

HLIB Research

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BUY (Maintain)

Target Price: **RM0.96**
Previously: **RM0.96**
Current Price: **RM0.86**

Capital upside	11.6%
Dividend yield	8.3%
Expected total return	19.9%

Sector coverage: REIT

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

Share price


Historical return (%)	1M	3M	12M
Absolute	9.6	11.0	-13.6
Relative	2.0	3.3	-16.9

Stock information

Bloomberg ticker	MQREITMK
Bursa code	5123
Issued shares (m)	1,072
Market capitalisation (RM m)	922
3-mth average volume ('000)	352
SC Shariah compliant	No

Major shareholders

MRCB	27.8%
Employees Provident Fund	12.1%
CapitalLand Ltd	10.9%

Earnings summary

FYE (Dec)	FY19	FY20f	FY21f
PAT – core (RM m)	72.1	78.3	79.5
EPD – core (sen)	6.7	7.3	7.4
P/E (x)	12.8	11.8	11.6

MRCB-Quill REIT

Earnings to remain resilient

MQREIT shared that the recently improved 3Q20 showing was mainly boosted by new tenancies, positive rental reversion in some of the properties as well as the absence of rental rebates to retail tenants. Portfolio occupancy remains strong at 90.5% and management expect it to remain stable. Although WFH practices have been implemented throughout some period of the year, MQREIT has not seen their tenants downsizing their space. Besides, management saw some of their MNCs tenants were undergoing renovation in view of physical distancing practices. We believe MQREIT will be able to sustain its earnings through high occupancies (at least in the near term), due to tenancy with big corporations and MNCs. Maintain our forecast, BUY call with an unchanged TP of RM0.96.

We recently organized a conference call with MQREIT. Following are some key takeaways.

New tenancies have lifted their earnings... Management shared the recently improved 3Q20 profit performance of RM21.5m (+12.6% QoQ, +21.8% YoY), which brought 9M20 core earnings to RM60.3m (+12.8% YoY), were partly buoyed by new tenancies of few properties. Such properties are (i) Menara Shell (Google has taken up c.30k sq ft of space), (ii) Platinum Sentral (co working space operator has increased its space of about 23k sq ft), and (iii) Plaza Mont Kiara.

...as well as positive rental reversion. Apart from new tenancies, the company also achieved a positive rental reversion YTD that contributed to the better performance during the year. This comes from step-up in rental reversion from their tenant, Shell in Menara Shell, Tesco buildings as well as anchor tenants SME Corp in Platinum Sentral. For FY21, management is expecting a marginal increase in reversion coming from the 21% of total net lettable area (NLA) that are due for renewal in FY21.

Chances of tenancy renewal are high. As at 3Q20, lease negotiations for approximately 241k sq ft were concluded with 216k sq ft renewed while 25ksq ft not renewed. This translates to a total renewal rate to 90% as at 3Q 2020. About 130k sq ft of leases is due in 4Q20 predominantly from SBM Malaysia in Platinum Sentral (c.67k sq ft). For Menara Shell, c.25k sq ft of NLA are due for renewal, of which 18k sq ft is coming from Saipem Asia. The rest are from Wisma Technip (c.16k sq ft) as well as a tenant in QB3 (c.14k sqft) which is due for renewal. Active negotiations for renewal of the remaining leases are currently in progress and management assured that majority of this will be renewed due to their tenants' nature of business (big corporations and MNCs).

Occupancy remains strong at 90.5%, as of 3Q20 (a slight uptick from 90.4% in 2Q20). Out of 9 properties (excluding recently proposed disposal of QB5), 4 properties have 100% occupancy. The rest of properties, for instances, Menara Shell, QB3 BMW, Wisma TechnipFMC, Plaza Mont Kiara and Platinum Sentral have occupancy of approximately 99%, 91%, 90%, 89% and 84% respectively. Although WFH practices have been implemented throughout some periods of the year, MQREIT has not seen their tenants downsizing their space. Besides, management observed that some of their MNCs tenants were undergoing renovation in view of physical distancing practices, to prepare their employees when they come back to office. After all, management believes that certain work discussions are more efficient to be done at office, hence ensuring a resilient demand in office space.

