

18 Jan 2019

Buy

Price
RM1.12Target Price
RM1.25

Market Data

Bloomberg Code	MQREIT MK
No. of shares (m)	1,071.8
Market cap (RMm)	1,200.4
52-week high/low (RM)	1.26 / 1.00
Avg daily turnover (RMm)	0.1
KLCI (pts)	1,683.0

Source: Bloomberg, KAF

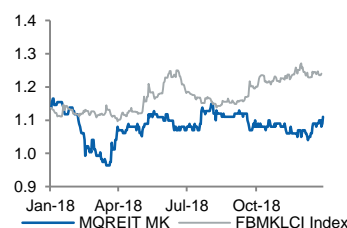
Major Shareholder (%)

MRCB	(27.8%)
KWSP	(11.9%)
CapitalLand Ltd	(10.9%)
Free Float	330.9

Source: Bloomberg, KAF

Performance

	3M	6M	12M
Absolute (%)	3.7	0.9	(8.2)
Rel Market (%)	7.3	4.2	(0.3)



Source: Bloomberg, KAF

MRCB-Quill REIT

Lowering estimates

We maintain our Buy recommendation on MRCB-Quill REIT (MQREIT) with a lower target price of RM1.25, based on our DDM valuation. We cut FY19-21F earnings by 4-6% to account for the non-renewals of some tenants at Platinum Sentral and Menara Shell (c.55k sq ft). The rental weakness, however, has been priced in by the decline in its share price. On lowered DPU estimates, the stock offers attractive dividend yields of 7.0-7.5%.

Financial Highlights

FYE Dec	2017	2018	2019F	2020F	2021F
Revenue (RM mil)	180.1	173.4	176.7	180.3	184.9
Net Property Income	140.0	133.7	136.2	139.0	142.5
Realised Net profit (RM mil)	87.0	82.5	84.0	86.4	89.5
EPU (sen)	8.1	7.7	7.8	8.1	8.4
EPU Growth (%)	48.7	(5.4)	1.8	2.9	3.6
DPU (sen)	8.4	8.1	7.8	8.1	8.4
PE (x)	13.8	14.5	14.3	13.9	13.4
Div yield (%)	7.5	7.2	7.0	7.2	7.5
ROE (%)	5.0	5.3	6.1	6.3	6.5
Gearing (%)	37.3	37.5	37.5	37.5	37.5

Source: Company, KAF

FY18 results within expectations

MQREIT posted revenue and core net profit of RM42.7m and RM19.6m in 4Q18, down 4% and 9%, respectively yoy. This has brought cumulative net profit down to RM83.1m, a decline of 6% yoy, making up 101% of our full-year estimates. The earnings decline was mainly attributed to: i) lower revenue contribution from Platinum Sentral and Menara Shell and ii) loss of revenue from Quill Building 8 after the disposal took place in April 2018. MQREIT declared a final gross DPU of 3.85 sen, bringing total DPU of 8.08 sen for the year, which on an annualized basis, was slightly below our full-year DPU forecast of 8.3 sen.

Minimal rental growth and to focus on tenant retention

The Klang Valley office property market is expected to remain challenging with approximately 20m sq ft of office space set to enter the market within the next two years. This increase in office supply is likely to exert pressure on rental rates and therefore, looking ahead, we believe MQREIT will focus on retaining its current tenants. To note, the REIT managers have successfully managed to renew c.454k sq ft of net lettable area (NLA) that was due in FY18 (renewal rate of 75%). Going forward, about 12% of its NLA is expiring in FY19. While management has guided for minimal non-renewal risks, we expect this to be capped at minimal rental reversions of flat to low single digit reversions.

Earnings revision

We have tweaked our forecasts for FY19-20 to reflect the non-renewals of c.55k sq ft space at Platinum Sentral and Menara Shell. This leads to a 1-2% decline in FY19-20F revenue and 4-6% cut in FY19-20F EPS. Consequently, our DPU forecasts are revised downwards to 7.8-8.1 sen, based on a 100% distribution rate. This translates to dividend yields of 7.0-7.2% for FY19-20F. Upon earnings revision and rolling forward valuations, we obtain a lower target price of RM1.25 (from RM1.50). Our DDM-derived TP is based on cost of equity and growth assumptions of 8.8% and 2.5%, respectively.

Retain Buy call with lower target price of RM1.25

We continue to like MQREIT for its quality assets which are strategically located and backed by long-term leases. At the current price level, MQREIT offers a yield of 7.0%, which translates to a yield spread of 295 bps over the 10-year MGS of 4.1%. Key downside risks are non-renewal of expiring leases and worse-than-expected office oversupply situation.

