

Flash Note

Refer to important disclosures at the end of this report

Malaysia Equity Research

3 Aug 2016

MRCB-Quill REIT (MQREIT MK) : HOLD

Mkt. Cap: US\$196m | 3m Avg. Daily Val: US\$0.07m

Last Traded Price : RM1.20

Price Target 12-mth: RM1.26 (5% upside) (Prev RM1.26)

Shariah Compliant: No

Analyst

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Steady as she goes

- In-line 2Q16 earnings
- Declares DPU of 4.23 sen, with ex-date of Aug 16
- Outlook for office rental remains lukewarm; earnings from proposed acquisition of Menara Shell to be accretive in 1Q17
- Maintain HOLD and TP of RM1.26

Forecasts and Valuation

FY Dec (RMm)	2015A	2016F	2017F	2018F
Gross Revenue	115	124	178	182
Net Property Inc	90.3	97.8	140	145
Total Return	54.0	55.8	82.0	86.6
Distribution Inc	50.9	55.8	82.0	86.6
EPU (sen)	10.2	8.44	7.68	8.09
EPU Gth (%)	(1)	(17)	(9)	5
DPU (sen)	8.47	8.44	7.68	8.09
DPU Gth (%)	1	0	(9)	5
NAV per shr (sen)	137	137	125	125
PE (X)	11.8	14.2	15.6	14.8
Distribution Yield (%)	7.1	7.0	6.4	6.7
P/NAV (x)	0.9	0.9	1.0	1.0
Aggregate Leverage (%)	43.6	43.8	41.5	41.7
ROAE (%)	8.4	6.2	7.3	6.5

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P

Highlights

- MQREIT's 2Q16 net distributable income of RM15.4m (+13% y-o-y) was in line within our/consensus expectations. The increase in income is attributable to the contribution from the sizeable Platinum Sentral (PS) injection from 2Q15 onwards. 2Q16 NPI margin of c.79% was within expectations, higher than the 76% in 2Q15 as PS carries higher margins.
- A distribution of 4.23 sen was declared in 1H16, implying a c.91% payout.

Stable occupancy, some lease expiries coming up

- Portfolio occupancy was steady at c.97%, up from 93% in 2Q15, due to the disposal of the fully vacant QB10 and minor take-ups at PS retail space and Plaza Mont Kiara.
- About c.6.7% of total NLA was due for renewal in FY16, out of which c.56% of these leases have been renewed. Expiring leases in FY17 are 13% of total NLA, and 26% in FY18.
- Going forward, we expect some challenges in negotiating positive rental reversions, and occupancy replenishment for MQREIT's office assets. This is due to additional space coming onstream, prolonging the office supply overhang, particularly in Kuala Lumpur and Selangor where MQREIT's office assets are located.
- Management will be carrying out asset enhancement works to selected properties within its portfolio, notably, Quill Building 1-DHL and Quill Building 4-DHL.

These enhancements will be centred upon helping tenants to conserve energy and costs, as well as reduces carbon footprint.

Outlook

Expected inclusion of Menara Shell in FY17. MQREIT has signed a conditional sale and purchase agreement (SPA) to acquire Menara Shell located at Kuala Lumpur Sentral for RM640m from its major shareholder Malaysian Resources Corporation Berhad (MRCB). The proposed acquisition is expected to be completed by Dec 2016 and will be earnings accretive from 1QFY17. Upon completion, this asset will expand MQREIT's portfolio size from RM1.6bn in FY15 to c.RM2.3bn in FY17. We previously increased our FY17/18F earnings by c.40%, and consequently forecasted a massive 61% equity dilution arising from its proposed private placement. Management will mitigate the near-term DPU dilution by increasing the payout ratio to 100% until DPU returns to current levels. Taking into account the higher payout ratio and our FY17 NPI yield forecast of 6.1% for Menara Shell, we expect a more moderate 9% DPU dilution in FY17. We maintain our HOLD recommendation as we expect the massive equity fund-raising will lead to an overhang on the share price in the near term.

Revamped profile with new injections. MQREIT's asset portfolio has undergone a drastic shift with the acquisition of the RM740m Platinum Sentral (PS) asset in FY15. Moving forward, we expect the overall portfolio to improve further with the proposed acquisition of Menara Shell. We have assumed that PS and Menara Shell will increase overall occupancy levels for its portfolio from 91% in FY15 to 96% in FY17, and raise average rent psf from RM4.80 in FY15 to RM5.60 in FY17.

