

HLIB Research

PP 9484/12/2012 (031413)

Farah Diyana Kamaludin
farahdiyana@hlib.hongleong.com.my

(603) 2083 1719

BUY (Maintain)

Target Price: **RM1.40**
Previously: **RM1.44**
Current Price: **RM1.12**

Capital upside	25.0%
Dividend yield	7.9%
Expected total return	32.9%

Sector coverage: REIT

Company description: MRCB-Quill REIT invests in office and retail buildings, business/technology parks, data processing centers, and car parking facilities primarily in Malaysia.

Share price


Historical return (%)	1M	3M	12M
Absolute	1.8	-5.1	-13.8
Relative	3.2	-5.9	-17.9

Stock information

Bloomberg ticker	MQREITMK
Bursa code	5123
Issued shares (m)	1,072
Market capitalisation (RM m)	1,200
3-mth average volume ('000)	657
SC Shariah compliant	No

Major shareholders

MRCB	27.8%
Capita Commercial Trust	10.9%
Employees Provident Fund	7.2%

Earnings summary

	FY17	FY18f	FY19f
FYE (Dec)			
PAT – core	89.7	91.5	93.7
EPU – core (sen)	8.4	8.5	8.6
P/E (x)	13.4	13.2	13.0

MRCB-Quill REIT

Stable performance

MQREIT 1Q18 core net profit RM21.0m (-2.3% QoQ, -9.3% YoY) was broadly in line with our expectation and consensus. The reduction was driven by a decline in revenue, higher operating expenses & administrative expenses but slightly mitigated by lower finance costs. We lower our FY18-20 earnings by 2% followed by a decrease in FY18-20 DPU by 5% as we take into account the completion for the disposal of QB8-DHL (XPJ). We maintain BUY call with lower TP of RM1.40 (from RM1.44) based on unchanged targeted yield of 6.4%

Within expectations. 1Q18 gross revenue of RM44.0m (-1.4% QoQ, -3.3% YoY) translated into core net profit of RM21.0m (-2.3% QoQ, -9.3% YoY). The results were broadly in line with ours and consensus expectations, accounting for 22.8% and 23.2%, respectively.

Deviation. We deem it to be in line as we feel the administrative expenses would normalise in the coming quarters.

Dividend. None as dividend is usually payable semi-annually.

QoQ. Total gross revenue declined by 1.4% to RM44.0m (from RM44.7m in 4Q17), following a decrease in core net profit at RM21.0m. The reduction was caused by lower revenue contribution and higher administrative expenses pertaining to the disposal of QB8-DHL (XPJ). However, this was slightly offset by the decrease in finance costs for the quarter.

YoY. Core net profit declined by 9.3% at RM21.0m. The was driven by (1) lower revenue contribution, mainly from Platinum Sentral and Menara Shell, (2) increase in routine property operating expenses, (3) higher administrative expenses related to the proposed disposal of QB8-DHL (XPJ). This is slightly cushioned by lower finance costs due to lower amortisation of transaction costs incurred.

Occupancy and gearing. Overall occupancy rate remained healthy at 96.2% (4Q17: 96.3%). Average debt to maturity has decreased slightly from 2.79 years to 2.55 years, while average cost of debt maintained at 4.4%. The gearing level increased slightly to 38% (4Q17: 37%), which is still comfortably below the 50% limit.

Outlook. Despite the lacklustre overall office market, MQREIT's office space will remain relatively stable and well-guarded by its long weighted average term to expiry with well-spread NLA expiry. To date, management has successfully completed 81% renewals due in 1Q18. We continue to like MQREIT given its attractive dividend yield of 8.2% (highest among REITs in our universe), stable assets in prime location of KL Sentral with high occupancy rate and healthy WALE profile.

Forecast. Although the results were broadly in line, we take this opportunity to adjust our FY18-20 earnings marginally lower by 2% to account for the completion of the disposal of QB8-DHL (XPJ) building. As a result, our FY18-20 DPS forecast is also reduced by 5%.

