05 October 2016

MRCB-Quill REIT

Stable DPU; more upside from acquisitions

Buy

Price
RM1.28

Target price
RM1.45

Market data

Bloomberg code	MQREIT MK
No. of shares (m)	661
Market cap (RMm)	847
52-week high/low (RM)	1.32 / 0.98
Avg daily turnover (RMm)	0.3
KLCI (pts)	1,663

Source: Bloomberg

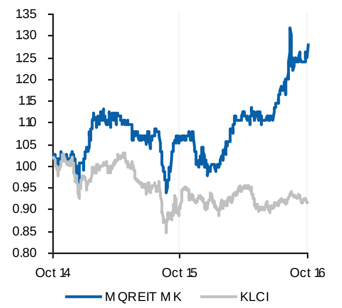
Valuation

Target price (RM)	1.45
Methodology	DDM
Key assumptions	COE = 9%
	g = 3%
Implied FY17 PE (x)	17.7
Implied FY17 PBV (x)	1.2
Implied FY17 Yield (%)	5.4

Source: KAF

Performance

	1M	3M	12M
Absolute (%)	3	12	21
Rel market (%)	4	11	20



Source: KAF

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The acquisition of Menara Shell should drive up earnings in FY17F, and MRCB's Menara Celcom and Ascott Sentral would be the next two injections into the REIT. The stock offers an attractive and stable dividend yield of 6.8%. The scope for market cap enlargement should help drive re-rating.

Financial Highlights

FYE Dec (RM m)	2014	2015	2016F	2017F	2018F
Revenue	70.2	115.2	127.6	181.0	186.3
Reported net profit	40.3	60.7	60.1	87.4	91.3
Normalised net profit	34.2	53.4	60.1	87.4	91.3
EPS (sen)	10.3	9.2	9.1	8.2	8.5
Net DPS (sen)	8.4	8.5	8.7	7.8	8.1
P/E (x)	12.4	13.9	14.1	15.6	15.0
ROE (%)	7.5	8.4	6.6	7.8	6.8
Net yield (%)	6.5	6.6	6.8	6.1	6.4
Net gearing (%)	35.1	42.4	42.3	40.0	39.9
P/BV (x)	0.9	0.9	0.9	1.0	1.0

Source: Company, KAF

Buy with a TP of RM1.45

We reiterate our Buy recommendation on MRCB-Quill REIT (MQREIT) with a RM1.45 TP, as we factor in the acquisition of Menara Shell into our forward DPU forecasts from FY17F onwards and roll our valuations one year forward. The stock offers an attractive FY16F dividend yield of 6.8% (based on a 95% distribution rate), which is the highest within our sector coverage, and provides a comfortable spread of 325bps against the 10-yr MGS.

More acquisitions in the future

The acquisition of Menara Shell for RM640m is set to conclude in 4Q16. Based on an earlier announcement, the acquisition is expected to be funded via placements and borrowings, with a ratio of 65:35. MRCB will take up about 23% of the enlarged share base, while EPF has expressed interest to take up 7%. We expect FY17 earnings to jump 43% after the inclusion of Menara Shell, and subsequently earnings should be driven by stable rental increases at ~3% p.a. Management also guided that Menara Celcom in PJ Sentral may be next to be injected into the REIT, followed by Ascott Sentral for a combined RM548m. The inclusion of these two buildings as well as Menara Shell would push up MQREIT's TAV to RM2.8bn.

DPU to still grow despite yield compression

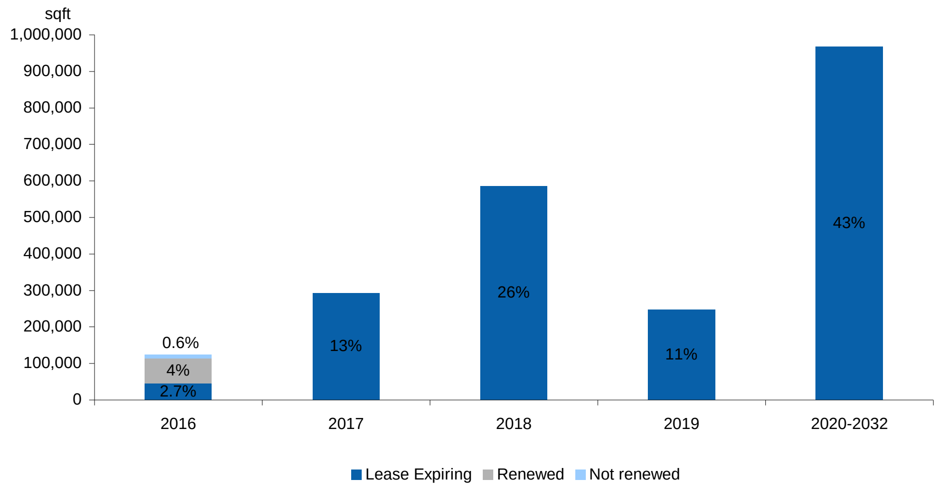
The share price has done well, increasing 27% YTD (vs. -2% for KLCI), largely supported by the collapse in the risk free rate, as well as positive newsflow related to the REIT sector in recent months such as the OPR cut. The rally has caused yields to compress from a YTD average of 7.6% to 6.8% currently. While historical DPU growth has been flat, we expect DPU to grow by a CAGR of 2% in FY15-18, which should largely come from Platinum Sentral and Menara Shell, both of which contribute 60% of total revenue.

