

MRCB-Quill REIT (MQREIT MK)

Property - REITS

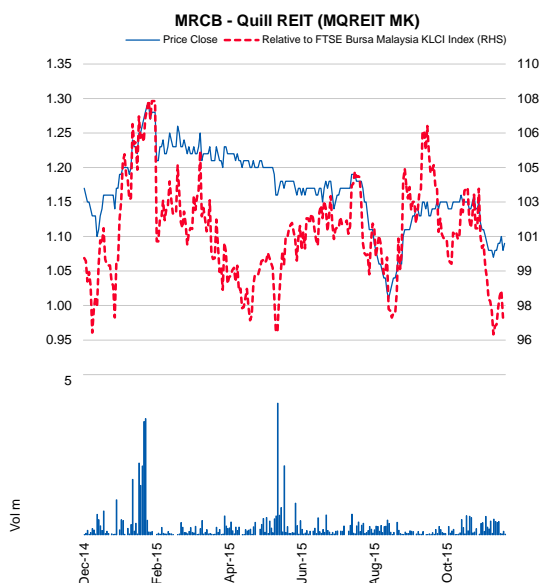
Market Cap: USD170m

Buy (from Neutral)

Target Price: MYR1.23

Price: MYR1.09

One Step Closer To Acquiring Shell Tower

Macro
Risks
Growth
Value


Source: Bloomberg

| | |
|----------------------------|-------------|
| Avg Turnover (MYR/USD) | 0.15m/0.04m |
| Cons. Upside (%) | 16.5 |
| Upside (%) | 12.4 |
| 52-wk Price low/high (MYR) | 1.01 - 1.29 |
| Free float (%) | 40 |
| Share outstanding (m) | 661 |
| Shareholders (%) | |
| CapitaCommercial Trust | 30.0 |
| Quill Group | 30.0 |

Share Performance (%)

| | YTD | 1m | 3m | 6m | 12m |
|----------|-------|-------|-------|-------|-------|
| Absolute | (6.8) | (4.4) | 2.8 | (7.6) | (6.8) |
| Relative | (2.0) | (4.3) | (1.8) | (3.5) | (2.2) |

MQREIT announced that it has entered into a HOA with MRCB for the acquisition of Shell Tower for MYR640m. Upgrade to BUY with an unchanged TP of MYR1.23 (13% upside) due to its more compelling growth prospects. Although acquisition details have yet to be finalised, we believe that the injection of the asset should be earnings-accretive for the REIT, given the asset's long-term lease and strategic location.

- ◆ **Signing a HOA for Shell Tower with MRCB.** MRCB-Quill REIT (MQREIT) has entered into a heads of agreement with its sponsor, Malaysian Resources Corp (MRCB) (MRC MK, BUY, TP: MYR1.60) for the potential acquisition of Shell Tower for MYR640m. Barring any unforeseen circumstances, a formal sale and purchase agreement (SPA) is expected to be signed within the next 60 business days. The acquisition will be funded through a combination of equity and debt, due to MQREIT's relatively high gearing of 0.43x. If the deal goes through, its total investment asset value will breach the MYR2bn mark (from MYR1.56bn as at end-3Q15).
- ◆ **Good prospects for the asset.** We are positive on the prospects for the asset due to its strategic location and full occupancy. Based on our checks with management, Shell, which takes up 60% of the total NLA of 556,468 sqf, has signed a long-term lease largely to minimise future vacancy risks. Refurbishment expenses will also be minimised as the building is only two years old. Although the impact on bottomline should be positive, we believe that the DPU growth will likely be slower than the net profit growth due to the placement of new units.
- ◆ **Earnings forecasts.** We maintain our FY15-17 earnings forecasts. Note that should the deal go through, at an assumed gross yield of 6.5% (similar to that of Platinum Sentral), we believe that MQREIT's topline could see an increase of about 10-33% for FY16-17.
- ◆ **Upgrade to BUY (from Neutral).** We maintain our DDM-based TP of MYR1.23. Our call upgrade (13% upside) is on the basis of MQREIT's stable growth prospects as: i) most of its tenants are on long-term leases (>5 years), ii) high relocation costs for some tenants ensure tenants' "stickiness", and iii) MRCB and Quill Group could provide inorganic growth opportunities. Key risks include: i) slower-than-expected rental reversions, and ii) competition from an influx of new office space. MQREIT's implied FY16F P/E of 14.5x is at a significant discount to our sector's FY16F implied average P/E of 16.6x.

