REITs

Malaysia

MRCB-Quill REIT (MQREIT MK)

Next catalyst just around the corner

BUY

Share Price	MYR 1.15
12m Price Target	MYR 1.15 (+0%)
Previous Price Target	*MYR 1.15*

Large asset inbound

We believe the expected injection of Menara Shell (MS) in early-2017 could significantly lift earnings while MQREIT's long-term earnings outlook is supported by its anchor tenants. We think that MS injection will also be value-accretive. We maintain our forecasts pending the confirmation of MS' funding structure. We maintain our BUY call with an unchanged DCF-TP of MYR1.15 (WACC: 6.6%, terminal yield: 7%); FY16 net yield remains attractive at 6.1%, with valuations upside from MS.

Menara Shell to lift earnings

We understand that the acquisition of MS is still in progress and injection into MQREIT could take place in early-2017. Based on our latest estimates, MS could raise FY17/18 net profit by +39/+38% to MYR83.8m/ 88.1m (12-month contribution each) assuming: (i) ARR of ~MYR8 psf, (ii) 100% occupancy rate, (iii) 75% net property margin, and (iv) 40%:60% debt:equity funding with interest cost of 4.6%. We also derive a FY17 net property yield of 6.5% - above our estimated funding cost of 5.9%. Nonetheless, our forecasts are unchanged pending the confirmation of the funding structure.

Other assets are stable

Elsewhere, we note that Platinum Sentral (PS), which contributes ~41% of FY16-18E revenue (before including MS), has remained 100%-occupied as large tenants such as SPAD, SME and PEMANDU are on leases of 6-15 years. MQREIT's occupancy risks are also lowered by the renewals over the past 12-24 months such as on: (i) QB1-DHL1 and QB4-DHL2 (5-year leases), (ii) QB3-BMW (10-year); and (iii) QB2-HSBC (5-year).

But still highly geared

We estimate that gross gearing would remain high at 0.42x by end-FY16E (unchanged from end-FY15's) which could limit future sizeable acquisitions as MQREIT could only borrow up to ~MYR274m (statutory limit: 0.5x). Nonetheless, we forecast that the purchase of MS via debt and new REIT units issuance has marginal impact to gross gearing.

FYE Dec (MYR m)	FY14A	FY15A	FY16E	FY17E	FY18E
Revenue	70	115	124	129	133
Net property income	53	90	100	104	107
Distributable income	34	54	57	61	64
DPU (sen)	7.5	6.9	7.0	7.4	7.9
DPU growth (%)	0.0	(8.1)	0.8	6.5	5.7
Price/DPU(x)	15.2	16.6	16.5	15.5	14.6
P/BV (x)	0.8	0.8	0.8	0.8	0.8
DPU yield (%)	6.6	6.0	6.1	6.5	6.8
ROAE (%)	6.4	7.5	6.3	6.7	7.0
ROAA (%)	4.0	4.3	3.5	3.7	3.9
Debt/Assets (x)	0.4	0.4	0.4	0.4	0.4
Consensus DPU	-	-	8.8	9.1	9.3
MKE vs. Consensus (%)	-	-	(11.6)	(9.4)	(5.9)

Company Description

MRCB-Quill REIT engages in the investment in commercial properties which are mainly located in the Klang Valley.

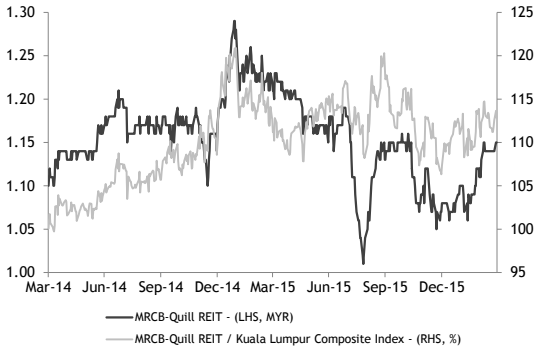
Statistics

52w high/low (MYR)	1.23/1.01
3m avg turnover (USDm)	0.1
Free float (%)	27.6
Issued shares (m)	661
Market capitalisation	MYR760.6M
	USD190M

