

18 May 2018

Property | REITS

MRCB-Quill REIT

Waiting For Tenant Renewal

Maintain NEUTRAL, with a new DDM-based MYR1.05 TP from MYR1.02, 7% downside. We make no changes to our FY18F-20F earnings, as we expect the occupancy rate for Menara Shell to improve in 2H. However, we remain cautious on the potential non-renewal risk, as another 23% of leases are set to expire by December. 1Q18 earnings were in line with expectations, down 9.3% YoY due to lower revenue generated from Platinum Sentral and Menara Shell.

MRCB-Quill REIT's (MRCB-Quill) 1Q18 core net profit of MYR21m was in line with our and market expectations, making up 24% of full-year estimates. Revenue lowered by 3.3% YoY, mainly due to the lower revenue generated from Platinum Sentral and Menara Shell – this was because of Tradewinds' non-renewal.

Core net profit fell by 9.3% YoY due to higher opex incurred for some of its properties. No dividend was declared during the quarter, as the REIT distributes its income on a semi-annual basis.

The occupancy rate of all MRCB-Quill's assets as at March remained healthy at 96.2%, dropping marginally from Dec 2017's 96.3%. In FY18, about 28% of leases by NLA are up for renewal, out of which 4% has been renewed. This includes Huawei at QB3, as well as MyHSR and MSU University at Platinum Sentral. Meanwhile, about 1% of the leases have not been renewed – this was from an oil & gas company at Platinum Sentral.

We remain cautious on the potential tenant retention risk, considering that the Klang Valley office market is still quite challenging due to an office space oversupply scenario. According to CH William Talhar & Wong, the Klang Valley's cumulative supply of office space currently stands at 105.1m sq ft, and is expected to increase by another 4.13m sq ft in 2018.

Currently, the REIT still has another 23% of leases to be renewed. These include the whole of Wisma Technip (due for renewal by 31 Dec with a total NLA of 230,000 sq ft), AmGeneral (occupying 140,000 sq ft at Menara Shell), and some smaller tenants at Platinum Sentral. We are concerned that the REIT may have to give in on rentals in order to retain its tenants.

The expectation of another rate hike by Bank Negara Malaysia (BNM) in 2H18 should not have a significant impact on MRCB-Quill's earnings, given that 76% of its borrowings are locked-in at a fixed rate.

Maintain NEUTRAL. We make no changes to our FY18F-20F earnings, as we expect the occupancy rate for Menara Shell to improve in 2H to 96% from 94% – a new tenant is reportedly on-board in this quarter.

We maintain our NEUTRAL call with a new DDM-based TP of MYR1.05 from MYR1.02, 7% downside, as we fine-tune our dividend payout assumption to 97% (based on FY17) from 95% previously.

Neutral (Maintained)

Target Price: MYR1.05

Price: MYR1.12

Market Cap: USD302m

Bloomberg Ticker: MQREIT MK

Share Data

Avg Daily Turnover (MYR/USD)	0.63m/0.16m
52-wk Price low/high (MYR)	1.00 - 1.35
Free Float (%)	33
Shares outstanding (m)	390
Estimated Return	-7%

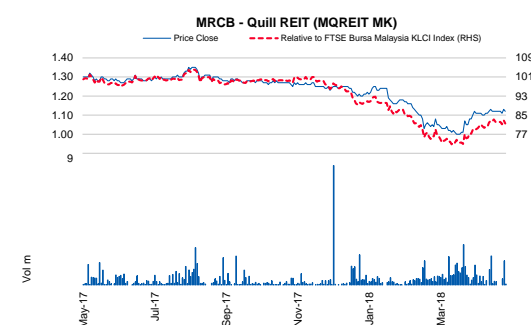
Shareholders (%)

Malaysian Resources Corp (MRCB)	27.9
Quill Group	11.0
CapitaCommercial Trust	11.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(10.4)	3.7	(5.1)	(11.1)	(13.9)
Relative	(13.8)	4.8	(6.2)	(19.3)	(18.4)

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (MYRm)	132	180	177	180	185
Net property income (MYRm)	102	140	135	138	142
Reported net profit (MYRm)	59.2	69.9	89.0	92.0	95.4
Total distributable income (MYRm)	59.2	92.1	89.0	92.0	95.4
DPS (MYR)	0.08	0.08	0.08	0.08	0.09
DPS growth (%)	(1.1)	0.1	(3.7)	3.4	3.7
Recurring P/E (x)	12.5	13.6	13.6	13.0	12.5
P/B (x)	0.88	0.86	0.86	0.86	0.86
Dividend Yield (%)	7.5	7.5	7.2	7.5	7.7
Return on average equity (%)	5.2	5.1	6.4	6.6	6.9
Return on average assets (%)	3.0	3.0	3.9	4.0	4.2
Interest cover (x)	2.72	3.09	3.39	3.47	3.57
Our vs consensus EPS (adjusted) (%)			(6.7)	(2.1)	0.4

Source: Company data, RHB

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Financial Exhibits

Financial model updated on: 2018-05-17.

