

Company Focus

Quill Capita Trust

Bloomberg: QUIL MK | Reuters: QCAP.KL

Refer to important disclosures at the end of this report

Malaysia Equity Research

8 Apr 2015

HOLD RM1.22 KLCI : 1,856.51

Price Target : 12-month RM 1.25

Shariah Compliant: No

Reason for Report : Earnings, DPU adjustment

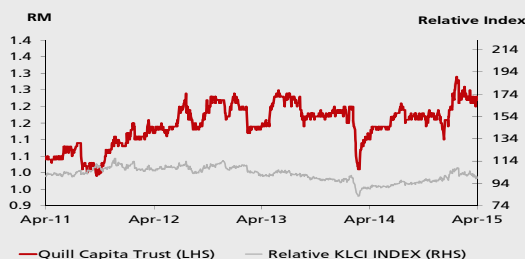
Potential Catalyst: Replenishing occupancy, asset injections

Where We Differ: Higher property and management cost assumptions

Analyst

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Price Relative



Forecasts and Valuation

FY Dec (RM m)	2014A	2015F	2016F	2017F
Gross Revenue	70	109	124	129
Net Property Inc	53	86	98	101
Total Return	40	50	57	58
Distribution Inc	33	50	57	58
EPU (sen)	10.3	8.4	8.6	8.8
EPU Gth (%)	10	(19)	2	3
DPU (sen)	8.4	8.4	8.6	8.8
DPU Gth (%)	0	0	2	3
NAV per shr (sen)	138.7	133.5	133.6	133.5
PE (X)	11.8	14.5	14.3	13.9
Distribution Yield (%)	6.9	6.9	7.0	7.2
P/NAV (x)	0.9	0.9	0.9	0.9
Aggregate Leverage (%)	36.3	44.4	44.7	45.0
ROAE (%)	7.5	7.0	6.4	6.6

DPU Chng (%):	-	1	2
Consensus DPU (sen):	8.5	8.7	8.9
Other Broker Recs:	B: 2	S: 0	H: 3

ICB Industry : Real Estate

ICB Sector: Real Estate Investment Trusts

Principal Business: An office-focused real estate investment trust with assets primarily in Petaling Jaya and Cyberjaya, with a small presence in Penang. The injection of Platinum Sentral gives it significant exposure to Kuala Lumpur.

Source of all data: Company, AllianceDBS, Bloomberg Finance L.P.

Upsizing complete

- Finalises placement and acquisition of Platinum Sentral, contribution from 2Q15 onwards
- Tidier portfolio with injection and disposal of QB10, but office space outlook remains subdued
- HOLD for decent 6.9% yield

MRCB makes its entrance. After fulfilling the conditions precedent, Quill Capita Trust (QCT) is ready to recognise Platinum Sentral (PS) contributions from 2Q15 onwards. Malaysian Resources Corp (MRCB) will come in as a major unitholder with 31% stake after the placement of 260m units, in addition to a 41% stake in the REIT management company and 3 out of 7 board seats.

New shine to asset portfolio. The PS assets take QCT's portfolio asset value to a respectable RM1.6bn, with about 1.7m sq ft of NLA across 10 assets. Also, portfolio occupancy will reach c.95% after taking into account PS' fully-occupied office space and the disposal of the vacant Quill Building 10 (QB10). With the larger portfolio, we estimate lease expiries by NLA (for the rest of 2015) will drop from 24% of total occupied space to 17%.

Temperate growth for now. We reiterate our view of a challenging office space market, and hence, expect mild rental and earnings growth in the near term. While QCT will have the right of first refusal to MRCB's investment properties, the post-PS injection gearing is now at 45%, close to the 50% ceiling as per REIT guidelines. This means future acquisition of sizeable properties may involve the issue of new units.

We adjusted our forecasts for the revised PS contribution period (previously full-year for FY15), specifics of the share placement, as well as the QB10 disposal. This led us to revise DPU by 0%/1%/2% for FY15/16/17F. We assumed 100% payout of distributable income going forward as management guided DPU will at least match that in FY14.