Analyst

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Exhibit 1: Quarterly earnings trend

(RM m)						Change		Cumulative		
FYE 31 Dec	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	% qoq	% yoy	12M17	12M18	% chg
Revenue	44.7	44.0	43.7	43.6	42.7	(2)	(4)	180.1	174.0	(3)
Property operating expenses	(10.0)	(9.8)	(10.0)	(9.9)	(10.0)	1	(0)	(40.2)	(39.7)	(1)
Net property income	34.6	34.3	33.6	33.7	32.7	(3)	(6)	140.0	134.3	(4)
Interest income	1.7	0.7	0.9	1.0	1.7	66	(2)	3.6	4.3	21
Trust expenses	(3.9)	(4.3)	(3.0)	(3.7)	(3.9)	4	(0)	(14.9)	(14.9)	(0)
Borrowing costs	(11.0)	(9.7)	(9.9)	(10.1)	(10.9)	8	(1)	(40.5)	(40.6)	0
Exceptional items	(18.2)	2.2			(11.6)	nm	(36)	(18.2)	(9.4)	-
Profit before tax	3.3	21.0	23.8	20.9	8.0	(62)	142	69.9	73.7	5
Tax	-	-	-	-	-	nm	nm	-	-	
Net profit	3.3	21.0	23.8	20.9	8.0	(62)	142	69.9	73.7	5
Normalized net profit	21.5	21.0	21.6	20.9	19.6	(6)	(9)	88.1	83.1	(6)

Source: Company, KAF

Exhibit 2: Earnings revision

	Original		Revised		Change	
	FY19F	FY20F	FY19F	FY20F	FY19F	FY20F
Revenue	180.0	182.4	176.7	180.3	-1.8%	-1.2%
NPI	140.3	141.7	136.2	139.0	-2.9%	-1.9%
Pretax profit	88.8	90.0	84.0	86.4	-5.5%	-4.0%
Net profit	88.8	90.0	84.0	86.4	-5.5%	-4.0%

Source: Company, KAF

Exhibit 3: PB Band chart

Source: Company, KAF, Bloomberg

Exhibit 4: PE Band chart

Source: Company, KAF, Bloomberg

MRCB-Quill REIT

Income Statement

FYE Dec (RMm)	2017	2018	2019F	2020F	2021F
Gross rental income	180.1	173.4	176.7	180.3	184.9
Property operating expenses	(40.2)	(39.7)	(40.5)	(41.3)	(42.4)
Net property income	140.0	133.7	136.2	139.0	142.5
Non-property expenses	(14.9)	(14.9)	(15.2)	(15.5)	(15.9)
PBITDA	125.0	118.8	121.1	123.5	126.6
PBIT	125.0	118.8	121.1	123.5	126.6
Interest expense	(40.5)	(40.6)	(40.6)	(40.6)	(40.6)
Exceptional item	(18.2)	(9.4)	-	-	-
PBT	68.8	73.1	84.0	86.4	89.5
Tax	-	-	-	-	-
Distributable Income	68.8	73.1	84.0	86.4	89.5
Core Net Profit	87.0	82.5	84.0	86.4	89.5

Balance Sheet

FYE Dec (RMm)	2017	2018	2019F	2020F	2021F
Investment Properties	2,181.4	2,156.4	2,156.4	2,156.4	2,156.4
Trade and other receivables	31.0	29.8	30.4	31.0	31.8
Cash and cash equivalents	76.0	91.0	90.8	90.6	90.3
Inventories	-	-	-	-	-
Total Assets	2,288.4	2,277.2	2,277.5	2,277.9	2,278.5
Payables and accruals	33.1	32.4	32.8	33.1	33.7
Short-term Borrowings	116.9	116.9	116.9	116.9	116.9
Long-term Borrowings	736.6	736.6	736.6	736.6	736.6
Payables and accruals	17.1	17.1	17.1	17.1	17.1
Unit holder's capital	1,231.9	1,231.9	1,231.9	1,231.9	1,231.9
Undistributed income to Reserves	152.8	142.3	142.3	142.3	142.3
Total unit holder's fund	1,384.7	1,374.3	1,374.3	1,374.3	1,374.3
Total liabilities and shareholder's fund	2,288.4	2,277.2	2,277.5	2,277.9	2,278.5

Cash flow Statement

FYE Dec (RMm)	2017	2018	2019F	2020F	2021F
Pretax profit	68.8	73.1	84.0	86.4	89.5
Working Capital	124.8	109.4	121.1	123.5	126.6
Others	nm	nm	nm	nm	nm
Operating cash flows	128.2	109.8	120.9	123.3	126.4
Acquisitions	(0.4)	-	-	-	-
Enhancement exp.	2.1	4.3	3.5	3.4	3.4
Others	(6.6)	-	-	-	-
Investing cash flows	(4.8)	4.3	3.5	3.4	3.4
Issue of shares	-	-	-	-	-
Dividend paid	(72.6)	(86.6)	(84.0)	(86.4)	(89.5)
Borrowings	(0.3)	-	-	-	-
Others	(35.7)	(40.6)	(40.6)	(40.6)	(40.6)
Financing cash flow	(108.6)	(127.2)	(124.5)	(126.9)	(130.1)
Net inflows/(outflows)	14.7	(13.1)	(0.2)	(0.2)	(0.3)
Change in receivables	13.5	1.2	(0.6)	(0.6)	(0.8)
Change in payables	(10.1)	(0.8)	0.4	0.4	0.5

Source: Bloomberg, 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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