT's assets stood at 90% as at end-FY19, a marginal increase from 89% in 3Q19. Of the 19% total NLA up for renewal in 2019, 17% was renewed as at year-end. The 2% that did not renew included tenants at Plaza Mont Kiara and Platinum Sentral. Regardless, we believe the impact of non-renewal will be cushioned by the arrival of new tenants occupying c.70,000 sqf of NLA in Platinum Sentral and 28,000 sqf in Menara Shell – which should be reflected in its occupancy rate in 1Q20. Currently, Platinum Sentral and Menara Shell are at 84% and 95% occupancy respectively, a slight dip from the previous quarter of 88% and 96%.

- **We maintain our cautious stance** on MQREIT given the fact that 18% of leases (of total NLA) are up for renewal in FY20. With the trend of lease termination demonstrated by Transit Acquirer SB, IBM, MyHSR Corp SB and SPAD in FY19, we believe the prospects for MQREIT at this juncture are rather bleak – further emphasised by muted activity in the office segment. Note that QB5 remained 100% vacant as of Dec 2019. The current blended rental reversion rate maintained by the REIT is flat, but we foresee the possibility of a change to negative in the future in an effort to retain tenants.

- **We leave our forecasts unchanged**, and introduce our FY22F earnings of MYR72m; TP increases slightly to MYR0.97 after some house-keeping adjustments. An upside risk is the possibility of a yield accretive acquisition in the future. A persistent office space glut poses as a downside risk.

Forecasts and Valuations	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (MYRm)	173	162	148	148	148
Net property income (MYRm)	134	123	114	114	114
Reported net profit (MYRm)	73	29	71	71	72
Total distributable income (MYRm)	85	72	71	71	72
DPS (MYR)	0.08	0.07	0.07	0.07	0.07
P/B (x)	0.78	0.81	0.81	0.81	0.81
Dividend Yield (%)	8.08	6.80	6.60	6.59	6.65
Return on average equity (%)	5.33	2.20	5.40	5.39	5.43
Return on average assets (%)	3.22	1.32	3.23	3.22	3.25
Gross gearing (%)	37.58	37.75	37.73	37.70	37.68

Source: Company data, RHB

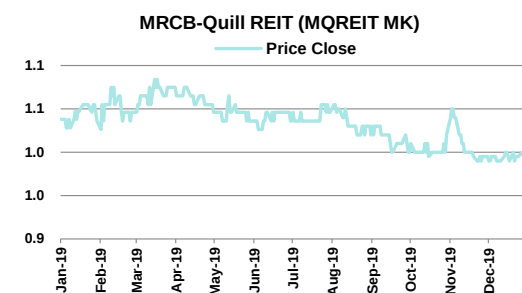
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	0.0	0.5	0.0	(6.5)	(10.7)
Relative	(0.4)	(0.7)	(1.4)	(2.8)	(5.5)
52-wk Price low/high (MYR)	0.985 - 1.13				