| Forecasts and Valuations | Dec-13 | Dec-14 | Dec-15F | Dec-16F | Dec-17F |
|-------------------------------------|--------|--------|---------|---------|---------|
| Total turnover (MYRm) | 69 | 70 | 110 | 124 | 126 |
| Net property income (MYRm) | 53.2 | 53.3 | 83.3 | 91.0 | 92.6 |
| Reported net profit (MYRm) | 34.5 | 34.1 | 55.1 | 56.4 | 57.8 |
| Total distributable income (MYRm) | 34.5 | 34.1 | 55.1 | 56.4 | 57.8 |
| DPS (MYR) | 0.08 | 0.08 | 0.09 | 0.08 | 0.08 |
| DPS growth (%) | 0.0 | 0.0 | 2.5 | (3.8) | 2.4 |
| Recurring P/E (x) | 12.3 | 12.5 | 9.7 | 12.1 | 12.5 |
| P/B (x) | 0.80 | 0.79 | 0.71 | 0.79 | 0.79 |
| Dividend Yield (%) | 7.7 | 7.7 | 7.9 | 7.6 | 7.8 |
| Return on average equity (%) | 6.5 | 6.3 | 7.6 | 6.2 | 6.3 |
| Return on average assets (%) | 4.0 | 3.9 | 4.4 | 3.4 | 3.5 |
| Interest coverage ratio (x) | 3.47 | 3.38 | 3.40 | 2.93 | 2.98 |
| Our vs consensus EPS (adjusted) (%) | | | 24.5 | (4.4) | (10.9) |

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Figure 1: MQREIT's DDM breakdown

| | FY15 | FY16 | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 | FY23 | FY24 | FY25 |
|------------------------|-------------|------|------|------|------|------|-------|-------|-------|-------|-------|
| EPU (sen) | 9.29 | 8.53 | 8.73 | 9.43 | 9.65 | 9.88 | 10.11 | 10.34 | 10.58 | 10.82 | 11.06 |
| DPU (sen) | 8.59 | 8.27 | 8.47 | 9.15 | 9.36 | 9.58 | 9.80 | 10.03 | 10.26 | 10.50 | 10.73 |
| Payout ratio (%) | 93% | 97% | 97% | 97% | 97% | 97% | 97% | 97% | 97% | 97% | 97% |
| COE assumptions | | | | | | | | | | | |
| Risk-free rate | 4.3% | | | | | | | | | | |
| Beta | 0.72 | | | | | | | | | | |
| Risk premium | 5.9% | | | | | | | | | | |
| COE | 8.5% | | | | | | | | | | |
| Terminal growth (%) | 1.00% | | | | | | | | | | |
| TP (MYR) | 1.23 | | | | | | | | | | |

