MRCB-Quill REIT (MQREIT MK) : HOLD

Mkt. Cap: US$262m I **3m Avg. Daily Val:** US$0.04m

Last Traded Price (25 Nov 2019): RM1.02

Price Target 12-mth: RM1.10 (8% upside) (Prev RM1.15)

Analyst

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Pressured occupancy rates

- 9MFY19 earnings below expectations
- Decline due to lower occupancy; revenue down 7.7% y-o-y
- Trim earnings forecast to reflect lower rental rates
- Maintain HOLD with lower TP RM1.10

Forecasts and Valuation

FY Dec (RMm)	2018A	2019F	2020F	2021F
Gross Revenue	173	164	167	171
Net Property Inc	134	123	124	125
Total Return	73.1	72.8	72.9	73.6
Distribution Inc	86.6	70.6	70.7	71.4
EPU (sen)	6.82	6.78	6.78	6.83
EPU Gth (%)	4	(1)	0	1
DPU (sen)	8.08	6.58	6.57	6.62
DPU Gth (%)	(4)	(19)	0	1
NAV per shr (sen)	128	128	128	129
PE (X)	14.9	15.0	15.0	14.9
Distribution Yield (%)	7.9	6.4	6.4	6.5
P/NAV (x)	0.8	0.8	0.8	0.8
Aggregate Leverage (%)	37.6	37.8	38.0	38.1
ROAE (%)	5.3	5.3	5.3	5.3

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P

What's New

3QFY19 results below expectations. MRCB-Quill REIT's (MQREIT) 3QFY19 core earnings came in at RM17.6m (-14.3% y-o-y; +6.3% q-o-q). 9MFY19 earnings missed our and consensus expectations.

The 3QFY19 earnings decline was mainly due to lower revenue generated from Platinum Sentral, Wisma Technip and Quill Building 5 (QB5). Revenue came in at RM39.9m (-7.7% y-o-y; +2.9% q-o-q). There was a slight improvement q-o-q due to a new tenant in Platinum Sentral which entered in July 2019, occupying about 15% of net lettable area (NLA).

Property operating expenses amounted to RM9.7m (-2.0% y-o-y; +0.3% q-o-q) as MQREIT tightened control on costs. Net property income (NPI) for the quarter came in at RM30.2m (-9.4% y-o-y; +3.8% q-o-q).

Outlook

Occupancy under pressure. MQREIT's portfolio occupancy fell to 89% in 3QFY19 vs 94% in 3QFY18. We understand that there were lower occupancies in QB5-IBM, Platinum Sentral and Wisma Technip as tenants downsized operations.

MQREIT is still looking for tenants to replace the vacancy in QB5 after its tenant IBM moved out in 1Q19. Other than that, contributions from Platinum Sentral should be able to improve as it has secured a new tenant with committed occupancy for the building at 88%.

Nonetheless, we trim our earnings forecast by 4% for FY19F-21F as we factor in lower rentals for Platinum Sentral. We believe rental rates would be pressured amidst the challenging office segment.

About 19.0% of MQREIT's total NLA is expiring in FY19, of which c.11.0% has been renewed and 4% not renewed. The expiring leases in FY20 form 18% of total NLA. We understand that rental reversions were flattish as MQREIT prioritised tenant retention to cope with a challenging operating environment. Going forward, we expect some challenges in negotiating positive rental reversions due to the oversupply of office space in the market.

