

MRCB-Quill REIT (BUY ↔, EPS ↑)

INDUSTRY: NEUTRAL
EARNINGS EVALUATION
14 August 2017
Target Price: RM1.48 (↑)
Share Price: RM1.32

1HFY17 results- Above expectations

Results

- Reported 1HFY17 gross revenue of RM90.6m (+39% yoy) which translated to normalised net profit of RM45.2m (+47.7% yoy), accounting for 55.2% and 53.4% of HLIB and consensus full year forecasts, respectively.

Deviations

- Above expectations due to lower than expected property operating expenses.

Dividends

- DPU of 4.23 sen (1HFY16: 4.23 sen) was declared, representing a payout ratio of 95.4%.

Highlights

- YoY:** Higher revenue (+38.4%) recorded on the back of additional revenue from the newly acquired Menara Shell and higher rental income from QB2, QB3 and Wisma Technip.
- QoQ:** Net income declined 4.8% to RM22m due to lower revenue and higher property operating expenses.
- YTD:** Revenue was higher (+39%) due to the newly acquired Menara Shell as well as step-up rent adjustments for other properties. Net income growth (+47.7%) is higher than revenue growth mainly due to slower growth in finance costs (+23.6%).
- Overall occupancy rate slightly reduced to 96.5% (from 97%) but still remained healthy. Meanwhile, c.36% of total lease expiry in FY17 (14% of total NLA) has been renewed.
- Outlook:** Despite the lacklustre overall office market, MQREIT's performance is expected to remain stable due to its healthy occupancy rate and long WALE (5.6 years) with well-spread NLA expiry (26% and 13% expiring in FY18 and FY19, respectively).

Risks

- High gearing compare to industry average.
- Slower rental reversion rate for office market.

Forecasts

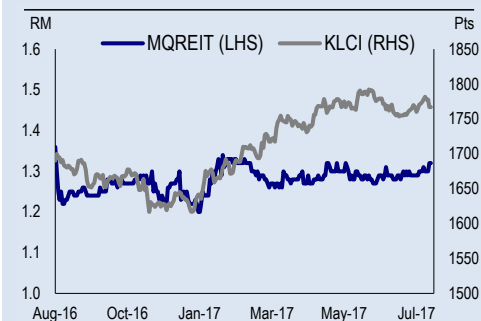
- Our FY17-19 earnings forecasts are raised by c.2% after incorporating lower property operating expenses assumption.

Rating
BUY ↔, TP: RM1.48 ↑
Valuation

- We continue to like MQREIT given its high dividend yield (highest among REITs in our universe), stable assets in prime location of KL Sentral with high occupancy rate and healthy WALE profile. The larger portfolio size allowed MQREIT to enjoy greater operating efficiency arising from economies of scale.
- TP is revised higher to **RM1.48** (from RM1.45) after incorporating our earnings forecasts.
- Maintain **BUY** with unchanged targeted yield of 6.2%.

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KLCI	1767.0
Expected share price return	12.1%
Expected dividend return	6.7%
Expected total return	18.8%

Share price

Information

Bloomberg Ticker	MQREITMK
Bursa Code	5123
Issued Shares (m)	1,068
Market cap (RM m)	1,410
3-mth avg. volume ('000)	321
SC Shariah-compliant	No

Price Performance

	1M	3M	12M
Absolute	3.1	1.5	4.9
Relative	2.4	2.1	0.0

Major Shareholders

MRCB	27.9%
Capitaland	11.0%
EPF	7.3%
Quill Estates SB	5.2%

Summary Earnings Table

FYE Dec (RMm)	2016A	2017E	2018F	2019F
Revenue	136.6	185.3	189.1	192.9
NPI	107.2	140.3	143.1	146.0
Netinvestincome	108.2	141.9	144.4	146.7
PAT	62.8	87.9	91.0	93.3
EPU (sen)	9.3	8.2	8.4	8.6
Norm. PER (x)	15.0	16.1	15.7	15.4
FD PER (x)	15.0	16.1	15.7	15.4
EV/EBITDA (x)	18.3	17.8	17.5	17.3
NetDPU (sen)	8.4	8.8	9.2	9.2
Distb. yield (%)	6.3	6.7	7.0	7.0
BVPS (RM)	2.0	1.3	1.3	1.3
P/B (x)	0.7	1.0	1.0	1.1

