

MRCB-Quill REIT (BUY ↔, EPS ↑)

INDUSTRY: NEUTRAL
EARNINGS EVALUATION
22 January 2018
Target Price: RM1.44 (↑)
Share Price: RM1.22

4Q17 results - Above expectations

Results

- Above expectations.** 4Q17 normalised net profit of RM21.5m (QoQ: +0.6%; YoY: +60.8%) ended FY17 with RM88.1m (+48.8% YoY). The results were above our expectations but in line with consensus, accounting for 102.3% of ours and 98.7% of consensus FY estimates, respectively.

Deviations

- Above expectations due to lower than expected property operating expenses.

Dividends

- Declared dividend of 4.16 sen, bringing YTD dividend to 8.39 sen (FY16: 8.38 sen) per unit.

Highlights

- YoY:** Normalized net profit increased 60.8% on the back of additional revenue from the newly acquired Menara Shell and higher rental income from QB2, QB3 and Wisma Technip.
- QoQ:** Remained flattish as lower property operating expenses were offset by higher finance cost.
- FY17:** Normalized net profit increased 48.8% due to additional revenue from the newly acquired Menara Shell (full year impact as it was acquired in Dec 2016) and rental rate increases from QB2, QB3 and Wisma Technip.
- Overall occupancy rate remained healthy at 96.3%.
- Average debt to maturity has decreased slightly from 3.05 years to 2.79 years while average cost of debt (4.4% p.a.) was maintained. The gearing level of MQREIT remained unchanged at 37% which is still comfortably below the limit of 50%.
- Outlook:** Despite the lacklustre overall office market, MQREIT's office space will remain stable and well-guarded from its long weighted average term to expiry with well-spread NLA expiry (26% and 13% expiring in FY18 and FY19, respectively).

Risks

- High gearing compared to industry average.
- Slower rental reversion rate for office market.

Forecasts

- Our FY18-19 earnings forecasts are raised by c.4% after incorporating lower property operating expenses assumption.

Rating

BUY ↔, TP: RM1.44 ↑

- We continue to like MQREIT given its high dividend yield (highest among REITs in our universe), stable assets in prime location of KL Sentral with high occupancy rate and healthy WALE profile. The larger portfolio size allows MQREIT to enjoy greater operating efficiency arising from economies of scale.

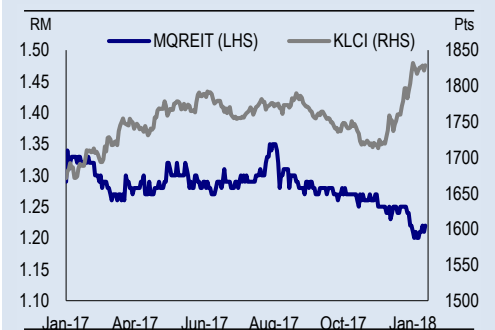
Valuation

- TP is revised higher to **RM1.44** (from RM1.42) after incorporating our latest earnings forecasts.
- Maintain **BUY** with unchanged targeted yield of 6.3%.

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KLCI	1828.8
Expected share price return	18.0%
Expected dividend return	7.5%
Expected total return	25.5%

Share price



Information

Bloomberg Ticker	MQREITMK
Bursa Code	5123
Issued Shares (m)	1,068
Market cap (RM m)	1,303
3-mth avg. volume ('000)	371

Price Performance	1M	3M	12M
Absolute	-2.4	-3.9	-7.6
Relative	-6.1	-8.6	-15.9

Major Shareholders

MRCB	27.9%
Capita Commercial Trust	11.0%
EPF	7.1%

Summary Earnings Table

FYE Dec (RMm)	2016A	2017A	2018F	2019F
Revenue	136.6	181.5	189.1	192.9
NPI	107.2	141.2	144.8	147.7
Net invest income	108.2	125.4	145.9	148.4
PAT	62.8	88.1	92.6	94.9
EPU (sen)	9.3	8.3	8.6	8.7
Norm. PER (x)	13.9	15.2	14.3	14.0
FD PER (x)	13.9	15.2	14.3	14.0
EV/EBITDA (x)	17.5	17.2	16.5	16.3
Net DPU (sen)	8.4	8.7	9.1	9.4
Distrib. yield (%)	6.9	7.1	7.5	7.7
BVPS (RM)	2.0	1.3	1.3	1.3
P/B (x)	0.6	1.0	1.0	1.0

