

26 November 2019

Property | REITs

MRCB-Quill REIT (MQREIT MK)

Neutral (Maintained)

Lukewarm Prospects For The Time Being

Target Price (Return) MYR0.96 (-6%)
 Price: MYR1.02
 Market Cap: USD262m
 Avg Daily Turnover (MYR/USD) 0.15m/0.04m

- **Maintain NEUTRAL with new TP of MYR0.96 from MYR0.97**, 6% downside. 9M19 earnings were in line with our but below consensus expectations. The lower contribution from MQREIT's commercial assets (Platinum Sentral, Wisma Technip and QB5) for the quarter comes as no surprise given the prolonged issue of oversaturation in the office segment in the Klang Valley. Having said that, we foresee occupancy rates for the REIT to remain under pressure.
- **Earnings in line with our expectations.** 3Q19 core earnings of MYR17.6m (+7.2% QoQ, -14.3% YoY) brought 9M19 core net profit to MYR53.5m. Making up 76% of our full-year estimates, results are deemed to have met our expectations, but missed consensus at 71%. 9M19 revenue of MYR120m fell 8.1% YoY, and in line with that, core net profit dipped 14.9% YoY on the back of lower rental contribution coming from Platinum Sentral, Wisma Technip and Quill Building 5 (QB5), which had all seen a decline in occupancy rates in 2Q19.
- **8% non-renewal YTD.** The average occupancy rate across all of MRCB-Quill's assets remains unchanged from the previous quarter at 89%. Of the 19% total NLA that is up for renewal in 2019, only 11% renewed as at Sep 2019. The 4% up for renewal encompasses tenants largely from Menara Shell and Platinum Sentral, but we believe the impact of non-renewal will be mitigated by the arrival of new tenants that will occupy c.70,000 sqf of NLA in Platinum Sentral and 28,000 sqf in Menara Shell next year. Currently, Platinum Sentral and Menara Shell are still at 88% and 96% occupancy respectively, unchanged from the previous quarter.
- **We remain mildly cautious on the REIT given the fact that 4% of leases (of the REIT's total NLA) are still up for renewal**, while another 4% (Transit Acquirer SB, IBM, MyHSR Corp SB and part of Land Public Transport Commission (SPAD)) decided to terminate their respective tenancies earlier in the year. The leases that have yet to be renewed come mainly from Menara Shell, Platinum Sentral and Plaza Mont Kiara. The current blended rental reversion rate maintained by the REIT is flat, but we foresee the possibility of a change to negative in the future in an effort to retain tenants.
- **Earnings fine-tuned, TP trimmed.** After adjusting our NLA assumptions to more accurately reflect the REIT's portfolio size moving forward, our FY19F-21F earnings are consequently trimmed marginally by c.2%. As such, our DDM-based TP is cut to MYR0.96.
- **Potential upside risk** to our call is the possibility of a yield accretive acquisition in the future. A downside risk to our call is the prolonged oversupply of commercial spaces that could lead to a lower occupancy rate for the REIT and ultimately, negative rental reversion.

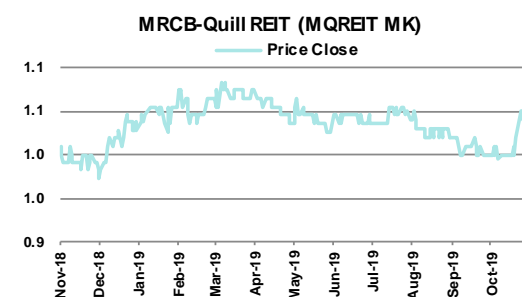
Analyst

Loong Kok Wen, CFA
 +603 9280 8861
loong.kok.wen@rhbgroupp.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(3.8)	2.0	(2.9)	(4.7)	(5.6)
Relative	2.1	0.6	(1.7)	(4.2)	0.6
52-wk Price low/high (MYR)	0.995 – 1.13				



Source: Bloomberg

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (MYRm)	180	173	147	148	148
Net property income (MYRm)	140	134	113	114	114
Reported net profit (MYRm)	70	73	70	71	70
Total distributable income (MYRm)	88	85	70	71	70
DPS (MYR)	0.1	0.1	0.1	0.1	0.1
DPS growth (%)	0.1	(3.1)	(20.3)	0.9	(0.8)
P/BV (x)	0.8	0.8	0.8	0.8	0.8
Dividend Yield (%)	8.2	7.9	5.7	5.8	5.7
Return on average equity (%)	5.0	5.3	5.1	5.2	5.1
Return on average assets (%)	3.1	3.2	3.1	3.1	3.1
Gross gearing (x)	37.3	37.5	37.5	37.5	37.4

Source: Company data, RHB

See important disclosures at the end of this report

Market Dateline / PP19489/05/2019 (035080)

