

MRCB-Quill REIT (MQREIT MK)

Facing some near-term setbacks

Maintain BUY; Net DPU yield still a strong 6.1%

2Q19 core net profit was slightly below our estimate. 1H19 core earnings were 46%/43% of our/consensus' full-year forecasts. However, 1st interim gross DPU of 3.43sen was within our expectation. Hence, we lower our FY19 earnings forecast by 5% but maintain our DDM-based TP of MYR1.18sen (Ke: 7.6%). MQREIT still has a decent 16% total return, including a favourable FY20E net DPU yield of 6.1%. In addition, earnings and occupancies could normalise from FY20 onwards and about half of FY19-21E revenue is still backed by assets with long-term tenants.

Some occupancy easing as expected

2Q19 core net profit was MYR16.5m (-23% YoY, -15% QoQ), taking 1H19 net profit to MYR35.9m (-15% YoY). The slower 2Q19 earnings growth (YoY) was largely attributed to: (i) vacancy of QB5 since end-1Q19; (ii) lower rental income at Platinum Sentral due to transition of tenants and softer occupancy rate of 88% (2Q18: 92%); and (iii) lower tenancy at Wisma Technip at 75% (2Q18: 100%). 2Q19 portfolio occupancy rate was 89% (2Q18: 96%, 1Q19: 89%).

Rental income shortfalls could be short-lived

Our current FY19-21 earnings estimates have factored in the vacancy at QB5 from 2Q19 onwards. However, we believe this will only be temporary as we understand there are interests from some of the existing tenants for the space and management is exploring the possibility of securing a co-working space tenant. Meanwhile, we note that Platinum Sentral's lower 2Q19 rental income was due to the entry of new tenants which are undergoing fit-outs. Hence, these new tenants are likely to contribute rental income from 3Q19-4Q19 onwards.

Long-term outlook remains decent

We remain positive on MQREIT's assets. We estimate its long-term tenants will contribute 51-52% of FY19-21E revenue - i.e. QB1, QB4, QB2, Tesco Building and Menara Shell (two anchor tenants occupy about ¾ of the building's NLA). We have not factored in any asset injections, and end-2Q19 gross gearing remains at 0.37x (unchanged YoY).

FYE Dec (MYR m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	180	173	163	164	167
Net property income	140	134	124	129	131
Core net profit	88	85	74	79	80
Core EPU (sen)	8.2	7.9	6.9	7.4	7.5
Core EPU growth (%)	(8.0)	(4.1)	(12.8)	6.7	1.9
Net DPU (sen)	7.6	7.3	6.1	6.5	6.6
Net DPU growth (%)	0.1	(3.7)	(16.4)	6.7	1.9
P/NTA (x)	1.0	0.8	0.8	0.8	0.8
Net DPU yield (%)	6.0	6.9	5.7	6.1	6.2
ROAE (%)	5.1	5.3	5.4	5.7	5.8
ROAA (%)	3.8	3.7	3.3	3.5	3.5
Debt/Assets (x)	0.37	0.38	0.38	0.38	0.38
Consensus Net DPU	-	-	6.9	6.9	7.2
MKE vs. Consensus (%)	-	-	(12.3)	(6.4)	(8.8)

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BUY

Share Price	MYR 1.07
12m Price Target	MYR 1.18 (+10%)
Previous Price Target	MYR 1.18

Company Description

MRCB-Quill REIT engages in the investment in commercial properties which are mainly located in the Klang Valley.

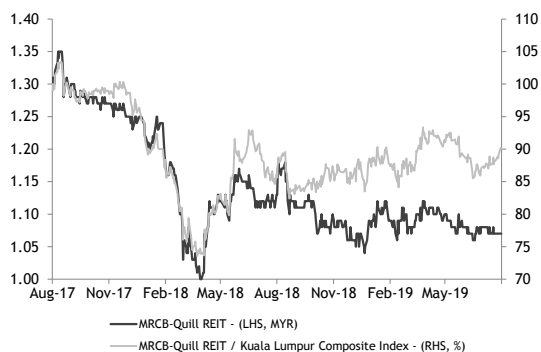
Statistics

52w high/low (MYR)	1.18/1.04
3m avg turnover (USDm)	0.1
Free float (%)	55.2
Issued shares (m)	1,068
Market capitalisation	MYR1.1B
	USD273M

Major shareholders:

Malaysian Resources Corp. Bhd.	19.3%
CapitaLand Commercial Trust	11.0%
Employees Provident Fund	7.3%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(1)	(3)	(5)
Relative to index (%)	4	(1)	5