Source: Company, RHB

Financial Exhibits

| Profit & Loss (MYRm) | Dec-13 | Dec-14 | Dec-15F | Dec-16F | Dec-17F |
|--|-----------|-----------|-----------|-----------|-----------|
| Total turnover | 69 | 70 | 110 | 124 | 126 |
| Property operating expenses | (16) | (17) | (26) | (33) | (33) |
| Net property income | 53 | 53 | 83 | 91 | 93 |
| Management fees | (5) | (5) | (6) | (6) | (6) |
| Trust expenses | (0) | (0) | (1) | (1) | (1) |
| Operating EBIT | 47 | 47 | 77 | 84 | 86 |
| Operating EBITDA | 47 | 47 | 77 | 84 | 86 |
| Interest income | 1 | 1 | 1 | 1 | 1 |
| Interest expense | (14) | (14) | (23) | (29) | (29) |
| Pre-tax profit | 35 | 34 | 55 | 56 | 58 |
| Profit after tax & minorities | 35 | 34 | 55 | 56 | 58 |
| Reported net profit | 35 | 34 | 55 | 56 | 58 |
| Total distributable income | 35 | 34 | 55 | 56 | 58 |

Source: Company data, RHB

| Cash flow (MYRm) | Dec-13 | Dec-14 | Dec-15F | Dec-16F | Dec-17F |
|--|------------|-------------|-------------|-------------|-------------|
| Operating profit | 47 | 47 | 77 | 84 | 86 |
| Change in working capital | (8) | (3) | (3) | (3) | (4) |
| Other operating cash flow | 3 | 0 | 2 | 2 | 2 |
| Operating cash flow | 42 | 44 | 76 | 83 | 84 |
| Interest received | 1 | 1 | 1 | 1 | 1 |
| Interest paid | (14) | (14) | (23) | (29) | (29) |
| Cash flow from operations | 29 | 31 | 54 | 55 | 56 |
| Capex | (2) | (6) | (2) | (2) | (2) |
| Cash flow from investing activities | (2) | (6) | (2) | (2) | (2) |
| Dividends paid | (33) | (33) | (42) | (53) | (55) |
| Proceeds from issue of shares | - | 0 | - | - | - |
| Increase in debt | 116 | 0 | - | - | - |
| Other financing cash flow | - | 0 | - | - | - |
| Cash flow from financing activities | 84 | (32) | (42) | (53) | (55) |
| Cash at beginning of period | 30 | 31 | 23 | 61 | 33 |
| Total cash generated | 111 | (7) | 10 | 0 | (1) |
| Implied cash at end of period | 141 | 24 | 33 | 61 | 32 |