HOLD for decent 6.9% yield. The forward yield is attractive relative to other REITs under our coverage, especially given QCT's larger size now. Maintain RM1.25 TP (DDM, cost of equity 8%, TG 1%).

At A Glance

Issued Capital (m shrs)	661
Mkt. Cap (RMm/US\$m)	807 / 222
Major Shareholders	
Malaysian Resources Corp (%)	31.1
Capitaland Financial Limited (%)	17.7
Quill group of companies (%)	17.7
Free Float (%)	33.5
Avg. Daily Vol.('000)	337

INVESTMENT THESIS

Profile	Rationale
Quill Capita Trust (proposed to change name to MRCB-Quill REIT) is a real estate investment trust that focuses on office property. Its assets are primarily in Petaling Jaya and Cyberjaya, with a small presence in Penang. The entry of Platinum Sentral and MRCB will give the trust exposure to more prime assets in Kuala Lumpur.	Upgrade asset base - The injection of Platinum Sentral is a significant milestone as it will increase portfolio asset value by 89%. The asset is also in a prime location in the Kuala Lumpur city centre, which is reflected in the higher rents it commands. MRCB sponsorship - The injection will see the entry of Malaysian Resources Corp (MRCB) as a major shareholder with 31% stake. This would give the REIT the first right of refusal to MRCB's stable of investment properties, as well as other assets under development. - MRCB's investment properties include: Menara Shell (office); Ascott Sentral (service apartments); Plaza Alam Sentral (retail); Sooka Sentral (lifestyle/retail); and Kompleks Sentral (industrial).
Valuation	Risks
We have a HOLD recommendation for Quill Capita Trust with RM1.25 price target based on the DDM model and assuming 8% cost of equity and 1% terminal growth rate.	Soft office rental market - The office sector remains tepid due to excess supply, especially in Kuala Lumpur, Klang Valley and Cyberjaya, where the REIT has exposure. Reversion potential is relatively weak and occupancies could be a risk factor. 17% of leases by NLA are expiring in 2015, though management has informed that the bulk of it (c.70%) comes from a single tenant (DHL) and that they are reasonably confident of securing their renewal. High gearing and borrowing costs - The borrowings required to enable the Platinum Sentral injection would result in gearing rising to 45%, near the 50% regulatory cap. Borrowing costs will rise accordingly, although most of its borrowings are at fixed rate, and it will finalise a new MTN programme to keep rates at 4.6%-4.8% over the medium term.

Source: AllianceDBS

Acquisition wrapped up as planned

QCT has finalised the financing structure for the RM740m Platinum Sentral acquisition largely according to initial targets, at 54:46 debt-equity split. This comprises:

- 1) 206.25m new unit issuance to MRCB at RM1.28/unit for a total of RM264m;
- 2) private placement of 65m new units at RM1.20/unit for a total of RM78m;
- 3) The rest is a mix of fixed- and floating-rate commercial papers (CP) at an average financing cost of 4.6%.

Unitholders have also approved the name change to **MRCB-Quill REIT**, reflecting the increased presence of MRCB through their 41% stake in the REIT management company, Quill Capita Management, and the increased board presence. Three new directors will replace three outgoing from the board of seven. As per Bursa Malaysia disclosures, they are: Mohd Imran Mohamad Salim (MRCB Executive Director); Kwan Joon Hoe (MRCB COO), and Ann Wan Tee (MRCB Chief Strategy Officer).

After factoring in the divestment, agent, and legal fees, the expected net gain is RM26k. We deem this immaterial to group earnings and gearing.

Nonetheless, the disposal will have a positive impact on portfolio occupancy - it will improve to above 95% (even sans PS injection) from 91-92% during FY13-14.