Advantage on quality assets with the backing of strong sponsors

MQREIT has demonstrated stable financial performance, underpinned by quality assets in prime locations. The tenancies have long leases of 5-10 years, and despite the current oversupply of offices, its occupancy rates have consistently been strong at an average of 98%, compared to the industry's office segment average of ~70-80%. This is largely due to its build-to suit profile, which enables MQREIT to lock in tenants for longer periods.

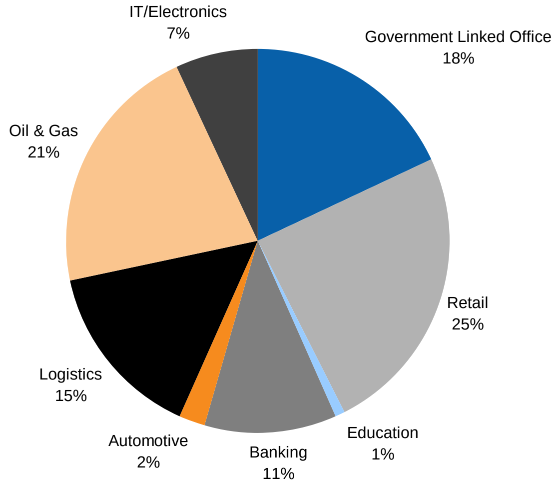
Relevant charts and tables

Chart 1 : MQREIT's portfolio lease expiry profile



Source: Company

Chart 2 : Well balanced tenancy mix (by NLA)



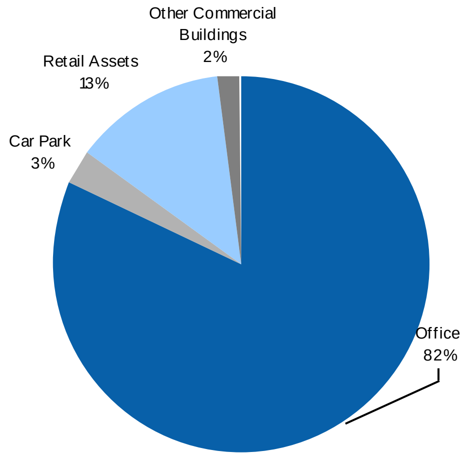
Source: Company

Table 1 : Historical DPU trends within our REIT universe

REIT	DPU (sen)				3-yr CAGR DPU growth	Price	FY15 yield
	FY15	FY14	FY13	FY12	(%)	(RM)	(%)
Al-'Aqar Healthcare REIT	7.70	7.65	7.85	7.80	0	1.58	4.87
Axis REIT	8.40	8.70	9.25	8.65	-1	1.75	4.80
IGB REIT	8.19	7.79	7.04	6.50	8	1.62	5.06
Pavilion REIT	8.23	7.96	7.36	6.87	6	1.80	4.57
MRCB-Quill REIT	8.47	8.38	8.38	8.38	0	1.28	6.62
Sunway REIT	9.18	8.73	8.36	8.30	3	1.71	5.37