Source: Company data, RHB

Financial Exhibits

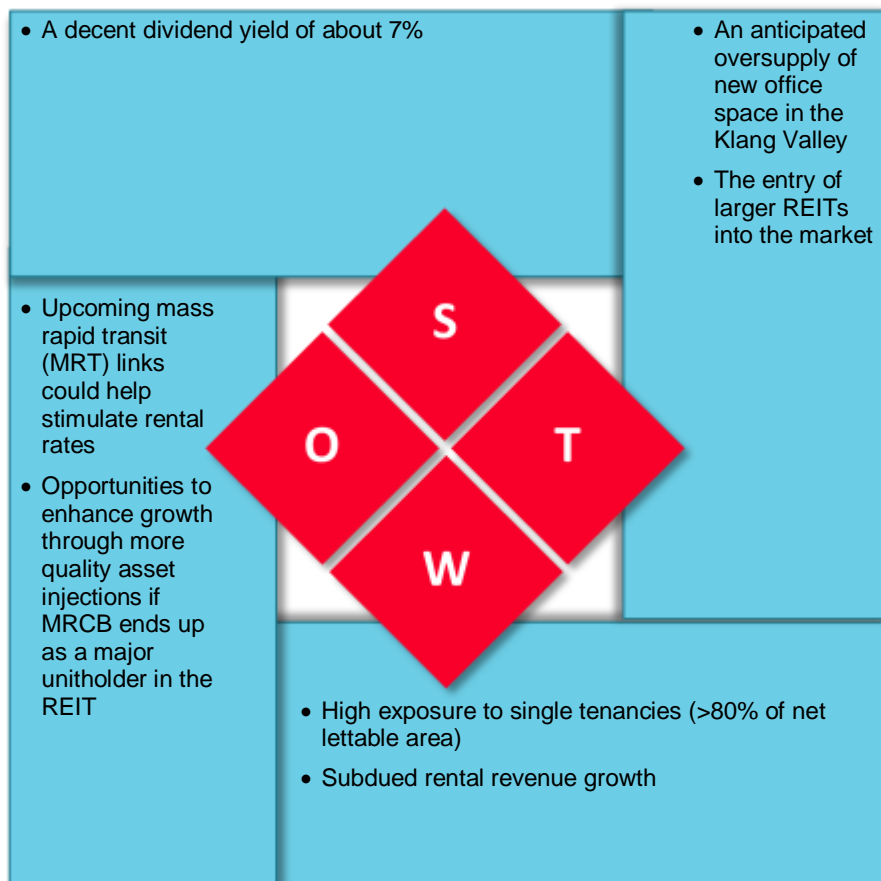
| Balance Sheet (MYRm) | Dec-13 | Dec-14 | Dec-15F | Dec-16F | Dec-17F |
|---------------------------------------|------------|------------|--------------|--------------|--------------|
| Total cash and equivalents | 31 | 23 | 61 | 33 | 32 |
| Accounts receivable | 3 | 6 | 6 | 6 | 6 |
| Other current assets | - | - | 17 | 46 | 49 |
| Total current assets | 34 | 29 | 84 | 85 | 87 |
| Total investments | 827 | 839 | 1,552 | 1,552 | 1,552 |
| Total other assets | 0 | 0 | 0 | 0 | 0 |
| Total non-current assets | 827 | 839 | 1,552 | 1,552 | 1,552 |
| Total assets | 860 | 868 | 1,636 | 1,638 | 1,640 |
| Accounts payable | 12 | 12 | 12 | 12 | 12 |
| Other current liabilities | 5 | 2 | 2 | 2 | 2 |
| Total current liabilities | 17 | 15 | 15 | 15 | 15 |
| Total long-term debt | 305 | 305 | 703 | 703 | 703 |
| Other liabilities | 5 | 8 | 8 | 8 | 8 |
| Total non-current liabilities | 310 | 313 | 711 | 711 | 711 |
| Total liabilities | 327 | 327 | 725 | 725 | 726 |
| Share capital | 412 | 412 | 676 | 676 | 676 |
| Retained earnings reserve | 122 | 130 | 235 | 237 | 238 |
| Shareholders' equity | 533 | 541 | 911 | 912 | 914 |
| Total equity | 533 | 541 | 911 | 912 | 914 |
| Total liabilities & equity | 860 | 868 | 1,636 | 1,638 | 1,640 |

Source: Company data, RHB

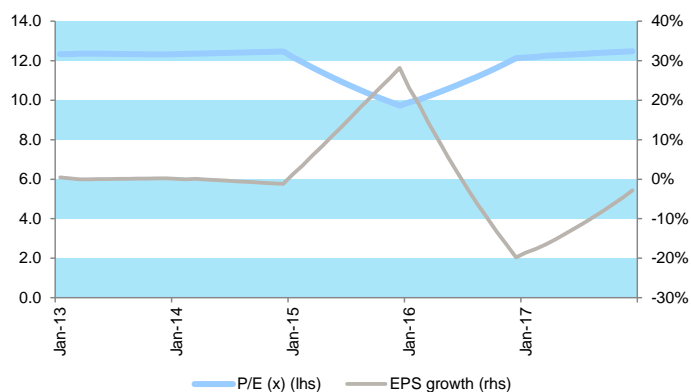
| Key Ratios (MYR) | Dec-13 | Dec-14 | Dec-15F | Dec-16F | Dec-17F |
|-------------------------------|--------|--------|---------|---------|---------|
| Revenue growth (%) | (0.8) | 1.9 | 55.9 | 13.0 | 1.8 |
| Net profit growth (%) | 0.2 | (1.2) | 61.6 | 2.3 | 2.4 |
| EPS growth (%) | 0.2 | (1.2) | 28.1 | (19.8) | (2.8) |
| BVPS growth (%) | 0.9 | 1.5 | 10.6 | (10.1) | 0.2 |
| Net profit margin (%) | 50.1 | 48.6 | 50.3 | 45.5 | 45.8 |
| Return on average assets (%) | 4.0 | 3.9 | 4.4 | 3.4 | 3.5 |
| Return on average equity (%) | 6.5 | 6.3 | 7.6 | 6.2 | 6.3 |
| Net debt to equity (%) | 51.4 | 52.1 | 70.6 | 73.4 | 73.4 |
| DPS | 0.08 | 0.08 | 0.09 | 0.08 | 0.08 |
| Recurrent cash flow per share | 0.07 | 0.08 | 0.11 | 0.09 | 0.08 |