HLIB

Figure #1 Quarterly Results Comparison

FYE Dec (RMm)	2Q16	1Q17	2Q17	QoQ (%)	YoY (%)	Comments
Gross revenue	32.6	45.6	45.1	-1.1	38.4	YoY: Higher due to additional revenue from Menara Shell and higher rental income post rent adjustment from QB2, QB3 and Wisma Technip.
Property operating expenses	-6.9	-9.4	-10.2	-7.7	-48.1	Higher due to acquisition of Menara Shell.
Net property income	25.7	36.1	34.9	-3.4	35.8	
Interest income	0.4	0.5	0.6	43.7	71.0	Higher due to higher bank balances.
Gain on divestment	0.0	0.0	0.0	NM	NM	
Net investment income	26.1	36.6	35.6	-2.8	36.3	
Finance costs	-8.0	-9.7	-9.8	-1.2	-23.4	Increased due to higher borrowings after the drawdown of RM144m CPs and RM20m MTN to finance Menara Shell.
Valuation fees	-0.1	-0.0	-0.1	-120.1	-3.3	
Administrative expenses	-0.1	-0.1	0.0	NM	NM	
Total Expenses	-10.7	-13.4	-13.5	-0.7	-26.3	
Normalised PBT	15.4	23.2	22.0	-4.8	43.3	
Normalised PAT	15.4	23.2	22.0	-4.8	43.3	
EPU (realised)	2.29	2.17	2.26	4.1	-1.2	Due to higher share base from placement exercise (excl. the divestment gain).
DPU (sen)	4.23	0.00	4.23	NM	0.0	

Company Data, HLIB

Figure #2 Cumulative Results Comparison

FYE Dec (RMm)	1HFY16	1HFY17	YoY (%)	Comments
Gross revenue	65.2	90.6	39.0	Additional revenue arising from the acquisition of Menara Shell on 22 Dec 2016 and higher rental rates for QB2, QB3 and Wisma Technip.
Property operating expenses	-14.1	-19.6	39.3	Higher due to acquisition of Menara Shell.
Net property income	51.1	71.0	38.9	
Interest income	0.8	1.1	43.2	
Gain on divestment	0.0	0.0	NM	
Net investment income	51.9	72.1	38.9	
Finance costs	-15.8	-19.6	23.6	Higher due to financial drawdown to fund acquisitions.
Valuation fees	-0.1	-0.1	5.0	
Administrative expenses	-0.2	-0.1	-73.4	
Total Expenses	-21.3	-26.9	26.4	
Normalised PBT	30.6	45.2	47.7	
Normalised PAT	30.6	45.2	47.7	Higher net property income and interest income, net of finance cost and expense.
EPU (realised)	4.55	4.43	-2.7	
DPU (sen)	4.23	4.23	0.0	

