

COMPANY UPDATE

MRCB-Quill REIT (MQREIT MK)

Inflection Point In 2H19

Being a prominent laggard among MREITs, MQREIT should re-rate further with its occupancy and earnings set to improve in 2H19. While the Malaysian office sector will continue to be dampened by oversupply in the intermediate term, MQREIT's properties are mostly insulated by its sought-after KL Sentral office properties and long tenancy agreements that ensure modest growth. MQREIT also has an attractive dividend yield of 6.7% for 2019. Upgrade to BUY with a target price of RM1.15.

WHAT'S NEW

- **Earnings to improve.** MRCB-Quill REIT's (MQREIT) management guided that efforts to attract and retain tenants are paying off and their assets should stabilise thereafter, pointing to good earnings and DPU increases in 2020.
- **Highest-yielding REIT in our coverage.** Among the REITs in our coverage, MQREIT yields the highest dividend at 6.7-7.0% for 2019-20. This suggests that it is a market laggard as share prices of other REITs have surged >10% ytd.

STOCK IMPACT

- **4.7% yoy earnings growth expected in 2020.** With the improvement in occupancy, we expect earnings to pick up in 2020. New tenants came in and could take up additional space in the near future. 2019 will see flattish earnings growth yoy at best, largely due to the disposal of an asset in 2018, in addition to rent-free periods for new tenants in 2019. Platinum Sentral and Menara Shell contribute >60% of rental revenue.
- **Total lease for renewals for 2019 and 2020 are at 19% and 18% of total NLA respectively.** Leases due in 1Q19 (c.59,000sf) which are predominantly in Platinum Sentral, were not renewed. However, approximately 48,000sf was taken by a new tenant in April. We gathered that the lease is long-term but with slightly lower rents.
- **Portfolio backed by long-term leases of sizeable tenants.** The average occupancy rate for MQREIT's properties (89% as at 31 Mar 19) has been well above the average of Klang Valley's average office occupancy rate which hovered at around 80% in 2018. This was mainly due to MQREIT's strategy which allows them to lock in tenants under long-term contracts. MQREIT's WALE is at 4.84 years, one of the highest in our coverage.

KEY FINANCIALS

Year to 31 Dec (RMm)	2017	2018	2019F	2020F	2021F
Net turnover	180	173	173	177	180
EBITDA	125	119	117	120	124
Operating profit	125	119	117	120	124
Net profit (rep./act.)	70	73	81	85	88
Net profit (adj.)	88	83	81	85	88
EPS (sen)	8.3	7.7	7.6	7.9	8.3
PE (x)	13.1	14.0	14.3	13.6	13.1
P/B (x)	0.8	0.8	0.8	0.8	0.8
EV/EBITDA (x)	15.4	16.2	16.4	16.0	15.6
Dividend yield (%)	7.8	7.5	6.7	7.0	7.3
Net margin (%)	38.9	42.2	47.0	48.0	49.1
Net debt/(cash) to equity (%)	54.3	56.0	55.7	55.5	55.3
Interest cover (x)	3.4	3.3	3.3	3.4	3.5
ROE (%)	5.1	5.3	5.9	6.2	6.4
Consensus net profit	-	-	83	84	87
UOBKH/Consensus (x)	-	-	0.98	1.02	1.02

Source: MRCB-Quill Reit, Bloomberg, UOB Kay Hian

BUY

(Upgraded)

Share Price	RM1.08
Target Price	RM1.15
Upside	+6.5%
(Previous TP)	RM1.10)

COMPANY DESCRIPTION

MRCB-Quill REIT invests in office and retail buildings, business/technology parks, data processing centres and car park facilities primarily in Malaysia

STOCK DATA

GICS sector	Real Estate
Bloomberg ticker	MQREIT MK
Shares issued (m)	1,071.8
Market cap (RMm)	1,157.5
Market cap (US\$m)	281.7
3-mth avg daily t'over (US\$m)	0.1

