

14 August 2017

Property | REITS

MRCB-Quill REIT

Neutral (Maintained)

Higher Earnings Driven By Menara Shell

MRCB-Quill's 2Q17 core net profit was within expectations, driven by an additional contribution from Menara Shell and a positive rental reversion from some of its office assets. We keep our FY17-19 forecast unchanged, but revise slightly up our DDM-derived TP to MYR1.35 (from MYR1.32, 4% upside) after updating our in-house assumptions on the market risk premium. Maintain NEUTRAL.

1HFY17 earnings within expectations. MRCB-Quill's 1HFY17 core net profit of MYR45.2m was within our and market expectations, making up 52% our full-year estimates. Revenue increased by 39% YoY, mainly due to the additional contribution from Menara Shell which was acquired on 22 Dec 2016, and positive rental reversion of 3-5% on Quill Building 2 - HSBC, Quill Building 3 - BMW and Wisma Technip. Core net profit grew by 47.6% YoY, as the net margin expanded to 49.9% (vs 1HFY16: 47%), due to a better net property income (NPI) margin from Menara Shell. A MYR0.0423 dividend per unit (DPU) was declared, similar to last year's.

Overall occupancy contracted marginally to 96.5% (from 97% in the previous quarter), due to a slight drop in the occupancy at Plaza Mon't Kiara and Platinum Sentral. The portfolio occupancy has fallen for two consecutive quarters, as Menara Shell's occupancy rate declined to 95% in last quarter from 99% mainly due to the non-renewal of one of its tenants - Tradewinds. Currently, management is still negotiating with potential new tenants, and we do not expect the space to be taken up too soon. Given the challenging office segment, due to an oversupply of office space, we think it would be difficult for the management to get a better rental rate from the potential new tenants. Nevertheless, Tradewinds's non-renewal is expected to have little impact to the REIT's overall performance (<0.5% of total revenue), based on our estimation.

We expect Menara Shell to continue to drive the REIT's earnings growth this year. This 33-storey office building is strategically located in the South-Western portion of KL Sentral, which is an integrated transit hub in Kuala Lumpur. It has a total NLA of 557,053 sq ft - about 25% of the REIT's overall portfolio - and has an occupancy rate of >90%, with a good mix of multinational and large conglomerates (Shell Trading Malaysia and AmGeneral are amongst the major tenants). We expect Menara Shell to continue to contribute 28% of the REIT's total revenue in FY17 and FY18.

Maintain NEUTRAL. We maintain our FY17-19 earnings forecasts but raise our DDM-derived TP to MYR1.35 (from MYR1.32, 4% upside) after updating our in-house assumption on the market risk premium. The potential injection of assets into the REIT from MRCB and Quill Group could be the potential catalysts to spur inorganic growth, in our view.

Risks. The key upside risk to our call would be higher-than-expected demand for office space. On the downside, the key risks would include oversupply of office properties, which might affect the portfolio's office property occupancy and rental rates.

Forecasts and Valuations	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (MYRm)	115	132	174	178	181
Net property income (MYRm)	90	102	130	136	140
Reported net profit (MYRm)	53.4	59.2	86.4	91.5	94.9
Total distributable income (MYRm)	53.4	59.2	86.4	91.5	94.9
DPS (MYR)	0.08	0.08	0.08	0.08	0.08
DPS growth (%)	1.1	(1.1)	(6.8)	4.2	3.8
Recurring P/E (x)	14.4	14.5	16.1	15.2	14.6
P/B (x)	0.95	1.02	1.02	1.02	1.01
Dividend Yield (%)	6.5	6.4	6.0	6.3	6.5
Return on average equity (%)	7.4	5.2	6.3	6.7	6.9
Return on average assets (%)	4.3	3.0	3.8	4.0	4.1
Interest cover (x)	2.81	2.72	3.35	3.49	3.59
Our vs consensus EPS (adjusted) (%)			(2.5)	(2.7)	(3.4)

Source: Company data, RHB

Target Price:	MYR1.35
Price:	MYR1.30
Market Cap:	USD324m
Bloomberg Ticker:	MQREIT MK

