

17 August 2020

Property | REITS

## MRCB-Quill REIT (MQREIT MK)

Beating Expectations Again; Maintain BUY

**Buy** (Maintained)

Target Price (Return): MYR0.83 (+9%)  
Price: MYR0.76  
Market Cap: USD193m  
Avg Daily Turnover (MYR/USD) 0.45m/0.11m

- **Still BUY, new DDM-derived MYR0.83 TP from MYR0.78, 9% upside with c.9% FY20F yield.** 1H20 earnings were above expectations, on higher contributions from the Tesco building, Menara Shell, and Wisma Technip. We are upbeat on the minimal impact of COVID-19 (and the subsequent rebates offered) on the REIT's 2Q20 numbers, as well as its ability to maintain a high occupancy rate of c.90% so far. However, we believe prospects of an acquisition will be frozen for the time being.

- **Earnings above expectations.** With 1Q20 core profit coming in at MYR19.1m (-3.6% QoQ, +16% YoY), MRCB-Quill REIT's 1H20 core profit of MYR38.9m (+8% YoY) exceeded our and Street's expectations: 60% and 57% of full-year projections. Revenue for 1H20 grew 2% YoY on higher contributions from Menara Shell, Wisma Technip, and its Tesco building. This mitigates the lack of a contribution from Quill Building 5, which is still vacant in the current quarter. Note that 1Q20 had also taken into consideration the rebates rolled out in 2Q20 to the retail players at Plaza Mont Kiara, as well as to the co-working space operator at Platinum Sentral. 1H20 DPU of 3.63 sen was 8% higher YoY vs 1H19's 3.35 sen.

- **17% of NLA still up for renewal in FY20**, with the bulk of it at Quill Building 1 and Quill Building 4. Meanwhile, the average occupancy rate across all of MQREIT's buildings is at 90.4%, indicating a slight dip from 90.5% in 1Q20. The lower occupancy rate at Platinum Sentral was due to the early termination of the lease by a small office tenant during these turbulent times. Management guided that the rest of the leases up for expiry are undergoing negotiations, and is optimistic that they will start to be renewed in 2H20. Based on FY19's performance, renewals took place across the year, but were mostly completed by 4Q19. We have reason to believe the same may take place this year, where the bulk of renewals should be made by 4Q20.

- **New gearing cap, and possible acquisition?** There have been talks of Menara Celcom being injected into MQREIT for a few years now. While the new temporary 60% gearing cap could provide relief to the REIT, we do not believe that the acquisition will take place anytime soon, as negotiations have yet to even commence. The higher-than-average gearing of 38% also suggests that such a large acquisition is also likely to warrant equity funding. Recall that MQREIT recorded a revaluation loss of MYR36m for FY19 and, while we are encouraged by the stable performance of the REIT YTD, we do not rule out the possibility of a further devaluation – albeit at a smaller magnitude.

- **We lift FY20-22F earnings by 10%** after imputing a low-single-digit reversion rate from negative previously. As such, our DDM-derived TP is raised to MYR0.83.

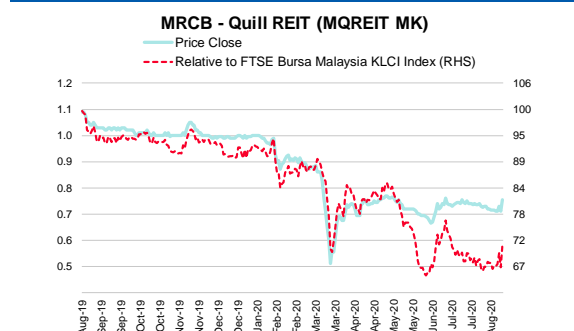
### Analyst

Loong Kok Wen, CFA  
+603 9280 8861  
[loong.kok.wen@rhbgroup.com](mailto:loong.kok.wen@rhbgroup.com)



### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(24.5)	2.0	0.7	(17.0)	(30.7)
Relative	(23.0)	4.1	(11.3)	(18.3)	(28.5)
52-wk Price low/high (MYR)				0.51	1.09



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (MYRm)	173	162	146	146	147
Net property income (MYRm)	134	123	112	113	113
Reported net profit (MYRm)	82.5	72.1	69.6	70.4	71.4
Total distributable income (MYRm)	82.5	72.1	69.6	70.4	71.4
DPS (MYR)	0.08	0.07	0.06	0.07	0.07
DPS growth (%)	(3.1)	(16.2)	(5.6)	1.2	1.4
P/B (x)	0.59	0.61	0.61	0.61	0.61
Dividend Yield (%)	10.8	9.0	8.5	8.6	8.7
Return on average equity (%)	6.0	5.3	5.3	5.3	5.4
Return on average assets (%)	3.6	3.2	3.1	3.2	3.2

Source: Company data, RHB

### Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD1bn.