Company Data, HLIB

Figure #3 1HFY17 Results vs. HLIB's Estimates and Consensus

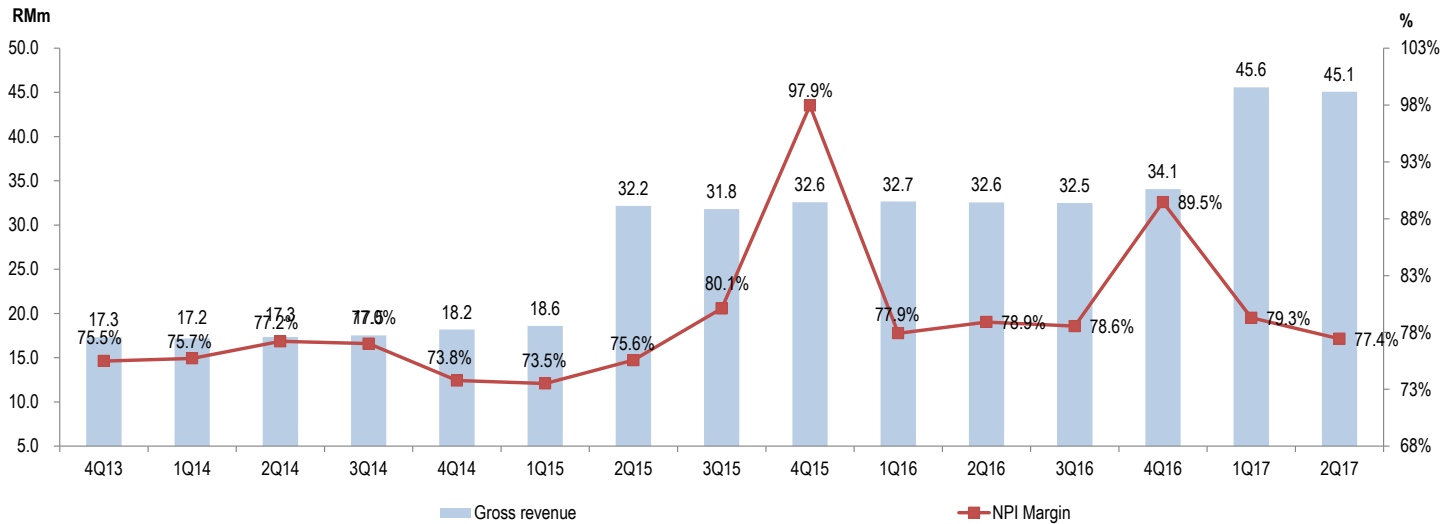
	Actual 1HFY17	HLIB FY17	Actual vs. HLIB (%)	Consensus FY17	Actual vs. Consensus (%)	Comments
Revenue	90.6	185.3	48.9	183.1	49.5	In line.
Normalised PAT	45.2	86.1	52.5	89.8	50.4	In line.
EPU (sen)	4.4	8.0	55.2	8.3	53.4	Above.
DPU (sen)	4.2	8.7	48.7	8.1	52.2	In line.

Company Data, HLIB, Bloomberg

Figure #4 HLIB Forecasts vs. Consensus

RMm	FY18F			FY19F		
	HLIB	Consensus	%	HLIB	Consensus	%
Normalised PAT	91.0	93.2	(2.3)	93.3	96.3	91.0
DPU (sen)	9.2	8.3	10.8	9.2	8.5	9.2

HLIB, Bloomberg

Figure #5 Gross Revenue & NPI Margin

HLIB, Bloomberg

Figure #6 Peers Comparison

Company	FYE	Price		Market Cap (m)	P/E (x)		P/B (x)		Gross DY (%)
					2017	2018	2017	2018	
Amanah Harta Tanah PNB	Dec	RM	0.94	206.8	NA	NA	NA	NA	5.74
Al'Aqar Healthcare REIT	Dec	RM	1.52	1,106.9	NA	NA	NA	NA	NA
AmFIRST Real Estate Investment Trust	Mar	RM	0.72	494.2	NA	NA	NA	NA	5.92
Amanahraya Real Estate Investment Trust	Dec	RM	0.94	538.8	14.9	14.0	NA	NA	5.85
Atrium Real Estate Investment Trust	Dec	RM	1.14	138.9	NA	NA	NA	NA	6.49
Axis Real Estate Investment Trust	Dec	RM	1.62	1,823.5	19.3	18.5	1.4	1.4	5.37
CapitaMalls Malaysia Trust	Dec	RM	1.48	3,397.8	17.4	16.4	1.1	1.1	5.81
Hektar Real Estate Investment Trust	Dec	RM	1.30	520.8	13.0	13.0	0.8	0.9	6.92
IGB Real Estate Investment Trust	Dec	RM	1.74	5,877.2	21.0	19.8	1.7	1.7	5.40
KIP Real Estate Investment Trust	Jun	RM	0.94	472.5	NA	NA	NA	NA	NA
KLCCP Stapled Group	Dec	RM	7.80	14,424.6	18.8	18.3	0.9	0.9	4.92
MRCB-Quill Real Estate Investment Trust	Dec	RM	1.32	1,377.7	16.1	15.7	1.0	1.0	6.67
Pavilion Real Estate Investment Trust	Dec	RM	1.71	5,235.5	21.1	18.6	1.2	1.2	4.91
Al-Salam Real Estate Investment Trust	Mar	RM	1.00	580.0	15.2	14.9	0.9	0.9	6.00
Sunway Real Estate Investment Trust	Jun	RM	1.74	5,095.0	19.1	17.8	1.2	1.2	5.23
Tower Real Estate Investment Trust	Dec	RM	1.20	336.6	NA	NA	NA	NA	5.78
UOA Real Estate Investment Trust	Dec	RM	1.65	697.7	NA	NA	NA	NA	5.07
YTL Hospitality REIT	Jun	RM	1.19	2,028.2	15.9	15.1	0.9	0.9	6.30
Average					17.4	16.6	1.1	1.1	5.8