Major shareholders:

Malaysian Resources Corp. Bhd.	31.2%
CapitaLand Commercial Trust	17.7%
Quill Land Sdn. Bhd.	7.4%

Price Performance



	-1M	-3M	-12M
Absolute (%)	3	7	(7)
Relative to index (%)	(1)	6	(1)

Source: FactSet

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Asset updates

Menara Shell: Potential earnings boost by >+30%

To recap, on 3 Dec 2015, MQREIT has entered into a Heads of Agreement (HOA) with 348 Sentral Sdn Bhd (a 100%-subsidiary of MQREIT's major unitholder) to acquire the MSC-status office building with 556k sq.ft. of NLA and 926 parking bays for MYR640m cash. We expect the SPA to be signed soon as the SPA execution is expiring in mid-April 2016 and we anticipate Menara Shell to be injected into MQREIT's portfolio in early-2017.

Menara Shell (MS) is currently 100%-tenanted and backed by two anchor tenants: (i) Shell People Services Asia – 306k NLA (55% of MS' NLA) and (ii) AmGeneral Insurance – 133k sq.ft. NLA (24%). MS has a low occupancy risk as both anchor tenants are on 15-year leases and cumulatively occupy 79% of MS' total NLA.

Based on our latest forecast, MS could increase MQREIT's FY17/18E net profit by +39%/+38% to MYR83.8 m/88.1m, assuming: (i) ARR of MYR8 psf in FY17, (ii) 100% occupancy rate, (iii) 75% net property margin, and (iv) 40%:60% debt:equity funding with interest cost of 4.6%. These assumptions also translate into FY17 net property yield of 6.5% which is above our latest funding cost estimate of 5.9%. We believe the property could yield higher returns in the near-future based on its current below-average rental rates. We understand that ARR for office buildings within the KL Sentral area is about MYR8-9 psf currently and this could provide more room for positive rental reversions.

We, however, maintain our earnings forecasts for now pending the confirmation of the acquisition's funding structure. That said, we believe that the acquisition should be value accretive to the trust.

Fig 1: Menara Shell (Jalan Tun Sambanthan, Kuala Lumpur)

Source: Shell Malaysia

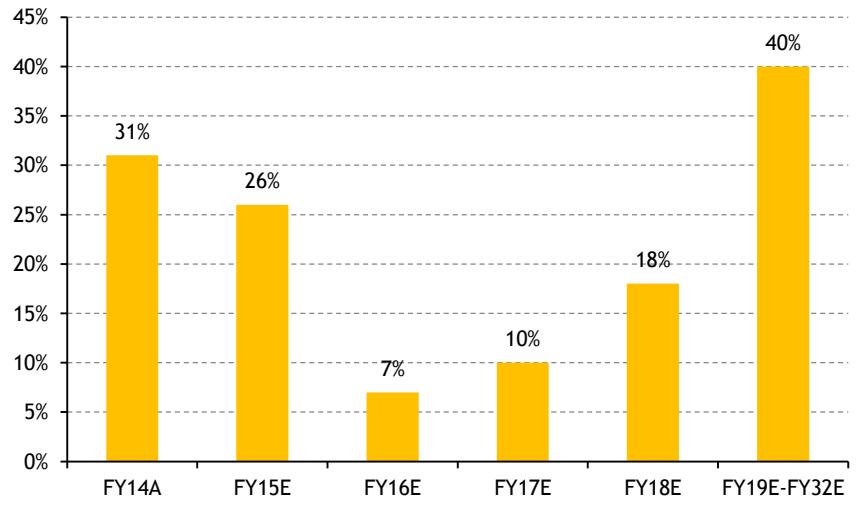
Low occupancy risks across assets

We note that 7%/10%/18% of MQREIT's total NLA is up for renewal in FY16/17/18. The lower lease expiries in FY16-17 are due to a bulk of the leases having been renewed in FY14 and FY15 while some buildings are on longer-term leases (beyond 3 to 5 years) i.e. QB2 (HSBC) and QB3 (BMW).