Source: Bloomberg

Financial Exhibits

Asia		Financial summary	Dec-18	Dec-20F	Dec-21F	Dec-22F
Malaysia		Recurring EPS (MYR)	0.08	0.07	0.07	0.07
REIT		EPS (MYR)	0.079	0.067	0.067	0.067
MRCB-Quill REIT		DPS (MYR)	0.081	0.068	0.066	0.067
MQREIT MK		BVPS (MYR)	1.28	1.23	1.24	1.24
		Weighted avg adjusted shares (m)	1,071.8	1,071.8	1,071.8	1,071.8
Shareholding (%)		Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F
Malaysian Resources	27.8	Recurring P/E (x)	12.6	14.9	15.0	14.9
Employees Provident Fund	12.1	P/E (x)	12.6	14.9	15.0	14.9
Capitaland	10.9	P/B (x)	0.78	0.81	0.81	0.81
Valuation basis		FCF Yield (%)	10.9	10.9	9.9	9.4
Dividend discount model (DDM)		Dividend yield (%)	8.1	6.8	6.6	6.7
Key drivers		EV/EBITDA (x)	13.7	20.6	16.0	16.1
Higher-than-expected demand for office space and inorganic growth opportunities arising from MRCB and Quill Group.		EV/EBIT (x)	13.7	20.6	16.0	16.1
Key risks		Income statement (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F
An upside risk is the possibility of a yield accretive acquisition in the future. Downside risk includes a prolonged oversupply of office space that could lead to a lower occupancy rate and negative rental reversion.		Total turnover	173	162	148	148
		Gross profit	134	123	114	114
		EBITDA	135	89	117	117
		Depreciation and amortisation	-	-	-	-
		Operating profit	135	89	117	117
		Net interest	(41)	(40)	(35)	(35)
		Income from associates & JVs	-	1	2	3
		Exceptional income - net	(3)	(37)	-	-
		Pre-tax profit	79	35	71	71
		Taxation	(6)	(6)	-	-
		Minority interests	-	1	2	3
		Recurring net profit(adj)	85	72	71	71
Company Profile		Cash flow (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F
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		Change in working capital	(4)	(4)	(4)	(5)
		Cash flow from operations	117	106	101	101
		Capex	(2)	(2)	(2)	(2)
		Cash flow from investing activities	4	1	1	1
		Dividends paid	(88)	(80)	(72)	(71)
		Cash flow from financing activities	(129)	(120)	(107)	(106)
		Cash at beginning of period	52	43	31	27
		Net change in cash	(8)	(12)	(5)	(4)
		Ending balance cash	43	31	27	23
		Balance sheet (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F
		Total cash and equivalents	86	63	27	23
		Tangible fixed assets	2,179	2,144	2,144	2,144
		Intangible assets	-	-	-	-
		Total investments	-	-	-	-
		Total other assets	1	1	38	44
		Total assets	2,272	2,214	2,215	2,216
		Short-term debt	-	333	333	333
		Total long-term debt	854	503	503	503
		Other liabilities	46	54	55	56
		Total liabilities	899	890	891	892
		Shareholders' equity	1,372	1,323	1,324	1,325
		Minority interests	-	1	2	3
		Total equity	1,372	1,323	1,324	1,325
		Net debt	768	772	809	813
		Total liabilities & equity	2,272	2,214	2,215	2,216
		Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F
		Revenue growth (%)	(3.7)	(6.5)	(8.6)	(0.3)
		Recurrent EPS growth (%)	(4.0)	(14.9)	(0.9)	(0.1)
		Gross margin (%)	77.1	75.8	77.1	77.1
		Operating EBITDA margin (%)	77.7	55.1	79.3	79.3
		Net profit margin (%)	48.8	44.5	48.3	48.4
		Dividend payout ratio (%)	102.1	101.0	99.0	99.0
		Capex/sales (%)	1.2	1.2	1.4	1.4
		Interest cover (x)	3.3	2.3	3.3	3.3

Source: Company data, RHB

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Results at a Glance

Figure 1: MQREIT's 4Q19 results summary

FYE Dec (MYRm)	4Q18	3Q19	4Q19	QoQ (%)	YoY (%)	FY18	FY19	YoY (%)	Comments
Revenue	42.7	39.9	42.0	5.2	(1.6)	173.4	162.1	(6.5)	Lower YoY because of lower revenue generated from Platinum Sentral, QB5 and Wisma Technip.
Net property income (NPI)	32.7	30.2	31.5	4.3	(3.6)	133.7	122.8	(8.1)	
Interest expense	(10.9)	(9.7)	(10.3)	5.4	(5.7)	(40.6)	(39.6)	(2.5)	
Interest income	1.7	0.7	1.1	60.3	(33.7)	4.3	3.2	(25.5)	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI	(5.4)	0.0	(36.7)	nm	575.9	(3.2)	(36.7)	1,034.5	
Others	(3.9)	(3.5)	(3.8)	7.2	(2.3)	(14.9)	(14.4)	(3.5)	
Pretax profit	14.2	17.6	(18.1)	(202.9)	(227.9)	79.3	35.4	(55.4)	
Tax	(6.1)	0.0	(6.2)	nm	1.7	(6.1)	(6.2)	1.7	
Minority Interest	(6.1)	0.0	(6.2)	nm	1.7	(6.1)	(6.2)	1.7	
Net Profit	8.0	17.6	(24.4)	(238.2)	(403.0)	73.1	29.1	(60.2)	
Core Profit	19.6	17.6	18.6	5.5	(4.9)	84.7	72.1	(14.8)	Within expectations
Core earnings per unit (sen)	1.83	1.65	1.74	5.5	(4.9)	7.91	6.73	(14.9)	
Dividends per unit (sen)	3.85	0.00	3.37	nm	(12.5)	8.08	6.80	(15.8)	
<i>NPI Margin (%)</i>	76.6	75.6	75.0			77.1	75.8		
<i>Pretax Margin (%)</i>	33.2	44.2	(43.2)			45.7	21.8		
<i>Net Margin (%)</i>	45.9	44.2	44.3			48.8	44.5		

Source: Company data, RHB

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