9 August 2018

Property | REITS

Neutral (Maintained)

MRCB-Quill REIT

Occupancy Risk Still The Biggest Concern

Target Price:	MYR1.20
Price:	MYR1.17
Market Cap:	USD308m
Bloomberg Ticker:	MQREIT MK

Maintain NEUTRAL, new TP of MYR1.20 from MYR1.22 implies 3% upside. 1H earnings decreased 6.4% YoY, due to lower income from Platinum Sentral and Menara Shell as well as loss of income from the disposal of QB8. We trim FY18-20F earnings by 1-2% due to higher-than-expected income loss from the disposal of QB8 and Tradewinds. The REIT's expected dividend yield of 6.6% is higher than the sector average – which is fair, given the higher occupancy risk.

MRCB-Quill's 1H core net profit of MYR42.3m is in line with our and market expectations, making up 48% of our full-year estimate. 1H revenue dropped by 3.5% YoY, mainly due to lower income generated from Platinum Sentral and Menara Shell (due to non-renewal of Tradewinds) as well as loss of revenue from Quill Building 8 – DHL (QB8) which took place in April. Meanwhile, core net profit declined by 6.4% YoY, as the net margin narrowed from the disposal. The REIT distributes its income on a semi-annual basis. A 4.23 sen DPU wasdeclared for 1H, unchanged from 1H17.

Disposal of QB8. The disposal of QB8 was completed in April, for a cash consideration of MYR28m. The divestment resulted in a gain of MYR2.2m. To recap, the building has a total NLA of 65,205sqf and was single-tenanted by DHL Express (Malaysia) SB, located at Hicom Glenmarie Industrial Park, Section U1, Shah Alam, Selangor. The rationale for the disposal was mainly due to streamlining of its assets, as this is the only one located in Shah Alam. The asset only contributed c.2% of the REIT's income previously.

24% of NLA up for renewal in 2H. Occupancy rate of all MRCB-Quill's assets as at March remained healthy at 96%, signifying a slight dip from 96.3% in Dec 2017. In FY18, about 28% of the REIT's total NLA (or c.609,000 sqf) will be up for renewal. 14% of these leases were due in 1H18, of which 70% have been renewed with 1-3% rental reversion. These include Huawei in QB3, as well as MyHSR (short extension) and MSU University in Platinum Sentral.

Occupancy risk. We remain cautious on the REIT's outlook, given that it still has 24% of leases up for renewal. These include the whole Wisma Technip due for renewal by 31 Dec with a total NLA of 230,000 sqf, AmGeneral which occupied 140,000 sqf in Menara Shell, and some tenants in Platinum Sentral. We are concerned that the REIT may have to give in on rental rate negotiations to retain the tenants.

Maintain NEUTRAL. We trim FY18-20F earnings by 1-2% to reflect the higher-than-expected loss of income from QB8 and Tradewinds. We maintain our NEUTRAL call but lower our DDM-based TP of MYR1.20 (from MYR1.22, 3% upside). The REIT's expected dividend yield of 6.6% is higher than the sector average. However, we believe this is fair, given its occupancy risk. Our Top Picks for the sector are IGB REIT (IGBREIT MK, BUY, TP: MYR1.86) and Sunway REIT (SREIT MK, BUY, TP: MYR1.88).

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (MYRm)	132	180	171	173	176
Net property income (MYRm)	102	140	131	133	135
Reported net profit (MYRm)	59.2	69.9	84.9	86.7	88.8
Total distributable income (MYRm)	59.2	92.1	84.9	86.7	88.8
DPS (MYR)	0.08	0.08	0.08	0.08	0.08
DPS growth (%)	(1.1)	0.1	(8.1)	2.1	2.4
Recurring P/E (x)	13.1	14.2	14.9	14.4	14.1
P/B (x)	0.92	0.90	0.90	0.90	0.90
Dividend Yield (%)	7.2	7.2	6.6	6.7	6.9
Return on average equity (%)	5.2	5.1	6.1	6.2	6.4
Return on average assets (%)	3.0	3.0	3.7	3.8	3.9
Interest cover (x)	2.72	3.09	3.27	3.32	3.38
Our vs consensus EPS (adjusted) (%)			(11.1)	(7.8)	(6.6)

Source: Company data, RHB

Share Data

Avg Daily Turnover (MYR/USD)	0.29m/0.07m
52-wk Price low/high (MYR)	1.00 - 1.35
Free Float (%)	33
Shares outstanding (m)	390
Estimated Return	3%