DDM Valuation

	FY15	FY16	FY17	
<i>Period</i>	<i>0.75</i>	<i>1.75</i>	<i>2.75</i>	<i>Terminal</i>
Payout (RM)	0.065	0.086	0.088	1.264
Discounted Dividend	0.061	0.075	0.071	1.022
Fair Value (RM)				1.25

Beta	0.55	Cost of Equity	8.03%
Risk free rate	4%	(RF + β *MRP)^	
Market risk premium	6%	Terminal growth	1.00%

[^]inc 10% premium on CoE due to high gearing

Source: AllianceDBS

QB10 disposal to cause no waves

QCT had earlier announced the disposal of Quill Building 10 for RM27.3m, with completion targeted by end-May. As mentioned in our earlier reports, QB10 has been vacant since early-2013 after HSBC moved out; HSBC had been utilising it for their credit card processing centre.

Peer comparison

					DPU Growth (YoY)		DPU (sen)		Price/NAV		Dividend Yield		EPS (sen)	
	Call	TP	Price	Mkt Cap (RM m)	CY2015	CY2016	CY2015	CY2016	CY2015	CY2016	CY2015	CY2016	CY2015	CY2016
<u>AllianceDBS forecasts</u>														
KLCC Stapled Securities	Hold	6.80	7.12	12,854.0	(0%)	7%	33.5	35.8	1.07x	1.06x	4.7%	5.0%	39.5	40.7
Sunway REIT	Buy	1.75	1.70	4,990.5	8%	10%	9.3	10.2	1.34x	1.35x	5.5%	6.0%	8.7	9.7
Pavilion REIT	Hold	1.55	1.56	4,704.9	2%	5%	8.1	8.5	1.24x	1.24x	5.2%	5.5%	8.0	8.4
IGB REIT	Hold	1.35	1.35	4,661.9	(2%)	3%	7.6	7.8	1.24x	1.25x	5.6%	5.8%	6.9	7.3
CapitaMalls Malaysia Trust	Hold	1.50	1.52	2,704.0	2%	3%	9.1	9.4	1.23x	1.24x	6.0%	6.2%	8.6	8.9
Axis REIT	Hold	3.60	3.61	1,977.4	2%	8%	20.3	21.9	1.48x	1.48x	5.6%	6.1%	19.8	21.4
Quill Capita Trust	Hold	1.25	1.22	806.9	0%	2%	8.4	8.6	0.82x	0.91x	6.9%	7.0%	8.4	8.6
<i>ADBS total / weighted avg</i>				32,699.5	2%	3%	19.0	20.3	1.19x	1.19x	5.2%	5.6%	21.1	21.9
<i>(ex-KLCCSS)</i>				19,845.5	3%	6%	9.7	10.2	1.27x	1.28x	5.6%	5.9%	9.2	9.8

Income Statement (RM m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Gross revenue	69	70	109	124	129
Property expenses	(16)	(17)	(24)	(26)	(27)
Net Property Income	53	53	86	98	101
Other Operating	(6)	(6)	(9)	(9)	(9)
Other Non Opg (Exp)/Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(13)	(13)	(27)	(32)	(34)
Exceptional Gain/(Loss)	2	6	0	0	0
Net Income	37	40	50	57	58
Tax	0	0	0	0	0
Minority Interest	0	0	0	0	0
Preference Dividend	0	0	0	0	0
Net Income After Tax	37	40	50	57	58
Total Return	37	40	50	57	58
Non-tax deductible Items	4	8	0	0	0
Net Inc available for Dist.	33	33	50	57	58
Growth & Ratio					
Revenue Gth (%)	(0.8)	1.9	55.9	13.5	3.7
N Property Inc Gth (%)	(1.9)	0.2	60.6	14.2	3.7
Net Inc Gth (%)	(8.6)	9.9	23.7	13.9	3.0
Dist. Payout Ratio (%)	94.7	95.7	99.9	99.9	100.0
Net Prop Inc Margins (%)	77.2	75.9	78.2	78.7	78.7
Net Income Margins (%)	53.2	57.3	45.5	45.7	45.4
Dist to revenue (%)	47.4	46.5	45.5	45.6	45.4
Managers & Trustee's fees to sales %)	8.4	8.3	8.3	7.0	6.8
ROAE (%)	6.9	7.5	7.0	6.4	6.6
ROA (%)	4.3	4.7	4.0	3.5	3.6
ROCE (%)	5.6	5.6	6.2	5.5	5.7
Int. Cover (x)	3.7	3.6	2.9	2.8	2.7