Price Performance (%)

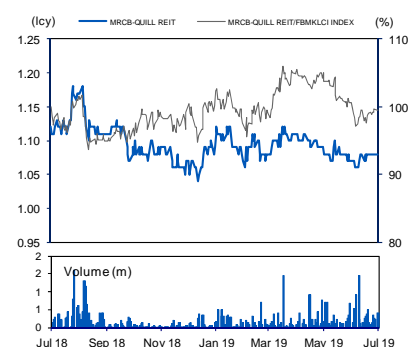
52-week high/low			RM1.18/RM1.04	
1mth	3mth	6mth	1yr	YTD
0.9	(2.7)	(0.9)	(3.6)	1.9

Major Shareholders

	%
Malaysian Resources Corp	27.8
Employees Provident Fund	12.1
Capitaland Ltd	10.9

FY19 NAV/Share (RM)	1.28
FY19 Net Debt/Share (RM)	0.72

PRICE CHART



Source: Bloomberg

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- **Gearing at 37.5%.** MQREIT's current gearing ratio is healthy and on par with peers, and this allows it to tap into the debt and equity markets for future acquisitions. 76% of total borrowings are on fixed rates.
- **Potential injection of Menara Celcom.** Menara Celcom was handed over to Celcom Axiata in Sep 18. Celcom has a 21-year lease on the building. The potential acquisition of Menara Celcom could re-rate MQREIT. However, we opine the acquisition will not take place in the near term. Recall that the acquisition of Menara Shell which was completed in Dec 16 had MQREIT's core earnings soaring by almost 50% yoy in 2017.

EARNINGS REVISION/RISK

- No change to earnings forecasts. We forecast portfolio occupancy rate to improve to about 94% in 2020 (currently 89% as at 31 Mar 19).

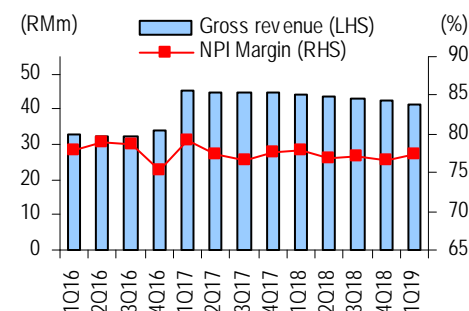
VALUATION/RECOMMENDATION

- **Upgrade to BUY with target price of RM1.15.** Our target price is based on a dividend discount model (required rate of return: 6.6%, terminal growth: 1.3%) and represents an implied dividend yield of 6.3%. We expect the likely sustained overhang on share price from tenancy renewal risks to be compensated for by high dividend yields of 6.7-7.3% for 2019-21. MQREIT's yield spread to Malaysian government securities (MGS) is currently at 3.59ppt compared to the sector average of 1.91ppt. We concur that there could be further upside to share price given the wide spread compared to peers.

SHARE PRICE CATALYST

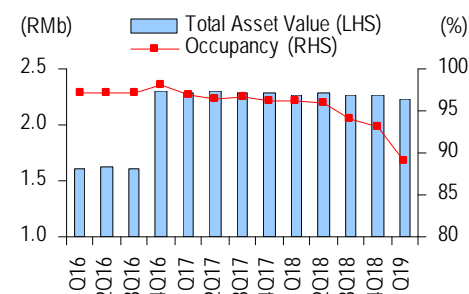
- Inorganic growth arising from acquisitions.