Source: FactSet

Fig 1: Results summary table

FY Dec (MYR m)	Quarterly			Cumulative				
	2QFY19	2QFY18	%YoY	1QFY19	%QoQ	1HFY19	1HFY18	%YoY
Gross revenue	38.8	43.4	(10.7)	41.4	(6.3)	80.2	87.5	(8.3)
Net property income	29.1	33.4	(12.8)	32.0	(9.2)	61.1	67.6	(9.6)
Interest income	0.6	0.9	(35.5)	0.8	(31.7)	1.4	1.6	(13.2)
Fair value gains/(loss)	-	-	NM	-	NM	-	-	NM
Finance costs	(9.7)	(9.9)	(2.1)	(9.9)	(1.3)	(19.6)	(19.6)	(0.2)
Other expenses/gains	(3.5)	(0.8)	324.1	(3.6)	(3.9)	(7.1)	(5.1)	37.8
Pretax profit	16.5	23.5	(29.9)	19.4	(15.2)	35.9	44.5	(19.4)
Tax	-	-	NM	-	NM	-	-	NM
Net profit	16.5	23.5	(29.9)	19.4	(15.2)	35.9	44.5	(19.4)
Net profit ex-EI	16.5	21.3	(22.7)	19.4	(15.2)	35.9	42.3	(15.2)
EPU ex-EI (sen)	1.5	2.0	(22.7)	1.8	(15.2)	3.3	4.0	(15.4)
Gross DPU (sen)	3.4	4.2	(18.9)	-	NM	3.4	4.2	(18.9)
	2QFY19	2QFY18	+/- ppt	1QFY19	+/- ppt	1HFY19	1HFY18	+/- ppt
Net property margin (%)	75.0	76.9	(1.9)	77.4	(2.4)	76.2	77.4	(1.1)
Net income ex-EI margin (%)	42.4	49.0	(6.6)	46.9	(4.5)	44.7	48.4	(3.6)

Note: 2Q18 net profit ex-EI excludes MYR2.2m divestment gain

Sources: Trust

Risk statement

There are several risk factors for our earnings estimates, target price and rating for MQREIT. Changes in rental rates, occupancy rates, operating expenses and interest rates may lead to lower earnings for MQREIT. 19% of MQREIT's total NLA is due for lease renewal in 2019 while 24% of MQREIT's total debt is based on floating rates.

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Metrics					
Price/DPU(x)	16.6	14.6	17.6	16.5	16.2
P/BV (x)	1.0	0.8	0.8	0.8	0.8
P/NTA (x)	1.0	0.8	0.8	0.8	0.8
DPU yield (%)	6.7	7.6	6.3	6.7	6.9
FCF yield (%)	9.7	10.0	9.6	9.9	10.2
INCOME STATEMENT (MYR m)					
Revenue	180.1	173.4	163.4	164.5	167.2
Net property income	140.0	133.7	124.3	129.4	131.0
Management and trustee fees	(14.9)	(14.9)	(14.6)	(14.7)	(14.8)
Net financing costs	(36.9)	(36.3)	(35.8)	(35.8)	(35.9)
Exceptionals	(18.2)	(3.2)	0.0	0.0	0.0
Pretax profit	69.9	79.3	73.9	78.8	80.3
Income tax	0.0	(6.1)	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Net profit	69.9	73.1	73.9	78.8	80.3
Distributable inc to unitholders	92.4	87.1	73.9	78.8	80.3
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	76.0	85.8	85.7	84.2	84.7
Accounts receivable	5.2	5.6	5.3	5.4	5.4
Property, Plant & Equip (net)	0.2	0.3	2.0	3.4	4.8
Investment properties	2,159.5	2,158.7	2,158.7	2,158.7	2,158.7
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	47.5	20.9	20.9	20.9	20.9
Total assets	2,288.4	2,271.4	2,272.6	2,272.6	2,274.6
ST interest bearing debt	116.9	0.0	0.0	0.0	0.0
Accounts payable	20.3	15.8	15.6	14.0	14.4
LT interest bearing debt	736.6	853.7	853.7	853.7	853.7
Other liabilities	29.9	29.6	29.6	29.6	29.6
Total Liabilities	903.7	899.1	898.9	897.3	897.7
Shareholders Equity	1,384.7	1,372.3	1,373.8	1,375.3	1,376.9
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	1,384.7	1,372.3	1,373.8	1,375.3	1,376.9
Total liabilities and equity	2,288.4	2,271.4	2,272.6	2,272.6	2,274.6
CASH FLOW (MYR m)					
Cash flow from operations	129.1	113.3	109.8	113.1	116.8
Acquisitions & investments	(0.4)	(4.1)	(1.6)	(1.6)	(1.7)
Disposal of FA & investments	0.0	28.0	0.0	0.0	0.0
Dividend income from associates	0.0	0.0	0.0	0.0	0.0
Other investing cash flow	2.2	3.7	4.7	4.7	4.6
CF from investing activities	1.8	27.6	3.1	3.1	3.0
Dividends paid	(72.6)	(89.8)	(72.4)	(77.2)	(78.7)
Interest expense	(37.2)	(39.2)	(40.6)	(40.6)	(40.6)
Change in debt	1.0	0.0	0.0	0.0	0.0
Equity raised / (purchased)	0.0	4.0	0.0	0.0	0.0
Other financial activities	(0.0)	(0.0)	0.0	0.0	0.0
CF from financing activities	(108.8)	(125.0)	(112.9)	(117.8)	(119.3)
Effect of exchange rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	22.0	15.9	(0.0)	(1.5)	0.5

