

MRCB-Quill REIT (MQREIT MK)

Positive 2Q16

Upgrade to BUY

2Q16 results was a positive surprise whereby the higher net profit margin was lifted by higher revenue, lower opex and lower net financing costs. The 1st interim gross DPU of 4.23sen was also better than expected. We adjust FY16-18 net profit forecasts by +4-6% and raise our DCF-TP by 13sen to MYR1.23 after revising our valuation parameters. Long-term lease agreements provide for resilient earnings while dividend yields at 6.4% net are attractive, these being the premise of our revised BUY call.

Profit margin has improved

2Q16 net profit was MYR15.4m (+12.9% YoY, +1.0% QoQ), bringing 1H16 net profit to MYR30.6m (+39.8% YoY) which accounted for 54%/53% of our/consensus' FY16 estimates. YoY, 2Q16 earnings were lifted by: 1) higher revenue (+1.2%, +MYR0.4m) from step-up rent adjustments at QB2, QB3, QB8, 2) lower operating expenses (-12.7%, -MYR1.0m) namely from Platinum Sentral and Plaza Mont Kiara, and 3) lower financing expenses (-2.6%, -MYR0.4m) attributed to lower total borrowings and higher amount of cash placed in financial institutions. Hence, 2Q16 net profit margin improved to 47.2% from 42.4% in 2Q15. Meanwhile, QoQ earnings were flattish as rental income across its portfolio was stable.

Raising forecasts

We raise FY16/17/18 net profit forecasts by 5.5%/4.2%/4.1% after incorporating lower opex assumptions at Platinum Sentral. We also raise our DCF-based TP by 13sen to MYR1.23 (WACC: 6.6%, terminal yield: 7%) as we roll forward our valuation base year to FY17 and peg our WACC to a lower beta of 0.55x (from 0.60x) which reflects lower risks. MQREIT has successfully renewed 87% of its leases due for renewal in 1H16 and is in advanced talks for the balance of leases up for renewal in 2016. Average occupancy rate remains resilient at 97.2% of NLA at end-Jun 2016.

Earnings to remain resilient

We remain positive on MQREIT's office assets with tenants on long-term leases such as Platinum Sentral (40% of FY16E revenue) and the upcoming Menara Shell which has two anchor tenants on 15-year leases. Menara Shell is estimated to lift our FY17-18 earnings forecasts for MQREIT by ~44% and the acquisition is expected to be completed in 4Q16.

FYE Dec (MYR m)	FY14A	FY15A	FY16E	FY17E	FY18E
Revenue	70	115	126	188	194
Net property income	53	90	104	149	154
Core net profit	34	54	60	92	96
Core EPU (sen)	8.8	8.2	9.1	8.6	9.0
Core EPU growth (%)	(1.1)	(6.7)	11.1	(5.5)	5.3
Net DPU (sen)	7.5	6.9	7.7	7.7	8.1
Net DPU growth (%)	0.0	(8.1)	10.8	0.5	5.3
P/NAV (x)	0.9	0.9	0.9	0.9	0.9
Net DPU yield (%)	6.3	5.8	6.4	6.4	6.8
ROAE (%)	6.4	7.5	6.6	8.1	7.1
ROAA (%)	4.0	4.3	3.7	4.6	4.1
Debt/Assets (x)	0.35	0.42	0.42	0.39	0.39
Consensus Net DPU	-	-	7.4	7.2	7.6
MKE vs. Consensus (%)	-	-	4.1	6.6	6.4

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BUY

[Prior:HOLD]

Share Price	MYR 1.20
12m Price Target	MYR 1.23 (+3%)
Previous Price Target	MYR 1.10

Company Description

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

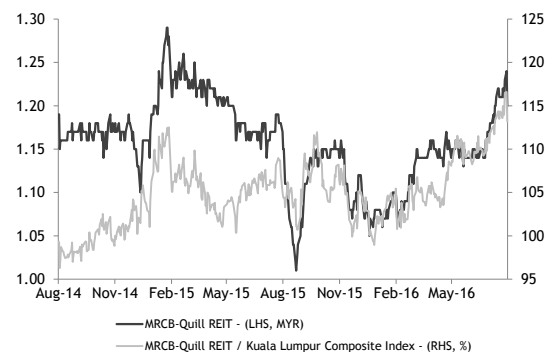
Statistics

52w high/low (MYR)	1.24/1.01
3m avg turnover (USDm)	0.1
Free float (%)	27.6
Issued shares (m)	661
Market capitalisation	MYR793.7M
	USD197M