HLIB, Bloomberg

MRCB-Quill REIT (BUY, TP: RM1.48, CP: RM1.32)**Income Statement**

FYE Dec (RM m)	2015A	2016A	2017E	2018F	2019F
Gross rental income	99.5	115.9	165.8	169.1	172.5
Car park income	10.3	10.9	13.9	14.2	14.4
Other revenue	5.4	5.0	5.7	5.8	5.9
Total Revenue	120.3	136.6	185.3	189.1	192.9
Assessment & quit rent	(4.5)	(5.3)	(7.8)	(7.9)	(8.1)
Depreciation	(0.0)	(0.1)	(0.0)	(0.0)	(0.0)
Insurance	(0.7)	(0.7)	(1.1)	(1.1)	(1.1)
Property management fees	(2.2)	(2.3)	(5.0)	(5.1)	(5.2)
Service contracts	(7.3)	(9.6)	(12.9)	(13.2)	(13.5)
Utilities	(10.2)	(11.5)	(18.2)	(18.6)	(19.0)
Total Opex	(24.9)	(29.5)	(45.0)	(45.9)	(46.8)
Net property income	95.4	107.2	140.3	143.1	146.0
Net investment income	99.1	108.2	141.9	144.4	146.7
Pretax profit	60.7	62.8	87.9	91.0	93.3
Taxation	0.0	0.0	0.0	1.0	2.0
Net profit	53.4	59.2	87.9	91.0	93.3
No of units (m)	596.0	672.5	1,074.1	1,081.3	1,088.5
EPU (sen)	10.2	9.3	8.2	8.4	8.6

Cash Flows

FYE Dec (RM m)	2015A	2016A	2017E	2018F	2019F
PBT	60.7	62.8	87.9	91.0	93.3
Finance costs	28.0	33.0	0.0	0.0	0.0
Depreciation	0.0	0.1	0.1	0.0	0.0
Fair value gain of assets	(7.3)	(3.5)	0.0	0.0	0.0
Interest income	(0.9)	(2.4)	0.0	0.0	0.0
Others	(21.5)	(19.7)	(23.3)	0.3	0.3
Operating cashflow	59.0	70.3	64.6	91.4	93.6
Capex	(751.9)	(647.4)	(2.0)	(2.0)	(2.0)
Disposal / (purchase)	(0.2)	(1.5)	(0.0)	(0.0)	(0.0)
Others	24.9	0.0	0.0	0.0	0.0
Investing Cashflow	(727.3)	(648.9)	(2.0)	(2.0)	(2.0)
Distribution paid	(38.7)	(56.9)	(87.0)	(90.1)	(91.4)
Proceeds from borrowings	534.0	164.0	200.0	100.0	0.0
Repayment of borrowings	(145.0)	0.0	(189.1)	(117.0)	0.0
Placement / New shares	342.0	487.9	0.0	0.0	0.0
Financing cashflow	692.3	595.1	(76.1)	(107.1)	(91.4)

Balance Sheet

FYE Dec (RM m)	2015A	2016A	2017E	2018F	2019F
PPE	0.2	0.2	0.2	0.2	0.1
Investment properties	1,569.8	2,222.0	2,224.0	2,226.0	2,228.0
Others	3.6	2.7	2.7	2.7	2.7
Non-current assets	1,573.6	2,225.0	2,226.9	2,228.9	2,230.9
Trade receivables	6.1	18.3	17.4	17.7	18.1
Cash	44.9	54.1	40.5	22.8	23.0
Total Current Assets	51.7	72.4	57.9	40.5	41.0
Total assets	1,625.3	2,297.3	2,284.8	2,269.4	2,271.9
Unitholders' capital	751.3	1,231.9	1,231.9	1,231.9	1,231.9
Undistributed profit	152.6	127.8	128.6	129.5	131.4
Total Equity	903.9	1,359.7	1,360.6	1,361.5	1,363.4
Borrowings	689.7	851.6	862.5	845.5	845.5
Security Deposits	18.1	29.3	29.3	29.3	29.3
Derivatives	0.0	1.0	1.0	1.0	1.0
Trade payables	13.6	55.8	31.5	32.1	32.8
Total liabilities	721.5	937.6	924.3	907.9	908.5
Total liabilities & equity	1,625.3	2,297.3	2,284.8	2,269.4	2,271.9