Maintain BUY, TP: RM1.40. While we maintain our BUY call, our TP is lowered from RM1.44 to RM1.40 following the lowered DPU projection. Our TP is based on FY18 targeted yield of 6.4% which is derived from 1SD below 2 years historical average yield spread of MQREIT and 10-year MGS.

Financial Forecast

All items in (RM m) unless otherwise stated

Balance Sheet

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Cash	54.1	76.0	61.1	61.8	73.1
Receivables	18.3	6.0	6.1	6.2	6.3
Investment properties	2,222.0	2,179.2	2,181.2	2,183.2	2,185.2
PPE	0.2	0.2	0.1	0.1	0.1
Others	2.7	27.0	27.0	27.0	27.0
Assets	2,297.3	2,288.4	2,275.5	2,278.3	2,291.7
Payables	55.8	20.3	23.5	24.0	24.5
Debt	851.6	853.5	836.5	836.5	847.5
Security deposits	29.3	29.2	29.2	29.2	29.2
Derivatives	1.0	0.7	0.7	0.7	0.7
Liabilities	937.6	903.7	889.9	890.4	901.9
Unitholders' capital	1,231.9	1,231.9	1,231.9	1,231.9	1,231.9
Undistributed profit	127.8	152.8	153.7	155.9	157.9
Equity	1,359.7	1,384.7	1,385.6	1,387.9	1,389.8

Cash Flow Statement

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Profit before taxation	62.8	69.9	89.7	91.5	93.7
Finance costs	33.0	40.5	0.0	0.0	0.0
Depreciation	0.1	0.1	0.1	0.0	0.0
Fair value gain of assets	-3.5	18.2	0.0	0.0	0.0
Interest income	-2.4	-3.6	0.0	0.0	0.0
Others	-19.7	4.0	3.1	0.4	0.4
CFO	70.3	129.1	92.9	91.9	94.1
Capex	-647.4	-0.4	-2.0	-2.0	-2.0
Disposal / (purchase)	-1.5	0.0	0.0	0.0	0.0
Others	0.0	2.2	0.0	0.0	0.0
CFI	-648.9	1.8	-2.0	-2.0	-2.0
Distribution paid	-56.9	-72.6	-88.8	-89.6	-91.8
Proceeds from borrowings	164.0	191.0	100.0	0.0	400.0
Repayment of borrowings	0.0	-190.0	-117.0	0.0	-389.0
Placement / new share	487.9	-37.2	0.0	0.0	0.0
CFF	595.1	-108.8	-105.8	-89.6	-80.8
Net cash flow	16.5	22.0	-14.9	0.2	11.3

Assumptions

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Gross rental income					
Quill Building 1 - DHL 1			4.9	5.0	5.1
Quill Building 4 - DHL 2			5.3	5.4	5.5
Quill Building 2 - HSBC			9.8	10.0	10.2
Quill Building 3 - BMW			5.1	5.2	5.3
Wisma Technip			12.4	12.7	12.9
Part of Plaza Mont Kiara			4.0	4.1	4.2
Quill Building 5 - IBM			4.0	4.0	4.1
Quill Building 8 - DHL XPJ			0.0	0.0	0.0
Tesco Building - Penang			14.6	14.9	15.2
Platinum Sentral			57.6	58.8	59.9
Menara Shell			48.1	49.1	50.1
Total:			165.9	169.2	172.6

Income Statement

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Gross rental income	115.9	162.1	165.9	169.2	172.6
Car park income	10.9	12.8	14.2	14.4	14.7
Other revenue	5.0	5.2	5.8	5.9	6.1
Total revenue	136.6	181.5	185.9	189.6	193.4
Assessment & quit rent	-5.3	-8.5	-14.2	-14.5	-14.8
Depreciation	-0.1	-0.1	-0.1	-0.1	-0.1
Insurance & Prop mgmt	-3.1	-3.9	-4.0	-4.1	-4.2
Service contracts	-9.6	-10.9	-11.2	-11.4	-11.7
Utilities	-11.5	-16.7	-17.1	-17.5	-17.8
Total opex	-29.5	-40.2	-46.6	-47.5	-48.5
Net property income	77.7	101.2	92.7	94.6	96.5
Net investment income	108.2	125.4	144.4	146.2	149.1
Pretax profit	62.8	69.9	89.7	91.5	93.7
Taxation	0.0	0.0	0.0	0.0	0.0
Net profit	59.2	88.1	89.7	91.5	93.7
No. of units (units)	1,068.0	1,068.0	1,074.0	1,081.2	1,088.5