Meanwhile, MQREIT's portfolio occupancy rate was 97.5% as at end-FY15 which was a significant improvement as compared to end-FY14's 91%. This was mainly lifted by the disposal of QB10 in Sep 2015 and increase in leased space in QB3 by BMW in Jul 2015 (occupancy improved by 7ppt to 80%). Elsewhere, the portfolio occupancy rate was also sustained by the recent renewals of its existing major tenants in QB1 (DHL1), QB4 (DHL2), QB3 (BMW) and QB2 (HSBC) with leases ranging between 5-10 years.

Overall, based on the recent successful renewals of key tenants, we expect MQREIT's near-term occupancy risks to remain low and it should sustain its current favourable occupancy rate.

Fig 2: Lease expiry profile (% of total NLA)



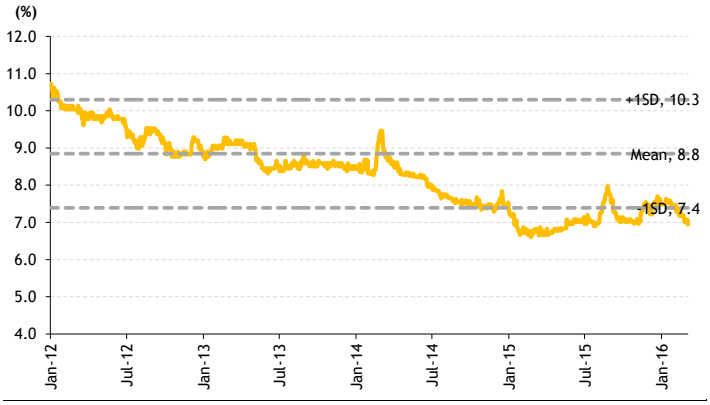
Note: Platinum Sentral was injected in FY15 and not included in the lease expiry profile prior to FY15
Source: Trust, Maybank Kim Eng

Valuation

Unchanged MYR1.15 TP with 6.1% net yield

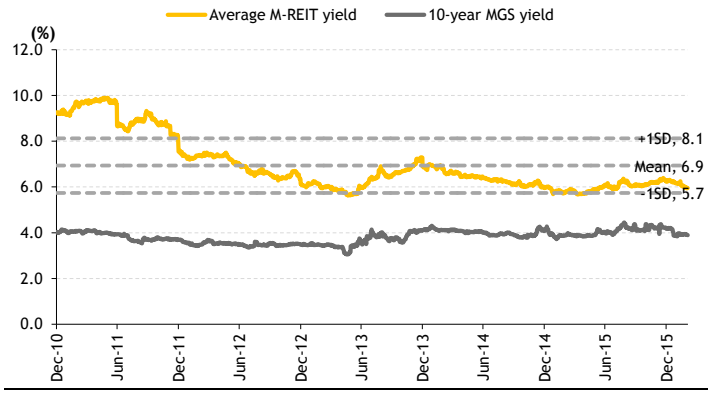
MQREIT remains a BUY as FY16. Despite the REIT price having moved towards our target since we upgraded our call on 25 Jan 2016, we think there is valuation upside from the MS injection. Still attractive net dividend yield of 6.1% compared to the sector average of 5.2% (and which is also the highest among M-REITs under our coverage) also provides the upside potential to the REIT price. The acquisition of MS could be the next re-rating catalyst but the extent of its impact is still subject to the funding structure (equity+debt). Hence, our earnings forecasts and DCF-based TP of MYR1.15 are unchanged at this juncture.