Asia	Financial summary	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Malaysia	Recurring EPS (MYR)	0.09	0.08	0.08	0.09	0.09
Property	EPS (MYR)	0.09	0.07	0.08	0.09	0.09
MRCB-Quill REIT	DPS (MYR)	0.08	0.08	0.08	0.08	0.09
Bloomberg MREIT MK	BVPS (MYR)	1.27	1.30	1.30	1.30	1.30
Neutral	Weighted avg adjusted shares (m)	661	1,068	1,068	1,068	1,068
Valuation basis	Valuation metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Dividend discount model.	Recurring P/E (x)	12.5	13.6	13.6	13.0	12.5
Key drivers	P/E (x)	12.5	17.1	13.4	13.0	12.5
Higher-than-expected demand of office space and inorganic growth opportunities arising from MRCB and Quill.	P/B (x)	0.88	0.86	0.86	0.86	0.86
Key risks	FCF Yield (%)	(49.8)	7.1	7.1	7.4	7.6
Downside risks oversupply of office properties might affect the portfolio's office property occupancy and rental rates.	Dividend Yield (%)	7.5	7.5	7.2	7.5	7.7
Company Profile	EV/EBITDA (x)	(1.59)	(1.66)	(1.31)	(1.29)	(1.27)
MRCB-Quill REIT is a mid-cap MREIT that focuses on office/commercial assets. Assets are largely concentrated in the Klang Valley and Cyberjaya areas.	EV/EBIT (x)	(1.59)	(1.66)	(1.31)	(1.29)	(1.27)
	Income statement	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Total turnover (MYRm)	132	180	177	180	185
	EBITDA (MYRm)	90	125	121	124	128
	Operating profit (MYRm)	90	125	121	124	128
	Net interest (MYRm)	(31)	(37)	(32)	(32)	(32)
	Pre-tax profit (MYRm)	59	70	89	92	95
	Recurring net profit (MYRm)	59	88	88	92	95
	Cash flow (MYRm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Change in working capital	(3)	(4)	(4)	(4)	(4)
	Cash flow from operations	58	86	87	90	93
	Capex	(427)	(2)	(2)	(2)	(2)
	Cash flow from investing activities	(427)	(2)	(1)	(1)	(1)
	Proceeds from issue of shares	448	63	0	0	0
	Dividends paid	(53)	(73)	(88)	(88)	(91)
	Cash flow from financing activities	786	65	(88)	(88)	(91)
	Cash at beginning of period	45	54	76	50	52
	Net change in cash	417	149	(2)	2	2
	Ending balance cash	462	203	75	52	53
	Balance sheet (MYRm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Total cash and equivalents	54	76	50	52	53
	Total investments	2,225	2,181	2,156	2,156	2,156
	Total other assets	0	25	0	0	0
	Total assets	2,297	2,288	2,289	2,292	2,295
	Short-term debt	189	117	117	117	117
	Total long-term debt	662	737	734	734	734
	Other liabilities	23	24	24	25	25
	Total liabilities	938	903	901	902	902
	Shareholders' equity	1,360	1,385	1,387	1,390	1,393
	Total equity	1,360	1,385	1,387	1,390	1,393
	Net debt	798	777	801	799	798
	Total liabilities & equity	2,297	2,288	2,289	2,292	2,295
	Key metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
	Revenue growth (%)	14.4	36.7	(2.0)	1.8	2.8
	Recurrent EPS growth (%)	(0.5)	(7.9)	(0.4)	4.9	3.7
	Operating EBITDA margin (%)	68.2	69.4	68.6	69.1	69.1
	Net profit margin (%)	44.9	38.8	50.4	51.2	51.7
	Dividend payout ratio (%)	93.6	128.2	128.2	128.2	128.2
	Capex/sales (%)	324.0	1.1	1.1	1.1	1.1
	Interest cover (x)	2.72	3.09	3.39	3.47	3.57