Valuation & Ratios

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Core EPU (sen)	5.9	6.5	8.4	8.5	8.6
P/E (x)	20.2	13.6	13.4	13.2	13.0
EBITDA	92.3	128.7	129.5	131.2	134.0
EBIT	92.3	128.6	129.4	131.2	133.9
EV	1,993.7	1,973.6	1,978.2	1,985.7	1,993.5
EV/EBITDA (x)	21.6	15.3	15.3	15.1	14.9
DPU (sen)	8.4	8.4	8.9	9.0	9.2
Dividend yield	7.5	7.5	7.9	8.1	8.2
NTA/ share (sen)	126.8	129.0	128.3	127.5	126.7
P/ NTA	0.9	0.9	0.9	0.9	0.9
BVPS (RM)	1.3	1.3	1.3	1.3	1.3
P/B (x)	0.9	0.9	0.9	0.9	0.9
EBITDA margin	0.7	0.7	0.7	0.7	0.7
EBIT margin	0.7	0.7	0.7	0.7	0.7
PBT margin	0.5	0.4	0.5	0.5	0.5
Net margin	0.4	0.5	0.5	0.5	0.5
ROE	4.6	5.0	6.5	6.6	6.7
ROA	2.6	3.8	3.9	4.0	4.1
Net gearing	0.3	0.3	0.3	0.3	0.3

Quarterly financial summary

FYE Dec	1Q17	4Q17	1Q18	QoQ (%)	YoY (%)
Gross revenue	45.6	44.7	44.0	-1.4	-3.3
Property opex	-9.4	-10.0	-9.8	2.7	-3.4
Net property income	36.1	36.0	34.3	-4.8	-5.1
Interest income	0.5	1.7	0.7	-58.1	61.3
Revaluation gains	0.0	-18.2	0.0	N/A	N/A
Net investment income	36.6	18.2	35.0	92.5	-4.3
Finance costs	-9.7	-11.0	-9.7	11.8	0.3
Valuation fees	0.0	-0.1	-0.1	-27.1	-192.8
Administrative expenses	-0.1	-0.3	-0.7	-157.3	-1,008.6
TOTAL EXPENSES	-13.4	-14.9	-14.0	5.8	-4.4
Normalised PBT	23.2	21.5	21.0	-2.3	-9.3
Normalised PAT	23.2	21.5	21.0	-2.3	-9.3
EPU (realised)	2.2	2.0	2.0	-2.3	-9.3
DPU (sen)	0.0	4.2	0.0	N/A	N/A

Figure #1 **Quarterly results comparison**

FYE Dec (RM m)	1Q17	4Q17	1Q18	QoQ (%)	YoY (%)
Gross Revenue	45.6	44.7	44.0	-1.4	-3.3
Property operating expenses	-9.4	-10.0	-9.8	2.7	-3.4
Net property income	36.1	36.0	34.3	-4.8	-5.1
Interest income	0.5	1.7	0.7	-58.1	61.3
Gain on divestment	0.0	0.0	0.0	N/A	N/A
Net interest income	36.6	18.2	35.0	92.5	-4.3
Finance costs	-9.7	-11.0	-9.7	11.8	0.3
Valuation fees	-0.0	-0.1	-0.1	-27.1	-192.8
Administrative expenses	-0.1	-0.3	-0.7	-157.3	-1,008.6
Total expenses	-13.4	-14.9	-14.0	5.8	-4.4
Core PBT	23.2	21.5	21.0	-2.3	-9.3
Core PAT	23.2	21.5	21.0	-2.3	-9.3
Distributable adjustments	0.0	0.0	1.4	N/A	N/A
Distributable income	23.2	21.5	22.4	N/A	N/A
EPU (realised)	2.17	2.01	1.97	-2.3	-9.3
DPU (sen)	0.00	4.16	0.00	N/A	N/A