HLIB

Figure #1 Quarterly Results Comparison

FYE Dec (RMm)	4Q16	3Q17	4Q17	QoQ (%)	YoY (%)	Comments
Gross revenue	34.1	44.8	44.7	-0.3	31.1	YoY: Higher due to additional revenue from Menara Shell as well as higher rental income post rent adjustment from QB2, QB3 and Wisma Technip.
Property operating expenses	-8.5	-10.5	-10.0	4.8	-18.6	Higher due to acquisition of Menara Shell.
Net property income	30.5	34.3	36.0	5.1	18.2	
Interest income	1.1	0.7	1.7	132.7	52.9	Higher due to higher bank balances.
Gain on divestment	0.0	0.0	0.0	NM	NM	
Net investment income	30.3	35.0	36.4	3.8	20.1	
Finance costs	-9.1	-10.0	-11.0	-10.4	-20.8	Increase due to higher borrowings incurred to finance the acquisition of Menara Shell.
Valuation fees	-0.2	-0.1	-0.1	-4.7	49.9	
Administrative expenses	-1.5	-0.0	-0.3	NM	82.5	
Total Expenses	-13.4	-13.7	-14.9	-9.0	-11.2	
Normalised PBT	13.4	21.4	21.5	0.6	60.8	
Normalised PAT	13.4	21.4	21.5	0.6	60.8	
EPU (realised)	1.99	2.00	2.01	-13.2	1.2	
DPU (sen)	4.15	0.0	4.16	NM	0.2	

Company Data, HLIB

Figure #2 Cumulative Results Comparison

FYE Dec (RMm)	FY16	FY17	YoY (%)	Comments
Gross revenue	131.8	180.1	36.7	Additional revenue arising from the acquisition of Menara Shell on 22 Dec 2016 and higher rental rates for QB2, QB3 and Wisma Technip.
Property operating expenses	-29.5	-40.2	-36.2	Higher due to acquisition of Menara Shell.
Net property income	107.2	141.3	31.9	
Interest income	2.4	3.6	50.6	
Gain on divestment	0.0	0.0	NM	
Net investment income	108.2	143.5	32.6	
Finance costs	-33.0	-40.5	-22.6	Higher due to financial drawdown to fund the acquisition of Menara Shell.
Valuation fees	-0.4	-0.3	17.3	
Administrative expenses	-1.7	-0.3	79.3	
Total Expenses	-45.5	-55.4	-22.0	
Normalised PBT	59.2	88.1	48.8	
Normalised PAT	59.2	88.1	48.8	Filter down from higher revenue.
EPU (realised)	8.81	8.76	-0.5	
DPU (sen)	8.38	8.39	0.1	