Source: Company data, RHB

SWOT Analysis

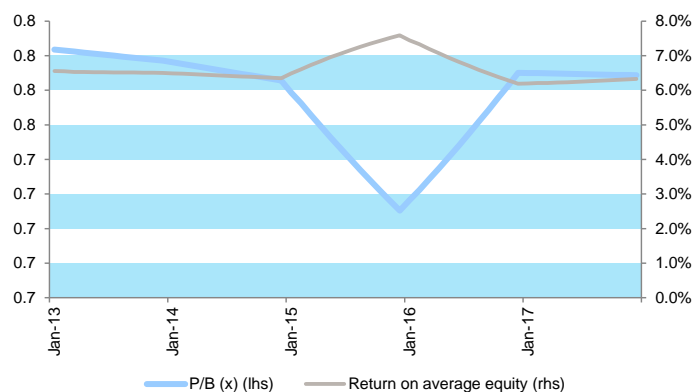


P/E (x) vs EPS growth



Source: Company data, RHB

P/BV (x) vs ROAE

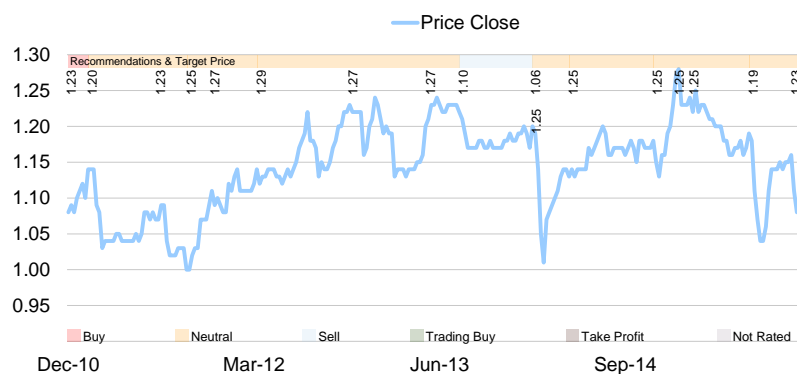


Source: Company data, RHB

Company Profile

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

Recommendation Chart



Source: RHB, Bloomberg

| Date | Recommendation | Target Price | Price |
|------------|----------------|--------------|-------|
| 2015-11-06 | Neutral | 1.23 | 1.16 |
| 2015-07-23 | Neutral | 1.19 | 1.19 |
| 2015-02-26 | Neutral | 1.25 | 1.23 |
| 2015-01-20 | Neutral | 1.25 | 1.25 |
| 2014-11-27 | Neutral | 1.25 | 1.18 |
| 2014-05-02 | Neutral | 1.25 | 1.13 |
| 2014-01-30 | Neutral | 1.25 | 1.20 |
| 2014-01-29 | Sell | 1.06 | 1.20 |
| 2013-08-02 | Sell | 1.10 | 1.22 |
| 2013-05-13 | Neutral | 1.27 | 1.21 |

Source : RHB, Bloomberg

RHB Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

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