Fig 3: 1-year forward gross dividend yield



Source: Maybank Kim Eng

Fig 4: M-REIT forward gross yield and 10-year MGS yield



Note: Average M-REIT forward gross yield for trusts within MKE coverage
Source: Maybank Kim Eng

Fig 5: Sector summary

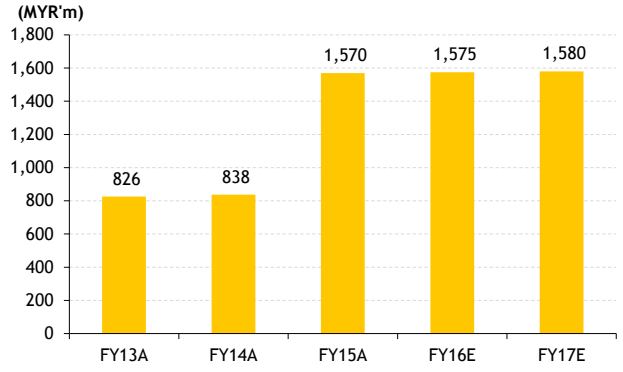
Company	Share Price	Market Cap	Target Price	PE		Net Div Yield		ROE		P/BV		EPU CAGR
				CY16	CY17	CY16	CY17	CY16	CY17	CY16	CY17	CY15-17
	(MYR)	(MYR m)	(MYR)	(x)	(x)	(%)	(%)	(%)	(%)	(x)	(x)	(%)
KLCCP Stapled	7.15	12,908	7.90	17.6	17.3	5.2	5.3	5.7	5.5	1.0	1.0	1.4
IGB REIT	1.52	5,286	1.55	19.8	18.8	5.2	5.4	7.2	7.6	1.4	1.4	4.8
Pavilion REIT	1.72	5,194	1.80	19.7	18.5	4.6	4.9	6.2	6.0	1.3	1.1	8.0
Sunway REIT	1.60	4,706	1.50	17.9	16.6	4.9	5.3	6.4	6.8	1.2	1.1	6.4
CapitaLand M'sia	1.44	2,916	1.45	17.6	17.0	5.5	5.6	6.2	6.5	1.1	1.1	5.2
Axis REIT	1.56	1,716	1.55	17.3	16.2	5.2	5.6	7.3	7.8	1.3	1.3	7.4
MRCB-Quill	1.15	761	1.15	13.4	12.6	6.1	6.5	6.3	6.7	0.8	0.8	5.9
Al-Salām	0.99	571	1.07	16.8	15.2	5.3	5.6	6.4	6.6	1.0	1.0	NM
Simple average				**17.5**	**16.5**	**5.2**	**5.5**	**6.5**	**6.7**	**1.1**	**1.1**	**5.6**

Sources: Trusts, Maybank Kim Eng

Value Proposition

- Hands on and experienced management team, backed by MRCB, the largest unit holder.
- MRCB develops and owns prominent office assets in the Kuala Lumpur city centre, which serve as new asset pipeline for the trust.
- Portfolio dominated by high-quality offices. Assets from MRCB include Platinum Sentral and Menara Shell.
- Portfolio backed by long-term leases of sizeable tenants - provide high occupancy rates and lower occupancy risks.
- Demand for office space, however, has remained soft plus there is an oversupply of office buildings.
- At 0.4x (statutory limit of 0.5x), the total borrowings-to-total asset ratio implies that future sizeable acquisitions would need to raise capital/dispose assets.

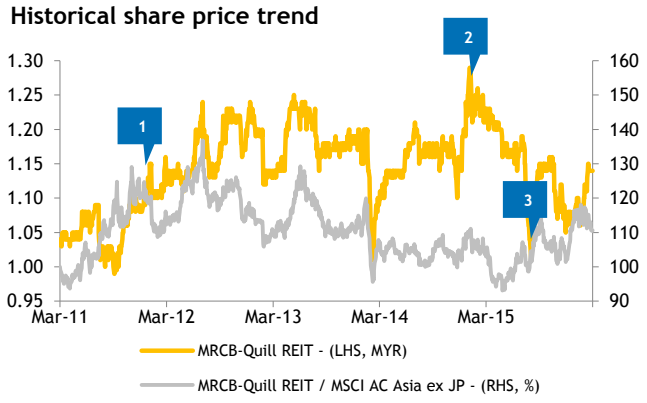
Total value of all investment properties