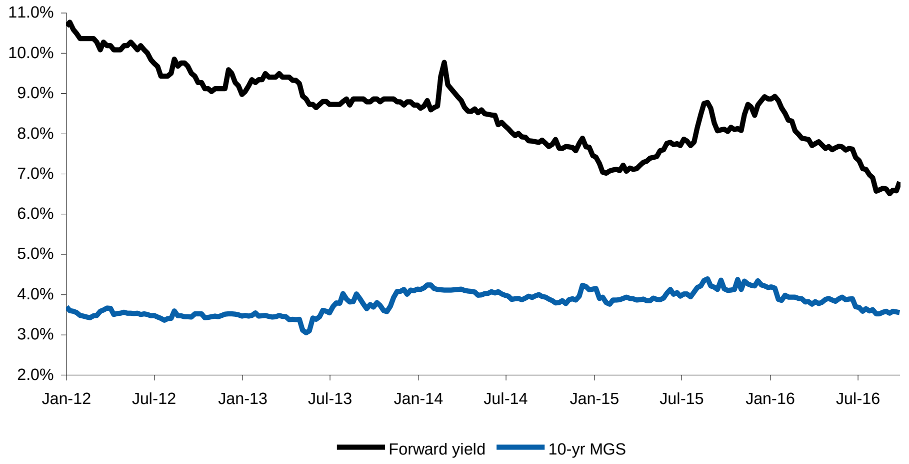
Source: Company, Bloomberg, KAF

Chart 3 : Diversified segmental contributions (by valuation)



Source: Company

Chart 4 : MQREIT's forward dividend yield vs 10-yr MGS



Source: Company, KAF

Income statement

FYE December (RMm)	2014	2015	2016F	2017F	2018F
Revenue	70.2	115.2	127.6	181.0	186.3
Property operating expenses	(16.9)	(24.9)	(27.6)	(39.1)	(40.3)
Net property income	**53.3**	**90.3**	**100.0**	**141.8**	**146.0**
Non-property operating expenses	(5.8)	(9.8)	(10.8)	(15.4)	(15.8)
EBIT	**47.5**	**80.5**	**89.2**	**126.5**	**130.2**
Interest income	0.7	0.9	1.3	1.4	1.6
Interest expense	(14.1)	(28.0)	(30.3)	(40.4)	(40.4)
Exceptional items	6.1	7.3	-	-	-
Pretax profit	**40.3**	**60.7**	**60.1**	**87.4**	**91.3**
Taxation	-	-	-	-	-
Net profit	**40.3**	**60.7**	**60.1**	**87.4**	**91.3**
Normalised net profit	**34.2**	**53.4**	**60.1**	**87.4**	**91.3**

Source: Company, KAF

Balance sheet

FYE December (RMm)	2014	2015	2016F	2017F	2018F
Non-current assets					
Investment properties	838.9	1,573.6	1,573.6	2,229.6	2,229.6
Current assets					
Trade and other receivables	6.1	6.7	7.5	10.6	10.9
Cash and bank balances	23.3	44.9	48.4	55.7	60.3
Total current assets	**29.4**	**51.6**	**55.9**	**66.3**	**71.2**
Total Assets	**868.4**	**1,625.2**	**1,629.5**	**2,295.9**	**2,300.8**
Current liabilities					
Payables and accruals	12.2	13.6	15.0	21.3	22.0
Security deposits	2.3	2.5	2.5	2.5	2.5
Borrowings	-	188.9	188.9	188.9	188.9
Total current liabilities	**14.5**	**205.0**	**206.5**	**212.8**	**213.4**
Financed by:					
Unit holder's capital	411.7	751.3	751.3	1,178.3	1,178.3
Retained earnings	129.5	152.6	155.4	159.5	163.8
Shareholders' funds	**541.3**	**903.9**	**906.7**	**1,337.8**	**1,342.1**
Non-current liabilities					
Borrowings	305.1	500.8	500.8	729.8	729.8
Security deposits	7.5	15.6	15.6	15.6	15.6
Total Finances	**868.4**	**1,625.2**	**1,629.5**	**2,295.9**	**2,300.8**

Source: Company, KAF

Cash flow statement

FYE December (RMm)	2014	2015	2016F	2017F	2018F
Pretax profit	40.3	60.7	60.1	87.4	91.3
Net change in working capital	47.5	80.6	89.2	126.5	130.2
Change in receivables	(3.3)	0.0	(0.7)	(3.1)	(0.3)
Change in payables	0.1	6.4	1.5	6.3	0.6
CFO	**44.4**	**87.0**	**89.9**	**129.6**	**130.5**
Capex	(5.3)	(724.0)	1.3	(654.6)	1.6
Others	0.7	(726.1)	1.3	(654.6)	1.6
CFI	**(5.3)**	**(726.4)**	**1.3**	**(654.6)**	**1.6**
Distribution to unitholders	(32.7)	(38.7)	(57.3)	(83.3)	(87.0)
Repayment of borrowings	-	-	-	-	-
Drawdown	-	389.0	-	229.0	-
Proceeds from issuance of new units	-	342.0	-	427.0	-
Others	(14.0)	(31.3)	(30.3)	(40.4)	(40.4)
CFF	**(46.7)**	**661.0**	**(87.6)**	**532.2**	**(127.5)**
Net change in cash and cash equivalents	**(7.6)**	**21.6**	**3.6**	**7.3**	**4.6**

Source: Company, 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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