

**HLIB Research**

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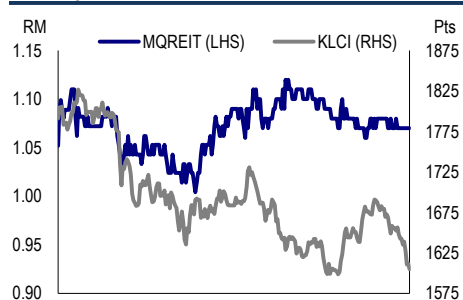
**HOLD** (from Buy)

**Target Price:** **RM1.09**
**Previously:** **RM1.15**
**Current Price:** **RM1.07**

|                       |      |
|-----------------------|------|
| Capital upside        | 1.9% |
| Dividend yield        | 6.6% |
| Expected total return | 8.5% |

**Sector coverage:** REIT

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

**Share price**


|                       |      |      |      |
|-----------------------|------|------|------|
| Historical return (%) | 1M   | 3M   | 12M  |
| Absolute              | -0.9 | -2.7 | -5.3 |
| Relative              | 3.9  | -0.6 | 5.7  |

**Stock information**

|                              |          |
|------------------------------|----------|
| Bloomberg ticker             | MQREITMK |
| Bursa code                   | 5123     |
| Issued shares (m)            | 1,072    |
| Market capitalisation (RM m) | 1,147    |
| 3-mth average volume ('000)  | 306      |
| SC Shariah compliant         | No       |

**Major shareholders**

|                         |       |
|-------------------------|-------|
| MRCB                    | 27.8% |
| EPF                     | 12.1% |
| Capita Commercial Trust | 10.9% |

**Earnings summary**

|                  |      |       |       |
|------------------|------|-------|-------|
| FYE (Dec)        | FY18 | FY19f | FY20f |
| PAT – core       | 84.7 | 76.3  | 77.9  |
| EPU – core (sen) | 7.9  | 7.1   | 7.3   |
| P/E (x)          | 13.7 | 15.2  | 14.9  |

# MRCB-Quill REIT

## Softer than expected 2Q

MQREIT's 2Q19 core net profit of RM16.5m (-15.2% QoQ, -22.7% YoY) translated to 1H19 core net profit of RM35.9m (-15.2% YoY). The result was below both ours and consensus estimates due to lower than expected revenue contribution. Declared dividend of 3.43 sen per unit. Overall, we cut FY19/20/21 earnings forecasts by -7.3%/-5.9%/-5.8% respectively after factoring in lower revenue. We downgrade to HOLD with lower TP of RM1.09 (from RM1.15) based on targeted yield of 6.7%. That said, we note that MQREIT still has an attractive dividend yield offering of >6% (highest among REITs in our universe).

**Falling below expectations.** 2Q19 core net profit of RM16.5m (-15.2% QoQ, -22.7% YoY) translated into 1H19 core earnings of RM35.9m (-15.2% YoY). The results were below both ours and consensus expectations; at 44% and 43% of full year forecast respectively. The deviation was due to lower than expected revenue.

**Dividend.** Declared semi-annual dividend of 3.43 sen per unit (1H18: 4.23 sen) going ex on 22<sup>nd</sup> August 2019.

**QoQ.** Total gross revenue decreased by 6.3% to RM38.8m, which then led to a fall in core net profit to RM16.5m. The cutback was caused by poorer revenue contribution by Platinum Sentral (SPAD downsized & MyHSR moved out in May), Wisma Technip (tenant downsized) and QB5 (IBM moved out in April). However, this was slightly cushioned by the decline in administrative expenses.

**YoY.** Core net profit fell by 22.7% to RM16.5m. The drop was driven by lower revenue contribution; mainly from Platinum Sentral, Wisma Technip and QB5. However, the fall was marginally mitigated by the reduction in property operating expense (-3.4%) owing to cost efficiency, lower finance costs as well as lower manager's fees.