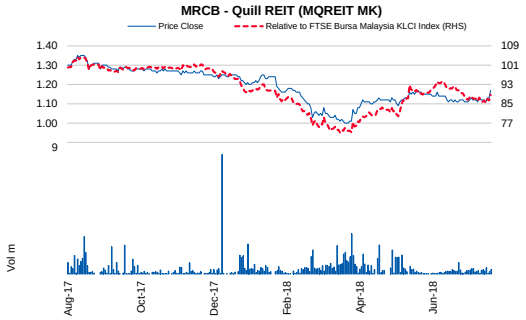
Shareholders (%)

MRCB	27.9
Quill Group	11.0
CapitaCommercial Trust	11.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(6.4)	5.4	4.5	0.9	(10.0)
Relative	(6.8)	(3.1)	6.8	2.8	(11.3)

Source: Bloomberg



Source: Bloomberg

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Financial Exhibits

Financial model updated on : 2018-08-08.

Asia
Malaysia
Property
MRCB-Quill REIT
Bloomberg MQREIT MK
Neutral

Valuation basis

DDM

Key drivers

Higher-than-expected demand of office space and inorganic growth opportunities arising from MRCB and Quill Group.

Key risks

Downside risk: oversupply of office properties might affect the portfolio's office property occupancy and rental rates.

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.

Financial summary	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Recurring EPS (MYR)	0.09	0.08	0.08	0.08	0.08
EPS (MYR)	0.09	0.07	0.08	0.08	0.08
DPS (MYR)	0.08	0.08	0.08	0.08	0.08
BVPS (MYR)	1.27	1.30	1.30	1.30	1.30
Weighted avg adjusted shares (m)	661	1,068	1,068	1,068	1,068

Valuation metrics	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Recurring P/E (x)	13.1	14.2	14.9	14.4	14.1
P/E (x)	13.1	17.9	14.7	14.4	14.1
P/B (x)	0.92	0.90	0.90	0.90	0.90
FCF Yield (%)	(47.7)	6.8	6.5	6.6	6.8
Dividend Yield (%)	7.2	7.2	6.6	6.7	6.9
EV/EBITDA (x)	(1.22)	(1.23)	(0.88)	(0.88)	(0.87)
EV/EBIT (x)	(1.22)	(1.23)	(0.88)	(0.88)	(0.87)

Income statement	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (MYRm)	132	180	171	173	176
EBITDA (MYRm)	90	125	117	119	121
Operating profit (MYRm)	90	125	117	119	121
Net interest (MYRm)	(31)	(37)	(32)	(32)	(32)
Pre-tax profit (MYRm)	59	70	85	87	89
Recurring net profit (MYRm)	59	88	84	87	89

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	83	85	87
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)	(86)	(83)	(85)
Cash flow from financing activities	786	65	(86)	(83)	(85)
Cash at beginning of period	45	54	76	48	49
Net change in cash	417	149	(4)	1	1
Ending balance cash	462	203	72	49	50

Balance sheet (MYRm)	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total cash and equivalents	54	76	48	49	50
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	803	802	801
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	(4.9)	0.9	1.9
Recurrent EPS growth (%)	(0.5)	(7.9)	(5.1)	3.7	2.4
Operating EBITDA margin (%)	68.2	69.4	68.3	68.8	68.7
Net profit margin (%)	44.9	38.8	49.6	50.2	50.5
Dividend payout ratio (%)	93.6	128.2	128.2	128.2	128.2
Capex/sales (%)	324.0	1.1	1.2	1.2	1.1
Interest cover (x)	2.72	3.09	3.27	3.32	3.38