Financial Exhibits

Asia Malaysia REIT MRCB-Quill REIT MQREIT MK	Financial summary					
		Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Recurring EPS (MYR)	0.08	0.08	0.07	0.07	0.07
	EPS (MYR)	0.08	0.08	0.07	0.07	0.07
	DPS (MYR)	0.08	0.08	0.06	0.06	0.06
	BVPS (MYR)	1.30	1.28	1.28	1.28	1.28
Shareholding (%) Malaysian Resources Employees Provident Fund Capitaland	Weighted avg adjusted shares (m)	1,068.0	1,071.8	1,071.8	1,071.8	1,071.8
Valuation basis Dividend discount model (DDM)	Valuation metrics					
		Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Recurring P/E (x)	12.4	12.9	15.6	15.5	15.6
	P/E (x)	12.4	12.9	15.6	15.5	15.6
	P/B (x)	0.8	0.8	0.8	0.8	0.8
	FCF Yield (%)	11.3	10.7	9.1	9.2	9.1
Key drivers Higher-than-expected demand for office space and inorganic growth opportunities arising from MRCB and Quill Group.	Dividend yield (%)	8.2	7.9	5.7	5.8	5.7
	EV/EBITDA (x)	14.9	13.8	16.3	16.2	16.2
	EV/EBIT (x)	14.9	13.8	16.3	16.2	16.2
Key risks An upside risk is the possibility of a yield accretive acquisition in the future. Downside risk includes a prolonged oversupply of office space that could lead to a lower occupancy rate and negative rental reversion.	Income statement (MYRm)					
		Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Total turnover	180	173	147	148	148
	Gross profit	140	134	113	114	114
	EBITDA	125	135	118	118	118
	Depreciation and amortisation	-	-	-	-	-
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	Operating profit	125	135	118	118	118
	Net interest	(41)	(41)	(36)	(36)	(36)
	Income from associates & JVs	-	-	-	-	-
	Exceptional income - net	(18)	(3)	-	-	-
	Pre-tax profit	70	79	70	71	70
	Taxation	-	(6)	-	-	-
	Minority interests	-	-	-	-	-
	Recurring net profit(adj)	88	85	70	71	70
	Cash flow (MYRm)					
		Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Change in working capital	(4)	(4)	(4)	(4)	(4)
	Cash flow from operations	123	117	100	100	99
	Capex	(2)	(2)	(2)	(2)	(2)
	Cash flow from investing activities	2	4	4	4	4
	Dividends paid	(73)	(88)	(78)	(70)	(70)
	Cash flow from financing activities	(113)	(129)	(114)	(106)	(106)
	Cash at beginning of period	40	52	43	33	31
	Net change in cash	12	(8)	(11)	(2)	(3)
	Ending balance cash	52	43	33	31	28
	Balance sheet (MYRm)					
		Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Total cash and equivalents	76	86	33	31	28
	Tangible fixed assets	2,181	2,179	2,179	2,179	2,179
	Intangible assets	-	1	2	3	4
	Total investments	-	-	-	-	-
	Total other assets	1	6	60	63	67
	Total assets	2,288	2,276	2,277	2,278	2,280
	Short-term debt	117	-	-	-	-
	Total long-term debt	737	854	854	854	854
	Other liabilities	50	50	51	51	52
	Total liabilities	904	904	904	905	905
	Shareholders' equity	1,385	1,372	1,373	1,374	1,374
	Minority interests	-	-	-	-	-
	Total equity	1,385	1,372	1,373	1,374	1,374
	Net debt	777	768	821	823	826
	Total liabilities & equity	2,288	2,276	2,277	2,278	2,280
	Key metrics					
		Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Revenue growth (%)	36.7	(3.7)	(15.2)	0.7	(0.3)
	Recurrent EPS growth (%)	(6.4)	(4.0)	(17.3)	0.9	(0.8)
	Gross margin (%)	77.7	77.1	77.1	77.1	77.1
	Operating EBITDA margin (%)	69.6	77.7	80.0	80.0	80.0
	Net profit margin (%)	48.9	48.8	47.7	47.8	47.5
	Dividend payout ratio (%)	101.8	102.1	89.1	89.1	89.1
	Capex/sales (%)	1.1	1.2	1.4	1.4	1.4
	Interest cover (x)	3.1	3.3	3.3	3.3	3.3

Source: Company data, RHB

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Results at a Glance

Figure 1: MRCB-Quill REIT's 3Q19 results summary

FYE Dec (MYRm)	3Q18	2Q19	3Q19	QoQ (%)	YoY (%)	9M18	9M19	YoY (%)	Comments
Revenue	43.3	38.8	39.9	2.9	(7.7)	130.7	120.1	(8.1)	Lower YoY because of lower revenue generated from Platinum Sentral, QB5 and Wisma Technip.
Net property income (NPI)	33.3	29.1	30.2	3.8	(9.4)	101.0	91.3	(9.6)	
Interest expense	(10.1)	(9.7)	(9.7)	0.2	(3.3)	(29.7)	(29.3)	(1.3)	
Interest income	1.0	0.6	0.7	24.2	(31.2)	2.6	2.1	(20.2)	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI	0.0	0.0	0.0	nm	nm	2.2	0.0	nm	
Others	(3.7)	(3.5)	(3.5)	1.5	(4.9)	(11.0)	(10.6)	(4.0)	
Pretax profit	20.6	16.5	17.6	7.2	(14.3)	65.1	53.5	(17.8)	
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	20.6	16.5	17.6	7.2	(14.3)	65.1	53.5	(17.8)	
Core Profit	20.6	16.5	17.6	7.2	(14.3)	62.9	53.5	(14.9)	Within our expectations
Core earnings per unit (sen)	1.92	1.54	1.65	7.1	(14.1)	6.08	4.99	(17.9)	
Dividends per unit (sen)	0.00	3.43	0.00	nm	nm	4.23	3.43	(18.9)	
NPI Margin (%)	77.1	75.0	75.6			77.3	76.0		
Pretax Margin (%)	47.6	42.4	44.2			49.8	44.6		
Net Margin (%)	47.6	42.4	44.2			48.1	44.6		

Source: Company data, RHB

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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 5093 9888
Fax : +6221 5093 9777

HONG KONG

RHB Securities Hong Kong Ltd.
12th Floor, World-Wide House
19 Des Voeux Road
Central
Hong Kong
Tel : +852 2525 1118
Fax : +852 2810 0908

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