

12 November 2020

Property | REITS

MRCB-Quill REIT (MQREIT MK)

Buy (Maintained)

Encouraging Earnings Once Again; Maintain BUY

- **Maintain BUY with new DDM-derived MYR0.87 TP from MYR0.83, 9% upside with c.9% FY20F yield.** 9M20 earnings were above expectations, on higher contributions from Tesco, Menara Shell, and Wisma Technip. MRCB-Quill REIT maintained a stable blended occupancy rate of above 90% so far this year. Therefore, we turn more upbeat on the REIT's tenant-retention abilities despite Quill Building 5 still remaining vacant. The REIT is also showing a lack of inorganic growth prospects at this point in time.
- **Earnings above expectations.** 3Q20 core profit of MYR21.5m (+12.6% QoQ, +21.8% YoY) brought MRCB-Quill REIT's 9M20 core profit to MYR60.3m (+12.8% YoY). At 81% of Street's estimates and 86% of ours, the results were well above expectations. The pick-up in revenue (+4.9% QoQ) and income for the quarter, both on a YoY and QoQ basis, were due to higher contributions from Menara Shell, Wisma Technip, and Tesco. This mitigates the lack of a contribution from Quill Building 5, which was still vacant during the current quarter.
- **7% of NLA still up for renewal in FY20.** We gather that renewals at Quill Buildings 1 and 4 have already taken place. Meanwhile, the average occupancy rate across all of MQREIT's buildings is at 90.5%, indicating a slight increase from 90.4% in 2Q20. The increased occupancy was demonstrated at Menara Shell and Plaza Mont Kiara, while the 1% non-renewal for this year was due to a tenant exiting Platinum Sentral. Management guided that the rest of the leases up for expiry are undergoing negotiations and is optimistic that they will start to be renewed this quarter. Based on the performance in 2019, renewals took place across the year, but were mostly completed by 4Q19. We have reason to believe the same pattern is likely taking place this year.
- **No talks of an acquisition.** While the new temporary 60% gearing cap could provide relief to the REIT, the acquisition of Menara Celcom is likely to remain on the backburner at this juncture, as negotiations have yet to 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 in 2019. While we are encouraged by the stable performance YTD of the REIT, we do not rule out the possibility of a further devaluation – albeit at a smaller magnitude.
- **We lift FY20-22F earnings by 4-10%,** after updating our occupancy and reversion rate assumptions. As such, our DDM-derived TP is raised to MYR0.87.

Target Price (Return):

MYR0.87 (8.7%)

Price:

MYR0.80

Market Cap:

USD207m

Avg Daily Turnover (MYR/USD)

0.36m/0.09m

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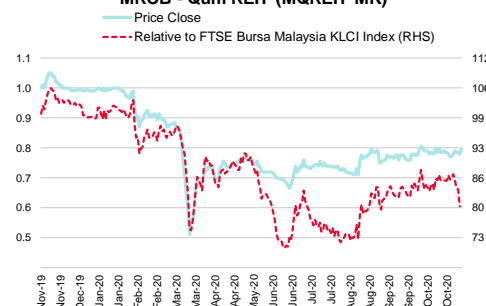
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(20.5)	0.6	12.0	4.6	(20.5)
Relative	(19.6)	(2.3)	11.3	(9.3)	(18.4)
52-wk Price low/high (MYR)				0.51	1.05

MRCB - Quill REIT (MQREIT MK)



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (MYRm)	173	162	155	150	151
Net property income (MYRm)	134	123	119	115	116
Reported net profit (MYRm)	82.5	72.1	76.4	73.1	74.3
Total distributable income (MYRm)	82.5	72.1	76.4	73.1	74.3
DPS (MYR)	0.08	0.07	0.07	0.07	0.07
DPS growth (%)	(3.1)	(16.2)	3.6	(4.4)	1.7
P/B (x)	0.62	0.64	0.64	0.64	0.64
Dividend Yield (%)	10.2	8.6	8.9	8.5	8.6
Return on average equity (%)	6.0	5.3	5.8	5.5	5.6
Return on average assets (%)	3.6	3.2	3.5	3.3	3.4

Source: Company data, RHB

Note:

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

Financial Exhibits

Asia	Financial summary	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Malaysia	Recurring EPS (MYR)	0.08	0.07	0.07	0.07	0.07
Property	EPS (MYR)	0.08	0.07	0.07	0.07	0.07
MRCB-Quill REIT	DPS (MYR)	0.08	0.07	0.07	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
Valuation basis	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Dividend discount model.	Recurring P/E (x)	10.1	11.8	11.2	11.7	11.5
	P/E (x)	10.1	11.8	11.2	11.7	11.5
	P/B (x)	0.6	0.6	0.6	0.6	0.6
Key drivers	FCF Yield (%)	13.7	13.7	12.5	12.4	12.0
Higher-than-expected demand of office space and inorganic growth opportunities arising from Malaysian Resources Corp and Quill Group.	Dividend yield (%)	10.2	8.6	8.9	8.5	8.6
	EV/EBITDA (x)	12.0	18.2	13.6	14.0	13.9
	EV/EBIT (x)	12.0	18.2	13.6	14.0	13.9
Key risks	Income statement (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Downside risks oversupply of office properties might affect the portfolio's office property occupancy and rental rates.	Total turnover	173	162	155	150	151
	Gross profit	134	123	119	115	116
	EBITDA	135	89	122	119	120
	Depreciation and amortisation	-	-	-	-	-
	Operating profit	135	89	122	119	120
	Net interest	(41)	(40)	(35)	(35)	(35)
	Income from associates & JVs	-	-	-	-	-
	Exceptional income - net	(3)	(37)	-	-	-
	Pre-tax profit	79	35	76	73	74
	Taxation	(6)	(6)	-	-	-
	Minority interests	-	-	-	-	-
	Recurring net profit(adj)	85	72	76	73	74
Company Profile	Cash flow (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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.	Change in working capital	(4)	(4)	(4)	(4)	(5)
	Cash flow from operations	117	106	106	103	104
	Capex	(2)	(2)	(2)	(2)	(2)
	Cash flow from investing activities	4	1	1	1	1
	Dividends paid	(88)	(80)	(74)	(74)	(73)
	Cash flow from financing activities	(129)	(120)	(109)	(109)	(108)
	Cash at beginning of period	52	43	31	29	24
	Net change in cash	(8)	(12)	(2)	(5)	(3)
	Ending balance cash	43	31	29	24	21
	Balance sheet (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	86	63	29	24	21
	Tangible fixed assets	2,179	2,144	2,144	2,144	2,144
	Intangible assets	-	-	-	-	-
	Total investments	-	-	-	-	-
	Total other assets	1	1	36	43	47
	Total assets	2,272	2,214	2,215	2,217	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	806	812	815
	Total liabilities & equity	2,272	2,214	2,215	2,217	2,218
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	(3.7)	(6.5)	(4.7)	(3.0)	0.7
	Recurrent EPS growth (%)	(4.0)	(14.9)	5.9	(4.4)	1.7
	Gross margin (%)	77.1	75.8	77.1	77.1	77.1
	Operating EBITDA margin (%)	77.7	55.1	79.2	79.2	79.2
	Net profit margin (%)	48.8	44.5	49.5	48.8	49.2
	Dividend payout ratio (%)	102.1	101.0	99.0	99.0	99.0
	Capex/sales (%)	1.2	1.2	1.3	1.3	1.3
	Interest cover (x)	3.3	2.3	3.5	3.4	3.4

Source: Company data, RHB

Results at a Glance

Figure 1: MQREIT's 3Q20 and 9M20 results summary

FYE Dec (MYRm)	3Q19	2Q20	3Q20	QoQ (%)	YoY (%)	9M19	9M20	YoY (%)	Comments
Revenue	39.9	40.1	42.1	4.9	5.4	120.1	123.9	3.2	Higher YoY on increased contributions generated from Tesco, Menara Shell, and Wisma Technip.
Net property income (NPI)	30.2	31.0	32.7	5.8	8.5	91.3	96.0	5.1	
Interest expense	(9.7)	(8.9)	(8.3)	(6.6)	(14.6)	(29.3)	(26.8)	(8.7)	
Interest income	0.7	0.5	0.6	16.3	(10.1)	2.1	1.8	(16.3)	
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)	(3.6)	1.9	1.8	(10.6)	(10.6)	0.4	
Pre-tax profit	17.6	19.1	21.5	12.6	21.8	53.5	60.3	12.8	
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	17.6	19.1	21.5	12.6	21.8	53.5	60.3	12.8	
Core profit	17.6	19.1	21.5	12.6	21.8	53.5	60.3	12.8	Above expectations.
Core earnings per unit (sen)	1.65	1.78	2.00	12.4	21.2	4.99	5.63	12.8	
Dividends per unit (sen)	1.65	3.43	2.00	(41.7)	21.2	5.08	5.43	6.9	
NPI margin (%)	75.6	77.2	77.9			76.0	77.5		
Pre-tax margin (%)	44.2	47.6	51.1			44.6	48.7		
Net margin (%)	44.2	47.6	51.1			44.6	48.7		

Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-08-17	Buy	0.83	0.78
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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