Share Data

Avg Daily Turnover (MYR/USD)	0.39m/0.09m
52-wk Price low/high (MYR)	1.20 - 1.36
Free Float (%)	33
Shares outstanding (m)	390
Estimated Return	4%

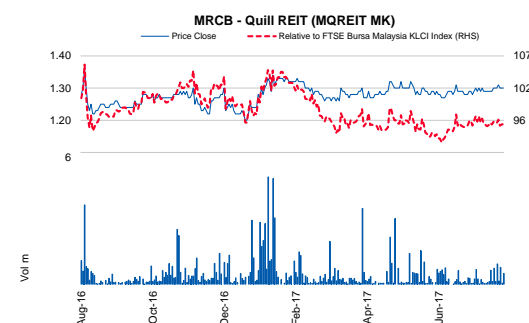
Shareholders (%)

MRCB	27.9
Quill Group	11.0
CapitaCommercial Trust	11.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	8.3	1.6	0.0	(1.5)	1.6
Relative	0.0	0.4	(0.6)	(6.1)	(4.7)

Source: Bloomberg



Source: Bloomberg

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Financial Exhibits

Financial model updated on : 2017-08-11.

Asia	Financial summary	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Malaysia	Recurring EPS (MYR)	0.09	0.09	0.08	0.09	0.09
Property	EPS (MYR)	0.09	0.09	0.08	0.09	0.09
MRCB-Quill REIT	DPS (MYR)	0.08	0.08	0.08	0.08	0.08
Bloomberg	BVPS (MYR)	1.37	1.27	1.28	1.28	1.28
MQREIT MK	Weighted avg adjusted shares (m)	594	661	1,068	1,068	1,068
Neutral						
Valuation basis	Valuation metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Dividend discount model	Recurring P/E (x)	14.4	14.5	16.1	15.2	14.6
	P/E (x)	14.4	14.5	16.1	15.2	14.6
	P/B (x)	0.95	1.02	1.02	1.02	1.01
	FCF Yield (%)	6.6	(42.9)	6.0	6.3	6.5
	Dividend Yield (%)	6.5	6.4	6.0	6.3	6.5
	EV/EBITDA (x)	(0.77)	(0.27)	(2.04)	(1.98)	(1.94)
	EV/EBIT (x)	(0.77)	(0.27)	(2.04)	(1.98)	(1.94)
Key drivers						
Higher-than-expected demand of office space and inorganic growth opportunities arising from MRCB and Quill Group.						
Key risks	Income statement	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Downside risks oversupply of office properties might affect the portfolio's office property occupancy and rental rates.	Total turnover (MYRm)	115	132	174	178	181
	EBITDA (MYRm)	80	90	120	125	128
	Operating profit (MYRm)	80	90	120	125	128
	Net interest (MYRm)	(27)	(31)	(33)	(33)	(33)
	Pre-tax profit (MYRm)	53	59	86	91	95
	Recurring net profit (MYRm)	53	59	86	91	95
Company Profile						
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.						
	Cash flow (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
	Change in working capital	(3)	(3)	(4)	(4)	(4)
	Cash flow from operations	53	58	85	90	93
	Capex	(2)	(427)	(2)	(2)	(2)
	Cash flow from investing activities	(2)	(427)	(2)	(2)	(2)
	Proceeds from issue of shares	353	448	0	0	0
	Dividends paid	(41)	(53)	(69)	(85)	(89)
	Cash flow from financing activities	507	786	(69)	(85)	(89)
	Cash at beginning of period	23	45	54	259	262
	Net change in cash	558	417	13	2	2
	Ending balance cash	581	462	67	262	264
	Balance sheet (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
	Total cash and equivalents	45	54	259	262	264
	Total investments	1,573	2,225	2,225	2,225	2,225
	Total other assets	0	0	0	0	0
	Total assets	1,625	2,297	2,300	2,305	2,310
	Short-term debt	189	189	189	189	189
	Total long-term debt	501	662	662	662	662
	Other liabilities	15	23	22	23	23
	Total liabilities	721	938	937	938	938
	Shareholders' equity	904	1,360	1,363	1,367	1,372
	Total equity	904	1,360	1,363	1,367	1,372
	Net debt	645	798	592	590	587
	Total liabilities & equity	1,625	2,297	2,300	2,305	2,310
	Key metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
	Revenue growth (%)	64.0	14.4	32.3	2.0	2.0
	Recurrent EPS growth (%)	2.9	(0.5)	(9.6)	5.8	3.8
	Operating EBITDA margin (%)	69.9	68.2	68.7	70.2	70.7
	Net profit margin (%)	46.4	44.9	49.6	51.4	52.3
	Dividend payout ratio (%)	94.1	93.6	93.6	93.6	93.6
	Capex/sales (%)	1.7	324.0	1.1	1.1	1.1
	Interest cover (x)	2.81	2.72	3.35	3.49	3.59