Valuation Ratios

FYE Dec (RM m)	2015A	2016A	2017E	2018F	2019F
EPU before mgr's fee	9.0	8.8	8.2	8.4	8.6
EPU after mgr's fee	10.2	9.3	8.2	8.4	8.6
PER (x)	14.7	15.0	16.1	15.7	15.4
No of units	596.0	672.5	1,074.1	1,081.2	1,088.4
Net DPU	8.5	8.4	8.8	9.2	9.2
Net DY (%)	6.4	6.3	6.7	7.0	7.0
NTA/ share (sen)	151.0	201.3	126.0	125.2	124.4
P/NTA (x)	0.9	0.7	1.0	1.1	1.1
FCF/ share (sen)	16.2	19.5	13.3	18.5	17.2
FCF yield (%)	12.3	14.8	10.1	14.1	13.0
Enterprise value	1,431.6	1,685.2	2,239.7	2,249.9	2,259.1
EV/ EBITDA (x)	17.4	18.3	17.8	17.5	17.3
ROE (%)	6.7	4.6	6.5	6.7	6.8
Net gearing (x)	0.4	0.3	0.4	0.4	0.4
Total gearing (x)	0.4	0.4	0.4	0.4	0.4
BVPS (RM)	1.5	2.0	1.3	1.3	1.3
P/B (x)	0.9	0.7	1.0	1.0	1.1

Assumption metrics

Gross Rental Income	2017E	2018F	2019F
Quill Building 1 - DHL 1	4.8	4.9	5.0
Quill Building 4 - DHL 2	5.2	5.3	5.4
Quill Building 2 - HSBC	9.6	9.8	10.0
Quill Building 3 - BMW	5.0	5.1	5.2
Wisma Technip	12.2	12.4	12.7
Part of Plaza Mont' Kiara	3.9	4.0	4.1
Quill Building 5 - IBM	3.9	4.0	4.0
Quill Building 6 - DHL XPJ	3.1	3.2	3.3
Tesco Building - Penang	14.4	14.6	14.9
Platinum Sentral	56.5	57.6	58.8
Menara Shell	47.2	48.1	49.1
Total	165.8	169.1	172.5

Quarterly Financial Summary

FYE Dec (RM m)	2Q16	1Q17	2Q17	QoQ (%)	YoY (%)
Gross revenue	32.6	45.6	45.1	(1.1)	38.4
Property operating expenses	(6.9)	(9.4)	(10.2)	(7.7)	(48.1)
Net property income	25.7	36.1	34.9	(3.4)	35.8
Interest income	0.4	0.5	0.6	43.7	71.0
Revaluation gains	0.0	0.0	0.0	NM	NM
Net investment income	26.1	36.6	35.6	(2.8)	36.3
Finance costs	(8.0)	(9.7)	(9.8)	(1.2)	(23.4)
Valuation fees	(0.1)	(0.0)	(0.1)	(120.1)	(3.3)
Administrative expenses	(0.1)	(0.1)	0.0	104.5	104.5
Total Expenses	(10.7)	(13.4)	(13.5)	(0.7)	(26.3)
Normalised PBT	15.4	23.2	22.0	(4.8)	43.3
Normalised PAT	15.4	23.2	22.0	(4.8)	43.3
EPU after mgmt fee	2.3	2.2	2.3	4.1	(1.2)
DPU (sen)	4	0	4	NM	0.0

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BUY	Positive recommendation of stock under coverage. Expected absolute return of more than +10% over 12-months, with low risk of sustained downside.
TRADING BUY	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between -10% and +10% over 12-months, with low risk of sustained downside.
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NOT RATED	No research coverage, and report is intended purely for informational purposes.

Industry rating definitions

OVERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of more than +5% over 12-months.
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