Sources: Trust, Maybank Kim Eng

Price Drivers

Historical share price trend



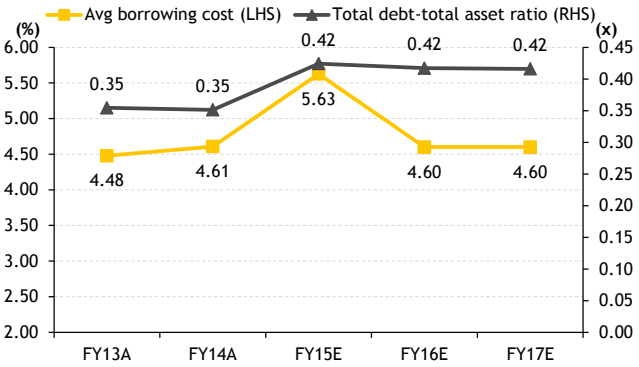
Sources: Trust, Maybank Kim Eng

1. Share price uptrend was a combination of improved organic growth and anticipation of more office asset acquisitions.
2. Pre-completion of the purchase of Platinum Sentral, a sizeable addition to its portfolio, which also entails the entrance of its largest unit holder, MRCB.
3. Sharp decline in share price due to fluctuation in 10-year MGS yield, which ranged between 3.9%-4.5% in 2H15.

Financial Metrics

- All of MQREIT's long-term borrowings are based on fixed rates. 56% only due for refinancing in 2020.
- Low positive rental reversions across office assets due to long-term leases, but these would lower occupancy risk. Portfolio occupancy expected to remain >95%.
- NPI margin could also be enhanced by lower opex (i.e. utilities) via better property management.
- DPU is stable as recent net income payout p.a. were ~95% (statutory payout of M-REITs is >90%).

Average borrowing costs and gross gearing



Sources: Trust, Maybank Kim Eng

Swing Factors

Upside

- Yield-accretive acquisitions of high-quality assets.
- Higher-than-expected positive rental reversions.
- Disposal of asset with an attractive price tag.

Downside

- Zero or negative rental reversions.
- Sizeable tenants vacating/downsizing space required. This more apparent for single-tenanted office buildings.
- Decline in asset value.
- Acquisition of less desirable new assets (low occupancy rates, less favourable locations, expensive acquisition costs etc).

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FYE 31 Dec	FY14A	FY15A	FY16E	FY17E	FY18E
Key Metrics					
Price/DPU(x)	15.2	16.6	16.5	15.5	14.6
P/BV (x)	0.8	0.8	0.8	0.8	0.8
P/NTA (x)	0.8	0.8	0.8	0.8	0.8
DPU yield (%)	7.3	6.7	6.7	7.2	7.6
FCF yield (%)	8.9	9.3	10.8	8.2	8.6
INCOME STATEMENT (MYR m)					
Gross revenue	70.2	115.2	124.4	128.9	133.5
Net property income	**53.3**	**90.3**	**100.3**	**103.5**	**107.2**
Net financing costs	(13.3)	(26.5)	(30.6)	(29.9)	(29.9)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Total return before tax	**34.2**	**54.0**	**56.9**	**60.6**	**64.0**
Income tax	0.0	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Total return avail to unitholders	34.2	54.0	56.9	60.6	64.0
Distributable inc to unitholders	**34.2**	**54.0**	**56.9**	**60.6**	**64.0**
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	23.3	44.9	73.1	72.7	72.6
Accounts receivable	6.1	5.7	5.7	5.7	5.7
Property, Plant & Equip (net)	0.0	0.0	0.0	0.0	0.0
Inverstment properties	837.7	1,569.8	1,574.8	1,579.8	1,584.8
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	1.2	4.9	0.0	0.0	0.0
Total assets	**868.4**	**1,625.3**	**1,653.6**	**1,658.2**	**1,663.1**
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	12.2	13.6	13.6	13.6	13.6
LT interest bearing debt	305.1	689.7	689.7	689.7	689.7
Other liabilities	9.8	18.1	43.5	45.1	46.9
Total Liabilities	**327.1**	**721.5**	**746.9**	**748.5**	**750.2**
Shareholders Equity	541.3	903.9	906.7	909.7	912.9
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	**541.3**	**903.9**	**906.7**	**909.7**	**912.9**
Total liabilities and equity	**868.4**	**1,625.3**	**1,653.6**	**1,658.2**	**1,663.1**

