9 January 2018

Property | REITS

MRCB-Quill REIT

Disposing Of Quill Building 8 – DHL (XPJ)

Neutral (Maintained)

Target Price:	MYR1.28
Price:	MYR1.21
Market Cap:	USD323m
Bloomberg Ticker:	MQREIT MK

MRCB-Quill is selling Quill Building 8 – DHL (XPJ) to Transmark Corp for MYR28m. The disposal could be a move to streamline the REIT's asset portfolio. Nevertheless, the sale would have a slight impact to our earnings due to the loss of income. We, therefore, revise down our FY19F earnings by 1% and trim our DDM-based TP to MYR1.28 (from MYR1.35, 6% upside). Maintain NEUTRAL.

Disposal of Quill Building 8 – DHL (XPJ). MRCB-Quill REIT (MRCB-Quill) announced its intention to dispose of Quill Building 8 – DHL (XPJ) to Transmark Corp SB (Transmark Corp) for a total cash consideration of MYR28m. The property is a single-storey detached warehouse, located at Hicom Glenmarie Industrial Park, Section U1, Shah Alam, Selangor.

Details of the property. Quill Building 8 – DHL (XPJ) was acquired by MRCB-Quill in Mar 2008 with a total investment cost of MYR28.8m. It has a total NLA of 65,205sqf. The building was single tenanted by DHL Express (Malaysia) SB with a 92% occupancy rate. Net book value as at Dec 2016 stood at MYR25m, and the sale would result in a net gain on disposal of about MYR1.28m.

Minimal impact to long-term earnings. Earnings to the REIT would be affected slightly after the completion of the disposal in 2Q18. We estimate that the property currently contributes around MYR2.5m to its topline and about MYR1.2m to the bottomline. We do not expect the disposal to have significant impact to its current gearing of c.37%.

Earnings revision. We revise down our FY18-19 earnings forecasts by 1% to reflect the loss of income from the building. Going forward, we are cautious on the REIT's portfolio occupancy, given that 26% of its total NLA is up for renewal in FY18 (FY17: 16%). In addition, tenant retention remains challenging, in view of the oversupply of office space in the Greater Kuala Lumpur area.

Maintain NEUTRAL. After imputing a lower future income, we trim our DDM-based TP to MYR1.28. We expect Bank Negara Malaysia (BNM) to raise interest rates this year – this is typically unfavourable for REITs, given the narrowing yield spread and higher interest expenses. The REIT sector is unlikely to outperform the market this year.

Inorganic growth could be catalyst. The potential injection of assets into the REIT from its sponsors – Malaysian Resources Corp (MRCB) (MRC MK, BUY, TP: MYR1.51) and Quill Group – could be the potential catalysts to spur inorganic growth, in our view. Risks include an oversupply of office properties that might affect the portfolio's office property occupancy and rental rates.

Share Data

Avg Daily Turnover (MYR/USD)	0.37m/0.09m
52-wk Price low/high (MYR)	1.21 - 1.35
Free Float (%)	33
Shares outstanding (m)	390
Estimated Return	6%

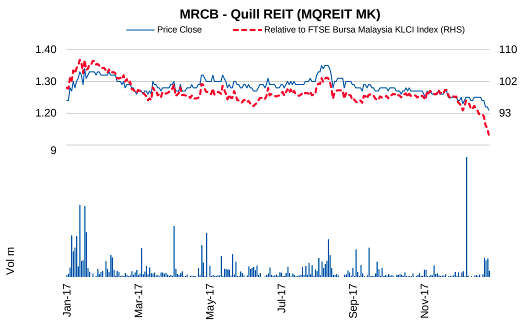
Shareholders (%)

Malaysian Resources Corp	27.9
Quill Group	11.0
CapitaCommercial Trust	11.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(3.2)	(3.2)	(5.5)	(5.5)	(2.4)
Relative	(5.2)	(9.6)	(9.4)	(9.6)	(11.8)