**YTD.** Revenue for 1H19 decreased by 8.3% to RM80.2m. Likewise, core net profit of RM35.9m showed a decrement of 15.2%. The lower revenue was due to (i) loss of revenue from QB8 (disposed in April 2018); (ii) lower occupancy rate from Platinum Sentral (SPAD downsized & MyHSR moved out), Wisma Technip (tenant downsized) and QB5 (IBM moved out). Nevertheless, it was cushioned by (i) lower property expenses (-3.8%) and (ii) lower finance costs (-0.2%).

**Occupancy and gearing.** Occupancy rate stayed at 89% (1Q19: 89%). The average debt to maturity decreased to 2.07 years from 2.32 years (1Q19), while average cost of financing was kept at 4.5%. As for gearing level, it tapered to 37.1% (1Q19: 37.5%), with a majority of its total borrowings being charged a fixed interest rate (76%).

**Outlook.** The lacklustre overall office market has dragged MQREIT's showing. Going forward, management will focus on cost discipline and tenant retention. We believe MQREIT will continue to sustain, despite the moving out of tenants in a few assets. While there are tenants moving out, new tenancies for approximately 89k sf of NLA have been executed which includes a co-working space. We expect income contribution from these new leases by 3Q/4Q19. However we do acknowledge that finding a tenant replacement in QB5 will take some time, as demand for office spaces in Cyberjaya is not as vibrant compared to areas in the KL fringes.

**Forecast.** We reduce our FY19/20/21 earnings forecasts by -7.3%/-5.9%/-5.8% respectively after factoring in lower rental income.

**Downgrade to HOLD, TP: RM1.09.** We cut our rating to HOLD with lower TP of RM1.09 (from RM1.15) based on targeted yield of 6.7%. Our valuation is based on the 2-year historical average yield spread between dividend yield and 10 year MGS.

Financial Forecast

All items in (RM m) unless otherwise stated

Balance Sheet

| FYE Dec               | FY17    | FY18    | FY19f   | FY20f   | FY21f   |
|-----------------------|---------|---------|---------|---------|---------|
| Cash                  | 76.0    | 85.8    | 83.1    | 92.3    | 91.4    |
| Receivables           | 6.0     | 6.7     | 6.4     | 6.5     | 6.6     |
| Investment properties | 2,179.2 | 2,177.6 | 2,179.6 | 2,181.6 | 2,183.6 |
| PPE                   | 0.2     | 0.3     | 0.3     | 0.2     | 0.2     |
| Others                | 27.0    | 1.3     | 1.3     | 1.3     | 1.3     |
| Assets                | 2,288.4 | 2,271.7 | 2,270.7 | 2,282.0 | 2,283.1 |
| Payables              | 20.3    | 16.1    | 15.1    | 15.4    | 15.6    |
| Debt                  | 853.5   | 853.7   | 853.7   | 864.7   | 865.7   |
| Security deposits     | 29.2    | 29.2    | 29.2    | 29.2    | 29.2    |
| Derivatives           | 0.7     | 0.4     | 0.4     | 0.4     | 0.4     |
| Liabilities           | 903.7   | 899.4   | 898.4   | 909.7   | 910.9   |
| Unitholders' capital  | 1,231.9 | 1,235.9 | 1,235.9 | 1,235.9 | 1,235.9 |
| Undistributed profit  | 152.8   | 136.4   | 136.4   | 136.4   | 136.4   |
| Equity                | 1,384.7 | 1,372.3 | 1,372.3 | 1,372.3 | 1,372.3 |