Company Data, HLIB

Figure #3 FY17 Results vs. HLIB's Estimates and Consensus

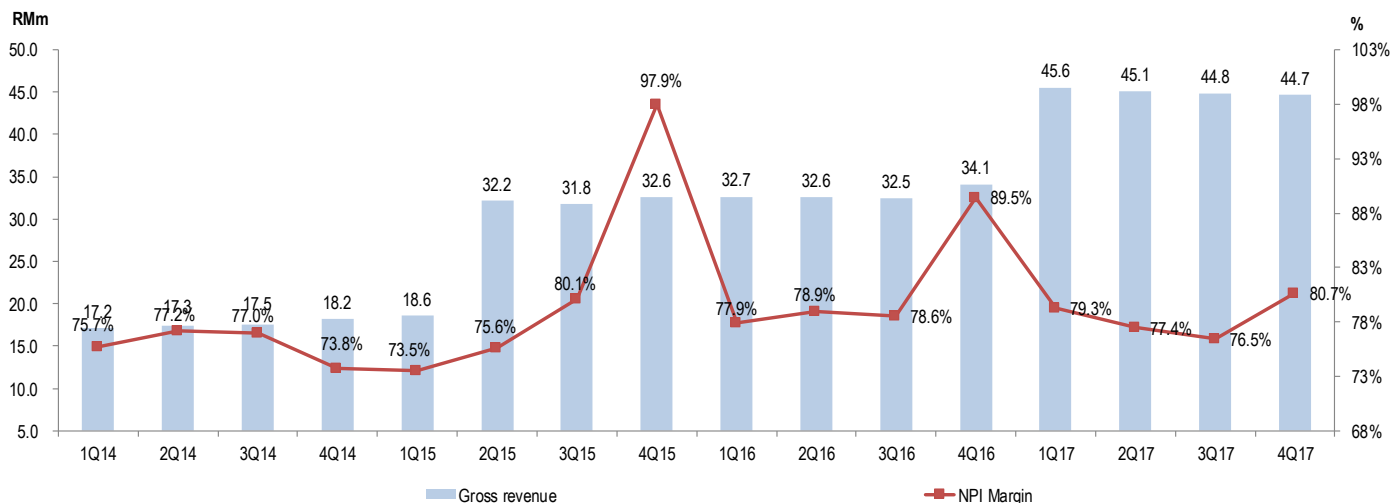
	Actual FY17	HLIB FY17	Actual vs. HLIB (%)	Consensus FY17	Actual vs. Consensus (%)	Comments
Revenue	180.1	185.3	97.2	181.5	99.2	In line.
Normalised PAT	88.1	86.1	102.3	89.3	98.7	In line.
EPU (sen)	8.3	8.0	103.5	8.3	100.0	In line.
DPU (sen)	8.4	8.7	96.7	8.3	101.1	In line.

Company Data, HLIB, Bloomberg

Figure #4 HLIB Forecasts vs. Consensus

RMm	FY18F			FY19F		
	HLIB	Consensus	%	HLIB	Consensus	%
Normalised PAT	92.6	92.7	(0.2)	94.4	95.6	(0.7)
DPU (sen)	9.1	8.4	8.8	9.4	8.5	10.4

HLIB, Bloomberg

Figure #5 Gross Revenue & NPI Margin

HLIB, Bloomberg

Figure #6 Peers Comparison

Company	FYE	Price	Market Cap (RM m)	P/E (x)		P/B (x)		Gross DY (%)
				2018	2019	2018	2019	2018
Amanah Harta Tanah PNB	Dec	RM 0.82	179.3	NA	NA	NA	NA	6.63
Al-Aqar Healthcare REIT	Dec	RM 1.32	961.3	NA	NA	NA	NA	6.29
AmFIRST Real Estate Investment Trust	Mar	RM 0.68	463.3	NA	NA	NA	NA	6.28
Amanahraya Real Estate Investment Trust	Dec	RM 0.91	521.6	15.4	14.0	NA	NA	5.71
Atrium Real Estate Investment Trust	Dec	RM 1.09	132.8	NA	NA	NA	NA	6.79
Axis Real Estate Investment Trust	Dec	RM 1.45	1,823.5	16.9	15.3	1.1	1.1	5.93
CapitaMalls Malaysia Trust	Dec	RM 1.41	3,397.8	16.8	16.1	1.1	1.1	6.33
Hektar Real Estate Investment Trust	Dec	RM 1.23	568.2	12.3	12.3	0.8	0.9	7.32
IGB Real Estate Investment Trust	Dec	RM 1.61	5,877.2	18.2	17.1	1.6	1.6	6.16
KIP Real Estate Investment Trust	Jun	RM 0.84	421.9	12.1	11.8	0.8	0.8	8.26
KLCCP Stapled Group	Dec	RM 7.90	14,424.6	18.6	18.2	0.9	0.9	4.85
MRCB-Quill Real Estate Investment Trust	Dec	RM 1.22	1,377.7	14.9	14.5	0.9	0.9	7.38
Pavilion Real Estate Investment Trust	Dec	RM 1.61	5,235.5	17.7	17.1	1.2	1.2	5.78
Al-Salam Real Estate Investment Trust	Mar	RM 0.98	565.5	15.7	14.3	0.9	0.9	5.95
Sunway Real Estate Investment Trust	Jun	RM 1.73	5,095.0	17.3	16.6	1.2	1.2	5.78
Tower Real Estate Investment Trust	Dec	RM 1.21	339.4	NA	NA	NA	NA	5.73
UOA Real Estate Investment Trust	Dec	RM 1.61	680.8	NA	NA	NA	NA	5.19
YTL Hospitality REIT	Jun	RM 1.19	2,028.2	14.9	13.8	0.9	0.9	6.55
Average				15.9	15.1	1.1	1.1	6.30