MRCB connection. MQREIT has the right of first refusal to MRCB's stable of investment properties, which is worth up to RM1.5bn in aggregate. However, MQREIT's current gearing of c.43% indicates that new equity issuance will likely be necessary for sizeable acquisitions in the near term.

Valuation

Our DDM-derived TP is RM1.26, with 7.7% cost of equity and 1% TG. We maintain our HOLD recommendation as we expect the massive equity fund-raising will lead to an overhang on the share price in the near term.

Key risk

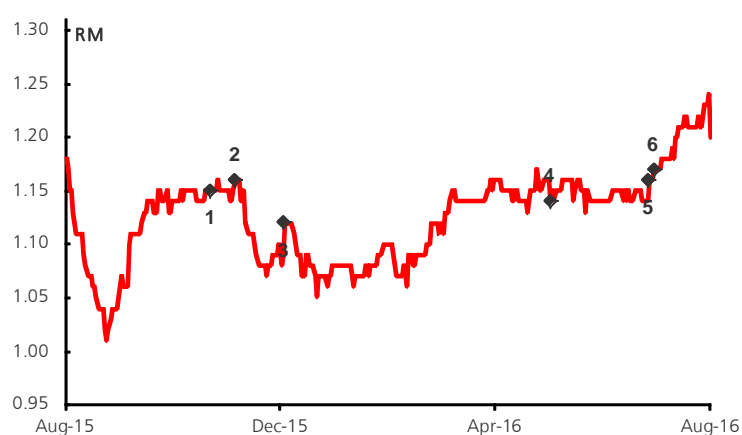
Earnings stability. Our earnings forecast assumes vacancies will not increase and an immediate renewal of expiring leases. Any delays in the leasing of released spaces will be negative for earnings and may de-rate the stock.

Quarterly / Interim Income Statement (RMm)

FY Dec	2Q2015	1Q2016	2Q2016	% chg yoy	% chg qoq
Gross revenue	32.2	32.7	32.6	1.2	(0.3)
Property expenses	(7.9)	(7.2)	(6.9)	(12.7)	(4.7)
Net Property Income	24.3	25.5	25.7	5.7	1.0
Other Operating expenses	(2.6)	(2.7)	(2.7)	3.1	(1.0)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	nm	nm
Net Interest (Exp)/Inc	(8.1)	(7.5)	(7.6)	5.6	(1.8)
Exceptional Gain/(Loss)	0.0	0.0	0.0	nm	nm
Net Income	13.6	15.2	15.4	12.9	1.0
Tax	0.0	0.0	0.0	nm	nm
Minority Interest	0.0	0.0	0.0	nm	nm
Net Income after Tax	13.6	15.2	15.4	12.9	1.0
Total Return	13.6	15.2	15.4	12.9	1.0
Non-tax deductible Items	0.0	0.0	0.0	nm	nm
Net Inc available for Dist.	13.6	15.2	15.4	12.9	1.0
Ratio (%)					
Net Prop Inc Margin	75.6	77.9	78.9		
Dist. Payout Ratio	107.7	0.0	181.8		

Source of all data: Company, AllianceDBS

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	23 Oct 15	1.15	1.20	HOLD
2:	06 Nov 15	1.16	1.20	HOLD
3:	04 Dec 15	1.12	1.20	HOLD
4:	03 May 16	1.14	1.20	HOLD
5:	28 Jun 16	1.16	1.30	HOLD
6:	01 Jul 16	1.17	1.26	HOLD

Note: Share price and Target price are adjusted for corporate actions.

Source: AllianceDBS

Analyst: Inani ROZIDIN

DISCLOSURE

Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

Commonly used abbreviations

Adex = advertising expenditure	EPS = earnings per share	PBT = profit before tax
bn = billion	EV = enterprise value	P/B = price / book ratio
BV = book value	FCF = free cash flow	P/E = price / earnings ratio
CF = cash flow	FV = fair value	PEG = P/E ratio to growth ratio
CAGR = compounded annual growth rate	FY = financial year	q-o-q = quarter-on-quarter
Capex = capital expenditure	m = million	RM = Ringgit
CY = calendar year	M-o-m = month-on-month	ROA = return on assets
Div yld = dividend yield	NAV = net assets value	ROE = return on equity
DCF = discounted cash flow	NM = not meaningful	TP = target price
DDM = dividend discount model	NTA = net tangible assets	trn = trillion
DPS = dividend per share	NR = not rated	WACC = weighted average cost of capital
EBIT = earnings before interest & tax	p.a. = per annum	y-o-y = year-on-year
EBITDA = EBIT before depreciation and amortisation	PAT = profit after tax	YTD = year-to-date

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