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## Financial Exhibits

<b>Asia</b>	<b>Financial summary</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
Malaysia	Recurring EPS (MYR)	0.08	0.07	0.06	0.07	0.07
Property	EPS (MYR)	0.08	0.07	0.06	0.07	0.07
<b>MRCB-Quill REIT</b>	DPS (MYR)	0.08	0.07	0.06	0.07	0.07
MQREIT MK	BVPS (MYR)	1.28	1.23	1.24	1.24	1.24
Buy	Weighted avg adjusted shares (m)	1,071.8	1,071.8	1,071.8	1,071.8	1,071.8
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
DDM	Recurring P/E (x)	9.4	11.0	11.4	11.3	11.1
	P/E (x)	9.4	11.0	11.4	11.3	11.1
	P/B (x)	0.6	0.6	0.6	0.6	0.6
	FCF Yield (%)	14.7	14.7	13.4	12.5	12.6
	Dividend yield (%)	10.8	9.0	8.5	8.6	8.7
	EV/EBITDA (x)	11.6	17.5	13.9	13.8	13.8
	EV/EBIT (x)	11.6	17.5	13.9	13.8	13.8
<b>Key drivers</b>	<b>Income statement (MYRm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
i. Higher-than-expected demand for office space;	Total turnover	173	162	146	146	147
ii. Inorganic growth opportunities arising from MRCB and Quill Group.	Gross profit	134	123	112	113	113
	EBITDA	135	89	116	116	117
	Depreciation and amortisation	-	-	-	-	-
	Operating profit	135	89	116	116	117
	Net interest	(41)	(40)	(35)	(35)	(35)
	Income from associates & JVs	-	-	-	-	-
	Exceptional income - net	(3)	(37)	-	-	-
	Pre-tax profit	79	35	70	70	71
	Taxation	(6)	(6)	-	-	-
	Minority interests	-	-	-	-	-
	Recurring net profit(adj)	85	72	70	70	71
<b>Key risks</b>	<b>Cash flow (MYRm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
The oversupply of office properties may affect the portfolio's office property occupancy and rental rates.	Change in working capital	(4)	(4)	(4)	(4)	(5)
	Cash flow from operations	117	106	99	100	101
	Capex	(2)	(2)	(2)	(2)	(2)
	Cash flow from investing activities	4	1	1	1	1
	Dividends paid	(88)	(80)	(71)	(69)	(70)
	Cash flow from financing activities	(129)	(120)	(106)	(104)	(105)
	Cash at beginning of period	52	43	31	26	23
	Net change in cash	(8)	(12)	(6)	(3)	(3)
	Ending balance cash	43	31	26	23	19
<b>Company Profile</b>	<b>Balance sheet (MYRm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
MQREIT is a mid-cap MREIT that focuses on office/commercial assets. Assets are largely concentrated in the Klang Valley and Cyberjaya areas.	Total cash and equivalents	86	63	26	23	19
	Tangible fixed assets	2,179	2,144	2,144	2,144	2,144
	Intangible assets	-	-	-	-	-
	Total investments	-	-	-	-	-
	Total other assets	1	1	39	44	49
	Total assets	2,272	2,214	2,215	2,216	2,218
	Short-term debt	-	333	333	333	333
	Total long-term debt	854	503	503	503	503
	Other liabilities	46	54	55	56	57
	Total liabilities	899	890	891	892	892
	Shareholders' equity	1,372	1,323	1,324	1,325	1,326
	Minority interests	-	-	-	-	-
	Total equity	1,372	1,323	1,324	1,325	1,326
	Net debt	768	772	810	813	817
	Total liabilities & equity	2,272	2,214	2,215	2,216	2,218
	<b>Key metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	Revenue growth (%)	(3.7)	(6.5)	(10.1)	0.5	0.5
	Recurrent EPS growth (%)	(4.0)	(14.9)	(3.5)	1.2	1.4
	Gross margin (%)	77.1	75.8	77.1	77.1	77.1
	Operating EBITDA margin (%)	77.7	55.1	79.3	79.3	79.3
	Net profit margin (%)	48.8	44.5	47.8	48.1	48.5
	Dividend payout ratio (%)	102.1	101.0	99.0	99.0	99.0
	Capex/sales (%)	1.2	1.2	1.4	1.4	1.4
	Interest cover (x)	3.3	2.3	3.3	3.3	3.3