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	3	2
Relative to index (%)	2	4	6

Source: FactSet

Fig 1: Results summary table

FY Dec (MYR m)	Quarterly					Cumulative		
	2QFY16	2QFY15	%YoY	1QFY16	%QoQ	1HFY16	1HFY15	%YoY
Gross revenue	32.6	32.2	1.2	32.7	(0.3)	65.2	50.8	28.4
Net property income	25.7	24.3	5.7	25.4	1.0	51.1	38.0	34.6
Interest income	0.4	0.1	>100	0.4	(2.4)	0.8	0.3	186.2
Fair value gains	-	-	n.m.	-	n.m.	-	-	n.m.
Finance costs	(8.0)	(8.2)	(2.6)	(7.9)	1.5	(15.8)	(11.7)	35.0
Other expenses	(2.7)	(2.6)	3.1	(2.7)	(1.0)	(5.5)	(4.6)	18.1
Pretax profit	15.4	13.6	12.9	15.2	1.0	30.6	21.9	39.8
Tax	-	-	n.m.	-	n.m.	-	-	n.m.
Net profit	15.4	13.6	12.9	15.2	1.0	30.6	21.9	39.8
Net profit ex-EI	15.4	13.6	12.9	15.2	1.0	30.6	21.9	39.8
 EPU ex-EI (sen) *	 2.3	 2.2	 5.9	 2.3	 1.3	 4.6	 4.3	 7.9
Gross DPU (sen) ^	4.2	2.2	90.5	-	n.m.	4.2	3.3	27.1
	2QFY16	2QFY15	+/- ppt	1QFY16	+/- ppt	1HFY16	1HFY15	+/- ppt
Net property margin (%)	78.9	75.6	3.4	77.9	1.0	78.4	74.8	3.6
Net income ex-EI margin (%)	47.2	42.4	4.9	46.7	0.6	47.0	43.1	3.8

* Based on reported figures

^ 1HFY15 includes first interim gross DPU of 1.11sen (declared prior to issuance of new units in 1Q15) which has been adjusted based on 690.1m units (pre-adjustment: 1.88sen)

Sources: Trust, Maybank Kim Eng

FYE 31 Dec	FY14A	FY15A	FY16E	FY17E	FY18E
Key Metrics					
Price/DPU(x)	15.9	17.3	15.6	15.6	14.8
P/BV (x)	0.9	0.9	0.9	0.9	0.9
P/NTA (x)	0.9	0.9	0.9	0.9	0.9
DPU yield (%)	7.0	6.4	7.1	7.1	7.5
FCF yield (%)	8.6	8.9	10.8	7.4	8.9
INCOME STATEMENT (MYR m)					
Revenue	70.2	115.2	125.8	187.6	193.6
Net property income	53.3	90.3	103.7	149.2	154.1
Management and trustee fees	(5.8)	(9.8)	(13.1)	(19.1)	(19.4)
Net financing costs	(13.3)	(26.5)	(30.6)	(38.6)	(38.3)
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/expenses	0.0	0.0	0.0	0.0	0.0
Pretax profit	34.2	54.0	60.0	91.5	96.3
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
Net profit	34.2	54.0	60.0	91.5	96.3
Distributable inc to unitholders	34.2	54.0	60.0	91.5	96.3
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	23.3	44.9	73.9	83.4	91.0
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
Investment properties	837.7	1,569.8	1,574.8	2,224.8	2,234.8
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	1,654.4	2,313.9	2,331.5
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	898.4	898.4
Other liabilities	9.8	18.1	43.5	46.3	63.9
Total Liabilities	327.1	721.5	746.9	958.3	975.9
Shareholders Equity	541.3	903.9	907.5	1,355.6	1,355.6
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	541.3	903.9	907.5	1,355.6	1,355.6
Total liabilities and equity	868.4	1,625.3	1,654.4	2,313.9	2,331.5
CASH FLOW (MYR m)					
Cash flow from operations	40.1	70.6	85.5	94.3	113.9
Capex	0.0	0.0	0.0	0.0	0.0
Acquisitions & investments	(12.1)	(732.1)	(5.0)	(650.0)	(10.0)
Disposal of FA & investments	0.0	0.0	0.0	0.0	0.0
Dividend income from associates	0.0	0.0	0.0	0.0	0.0
Other investing cash flow	0.0	0.0	0.0	0.0	0.0
CF from investing activities	(12.1)	(732.1)	(5.0)	(650.0)	(10.0)
Dividends paid	(32.7)	(50.9)	(56.4)	(91.5)	(96.3)
Interest expense	0.0	0.0	0.0	0.0	0.0
Change in debt	0.2	384.6	0.0	208.7	0.0
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Other financial activities	0.0	361.8	0.0	0.0	0.0
CF from financing activities	(32.5)	695.4	(56.4)	117.1	(96.3)
Effect of exchange rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	(4.5)	33.9	24.1	(438.6)	7.6