Source: Company data, RHB

Figure 1: MRCB-Quill's results comparison

FYE Dec (MYRm)	2QFY16	1QFY17	2QFY17	QoQ (%)	YoY (%)	1HFY16	1HFY17	YoY (%)	Comments
Revenue	32.6	45.6	45.1	(1.1)	38.4	65.2	90.6	39.0	Higher YoY revenue growth due to the additional contribution from Menara Shell (acquired on 22 Dec 2016) and positive rental reversions of its assets.
Net property income (NPI)	25.7	36.1	34.9	(3.4)	35.8	51.1	71.0	38.9	Higher operating expenses due to acquisition of Menara Shell.
Interest expense	(8.0)	(9.7)	(9.8)	1.2	23.4	(15.8)	(19.6)	23.6	Higher interest expense due to interest on additional borrowings to finance part of the acquisition of Menara Shell.
Interest income	0.4	0.5	0.6	43.7	71.0	0.8	1.1	43.2	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Others	(2.7)	(3.7)	(3.7)	(0.5)	35.2	(5.5)	(7.4)	34.8	
Pretax profit	15.4	23.2	22.0	(4.8)	43.3	30.6	45.2	47.6	
Tax	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Minority Interest	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
Net Profit	15.4	23.2	22.0	(4.8)	43.3	30.6	45.2	47.6	
Core Profit	15.4	23.2	22.0	(4.8)	43.3	30.6	45.2	47.6	Within expectations
Core earnings per unit (sen)	2.33	2.17	2.26	4.2	(3.0)	4.63	4.43	(4.3)	Lower due to increase in units pursuant to the placement exercise for acquisition of Menara Shell
Dividends per unit (sen)	4.23	0.00	4.23	nm	0.0	4.23	4.23	0.0	
NPI Margin (%)	78.9	79.3	77.4			78.4	78.4		
Pretax Margin (%)	47.2	50.8	48.9			47.0	49.9		
Net Margin (%)	47.2	50.8	48.9			47.0	49.9		