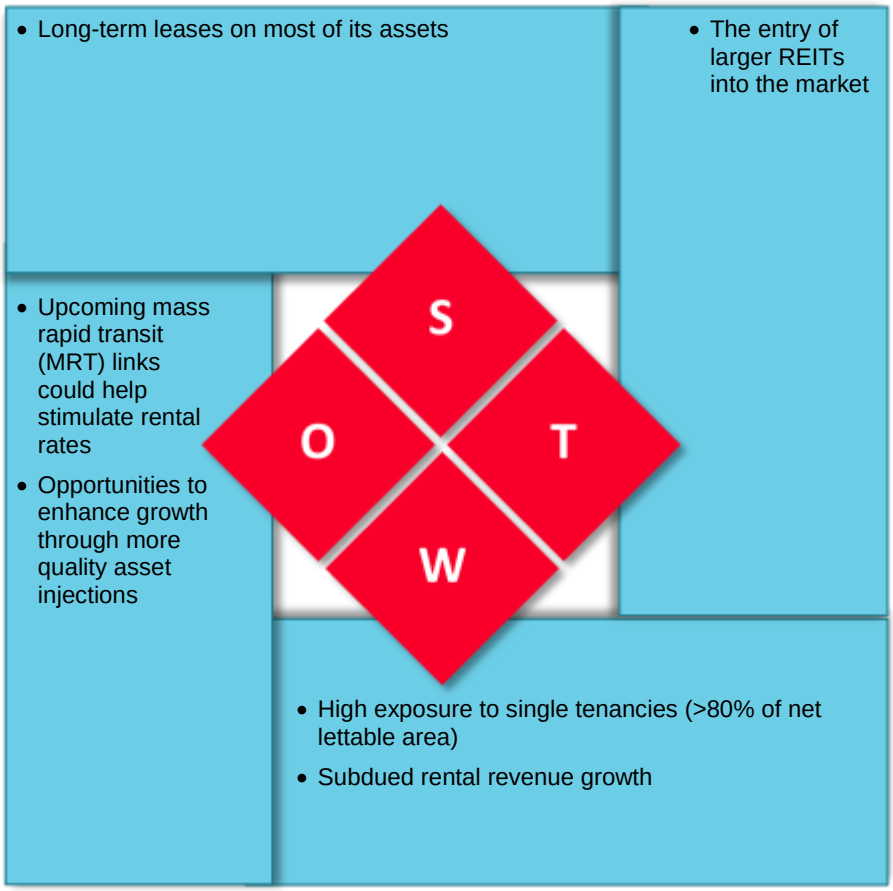
Source: Company data, RHB

Figure 1: MRCB-Quill's results comparison

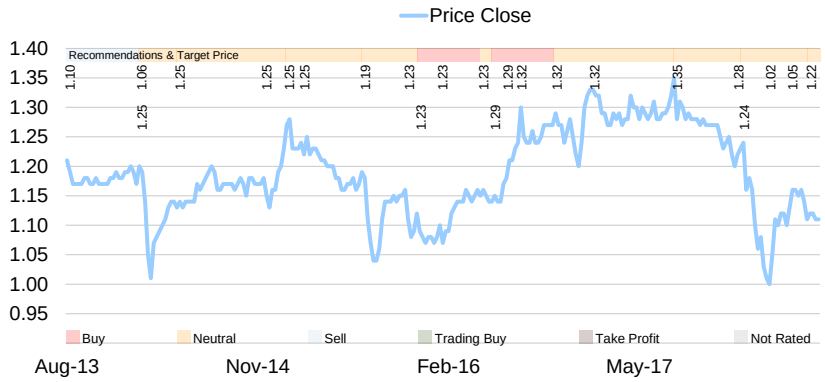
FYE Dec (MYRm)	2Q17	1Q18	2Q18	QoQ (%)	YoY (%)	1H17	1H18	YoY (%)	Comments
Revenue	**45.1**	**44.0**	**43.4**	**(1.5)**	**(3.7)**	**90.6**	**87.5**	**(3.5)**	Lower YoY, due to loss of revenue from QB8
Net property income (NPI)	**34.9**	**34.3**	**33.4**	**(2.7)**	**(4.4)**	**71.0**	**67.6**	**(4.8)**	Lower operating expenses incurred after disposal of QB8
Interest expense	(9.8)	(9.7)	(9.9)	2.5	1.0	(19.6)	(19.6)	0.3	
Interest income	0.6	0.7	0.9	20.2	35.0	1.1	1.6	45.8	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI	0.0	0.0	2.2	nm	nm	0.0	2.2	nm	Disposal gain of QB8
Others	(3.7)	(4.3)	(3.0)	(30.2)	(17.9)	(7.4)	(7.3)	(0.4)	
Pretax profit	**22.0**	**21.0**	**23.5**	**11.8**	**6.5**	**45.2**	**44.5**	**(1.6)**	
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	**22.0**	**21.0**	**23.5**	**11.8**	**6.5**	**45.2**	**44.5**	**(1.6)**	
Core Profit	**22.0**	**21.0**	**21.3**	**1.3**	**(3.4)**	**45.2**	**42.3**	**(6.4)**	Within expectations
Core earnings per unit (sen)	**2.26**	**1.97**	**2.28**	**15.9**	**0.9**	**4.43**	**4.25**	**(4.1)**	
Dividends per unit (sen)	**4.23**	**0.00**	**4.23**	**nm**	**0.0**	**4.23**	**4.23**	**0.0**	
NPI Margin (%)	*77.4*	*77.8*	*76.9*			*78.4*	*77.4*		
Pretax Margin (%)	*48.9*	*47.7*	*54.1*			*49.9*	*50.9*		
Net Margin (%)	*48.9*	*47.7*	*49.0*			*49.9*	*48.4*		

Source: Company data

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2018-07-02	Neutral	1.22	1.12
2018-05-18	Neutral	1.05	1.10
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

Source: RHB, Bloomberg

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Neutral: Share price may fall within the range of +/- 10% over the next 12 months
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