Source: Company data, RHB

## Results at a Glance

Figure 1: MQREIT's 1H20 results summary

FYE Dec (MYRm)	2Q19	1Q20	2Q20	QoQ (%)	YoY (%)	1H19	1H20	YoY (%)	Comments
Revenue	38.8	41.7	40.1	(3.8)	3.4	80.2	81.8	2.1	Higher YoY on increased contributions generated from Tesco, Menara Shell and Wisma Technip.
Net property income (NPI)	29.1	32.3	31.0	(4.1)	6.5	61.1	63.3	3.5	
Interest expense	(9.7)	(9.5)	(8.9)	(6.6)	(8.3)	(19.6)	(18.5)	(5.7)	
Interest income	0.6	0.6	0.5	(6.2)	(3.9)	1.4	1.1	(19.4)	
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	(3.5)	(3.5)	(3.5)	(0.6)	1.4	(7.1)	(7.1)	(0.3)	
Pretax profit	16.5	19.8	19.1	(3.6)	16.0	35.9	38.9	8.4	
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	16.5	19.8	19.1	(3.6)	16.0	35.9	38.9	8.4	
Core Profit	16.5	19.8	19.1	(3.6)	16.0	35.9	38.9	8.4	Above expectations.
Core earnings per unit (sen)	1.54	1.85	1.78	(3.8)	15.6	3.35	3.63	8.4	
Dividends per unit (sen)	3.43	0.00	3.43	nm	0.0	3.43	3.43	0.0	
NPI Margin (%)	75.0	77.4	77.2			76.2	77.3		
Pretax Margin (%)	42.4	47.4	47.6			44.7	47.5		
Net Margin (%)	42.4	47.4	47.6			44.7	47.5		

Source: Company data, RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-06-18	Buy	0.78	0.71
2020-04-06	Neutral	0.78	0.74
2020-01-20	Neutral	0.97	1.00
2019-11-26	Neutral	0.96	1.02
2019-08-08	Neutral	0.97	1.07
2019-05-10	Neutral	1.02	1.09
2019-01-18	Neutral	1.05	1.11
2019-01-10	Neutral	1.10	1.09
2018-11-28	Neutral	1.15	1.07
2018-08-09	Neutral	1.20	1.18

Source: RHB, Bloomberg

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<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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#### **KUALA LUMPUR**

**RHB Investment Bank Bhd**  
Level 3A, Tower One, RHB Centre  
Jalan Tun Razak  
Kuala Lumpur 50400  
Malaysia  
Tel : +603 9280 8888  
Fax : +603 9200 2216

#### **JAKARTA**

**PT RHB Sekuritas Indonesia**  
Revenue Tower, 11th Floor, District 8 - SCBD  
Jl. Jendral Sudirman Kav 52-53  
Jakarta 12190  
Indonesia  
Tel : +6221 509 39 888  
Fax : +6221 509 39 777

#### **BANGKOK**

**RHB Securities (Thailand) PCL**  
10th Floor, Sathorn Square Office Tower  
98, North Sathorn Road, Silom  
Bangrak, Bangkok 10500  
Thailand  
Tel: +66 2088 9999  
Fax :+66 2088 9799

#### **SINGAPORE**

**RHB Securities Singapore Pte Ltd.**  
10 Collyer Quay  
#09-08 Ocean Financial Centre  
Singapore 049315  
Tel : +65 6533 1818  
Fax : +65 6532 6211