FYE 31 Dec	FY14A	FY15A	FY16E	FY17E	FY18E
Key Ratios					
Growth ratios (%)					
Gross revenue growth	1.9	64.0	8.0	3.6	3.5
Total return before tax growth	(1.1)	58.1	5.3	6.5	5.7
Total return growth	(1.1)	58.1	5.3	6.5	5.7
Distributable income growth	(1.1)	58.1	5.3	6.5	5.7
Profitability ratios (%)					
Total return before tax margin	48.6	46.9	45.7	47.0	47.9
Payout ratio	86.1	84.8	81.2	81.2	81.2
DuPont analysis					
Total return margin (%)	48.6	46.9	45.7	47.0	47.9
Gross revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.6	1.8	1.8	1.8	1.8
ROAE (%)	6.4	7.5	6.3	6.7	7.0
ROAA (%)	4.0	4.3	3.5	3.7	3.9
Liquidity & Efficiency					
Days receivable outstanding	22.4	18.5	16.5	16.0	15.4
Days payables outstanding	254.1	187.1	203.9	193.7	187.0
Dividend cover (x)	1.2	1.2	1.2	1.2	1.2
Current ratio (x)	2.0	3.2	1.9	1.8	1.7
Leverage & Expense Analysis					
Asset/Liability (x)	2.7	2.3	2.2	2.2	2.2
Net debt/equity (%)	52.1	71.3	68.0	67.8	67.6
Net interest cover (x)	3.6	3.0	2.9	3.0	3.1
Debt/EBITDA (x)	6.4	8.6	7.9	7.8	7.7
Capex/revenue (%)	0.0	0.0	0.0	0.0	0.0
Net debt/ (net cash)	281.8	644.9	616.6	617.0	617.1

Source: Company; Maybank

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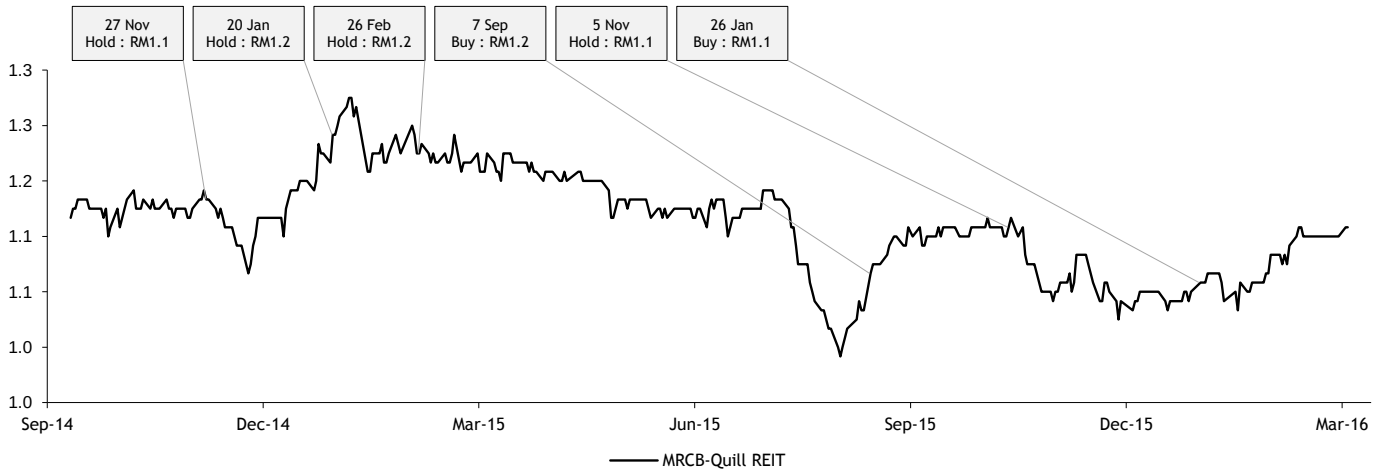

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