

Flash Note

Refer to important disclosures at the end of this report

Malaysia Equity Research

5 May 2017

MRCB-Quill REIT (MQREIT MK) : HOLD

Mkt. Cap: US\$326m | 3m Avg. Daily Val: US\$0.12m

Last Traded Price (4 May 2017): RM1.32

Price Target 12-mth: RM1.34 (2% upside) (Prev RM1.37)

Analyst

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Boost from Menara Shell

- In-line 1QFY17 earnings
- Earnings lifted by acquisition of Menara Shell in Dec 2016
- Occupancy rates stable but some lease expiring in the months ahead
- Maintain HOLD with lower TP of RM1.34

Forecasts and Valuation

FY Dec (RMm)	2016A	2017F	2018F	2019F
Gross Revenue	132	181	186	191
Net Property Inc	102	143	147	152
Total Return	58.8	85.1	90.0	93.8
Distribution Inc	58.8	85.1	90.0	93.8
EPU (sen)	9.49	7.96	8.42	8.75
EPU Gth (%)	(7)	(16)	6	4
DPU (sen)	8.89	7.96	8.42	8.75
DPU Gth (%)	5	(10)	6	4
NAV per shr (sen)	137	125	125	125
PE (X)	13.9	16.6	15.7	15.1
Distribution Yield (%)	6.7	6.0	6.4	6.6
P/NAV (x)	1.0	1.1	1.1	1.1
Aggregate Leverage (%)	43.8	41.5	41.7	41.9
ROAE (%)	6.9	7.6	6.7	7.0

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

What's New

1QFY17 results

- MQREIT's 1QFY17 net distributable income of RM23.2m (+52.0% y-o-y) was in line with our/consensus expectations. The increase in income is attributable to the contribution from the sizeable Menara Shell injection from 4Q16 onwards and higher rental income due to step-up rent adjustments from QB2, QB3 and Wisma Technip. 1QFY17 NPI margin of c.79.3% was within expectations.
- In addition, property operating expenses were also higher at RM9.4m (+30.9% y-o-y) due to the acquisition of Menara Shell. The higher finance costs this quarter were mainly due to higher borrowings after the drawdown of RM164m CPs on 22 December 2016 to finance the acquisition of Menara Shell and RM191m MTN to refinance the RM190m MTN that matured on 6 March 2017.

Stable occupancy, some lease expiries coming up

- Portfolio occupancy was steady at c.97%, slightly lower vs. 4QFY16's 98%. This may be partly due to the tenancy reconfiguration of Plaza Mont Kiara.
- About c.14.1% of total NLA was due for renewal in FY17, out of which c.1.8% of these leases have been renewed while 0.3% have not. The remaining 12% will expire in the months ahead. Management will continue to fill up the balance vacant spaces in FY17. The expiring leases in FY18 form 26% of total NLA, and 13% in FY19.
- 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, exacerbating the office supply overhang, particularly in Kuala

Flash Note

Lumpur and Selangor where MQREIT's office assets are located.

- Management will be carrying out asset-enhancement works on selected properties within its portfolio, notably, Quill Building 1-DHL and Quill Building 4-DHL. These enhancements will revolve around helping tenants to conserve energy and costs, and reduce their carbon footprint.

Outlook

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 and Menara Shell in FY16. We have assumed that PS and Menara Shell will increase the overall occupancy levels for MQREIT's portfolio from 91% in FY15 to 97% in FY17, and raise the 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.37% indicates that new equity issuance will likely be necessary for sizeable acquisitions in the near term.

Valuation

We have a HOLD recommendation with TP of RM1.34. Our DDM-derived TP decrease to RM1.34, with 7.0% cost of equity and 1% TG as we increase our risk-free rate to 4.0% from 3.9%.

Key risk

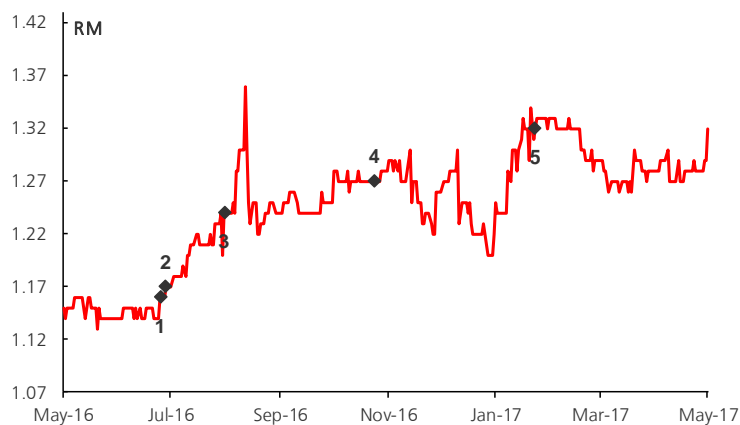
Earnings stability. Our earnings forecasts assume vacancies will not increase and an immediate renewal of expiring leases. Any delays in the leasing of released spaces will be negative for earnings and may de-rate the stock.

Quarterly / Interim Income Statement (RMm)

FY Dec	1Q2016	4Q2016	1Q2017	% chg yoy	% chg qoq
Gross revenue	32.7	34.1	45.6	39.5	33.7
Property expenses	(7.2)	(8.5)	(9.4)	30.9	11.7
Net Property Income	25.5	25.6	36.1	42.0	41.0
Other Operating expenses	(2.7)	(4.3)	(3.7)	34.4	(13.9)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	N/A	N/A
Net Interest (Exp)/Inc	(7.5)	(8.0)	(9.3)	(24.2)	(16.5)
Exceptional Gain/(Loss)	0.0	3.54	0.0	N/A	N/A
Net Income	15.2	16.9	23.2	52.0	36.9
Tax	0.0	0.0	0.0	N/A	N/A
Minority Interest	0.0	0.0	0.0	N/A	N/A
Net Income after Tax	15.2	16.9	23.2	52.0	36.9
Net Inc available for Dist.	15.2	13.4	23.2	52.0	73.2
Ratio (%)					
Net Prop Inc Margin	77.9	75.2	79.3		
Dist. Payout Ratio	0.0	205.2	0.0		

Source of all data: Company, AllianceDBS

Target Price & Ratings History



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

Source: AllianceDBS

Analyst: Siti Ruzanna MOHD FARUK

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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