Income Statement

| FYE Dec                   | FY17  | FY18  | FY19f | FY20f | FY21f |
|---------------------------|-------|-------|-------|-------|-------|
| Gross rental income       | 163.5 | 155.0 | 146.8 | 149.4 | 150.4 |
| Car park income           | 12.8  | 13.2  | 13.9  | 14.2  | 14.4  |
| Other revenue             | 5.2   | 4.4   | 5.4   | 5.6   | 5.7   |
| Total revenue             | 181.5 | 172.5 | 166.1 | 169.1 | 170.5 |
| Property opex             | -40.2 | -39.7 | -37.3 | -38.0 | -38.3 |
| Net property income       | 141.3 | 132.8 | 128.8 | 131.1 | 132.2 |
| Other income              | -16.0 | 1.9   | 2.7   | 2.7   | 3.0   |
| Net invest income         | 125.4 | 134.7 | 131.5 | 133.8 | 135.1 |
| Manager's fee             | -13.5 | -13.3 | -13.0 | -13.1 | -13.2 |
| Trustee's fee             | -0.7  | -0.7  | -0.7  | -0.7  | -0.7  |
| Finance costs             | -40.5 | -40.6 | -40.6 | -41.1 | -41.2 |
| Other non opex            | -0.8  | -0.9  | -0.9  | -0.9  | -0.9  |
| Profit before tax         | 69.9  | 79.3  | 76.3  | 77.9  | 79.2  |
| Taxation                  | 0.0   | -6.1  | 0.0   | 0.0   | 0.0   |
| Profit after tax          | 69.9  | 73.1  | 76.3  | 77.9  | 79.2  |
| Core net profit           | 88.1  | 84.7  | 76.3  | 77.9  | 79.2  |
| Distributable income      | 92.1  | 87.1  | 76.3  | 77.9  | 79.2  |
| Consensus core net profit |       |       | 82.8  | 84.4  | 85.6  |
| HLIB/ Consensus           |       |       | 92%   | 92%   | 93%   |

Cash Flow Statement

| FYE Dec                   | FY17   | FY18   | FY19f | FY20f  | FY21f  |
|---------------------------|--------|--------|-------|--------|--------|
| Profit before taxation    | 69.9   | 79.3   | 76.3  | 77.9   | 79.2   |
| Finance costs             | 40.5   | 40.6   | 0.0   | 0.0    | 0.0    |
| Depreciation              | 0.1    | 0.1    | 0.1   | 0.1    | 0.1    |
| Fair value gain of assets | 18.2   | 5.4    | 0.0   | 0.0    | 0.0    |
| Interest income           | -3.6   | -4.3   | 0.0   | 0.0    | 0.0    |
| Others                    | 3.8    | -14.6  | -0.8  | 0.2    | 0.1    |
| CFO                       | 128.8  | 106.5  | 75.6  | 78.1   | 79.3   |
| Capex                     | -0.4   | -3.8   | -2.0  | -2.0   | -2.0   |
| Disposal / (purchase)     | 0.0    | -0.2   | 0.0   | 0.0    | 0.0    |
| Others                    | 2.2    | 31.7   | 0.0   | 0.0    | 0.0    |
| CFI                       | 1.8    | 27.6   | -2.0  | -2.0   | -2.0   |
| Distribution paid         | -72.6  | -89.8  | -76.3 | -77.9  | -79.2  |
| Proceeds frm borrow'g     | 189.7  | 117.0  | 0.0   | 400.0  | 165.0  |
| Repayment of borrow'g     | -190.0 | -117.0 | 0.0   | -389.0 | -164.0 |
| Others                    | -35.7  | -34.6  | 0.0   | 0.0    | 0.0    |
| CFF                       | -108.6 | -124.3 | -76.3 | -66.9  | -78.2  |
| Net cash flow             | 22.0   | 9.7    | -2.7  | 9.2    | -0.9   |