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (MYRm)	115	132	174	177	180
Net property income (MYRm)	90	102	130	135	138
Reported net profit (MYRm)	53.4	59.2	85.8	90.5	93.6
Total distributable income (MYRm)	53.4	59.2	85.8	90.5	93.6
DPS (MYR)	0.08	0.08	0.08	0.08	0.08
DPS growth (%)	1.1	(1.1)	(7.5)	2.4	4.9
Recurring P/E (x)	13.4	13.5	15.1	14.5	13.8
P/B (x)	0.89	0.95	0.95	0.94	0.94
Dividend Yield (%)	7.0	6.9	6.4	6.6	6.9
Return on average equity (%)	7.4	5.2	6.3	6.6	6.8
Return on average assets (%)	4.3	3.0	3.8	4.0	4.1
Interest cover (x)	2.81	2.72	3.33	3.46	3.55
Our vs consensus EPS (adjusted) (%)			(3.2)	(5.1)	(4.7)

Source: Company data, RHB

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Financial Exhibits

Financial model updated on: 2018-01-08

Asia
Malaysia
Property
MRCB-Quill REIT
Bloomberg MQREIT MK
Neutral

Valuation basis

Dividend discount model.

Key drivers

i. Higher-than-expected demand of office space;
ii. Inorganic growth opportunities arising from MRCB and Quill Group.

Key risks

Oversupply of office properties might affect the portfolio's office property occupancy and rental rates.

Company Profile

MRCB-Quill REIT (MRCB-Quill) 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-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Recurring EPS (MYR)	0.09	0.09	0.08	0.08	0.09
EPS (MYR)	0.09	0.09	0.08	0.08	0.09
DPS (MYR)	0.08	0.08	0.08	0.08	0.08
BVPS (MYR)	1.37	1.27	1.28	1.28	1.29
Weighted avg adjusted shares (m)	594	661	1,068	1,068	1,068

Valuation metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Recurring P/E (x)	13.4	13.5	15.1	14.5	13.8
P/E (x)	13.4	13.5	15.1	14.3	13.8
P/B (x)	0.89	0.95	0.95	0.94	0.94
FCF Yield (%)	7.1	(46.1)	6.4	6.7	6.9
Dividend Yield (%)	7.0	6.9	6.4	6.6	6.9
EV/EBITDA (x)	(1.43)	(0.93)	(1.10)	(0.91)	(0.92)
EV/EBIT (x)	(1.43)	(0.93)	(1.10)	(0.91)	(0.92)

Income statement	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (MYRm)	115	132	174	177	180
EBITDA (MYRm)	80	90	119	124	127
Operating profit (MYRm)	80	90	119	124	127
Net interest (MYRm)	(27)	(31)	(33)	(33)	(33)
Pre-tax profit (MYRm)	53	59	86	91	94
Recurring net profit (MYRm)	53	59	86	89	94

Cash flow (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Change in working capital	(3)	(3)	(4)	(4)	(4)
Cash flow from operations	53	58	84	89	92
Capex	(2)	(427)	(2)	(2)	(2)
Cash flow from investing activities	(2)	(427)	(2)	(1)	(1)
Proceeds from issue of shares	353	448	0	0	0
Dividends paid	(41)	(53)	(69)	(84)	(87)
Cash flow from financing activities	507	786	(69)	(84)	(87)
Cash at beginning of period	23	45	54	53	57
Net change in cash	558	417	13	4	4
Ending balance cash	581	462	67	57	61

Balance sheet (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total cash and equivalents	45	54	53	57	61
Total investments	1,573	2,225	2,225	2,200	2,200
Total other assets	0	0	0	0	0
Total assets	1,625	2,297	2,262	2,266	2,271
Short-term debt	189	189	117	117	117
Total long-term debt	501	662	737	735	735
Other liabilities	15	23	22	23	23
Total liabilities	721	938	899	898	898
Shareholders' equity	904	1,360	1,363	1,368	1,373
Total equity	904	1,360	1,363	1,368	1,373
Net debt	645	798	801	795	791
Total liabilities & equity	1,625	2,297	2,262	2,266	2,271