Source: Company, AllianceDBS

Only three quarters of contribution from Platinum Sentral

Margins Trend



Assuming full payout from here on

Quarterly / Interim Income Statement (RM m)

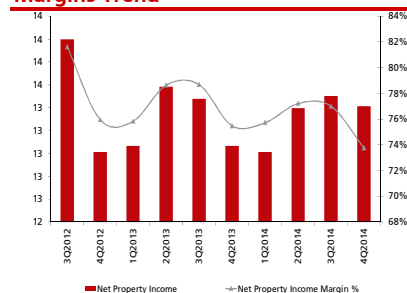
FY Dec	4Q2013	1Q2014	2Q2014	3Q2014	4Q2014
Gross revenue	17	17	17	18	18
Property expenses	(4)	(4)	(4)	(4)	(5)
Net Property Income	13	13	13	14	13
Other Operating	(1)	(2)	(2)	(1)	(2)
Other Non Opg (Exp)/Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(3)	(3)	(3)	(3)	(3)
Exceptional Gain/(Loss)	2	0	0	0	6
Net Income	11	8	9	9	15
Tax	0	0	0	0	0
Minority Interest	0	0	0	0	0
Net Income after Tax	11	8	9	9	15
Total Return	N/A	N/A	N/A	N/A	N/A
Non-tax deductible Items	N/A	N/A	N/A	N/A	N/A
Net Inc available for Dist.	17	0	16	0	17
Growth & Ratio					
Revenue Gth (%)	1	(1)	1	1	4
N Property Inc Gth (%)	(3)	0	3	1	(1)
Net Inc Gth (%)	20	(24)	5	4	64
Net Prop Inc Margin (%)	75.5	75.7	77.2	77.0	73.8
Dist. Payout Ratio (%)	95.3	0.0	95.6	0.0	95.7

Balance Sheet (RM m)

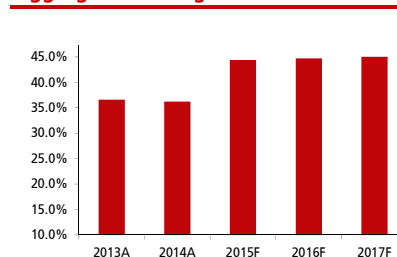
FY Dec	2013A	2014A	2015F	2016F	2017F
Investment Properties	826	838	1,555	1,565	1,575
Other LT Assets	1	1	1	1	1
Cash & ST Invt	31	23	49	50	51
Inventory	0	0	0	0	0
Debtors	3	6	10	11	11
Other Current Assets	0	0	0	0	0
Total Assets	860	868	1,615	1,627	1,639
ST Debt	5	2	405	415	425
Creditor	12	12	13	13	14
Other Current Liab	0	0	0	0	0
LT Debt	310	313	313	313	313
Other LT Liabilities	0	0	0	0	0
Unit holders' funds	533	541	884	886	887
Minority Interests	0	0	0	0	0
Total Funds & Liabilities	860	868	1,615	1,627	1,639
Non-Cash Wkg. Capital	(9)	(6)	(3)	(3)	(3)
Net Cash/(Debt)	(284)	(292)	(669)	(678)	(687)
Ratio					
Current Ratio (x)	2.0	2.0	0.1	0.1	0.1
Quick Ratio (x)	2.0	2.0	0.1	0.1	0.1
Aggregate Leverage (%)	36.6	36.3	44.4	44.7	45.0
Z-Score (X)	1.4	1.4	0.7	0.8	0.8

Source: Company, AllianceDBS

Margins Trend



Aggregate Leverage



Platinum Sentral acquisition will also involve additional debt financing of c.RM400m, raising gearing to c.45%