HLIB, Bloomberg

MRCB-Quill REIT (BUY, TP: RM1.44, CP: RM1.22)**Income Statement**

FYE Dec (RM m)	2015A	2016A	2017A	2018F	2019F
Gross rental income	99.5	115.9	161.9	169.1	172.5
Car park income	10.3	10.3	13.9	14.2	14.4
Other revenue	5.4	5.6	5.7	5.8	5.9
Total Revenue	120.3	136.6	181.5	189.1	192.9
Assessment & quit rent	(4.5)	(5.4)	(7.6)	(7.6)	(7.8)
Depreciation	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Insurance	(0.7)	(0.9)	(1.2)	(1.2)	(1.2)
Property management fees	(2.2)	(3.5)	(4.9)	(4.2)	(4.3)
Service contracts	(7.3)	(8.8)	(12.6)	(11.8)	(12.1)
Utilities	(10.2)	(10.9)	(13.9)	(19.4)	(19.8)
Total Opex	(24.9)	(29.5)	(40.3)	(44.3)	(45.2)
Net property income	95.4	107.2	141.2	144.8	147.7
Net investment income	99.1	108.2	125.4	145.9	148.4
Pretax profit	60.7	62.8	69.9	92.6	94.9
Taxation	0.0	0.0	0.0	1.0	2.0
Net profit	53.4	59.2	88.1	92.6	94.9
No of units (m)	596.0	672.5	1,068.0	1,082.3	1,090.1
EPU (sen)	10.2	9.3	8.3	8.6	8.7

Cash Flows

FYE Dec (RM m)	2015A	2016A	2017A	2018F	2019F
PBT	60.7	62.8	69.9	92.6	94.9
Finance costs	28.0	33.0	40.5	0.0	0.0
Depreciation	0.0	0.1	0.1	0.0	0.0
Fair value gain of assets	(7.3)	(3.5)	18.2	0.0	0.0
Interest income	(0.9)	(2.4)	(3.6)	0.0	0.0
Others	(21.5)	(19.7)	4.0	0.3	0.3
Operating cashflow	59.0	70.3	129.1	92.8	95.2
Capex	(751.9)	(647.4)	(0.4)	(2.0)	(2.0)
Disposal / (purchase)	(0.2)	(1.5)	(0.0)	(0.0)	(0.0)
Others	24.9	0.0	2.2	0.0	0.0
Investing Cashflow	(727.3)	(648.9)	1.8	(2.0)	(2.0)
Distribution paid	(38.7)	(56.9)	(72.6)	(89.8)	(93.0)
Proceeds from borrowings	534.0	164.0	191.0	100.0	0.0
Repayment of borrowings	(145.0)	0.0	(190.0)	(117.0)	0.0
Placement / New shares	342.0	487.9	(37.2)	0.0	0.0
Financing cashflow	692.3	595.1	(108.8)	(106.8)	(93.0)

Balance Sheet

FYE Dec (RM m)	2015A	2016A	2017A	2018F	2019F
PPE	0.2	0.2	0.2	0.2	0.2
Investment properties	1,569.8	2,222.0	2,179.2	2,226.0	2,228.0
Others	3.6	2.7	2.0	2.7	2.7
Non-current assets	1,573.6	2,225.0	2,181.4	2,229.0	2,231.0
Trade receivables	6.1	18.3	31.0	17.7	18.1
Cash	44.9	54.1	76.0	23.4	23.6
Total Current Assets	51.7	72.4	107.0	41.2	41.7
Total assets	1,625.3	2,297.3	2,288.4	2,270.1	2,272.7
Unitholders' capital	751.3	1,231.9	1,231.9	1,231.9	1,231.9
Undistributed profit	152.6	127.8	152.8	131.4	133.3
Total Equity	903.9	1,359.7	1,384.7	1,363.4	1,365.3
Borrowings	689.7	851.6	853.5	845.5	845.5
Security Deposits	18.1	29.3	29.2	29.3	29.3
Derivatives	0.0	1.0	0.7	1.0	1.0
Trade payables	13.6	55.8	20.3	31.0	31.6
Total liabilities	721.5	937.6	903.7	906.8	907.4
Total liabilities & equity	1,625.3	2,297.3	2,288.4	2,270.1	2,272.7