FYE 31 Dec	FY14A	FY15A	FY16E	FY17E	FY18E
Key Ratios					
Growth ratios (%)					
Revenue growth	1.9	64.0	9.3	49.1	3.2
Net property income growth	0.2	69.3	14.8	43.9	3.3
Core net profit growth	(1.1)	58.1	11.1	52.6	5.3
Distributable income growth	(1.1)	58.1	11.1	52.6	5.3
Profitability ratios (%)					
Net property income margin	75.9	78.4	82.4	79.5	79.6
Core net profit margin	48.6	46.9	47.7	48.8	49.8
Payout ratio	86.1	84.8	84.6	90.0	90.0
DuPont analysis					
Total return margin (%)	48.6	46.9	47.7	48.8	49.8
Gross revenue/Assets (x)	0.1	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.6	1.8	1.8	1.7	1.7
ROAE (%)	6.4	7.5	6.6	8.1	7.1
ROAA (%)	4.0	4.3	3.7	4.6	4.1
Liquidity & Efficiency					
Days receivable outstanding	22.4	18.5	16.4	11.0	10.6
Days payables outstanding	254.1	187.1	221.6	127.9	124.1
Dividend cover (x)	1.2	1.2	1.2	1.1	1.1
Current ratio (x)	2.0	3.2	1.9	2.0	1.6
Leverage & Expense Analysis					
Asset/Liability (x)	2.7	2.3	2.2	2.4	2.4
Net debt/equity (%)	52.1	71.3	67.9	60.1	59.6
Net interest cover (x)	3.6	3.0	3.0	3.4	3.5
Debt/EBITDA (x)	6.4	8.6	7.6	7.0	6.9
Capex/revenue (%)	0.0	0.0	0.0	0.0	0.0
Net debt/ (net cash)	281.8	644.9	615.9	815.0	807.4
Debt/Assets (x)	0.35	0.42	0.42	0.39	0.39

Source: Company; Maybank

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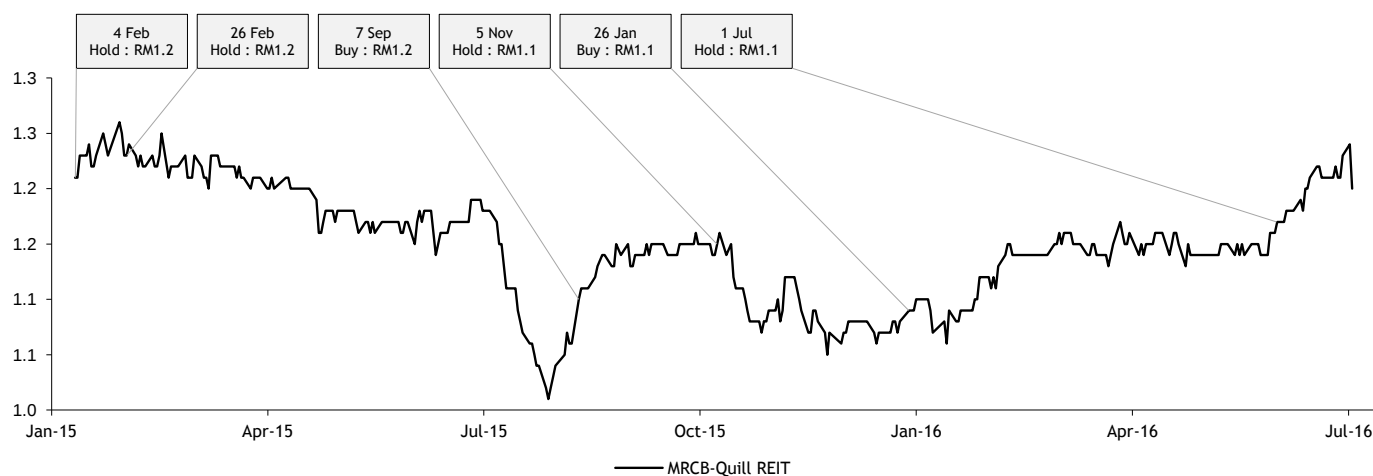
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