Other updates. Notably, no rental rebates were given to retail tenants in Plaza Mont Kiara during 3Q20. Management has not laid out any possibility of rental rebates in 4Q20 as they observed that some of the businesses have already picked up during end-Nov and early-Dec. Other than that, weighted average lease expiry (WALE) has

increased to 4.62 years in 3Q20 (from 4.4 years in 2Q20) attributable from renewal of tenancies by DHL in QB1 and QB4.

Outlook. We believe MQREIT will continue to register resilient earnings in 4Q supported by stable occupancy across its assets. We note that the current office market outlook for office REITs remains lacklustre due to unabated oversupply of office in KL city. However, we believe MQREIT will be able to sustain its earnings, at least in the near term, due to their tenancy with big corporations and MNCs.

Forecast. Unchanged as the meeting yielded no surprises.

Maintain BUY, with unchanged of TP: RM0.96 based on FY21 forward DPU on targeted yield of 7.6%, derived from its 2 years historical average yield spread of MQREIT and 10-year MGS. We like MQREIT for its attractive dividend yield of 8.3% (highest among REITs in our universe) and its relatively more resilient earnings amid Covid-19 given minimal retail exposure unlike other mall based REITs.

Financial Forecast

All items in (RM m) unless otherwise stated

Balance Sheet

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
Cash	85.8	63.3	73.3	74.5	74.6
Receivables	6.7	6.3	6.4	6.6	6.6
Investment properties	2,177.6	2,143.0	2,145.0	2,147.0	2,149.0
PPE	0.3	0.4	0.2	0.1	0.1
Others	1.3	0.8	0.8	0.8	0.8
Assets	2,271.7	2,213.7	2,225.7	2,229.0	2,231.1
Payables	16.1	15.7	15.2	15.8	15.4
Debt	853.7	835.7	846.7	847.7	848.7
Security deposits	29.2	38.5	38.5	38.5	38.5
Derivatives	0.4	0.0	0.0	0.0	0.0
Liabilities	899.4	889.9	900.3	902.0	902.5
Unitholders' capital	1,235.9	1,235.9	1,235.9	1,235.9	1,235.9
Undistributed profit	136.4	87.6	89.2	90.8	92.4
Equity	1,372.3	1,323.5	1,325.1	1,326.6	1,328.3
Total Liabilities & Equity	2,271.7	2,213.7	2,225.7	2,229.0	2,231.1

Income Statement

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
Gross rental income	155.0	144.1	151.0	154.7	155.6
Car park income	13.2	13.0	10.6	10.9	11.2
Other revenue	4.4	3.9	3.0	3.0	3.1
Total revenue	172.5	161.0	164.6	168.7	169.8
Property opex	-39.7	-39.2	-37.9	-39.6	-38.4
Net property income	132.8	121.7	126.7	129.1	131.5
Other income	1.9	-32.4	2.4	2.8	2.8
Net invest income	134.7	89.3	129.1	131.9	134.3
Manager's fee	-13.3	-12.8	-12.8	-13.0	-13.0
Trustee's fee	-0.7	-0.7	-0.7	-0.7	-0.7
Finance costs	-40.6	-39.6	-36.4	-37.7	-37.8
Other non opex	-0.9	-0.9	-0.9	-0.9	-0.9
Profit before tax	79.3	35.4	78.3	79.5	81.9
Taxation	-6.1	-6.2	0.0	0.0	0.0
Profit after tax	73.1	29.1	78.3	79.5	81.9
Core net profit	84.7	72.1	78.3	79.5	81.9
Distributable income	87.1	73.0	78.3	79.5	81.9
Consensus core net profit			74.8	75.5	76.7
HLIB/ Consensus			105%	105%	107%