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Key Ratios					
Growth ratios (%)					
Revenue growth	36.7	(3.7)	(5.8)	0.7	1.6
Net property income growth	36.8	(4.5)	(7.0)	4.1	1.3
Core net profit growth	48.6	(3.8)	(12.8)	6.7	1.9
Distributable income growth	56.2	(5.8)	(15.2)	6.7	1.9
Profitability ratios (%)					
Net property income margin	77.7	77.1	76.1	78.7	78.4
Core net profit margin	48.9	48.8	45.2	47.9	48.0
Payout ratio	115.4	106.6	88.2	88.2	88.2
DuPont analysis					
Total return margin (%)	38.8	42.2	45.2	47.9	48.0
Gross revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.7	1.7	1.7	1.7	1.7
ROAE (%)	5.1	5.3	5.4	5.7	5.8
ROAA (%)	3.8	3.7	3.3	3.5	3.5
Leverage & Expense Analysis					
Asset/Liability (x)	2.5	2.5	2.5	2.5	2.5
Net gearing (%) (excl. perps)	56.1	56.0	55.9	56.0	55.8
Net interest cover (x)	3.4	3.3	3.1	3.2	3.2
Debt/EBITDA (x)	6.8	7.2	7.8	7.4	7.3
Capex/revenue (%)	na	na	na	na	na
Net debt/ (net cash)	777.4	767.9	768.0	769.5	769.0
Debt/Assets (x)	0.37	0.38	0.38	0.38	0.38

Source: Company; Maybank

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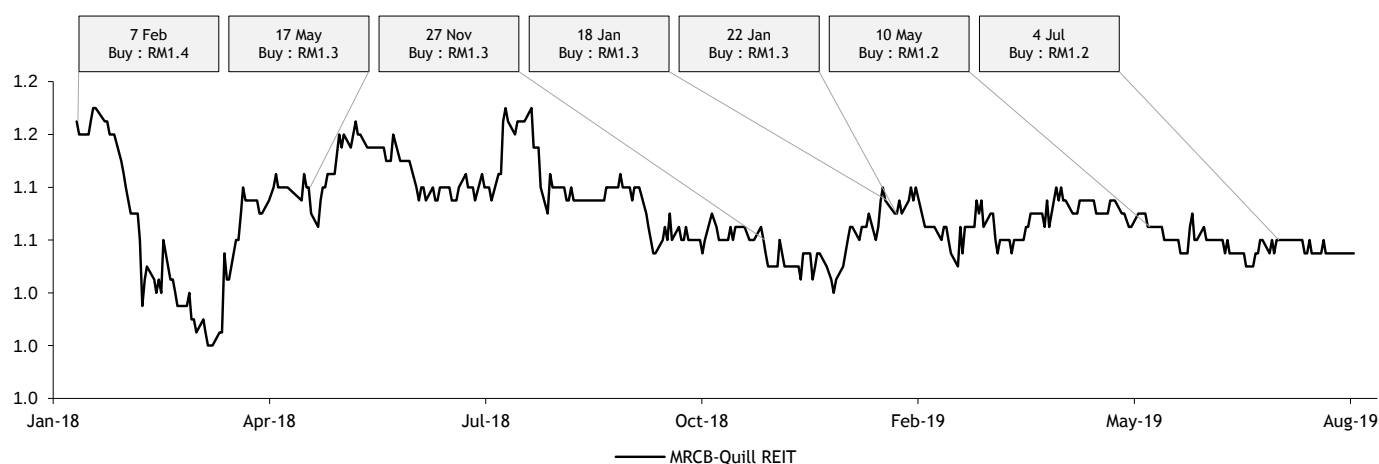
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