REVENUE AND NPI MARGIN



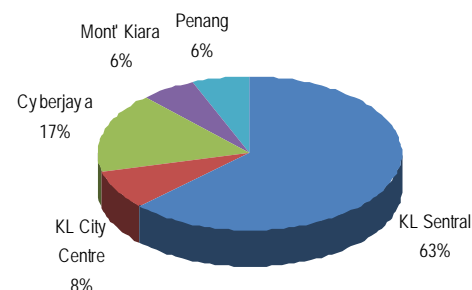
Source: MQREIT, UOB Kay Hian

TOTAL ASSET VALUE AND OCCUPANCY RATE



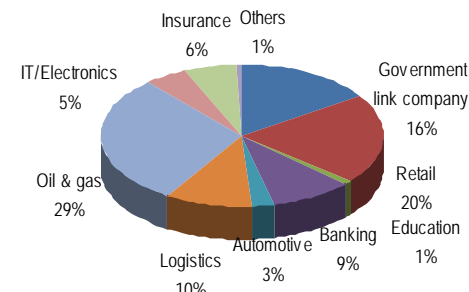
Source: MQREIT, UOB Kay Hian

GEOGRAPHICAL DIVERSIFICATION



Source: MQREIT, UOB Kay Hian

TENANCY MIX



Source: MQREIT, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (RMm)	2018	2019F	2020F	2021F
Net turnover	173	173	177	180
EBITDA	119	117	120	124
Deprec. & amort.	0	0	0	0
EBIT	119	117	120	124
Net interest income/(expense)	(36)	(36)	(35)	(35)
Pre-tax profit	79	81	85	88
Tax	(6)	0	0	0
Net profit	73	81	85	88
Net profit (adj.)	83	81	85	88

BALANCE SHEET

Year to 31 Dec (RMm)	2018	2019F	2020F	2021F
Fixed assets	2,178	2,180	2,182	2,184
Other LT assets	2	2	2	1
Cash/ST investment	86	87	74	59
Other current assets	6	6	6	7
Total assets	2,271	2,275	2,263	2,250
ST debt	0	0	0	0
Other current liabilities	32	28	28	27
LT debt	854	854	839	824
Other LT liabilities	13	18	18	18
Shareholders' equity	1,372	1,376	1,379	1,382
Total liabilities & equity	2,271	2,275	2,263	2,250

CASH FLOW

Year to 31 Dec (RMm)	2018	2019F	2020F	2021F
Operating	107	122	125	127
Pre-tax profit	79	81	85	88
Deprec. & amort.	0	0	0	0
Other operating cashflows	28	40	40	39
Investing	28	(2)	(2)	(2)
Capex (growth)	(4)	(2)	(2)	(2)
Proceeds from sale of assets	0	0	0	0
Others	31	0	0	0
Financing	(125)	(118)	(137)	(140)
Distribution to unitholders	(90)	(78)	(82)	(85)
Issue of shares	4	0	0	0
Proceeds from borrowings	0	15	0	0
Loan repayment	0	(15)	(15)	(15)
Others/interest paid	(39)	(40)	(40)	(40)
Net cash inflow (outflow)	10	2	(14)	(15)
Beginning cash & cash equivalent	101	86	87	74
Changes due to forex impact	(25)	0	0	0
Ending cash & cash equivalent	86	87	74	59

KEY METRICS

Year to 31 Dec (%)	2018	2019F	2020F	2021F
Profitability				
EBITDA margin	68.5	67.9	68.0	68.6
Pre-tax margin	45.7	47.0	48.0	49.1
Net margin	42.2	47.0	48.0	49.1
ROA	3.2	3.6	3.7	3.9
ROE	5.3	5.9	6.2	6.4
Growth				
Turnover	(3.7)	(0.5)	2.4	2.0
EBITDA	(5.1)	(1.3)	2.6	2.9
Pre-tax profit	13.1	2.3	4.7	4.1
Net profit	4.3	10.9	4.7	4.1
Net profit (adj.)	(6.5)	(1.7)	4.7	4.1
EPU	(6.8)	(1.7)	4.7	4.1
Leverage				
Debt to total capital	38.4	38.3	37.8	37.3
Debt to equity	62.2	62.1	60.8	59.6
Net debt/(cash) to equity	56.0	55.7	55.5	55.3
Interest cover (x)	3.3	3.3	3.4	3.5

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