HLIB Research

Disclaimer

The information contained in this report is based on data obtained from sources believed to be reliable. However, the data and/or sources have not been independently verified and as such, no representation, express or implied, are made as to the accuracy, adequacy, completeness or reliability of the info or opinions in the report.

Accordingly, neither Hong Leong Investment Bank Berhad nor any of its related companies and associates nor person connected to it accept any liability whatsoever for any direct, indirect or consequential losses (including loss of profits) or damages that may arise from the use or reliance on the info or opinions in this publication.

Any information, opinions or recommendations contained herein are subject to change at any time without prior notice. Hong Leong Investment Bank Berhad has no obligation to update its opinion or the information in this report.

Investors are advised to make their own independent evaluation of the info contained in this report and seek independent financial, legal or other advice regarding the appropriateness of investing in any securities or the investment strategies discussed or recommended in this report. Nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate to your individual circumstances or otherwise represent a personal recommendation to you.

Under no circumstances should this report be considered as an offer to sell or a solicitation of any offer to buy any securities referred to herein.

Hong Leong Investment Bank Berhad and its related companies, their associates, directors, connected parties and/or employees may, from time to time, own, have positions or be materially interested in any securities mentioned herein or any securities related thereto, and may further act as market maker or have assumed underwriting commitment or deal with such securities and provide advisory, investment or other services for or do business with any companies or entities mentioned in this report. In reviewing the report, investors should be aware that any or all of the foregoing among other things, may give rise to real or potential conflict of interests.

This research report is being supplied to you on a strictly confidential basis solely for your information and is made strictly on the basis that it will remain confidential. All materials presented in this report, unless specifically indicated otherwise, is under copyright to Hong Leong Investment Bank Berhad. This research report and its contents may not be reproduced, stored in a retrieval system, redistributed, transmitted or passed on, directly or indirectly, to any person or published in whole or in part, or altered in any way, for any purpose.

This report may provide the addresses of, or contain hyperlinks to, websites. Hong Leong Investment Bank Berhad takes no responsibility for the content contained therein. Such addresses or hyperlinks (including addresses or hyperlinks to Hong Leong Investment Bank Berhad own website material) are provided solely for your convenience. The information and the content of the linked site do not in any way form part of this report. Accessing such website or following such link through the report or Hong Leong Investment Bank Berhad website shall be at your own risk.

1. As of 18 May 2018, Hong Leong Investment Bank Berhad has proprietary interest in the following securities covered in this report:

(a) -

2. As of 18 May 2018, the analyst(s) whose name(s) appears on the front page, who prepared this report, has interest in the following securities covered in this report:

(a) -

Published & printed by:

Hong Leong Investment Bank Berhad (10209-W)

Level 28, Menara Hong Leong,

No. 6, Jalan Damanlela,

Bukit Damansara,

50490 Kuala Lumpur

Tel: (603) 2083 1800

Fax: (603) 2083 1766

Stock rating definitions

BUY	Expected absolute return of +10% or more over the next 12-months.
HOLD	Expected absolute return of -10% to +15% over the next 12-months.
SELL	Expected absolute return of -10% or less over the next 12-months.
UNDER REVIEW	Rating on the stock is temporarily under review which may or may not result to a change from the previous rating.
NOT RATED	Stock is not or no longer within regular coverage.

Sector rating definitions

OVERWEIGHT	Sector expected to outperform the market over the next -12 months.
NEUTRAL	Sector expected to perform in-line with the market over the next -12 months.
UNDERWEIGHT	Sector expected to underperform the market over the next -12 months.