Valuation & Ratios

| FYE Dec          | FY17    | FY18    | FY19f   | FY20f   | FY21f   |
|------------------|---------|---------|---------|---------|---------|
| Core EPU (sen)   | 8.2     | 7.9     | 7.1     | 7.3     | 7.4     |
| P/E (x)          | 13.1    | 13.7    | 15.2    | 14.9    | 14.6    |
| EBITDA           | 128.7   | 125.4   | 117.0   | 119.1   | 120.4   |
| EBIT             | 128.6   | 125.3   | 116.9   | 119.0   | 120.3   |
| EV               | 1,930.9 | 1,925.5 | 1,928.2 | 1,929.9 | 1,931.8 |
| EV/EBITDA (x)    | 15.0    | 15.4    | 16.5    | 16.2    | 16.0    |
| DPU (sen)        | 8.4     | 8.1     | 7.1     | 7.3     | 7.4     |
| Dividend yield   | 7.8     | 7.5     | 6.6     | 6.7     | 6.8     |
| NTA/ share (sen) | 129.0   | 127.3   | 127.3   | 127.3   | 127.3   |
| P/ NTA           | 0.8     | 0.8     | 0.8     | 0.8     | 0.8     |
| BVPS (RM)        | 1.30    | 1.28    | 1.28    | 1.28    | 1.28    |
| P/B (x)          | 0.8     | 0.8     | 0.8     | 0.8     | 0.8     |
| EBITDA margin    | 70.9%   | 72.7%   | 70.4%   | 70.4%   | 70.6%   |
| EBIT margin      | 70.9%   | 72.6%   | 70.4%   | 70.4%   | 70.6%   |
| PBT margin       | 38.5%   | 45.9%   | 45.9%   | 46.1%   | 46.4%   |
| Net margin       | 48.5%   | 49.1%   | 45.9%   | 46.1%   | 46.4%   |
| ROE              | 5.0%    | 5.3%    | 5.6%    | 5.7%    | 5.8%    |
| ROA              | 3.8%    | 3.7%    | 3.4%    | 3.4%    | 3.5%    |
| Net gearing      | 33.97%  | 37.70%  | 33.94%  | 33.85%  | 33.91%  |

Assumptions

| FYE Dec                   | FY19f | FY20f | FY21f |
|---------------------------|-------|-------|-------|
| Gross rental income       |       |       |       |
| Quill Building 1 - DHL 1  | 5.0   | 5.1   | 5.2   |
| Quill Building 4 - DHL 2  | 5.4   | 5.5   | 5.6   |
| Quill Building 2 - HSBC   | 9.9   | 10.1  | 10.2  |
| Quill Building 3 - BMW    | 5.8   | 5.9   | 6.0   |
| Wisma Technip             | 8.7   | 9.5   | 9.6   |
| Part of Plaza Mont' Kiara | 3.7   | 3.8   | 3.9   |
| Quill Building 5 - IBM    | 0.1   | 0.0   | 0.1   |
| Tesco Building - Penang   | 14.7  | 14.9  | 15.2  |
| Platinum Sentral          | 50.0  | 51.1  | 51.1  |
| Menara Shell              | 43.5  | 43.5  | 43.5  |
| Total:                    | 146.8 | 149.4 | 150.4 |

Quarterly financial summary

| FYE Dec                 | 2Q18  | 1Q19  | 2Q19  | QoQ (%) | YoY (%) |
|-------------------------|-------|-------|-------|---------|---------|
| Gross revenue           | 43.4  | 41.4  | 38.8  | -6.3    | -10.7   |
| Property opex           | -10.0 | -9.3  | -9.7  | -3.8    | 3.4     |
| Net property income     | 33.4  | 32.0  | 29.1  | -9.2    | -12.8   |
| Interest income         | 0.9   | 0.8   | 0.6   | -31.7   | -35.5   |
| Revaluation gains       | 0.0   | 0.0   | 0.0   | 0.0     | 0.0     |
| Net investment income   | 36.4  | 32.9  | 29.6  | -9.8    | -18.6   |
| Finance costs           | -9.9  | -9.9  | -9.7  | 1.3     | 2.1     |
| Valuation fees          | -0.1  | -0.1  | -0.1  | 0.0     | -57.5   |
| Administrative expenses | 0.6   | -0.1  | 0.0   | >100    | 104.7   |
| TOTAL EXPENSES          | -12.9 | -13.5 | -13.2 | 2.0     | -1.9    |
| Normalised PBT          | 21.3  | 19.4  | 16.5  | -15.2   | -22.7   |
| Normalised PAT          | 21.3  | 19.4  | 16.5  | -15.2   | -22.7   |
| EPU (realised)          | 2.0   | 1.8   | 1.5   | -15.2   | -22.7   |
| DPU (sen)               | 4.2   | 0.0   | 3.4   | NM      | NM      |