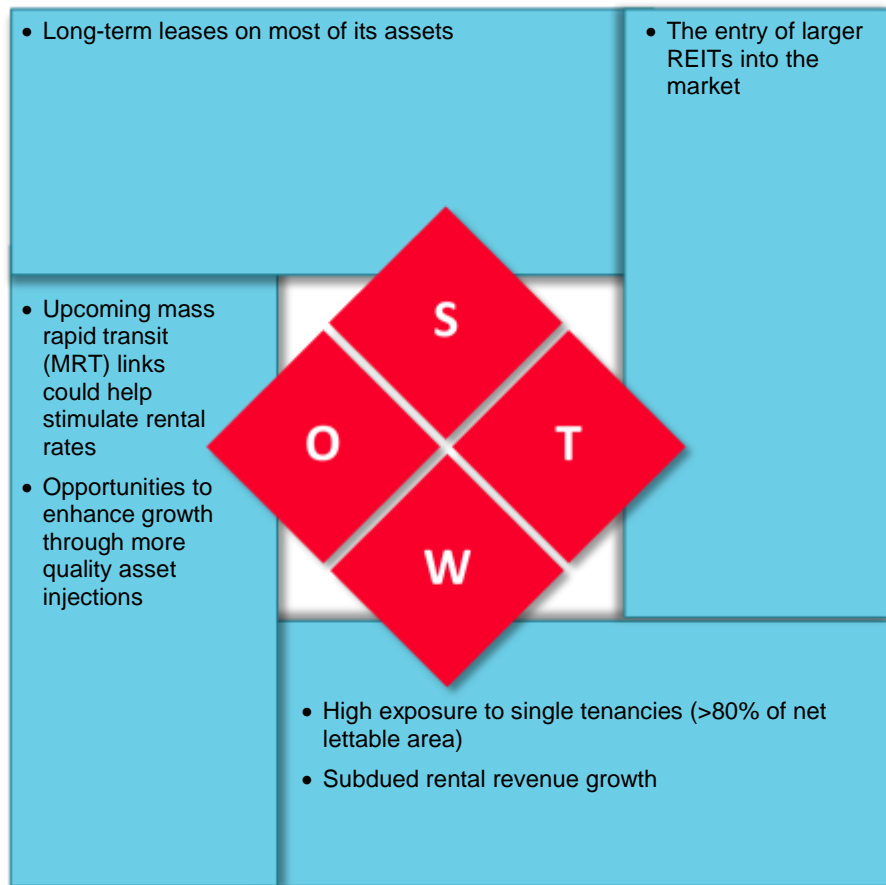
Source: Company data, RHB

Figure 1: MRCB-Quill's results comparison

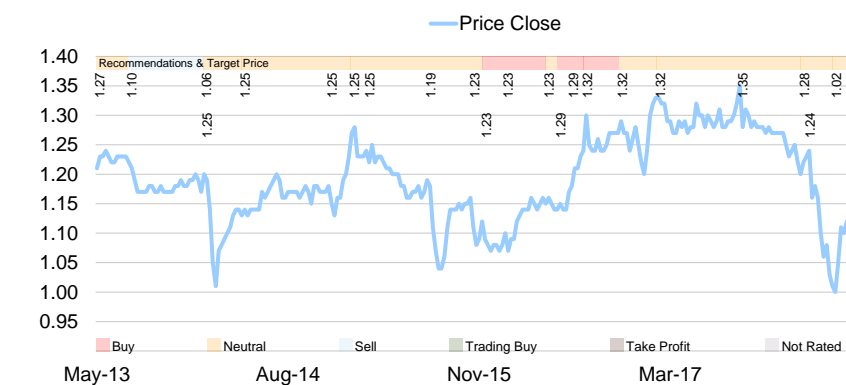
FYE Dec (MYRm)	1Q17	4Q17	1Q18	QoQ (%)	YoY (%)	Comments
Revenue	45.6	44.7	44.0	(1.4)	(3.3)	Lower YoY revenue due to less revenue generated from Platinum Sentral and Menara Shell.
Net property income (NPI)	36.1	34.6	34.3	(1.0)	(5.1)	Increased opex due to slightly higher routine opex incurred at some of its properties.
Interest expense	(9.7)	(11.0)	(9.7)	(11.8)	(0.3)	
Interest income	0.5	1.7	0.7	(58.1)	61.3	
Associates	0.0	0.0	0.0	nm	nm	
EI	0.0	(18.2)	0.0	nm	nm	
Others	(3.7)	(3.9)	(4.3)	11.2	17.0	
Pretax profit	23.2	3.3	21.0	532.5	(9.3)	
Tax	0.0	0.0	0.0	nm	nm	
Minority interest	0.0	0.0	0.0	nm	nm	
Net profit	23.2	3.3	21.0	532.5	(9.3)	
Core profit	23.2	21.4	21.0	(1.9)	(9.3)	Within expectations.
Core earnings per unit (sen)	2.17	2.01	1.97	(2.1)	(9.3)	
Dividends per unit (sen)	0.00	4.16	0.00	nm	nm	
<i>NPI margin (%)</i>	<i>79.3</i>	<i>77.6</i>	<i>77.8</i>			
<i>Pretax margin (%)</i>	<i>50.8</i>	<i>7.4</i>	<i>47.7</i>			
<i>Net margin (%)</i>	<i>50.8</i>	<i>48.0</i>	<i>47.7</i>			

Source: Company data

SWOT Analysis



Recommendation Chart



Date	Recommendation	Target Price	Price
2018-03-26	Neutral	1.02	1.03
2018-01-22	Neutral	1.24	1.24
2018-01-08	Neutral	1.28	1.21
2017-11-19	Neutral	1.35	1.27
2017-08-13	Neutral	1.35	1.32
2017-05-05	Neutral	1.32	1.32
2017-01-26	Neutral	1.32	1.32
2016-10-27	Neutral	1.32	1.27
2016-08-03	Buy	1.32	1.24
2016-07-01	Buy	1.29	1.17

Source: RHB, Bloomberg

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