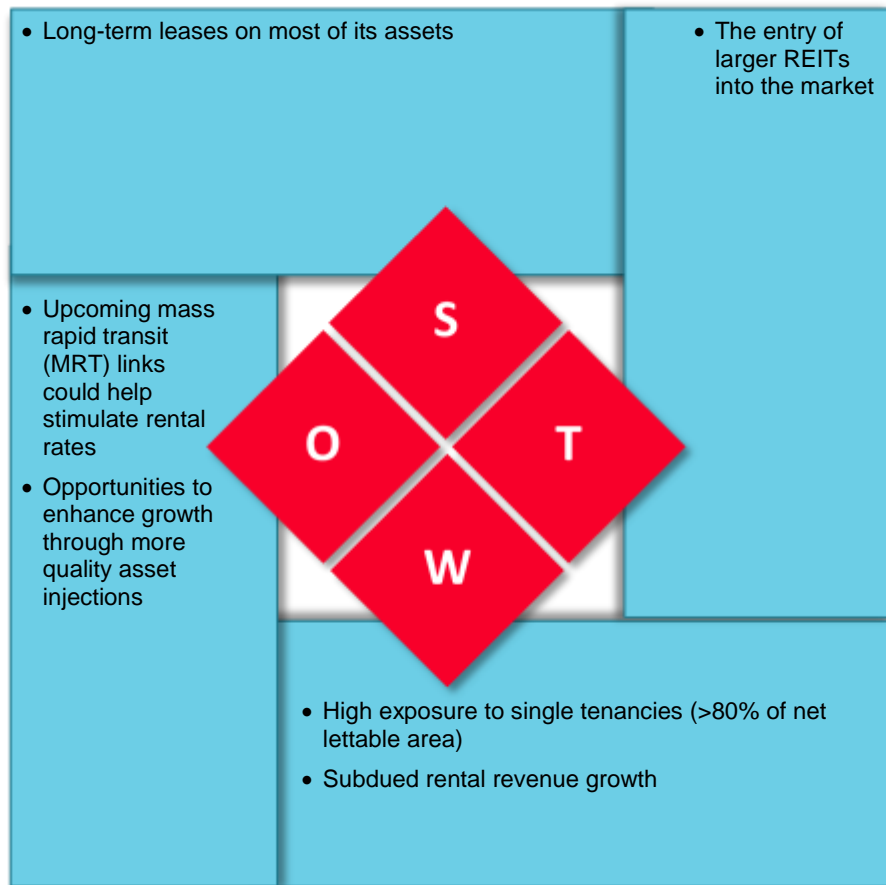
Source: Company

Figure 2: MRCB-Quill REIT – forecast assumptions

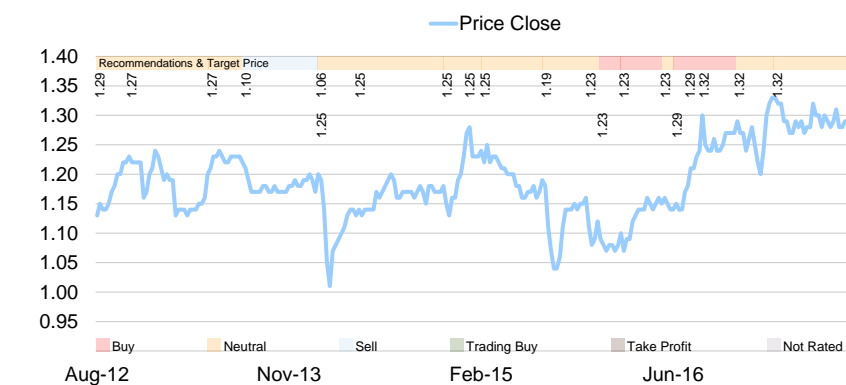
Asset	NLA / GFA	Average Rental Rates (MYR psf)		
	(sf)	FY17F	FY18F	FY19F
QB 1 - DHL 1	92,284	4.45	4.54	4.63
QB 4 - DHL 2	99,183	4.45	4.54	4.63
QB 2 - HSBC	184,453	4.45	4.54	4.63
QB 3 - BMW	117,198	4.45	4.54	4.63
QB 5 - IBM	81,602	3.33	3.44	3.56
Plaza MK	73,408	8.53	8.54	8.55
Wisma Technip	233,021	5.85	6.02	6.20
QB 10 - HSBC	68,377	3.33	3.44	3.56
QB 8 - DHL	65,205	3.33	3.44	3.56
Tesco Penang	275,020	3.09	3.16	3.22
Platinum Sentral	475,857	9.04	9.17	9.31
Shell Tower	557,053	7.28	7.46	7.65
DPU (sen)		7.81	8.14	8.44

Source: RHB, Company

SWOT Analysis



Recommendation Chart



Date	Recommendation	Target Price	Price
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
2016-05-31	Buy	1.29	1.14
2016-05-03	Neutral	1.23	1.14
2016-01-25	Buy	1.23	1.08
2015-12-04	Buy	1.23	1.12
2015-11-06	Neutral	1.23	1.16

Source: RHB, Bloomberg

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