Malaysia Results Review

8 August 2019

Property | REITs

MRCB-Quill REIT (MQREIT MK)

Neutral (Maintained)

Earnings Continue To Disappoint

Target Price (Return)	MYR0.97 (-9%)
Price:	MYR1.07
Market Cap:	USD274m
Avg Daily Turnover (MYR/USD)	0.33m/0.08m

- **Maintain NEUTRAL with a lower TP of MYR0.97,** from MYR1.02, 9% downside with a 6% 2019F yield. MRCB-Quill's dividend yield is above sector's average but we believe this is fair given its high occupancy risk. 1H19 earnings were below our and market expectation due to a lower income generated from its key assets. With the oversaturation of office spaces in the Klang Valley, we expect occupancy rate to remain under pressure.
- **Earnings below expectations.** MRCB-Quill's 1H19 core net profit of MYR35.9m was below our and market's expectation, making up only 47/43% of our/consensus estimates. 1H19 core net profit was 15% lower YoY due to a lower contribution from Platinum Sentral, Wisma Technip and Quill Building 5 (QB5). A 3.43 sen DPU was declared during the 1H19, 18.9% lower YoY.
- **4% non-renewal YTD.** The overall occupancy rate for all assets of MRCB-Quill's remains unchanged at 89% as of June 2019. In 1H19, of the 15% of REIT's total NLA that is up for renewal, only 11% renewed. This was mainly due to a non-renewal of SPAD, MyHSR and Transit Acquirer in Platinum Sentral. We believe the impact of non-renewal will be cushioned by the arrival of new tenants that will occupy c.42k sqf of NLA in Platinum Sentral and 28k sqf in Menara Shell in 2Q19. Currently, occupancy in Platinum Sentral and Menara Shell stands at 88% and 96% respectively, increased from 86% and 90% from the previous quarter.
- **We remain cautious on the REIT, as 4% of leases (from the total NLA) are still up for renewal** this year; these leases come mainly from Plaza Mont Kiara, two smaller tenants in Menara Shell and some retail tenants in Menara Shell. We envision the REIT may have to lower its rents in order to retain its tenants.
- **Potential acquisition.** Menara Celcom, Petaling Jaya was completed last year and is currently tenanted by Celcom. As this is one of its sponsor's assets, we think the asset may be injected into the REIT in FY19, the earliest but we understand the negotiation between the asset sponsor and the REIT has yet to commence.
- **Updating our numbers.** With the continuous drop in occupancy rate, we trim down our FY19-21F earnings by 6%. As such, our DDM-based TP is revised down to MYR0.97, from MYR1.02, 9% downside with a 6% FY19F yield. An upside risk is the possibility of a yield accretive acquisition in the future. Downside risk includes a prolong oversupply of office space that could lead to a lower occupancy rate and negative rental reversion.

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (MYRm)	180	173	149	148	147
Net property income (MYRm)	140	134	115	114	113
Reported net profit (MYRm)	70	73	72	71	69
Total distributable income (MYRm)	88	85	72	71	69
DPS (MYR)	0.1	0.1	0.1	0.1	0.1
DPS growth (%)	0.1	(3.1)	(18.6)	(1.4)	(1.8)
P/BV (x)	0.9	0.9	0.9	0.9	0.9
Dividend Yield (%)	7.8	7.6	6.2	6.1	6.0
Return on average equity (%)	5.0	5.3	5.2	5.1	5.1
Return on average assets (%)	3.1	3.2	3.1	3.1	3.0
Gross gearing (x)	37.3	37.5	37.5	37.5	37.4

Source: Company data, RHB

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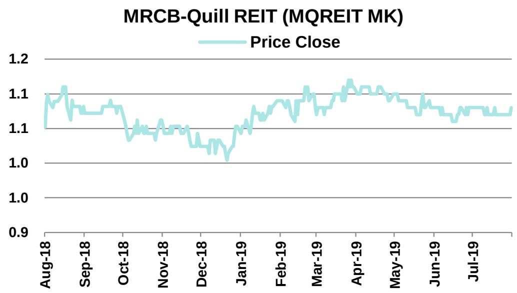
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	0.9	(0.9)	(2.7)	(1.8)	(5.3)
Relative	6.0	3.7	(0.6)	3.4	5.1
52-wk Price low/high (MYR)					1.04 - 1.19



Source: Bloomberg

Financial Exhibits

Asia
Malaysia
REIT
MRCB-Quill REIT
MQREIT MK

Valuation basis

Dividend discount model (DDM)

Key drivers

Higher-than-expected demand of office space and inorganic growth opportunities arising from MRCB and Quill Group

Key risks

An upside risk is the possibility of a yield accretive acquisition in the future. Downside risk includes a prolong oversupply of office space that could lead to a lower occupancy rate and negative rental reversion

Company Profile

MRCB-Quill REIT is a mid-cap MREIT that focuses on office/commercial assets. Assets are largely concentrated in the Klang Valley and Cyberjaya areas

Financial summary	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Recurring EPS (MYR)	0.08	0.08	0.07	0.07	0.06
EPS (MYR)	0.08	0.08	0.07	0.07	0.06
DPS (MYR)	0.08	0.08	0.06	0.06	0.06
BVPS (MYR)	1.30	1.28	1.28	1.28	1.28
Weighted avg adjusted shares (m)	1,068.0	1,071.8	1,071.8	1,071.8	1,071.8

Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Recurring P/E (x)	13.0	13.5	16.0	16.2	16.5
P/E (x)	13.0	13.5	16.0	16.2	16.5
P/B (x)	0.8	0.8	0.8	0.8	0.8
FCF Yield (%)	10.8	10.2	8.8	8.7	8.6
Dividend yield (%)	7.8	7.6	5.6	5.5	5.4
EV/EBITDA (x)	15.3	14.2	16.5	16.6	16.8
EV/EBIT (x)	15.3	14.2	16.5	16.6	16.8

Income statement (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover	180	173	149	148	147
Gross profit	140	134	115	114	113
EBITDA	125	135	119	118	117
Depreciation and amortisation	-	-	-	-	-
Operating profit	125	135	119	118	117
Net interest	(41)	(41)	(36)	(36)	(36)
Income from associates & JVs	-	-	-	-	-
Exceptional income - net	(18)	(3)	-	-	-
Pre-tax profit	70	79	72	71	69
Taxation	-	(6)	-	-	-
Minority interests	-	-	-	-	-
Recurring net profit(adj)	88	85	72	71	69

Cash flow (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Change in working capital	(4)	(4)	(4)	(4)	(4)
Cash flow from operations	123	117	101	100	99
Capex	(2)	(2)	(2)	(2)	(2)
Cash flow from investing activities	2	4	4	4	4
Dividends paid	(73)	(88)	(79)	(70)	(69)
Cash flow from financing activities	(113)	(129)	(115)	(106)	(105)
Cash at beginning of period	40	52	43	33	31
Net change in cash	12	(8)	(10)	(3)	(3)
Ending balance cash	52	43	33	31	28

Balance sheet (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total cash and equivalents	76	86	33	31	28
Tangible fixed assets	2,181	2,179	2,179	2,179	2,179
Intangible assets	-	1	2	3	4
Total investments	-	-	-	-	-
Total other assets	1	6	60	63	68
Total assets	2,288	2,276	2,277	2,278	2,280
Short-term debt	117	-	-	-	-
Total long-term debt	737	854	854	854	854
Other liabilities	50	50	51	51	52
Total liabilities	904	904	904	905	905
Shareholders' equity	1,385	1,372	1,373	1,374	1,374
Minority interests	-	-	-	-	-
Total equity	1,385	1,372	1,373	1,374	1,374
Net debt	777	768	820	823	826
Total liabilities & equity	2,288	2,276	2,277	2,278	2,280

Key metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Revenue growth (%)	36.7	(3.7)	(14.0)	(0.7)	(0.9)
Recurrent EPS growth (%)	(6.4)	(4.0)	(15.4)	(1.4)	(1.8)
Gross margin (%)	77.7	77.1	77.1	77.1	77.1
Operating EBITDA margin (%)	69.6	77.7	80.0	80.0	80.0
Net profit margin (%)	48.9	48.8	48.1	47.8	47.4
Dividend payout ratio (%)	101.8	102.1	89.1	89.1	89.1
Capex/sales (%)	1.1	1.2	1.3	1.4	1.4
Interest cover (x)	3.1	3.3	3.3	3.3	3.3

Source: Company data, RHB

Results at a Glance

Figure 1: MRCB-Quill REIT's 2Q19 results summary

FYE Dec (MYRm)	2Q18	1Q19	2Q19	QoQ (%)	YoY (%)	1H18	1H19	YoY (%)	Comments
Revenue	**43.4**	**41.4**	**38.8**	**(6.3)**	**(10.7)**	**87.5**	**80.2**	**(8.3)**	Lower YoY because of lower revenue generated from Platinum Sentral, QB5 and Wisma Technip. Also a loss of revenue from QB8-DHL XPJ after the disposal.
Net property income (NPI)	**33.4**	**32.0**	**29.1**	**(9.2)**	**(12.8)**	**67.6**	**61.1**	**(9.6)**	
Interest expense	(9.9)	(9.9)	(9.7)	(1.3)	(2.1)	(19.6)	(19.6)	(0.2)	Lower YoY interest expense because of lower borrowings after repayment of Murud's Fixed Rate Sub-ordinated Term Loan
Interest income	0.9	0.8	0.6	(31.7)	(35.5)	1.6	1.4	(13.2)	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI	2.2	0.0	0.0	nm	nm	2.2	0.0	nm	
Others	(3.0)	(3.6)	(3.5)	(3.9)	15.0	(7.3)	(7.1)	(3.5)	
Pretax profit	**23.5**	**19.4**	**16.5**	**(15.2)**	**(29.9)**	**44.5**	**35.9**	**(19.4)**	
Tax	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Minority Interest	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Net Profit	**23.5**	**19.4**	**16.5**	**(15.2)**	**(29.9)**	**44.5**	**35.9**	**(19.4)**	
Core Profit	**21.3**	**19.4**	**16.5**	**(15.2)**	**(22.7)**	**42.3**	**35.9**	**(15.2)**	Below expectation
Core earnings per unit (sen)	**2.19**	**1.81**	**1.54**	**(14.9)**	**(29.7)**	**4.16**	**3.35**	**(19.5)**	
Dividends per unit (sen)	**4.23**	**0.00**	**3.43**	**nm**	**(18.9)**	**4.23**	**3.43**	**(18.9)**	
NPI Margin (%)	*76.9*	*77.4*	*75.0*			*77.4*	*76.2*		
Pretax Margin (%)	*54.1*	*46.9*	*42.4*			*50.9*	*44.7*		
Net Margin (%)	*49.0*	*46.9*	*42.4*			*48.4*	*44.7*		

Source: Company data, RHB

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