Valuation Ratios

FYE Dec (RM m)	2015A	2016E	2017A	2018F	2019F
EPU before mgr's fee	9.0	8.8	8.0	8.6	8.7
EPU after mgr's fee	10.2	9.3	8.0	8.6	8.7
PER (x)	13.6	13.9	15.2	14.3	14.0
No of units	596.0	672.5	1,068.0	1,082.3	1,090.1
Net DPU	8.5	8.4	8.7	9.1	9.4
Net DY (%)	6.9	6.9	7.1	7.5	7.7
NTA/ share (sen)	151.0	201.3	126.0	125.2	124.4
P/NTA (x)	0.8	0.6	1.0	1.0	1.0
FCF/ share (sen)	16.2	19.5	13.1	18.6	17.4
FCF yield (%)	13.3	16.0	10.7	15.3	14.3
Enterprise value	1,372.0	1,618.0	2,131.7	2,142.5	2,151.8
EV/ EBITDA (x)	16.7	17.5	17.2	16.5	16.3
ROE (%)	6.7	4.6	6.3	6.8	6.9
Net gearing (x)	0.4	0.3	0.4	0.4	0.4
Total gearing (x)	0.4	0.4	0.4	0.4	0.4
BVPS (RM)	1.5	2.0	1.3	1.3	1.3
P/B (x)	0.8	0.6	1.0	1.0	1.0

Assumption metrics

Gross Rental Income	2017A	2018F	2019F
Quill Building 1 - DHL 1	4.8	4.9	5.0
Quill Building 4 - DHL 2	5.2	5.3	5.4
Quill Building 2 - HSBC	9.6	9.8	10.0
Quill Building 3 - BMW	5.0	5.1	5.2
Wisma Technip	12.2	12.4	12.7
Part of Plaza Mont' Kiara	3.9	4.0	4.1
Quill Building 5 - IBM	3.9	4.0	4.0
Quill Building 6 - DHL XPJ	3.1	3.2	3.3
Tesco Building - Penang	14.4	14.6	14.9
Platinum Sentral	56.5	57.6	58.8
Menara Shell	47.2	48.1	49.1
Total	165.8	169.1	172.5

Quarterly Financial Summary

FYE Dec (RM m)	4Q16	3Q17	4Q17	QoQ (%)	YoY (%)
Gross revenue	34.1	44.8	44.7	(0.3)	31.1
Property operating expenses	(8.5)	(10.5)	(10.0)	4.8	(18.6)
Net property income	30.5	34.3	36.0	5.1	18.2
Interest income	1.1	0.7	1.7	132.7	52.9
Revaluation gains	3.5	0.0	0.0	NM	NM
Net investment income	30.3	35.0	36.4	3.8	20.1
Finance costs	(9.1)	(10.0)	(11.0)	(10.4)	(20.8)
Valuation fees	(0.2)	(0.1)	(0.1)	(4.7)	49.9
Administrative expenses	(1.5)	(0.0)	(0.3)	(551.1)	82.5
Total Expenses	(13.4)	(13.7)	(14.9)	(9.0)	(11.2)
Normalised PBT	13.4	21.4	21.5	0.6	60.8
Normalised PAT	13.4	21.4	21.5	0.6	60.8
EPU after mgmt fee	2.0	2.3	2.0	(13.2)	1.2
DPU (sen)	4	0	4	NM	0.2

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2. As of 22 January 2018, the analyst, Farah Diyana Kamaludin who prepared this report, has interest in the following securities covered in this report:

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Equity rating definitions

BUY	Positive recommendation of stock under coverage. Expected absolute return of more than +10% over 12-months, with low risk of sustained downside.
TRADING BUY	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between -10% and +10% over 12-months, with low risk of sustained downside.
TRADING SELL	Negative recommendation of stock not under coverage. Expected absolute return of less than -10% over 6-months. Situational or arbitrage trading opportunity.
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NOT RATED	No research coverage, and report is intended purely for informational purposes.

Industry rating definitions

OVERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of more than +5% over 12-months.
NEUTRAL	The sector, based on weighted market capitalization, is expected to have absolute return between -5% and +5% over 12-months.
UNDERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of less than -5% over 12-months.