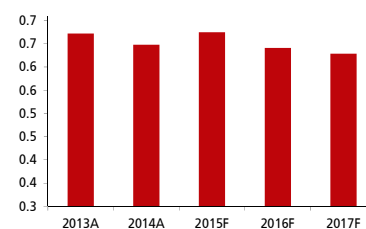
Quill Capita Trust

Cash Flow Statement (RM m)

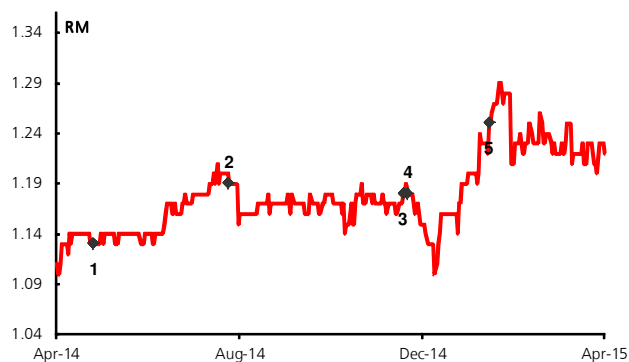
FY Dec	2013A	2014A	2015F	2016F	2017F
Pre-Tax Income	37	40	50	57	58
Dep. & Amort.	0	0	0	0	0
Tax Paid	0	0	0	0	0
Associates & JV Inc/(Loss)	0	0	0	0	0
Chg in Wkg.Cap.	1	(3)	(3)	(1)	0
Other Operating CF	11	13	27	32	34
Net Operating CF	49	50	74	88	93
Net Invst in Properties	(3)	(6)	(718)	(10)	(10)
Other Invt (net)	0	0	0	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc. & JVs	0	0	0	0	0
Other Investing CF	1	1	1	1	1
Net Investing CF	(2)	(5)	(717)	(9)	(9)
Distribution Paid	(33)	(33)	(50)	(57)	(58)
Chg in Gross Debt	0	0	403	10	10
New units issued	0	0	342	0	0
Other Financing CF	(13)	(14)	(27)	(34)	(35)
Net Financing CF	(46)	(47)	668	(80)	(84)
Currency Adjustments	0	0	0	0	0
Chg in Cash	0	(1)	25	(1)	0
Operating CFPS (sen)	12.2	13.7	12.9	13.4	13.9
Free CFPS (sen)	11.7	11.4	(108.4)	11.8	12.5

Source: Company, AllianceDBS

Distribution Paid / Net Operating CF



Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date	Closing Price	Target Price	Rating
1:	02 May 14	1.13	1.35	Buy
2:	31 Jul 14	1.19	1.35	Buy
3:	24 Nov 14	1.18	1.25	Hold
4:	27 Nov 14	1.18	1.25	Hold
5:	20 Jan 15	1.25	1.25	Hold

Source: AllianceDBS

DISCLOSURE

Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

Commonly used abbreviations

Adex = advertising expenditure	EPS = earnings per share	PBT = profit before tax
bn = billion	EV = enterprise value	P/B = price / book ratio
BV = book value	FCF = free cash flow	P/E = price / earnings ratio
CF = cash flow	FV = fair value	PEG = P/E ratio to growth ratio
CAGR = compounded annual growth rate	FY = financial year	q-o-q = quarter-on-quarter
Capex = capital expenditure	m = million	RM = Ringgit
CY = calendar year	M-o-m = month-on-month	ROA = return on assets
Div yld = dividend yield	NAV = net assets value	ROE = return on equity
DCF = discounted cash flow	NM = not meaningful	TP = target price
DDM = dividend discount model	NTA = net tangible assets	trn = trillion
DPS = dividend per share	NR = not rated	WACC = weighted average cost of capital
EBIT = earnings before interest & tax	p.a. = per annum	y-o-y = year-on-year
EBITDA = EBIT before depreciation and amortisation	PAT = profit after tax	YTD = year-to-date

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Wong Ming Tek, Executive Director

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