**Figure #1**      **Quarterly results comparison**

| <b>FYE Dec (RM m)</b>       | <b>2Q18</b> | <b>1Q19</b> | <b>2Q19</b> | <b>QoQ</b>    | <b>YoY</b>    | <b>1H18</b> | <b>1H19</b> | <b>YoY (%)</b> |
|-----------------------------|-------------|-------------|-------------|---------------|---------------|-------------|-------------|----------------|
| Gross revenue               | 43.4        | 41.4        | 38.8        | -6.3%         | -10.7%        | 87.5        | 80.2        | -8.3%          |
| Property operating expenses | -10.0       | -9.3        | -9.7        | 3.8%          | -3.4%         | -19.8       | -19.0       | -3.8%          |
| <b>Net property income</b>  | <b>33.4</b> | <b>32.0</b> | <b>29.1</b> | <b>-9.2%</b>  | <b>-12.8%</b> | <b>67.6</b> | <b>61.1</b> | <b>-9.6%</b>   |
| Interest income             | 0.9         | 0.8         | 0.6         | -31.7%        | -35.5%        | 1.6         | 1.4         | -13.2%         |
| Gain on divestment          | 2.2         | 0.0         | 0.0         | NM            | NM            | 2.2         | 0.0         | 100.0%         |
| Net investment income       | 36.4        | 32.9        | 29.6        | -9.8%         | -18.6%        | 71.5        | 62.5        | -12.5%         |
| Finance costs               | -9.9        | -9.9        | -9.7        | -1.3%         | -2.1%         | -19.6       | -19.6       | -0.2%          |
| Valuation fees              | -0.1        | -0.1        | -0.1        | 0.0%          | -57.2%        | -0.2        | -0.2        | 5.9%           |
| Administrative expenses     | 0.6         | -0.1        | -0.0        | -54.0%        | -104.7%       | -0.1        | -0.1        | -1.3%          |
| Total expenses              | -12.9       | -13.5       | -13.2       | -2.0%         | 1.9%          | -27.0       | -26.7       | -1.1%          |
| Core PBT                    | 21.3        | 19.4        | 16.5        | -15.2%        | -22.7%        | 42.3        | 35.9        | -15.2%         |
| <b>Core PAT</b>             | <b>21.3</b> | <b>19.4</b> | <b>16.5</b> | <b>-15.2%</b> | <b>-22.7%</b> | <b>42.3</b> | <b>35.9</b> | <b>-15.2%</b>  |
| Distributable adjustments   | 1.0         | 0.0         | 0.9         | >100%         | -10.0%        | 2.4         | 0.9         | -62.3%         |
| <b>Distributable income</b> | <b>22.3</b> | <b>19.4</b> | <b>17.4</b> | <b>-10.6%</b> | <b>-22.1%</b> | <b>44.7</b> | <b>36.8</b> | <b>-17.7%</b>  |
| Core EPU (sen)              | 2.0         | 1.8         | 1.5         | -15.2%        | -22.7%        | 3.9         | 3.3         | -15.2%         |
| DPU (sen)                   | 4.2         | 0.0         | 3.4         | NM            | NM            | 4.2         | 3.4         | -18.9%         |

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## Stock rating guide

|                     |   |
|---------------------|---|
| <b>BUY</b>          | Expected absolute return of +10% or more over the next 12 months.   |
| <b>HOLD</b>         | Expected absolute return of -10% to +10% over the next 12 months.   |
| <b>SELL</b>         | Expected absolute return of -10% or less over the next 12 months.   |
| <b>UNDER REVIEW</b> | Rating on the stock is temporarily under review which may or may not result in a change from the previous rating. |
| <b>NOT RATED</b>    | Stock is not or no longer within regular coverage.  |

## Sector rating guide

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

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