Valuation and Recommendation

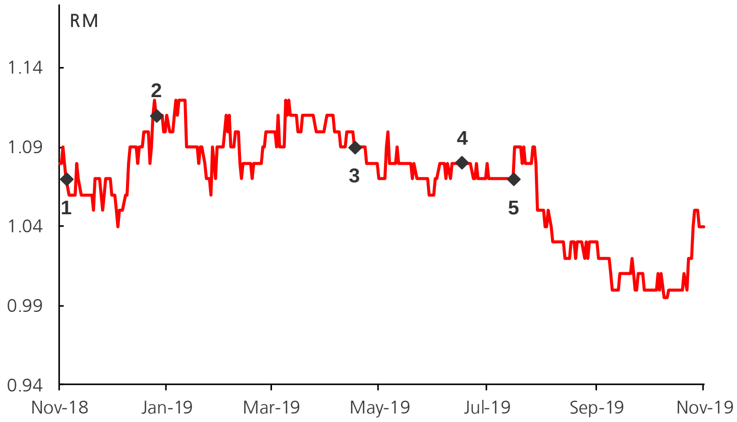
We maintain our HOLD call with a lower target price (TP) of RM1.10. Our dividend discount model (DDM)-derived TP employs 7.4% cost of equity and 1% terminal growth. The key concerns for the stock include the challenge of replacing vacancies, as well as downward pressure on rental rates as MQREIT grapples with incoming supply of new office space. As we factor in weakness in the office market, we see limited upside for the stock at this juncture. Downside risks include longer-than-expected time to replace vacancies.

Quarterly Income Statement (RMm)

FY Dec	3Q2018	2Q2019	3Q2019	% chg yoy	% chg qoq
Gross revenue	43.3	38.8	39.9	(7.7)	2.9
Property expenses	(9.9)	(9.7)	(9.7)	(2.0)	0.3
Net Property Income	33.3	29.1	30.2	(9.4)	3.8
Other Operating expenses	(3.7)	(3.5)	(3.5)	(4.9)	1.5
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	N/A	N/A
Net Interest (Exp)/Inc	(9.1)	(9.2)	(9.0)	0.1	1.3
Exceptional Gain/(Loss)	0.0	0.0	0.0	N/A	N/A
Net Income	20.6	16.5	17.6	(14.3)	7.2
Tax	0.0	0.0	0.0	N/A	N/A
Minority Interest	0.0	0.0	0.0	N/A	N/A
Net Income after Tax	20.6	16.5	17.6	(14.3)	7.2
Total Return	20.6	16.5	17.6	(14.3)	7.2
Non-tax deductible Items	0.0	0.0	0.0	nm	nm
Net Inc available for Dist.	20.6	16.5	17.6	(14.3)	7.2
Ratio (%)					
Net Prop Inc Margin	77.1	75.0	75.6		
Dist. Payout Ratio	0.0	101.7	0.0		

Source of all data: Company, AllianceDBS

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	28 Nov 18	1.07	1.24	BUY
2:	18 Jan 19	1.11	1.15	HOLD
3:	10 May 19	1.09	1.15	HOLD
4:	10 Jul 19	1.08	1.20	HOLD
5:	08 Aug 19	1.07	1.15	HOLD

***Note** : Share price and Target price are adjusted for corporate actions.*

Source: AllianceDBS
Analyst: Siti Ruzanna Mohd Faruk

DISCLOSURE

Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

Commonly used abbreviations

Adex = advertising expenditure
bn = billion
BV = book value
CF = cash flow
CAGR = compounded annual growth rate
Capex = capital expenditure
CY = calendar year
Div yld = dividend yield
DCF = discounted cash flow
DDM = dividend discount model
DPS = dividend per share
EBIT = earnings before interest & tax
EBITDA = EBIT before depreciation and amortisation

EPS = earnings per share
EV = enterprise value
FCF = free cash flow
FV = fair value
FY = financial year
m = million
M-o-m = month-on-month
NAV = net assets value
NM = not meaningful
NTA = net tangible assets
NR = not rated
p.a. = per annum
PAT = profit after tax

PBT = profit before tax
P/B = price / book ratio
P/E = price / earnings ratio
PEG = P/E ratio to growth ratio
q-o-q = quarter-on-quarter
RM = Ringgit
ROA = return on assets
ROE = return on equity
TP = target price
trn = trillion
WACC = weighted average cost of capital
y-o-y = year-on-year
YTD = year-to-date

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