Key metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Revenue growth (%)	64.0	14.4	31.8	1.7	1.8
Recurrent EPS growth (%)	2.9	(0.5)	(10.3)	4.0	4.9
Operating EBITDA margin (%)	69.9	68.2	68.7	70.2	70.7
Net profit margin (%)	46.4	44.9	49.4	51.3	52.1
Dividend payout ratio (%)	94.1	93.6	93.6	93.6	93.6
Capex/sales (%)	1.7	324.0	1.2	1.1	1.1
Interest cover (x)	2.81	2.72	3.33	3.46	3.55

Source: Company data, RHB

Figure 1: MRCB-Quill's forecast assumptions

	NLA / GFA (sqf)	Average rental rates (MYR psf)		
Asset		**FY17F**	**FY18F**	**FY19F**
QB 1 – DHL 1	92,284	4.58	4.68	4.77
QB 4 – DHL 2	99,183	4.58	4.68	4.77
QB 2 – HSBC	184,453	4.58	4.68	4.77
QB 3 – BMW	117,198	4.58	4.68	4.77
QB 5 – IBM	81,602	3.33	3.43	3.53
Plaza MK	73,408	8.78	8.79	8.80
Wisma Technip	233,021	6.26	6.45	6.64
QB 10 – HSBC	68,377	3.33	3.43	3.53
Tesco Penang	275,020	4.06	4.14	4.23
Platinum Sentral	475,857	9.31	9.59	9.88
Shell Tower	557,053	7.28	7.46	7.65
DPU (sen)		**7.75**	**7.94**	**8.33**

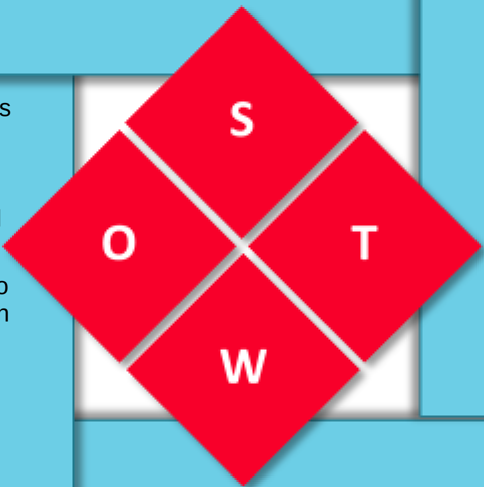
Source: RHB, Company data

SWOT Analysis

- Long-term leases on most of its assets

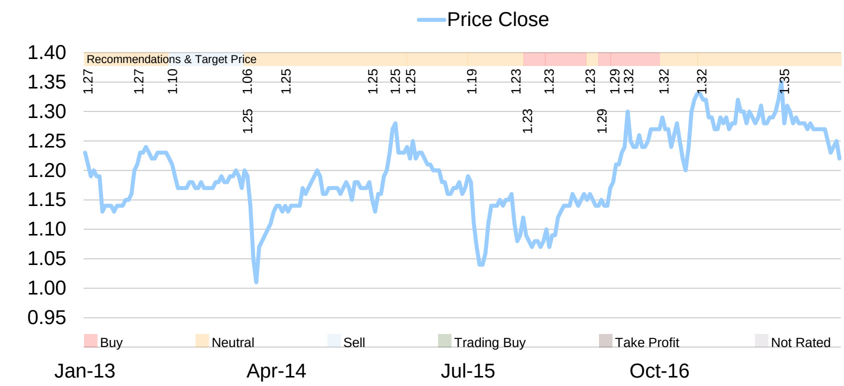
- The entry of larger REITs into the market

- Upcoming mass rapid transit (MRT) links could help stimulate rental rates
- Opportunities to enhance growth through more quality asset injections



- High exposure to single tenancies (>80% of NLA)
- Subdued rental revenue growth

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2017-11-19	Neutral	1.35	1.27
2017-08-13	Neutral	1.35	1.32
2017-05-05	Neutral	1.32	1.32
2017-01-26	Neutral	1.32	1.32
2016-10-27	Neutral	1.32	1.27
2016-08-03	Buy	1.32	1.24
2016-07-01	Buy	1.29	1.17
2016-05-31	Buy	1.29	1.14
2016-05-03	Neutral	1.23	1.14
2016-01-25	Buy	1.23	1.08

Source: RHB, Bloomberg

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