Cash Flow Statement

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
Profit before taxation	79.3	35.4	78.3	79.5	81.9
Finance costs	40.6	39.6	0.0	0.0	0.0
Depreciation	0.1	0.2	0.2	0.1	0.1
Fair value gain of assets	5.4	36.7	0.0	0.0	0.0
Interest income	-4.3	-3.2	0.0	0.0	0.0
Others	-14.6	2.2	-0.7	0.5	-0.5
CFO	106.5	110.9	77.7	80.1	81.5
Capex	-3.8	-2.1	-2.0	-2.0	-2.0
Disposal / (purchase)	-0.2	-0.2	0.0	0.0	0.0
Others	31.7	2.7	0.0	0.0	0.0
CFI	27.6	0.4	-2.0	-2.0	-2.0
Distribution paid	-89.8	-78.0	-76.7	-77.9	-80.3
Proceeds frm borrow'g	117.0	35.0	400.0	165.0	165.0
Repayment of borrow'g	-117.0	-54.0	-389.0	-164.0	-164.0
Others	-34.6	-36.8	0.0	0.0	0.0
CFF	-124.3	-133.8	-65.7	-76.9	-79.3
Net cash flow	9.7	-22.5	10.0	1.2	0.2
Beginning cash	76.0	85.8	63.3	73.3	74.5
Ending cash	85.8	63.3	73.3	74.5	74.6

Valuation & Ratios

FYE Dec	FY18	FY19	FY20f	FY21f	FY22f
Core EPU (sen)	7.9	6.7	7.3	7.4	7.6
P/E (x)	10.9	12.8	11.8	11.6	11.2
EBITDA	125.4	111.8	114.8	117.3	119.8
EBIT	125.3	111.7	114.7	117.2	119.7
EV	1,689.7	1,694.2	1,695.2	1,695.0	1,695.8
EV/EBITDA (x)	13.5	15.1	14.8	14.4	14.2
DPU (sen)	8.1	6.8	7.2	7.3	7.5
Dividend yield	9.4	7.9	8.3	8.5	8.7
NTA/ share (sen)	127.3	122.7	122.9	123.0	123.2
P/ NTA	0.7	0.7	0.7	0.7	0.7
BVPS (RM)	1.28	1.23	1.24	1.24	1.24
P/B (x)	0.7	0.7	0.7	0.7	0.7
EBITDA margin	72.7%	69.5%	69.8%	69.6%	70.5%
EBIT margin	72.6%	69.4%	69.7%	69.5%	70.5%
PBT margin	45.9%	22.0%	47.6%	47.1%	48.2%
Net margin	49.1%	44.8%	47.6%	47.1%	48.2%
ROE	5.3%	2.1%	5.9%	6.0%	6.2%
ROA	3.7%	3.3%	3.5%	3.6%	3.7%
Net gearing	33.80%	34.89%	34.75%	34.69%	34.69%

Assumptions

FYE Dec	FY19	FY20f	FY21f	FY22f
Gross rental income				
Quill Building 1 - DHL 1	5.0	5.0	5.1	5.1
Quill Building 4 - DHL 2	5.4	5.4	5.5	5.6
Quill Building 2 - HSBC	9.9	9.9	10.1	10.1
Quill Building 3 - BMW	5.8	5.8	5.8	5.9
Wisma Technip	8.0	8.4	8.9	8.9
Part of Plaza Mont' Kiara	3.7	3.0	3.0	3.1
Quill Building 5 - IBM	0.0	0.0	0.0	0.0
Tesco Building - Penang	14.7	14.9	15.2	15.3
Platinum Sentral	48.3	50.2	51.7	52.0
Menara Shell	44.4	48.4	49.4	49.6
Total:	145.2	151.0	154.7	155.6

Quarterly financial summary

FYE Dec	3Q19	2Q20	3Q20	QoQ (%)	YoY (%)
Gross Revenue	39.9	40.1	42.1	5%	5%
Property operating expen	-9.7	-9.1	-9.3	2%	-4%
Net Property Income	30.2	31.0	32.7	6%	8%
Interest income	0.7	0.5	0.6	16%	-10%
Net Investment Income	30.9	31.5	33.4	6%	8%
Total Expenses	-13.3	-12.4	-11.9	-4%	-10%
Normalised PBT	17.6	19.1	21.5	13%	22%
Normalised PAT	17.6	19.1	21.5	13%	22%
Distributable income	17.6	19.1	21.5	13%	22%
EPU (realised)	1.6	1.8	2.0	13%	22%
DPU (sen)	0.0	3.4	0.0	N.M.	N.M.

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Stock rating guide

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.
NOT RATED	Stock is not or no longer within regular coverage.

Sector rating guide

OVERWEIGHT	Sector expected to outperform the market over the next 12 months.
NEUTRAL	Sector expected to perform in-line with the market over the next 12 months.
UNDERWEIGHT	Sector expected to underperform the market over the next 12 months.

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