

18 January 2019

Property | REITs

MRCB-Quill REIT (MQREIT MK)

Neutral (Maintained)

Occupancy Rate Outlook a Concern

Target Price (Return)	MYR1.05 (-6%)
Price:	MYR1.12
Market Cap:	USD290m
Avg Daily Turnover (MYR/USD)	0.08m/0.02m

- **Maintain NEUTRAL with new TP of MYR1.05** from MYR1.10, 6% downside plus 6.7% 2019F yield after trimming FY19-FY20F earnings by 5-6% on lower occupancy rates. MRCB-Quill REIT's dividend yield is above the sector average but we believe this is fair, given its high occupancy risk. Our Top Picks for the sector are IGB REIT (IGBREIT MK, BUY, TP: MYR1.90) and Pavilion REIT (PREIT MK, BUY, TP: MYR1.80).
- **Results in line.** FY18 core net profit of MYR82.5m (ex-disposal gain of QB8 and revaluation loss) was in line/below our/Street expectations, at 98/94% of full-year estimates. Revenue dropped 3.7% YoY, mainly on lower income from Platinum Sentral and revenue loss from Quill Building 8 – DHL (QB8, sold in Apr 2018). Core net profit declined by 6.3% YoY, mainly due to the loss of income after the disposal. The REIT declared a DPU of 3.85 sen for this quarter (-7.5% YoY), taking total FY18 DPU to 8.08 sen (-3.7% YoY).
- **7% non-renewal for FY18.** Overall occupancy rate for all assets dropped to 93% as at 31 Dec 2018 (vs 96% in 31 Dec 2017). In FY18, of the 28% of total NLA (609,000 sqf) up for renewal, 7% was not renewed (ie 75% renewal) – mainly from tenants decreasing office space. The remaining 21% was renewed at a flat rental reversion. The non-renewal includes SBM, Amgeneral and Pemandu, which downsized their office spaces in Platinum Sentral. Platinum Sentral's occupancy rate as at 31 Dec fell to 87% (from 98% in 31 Dec 2017). Wisma Technip's occupancy rate also dropped to 74% (from 100%) as its tenant, Technip Geoproduction (M) SB, has also downsized. With the oversupply of office space in Klang Valley, we think it will take some time for the REIT to find replacement tenants for the vacant space.
- **19% up for renewal this year.** We remain cautious on outlook, despite only 19% of leases (from the total NLA) being up for renewal this year. This is mainly from the entire QB2-HSBC, due for renewal in 4Q19 with total NLA of 184,000 sqf as well as some smaller tenants in Plaza Mont Kiara and Menara Shell. Meanwhile, MyHSR and SPAD in Platinum Sentral are also currently under short lease extensions until 1Q19. We are concerned that the REIT may have to give in on rental rates to retain tenants.
- **Potential acquisition.** Menara Celcom Petaling Jaya has completed construction and is currently tenanted by Celcom. As this is one of the sponsor's assets, it will likely to be injected into the REIT in FY19 at the earliest. That said, negotiations between the asset sponsor and the REIT have yet to commence.

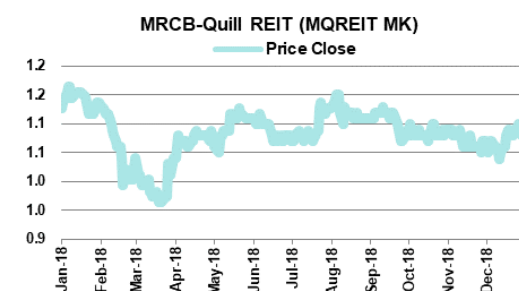
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	4.7	3.7	2.8	0.0	(9.0)
Relative	5.4	1.5	6.4	3.4	(0.8)
52-wk Price low/high (MYR)	0.995 - 1.26				



Source: Bloomberg

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (MYRm)	180	173	157	158	159
Net property income (MYRm)	140	134	121	122	122
Reported net profit (MYRm)	70	73	78	79	79
Total distributable income (MYRm)	88	85	78	79	79
DPS (MYR)	0.1	0.1	0.1	0.1	0.1
DPS growth (%)	0.1	(3.1)	(11.4)	0.7	0.3
P/BV (x)	0.90	0.91	0.91	0.91	0.91
Dividend Yield (%)	7.8	7.5	6.7	6.7	6.7
Return on average equity (%)	5.0	5.3	5.7	5.7	5.7
Return on average assets (%)	3.1	3.2	3.4	3.4	3.5
Interest cover (x)	3.5	3.3	3.4	3.4	3.4

Source: Company data, RHB

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Results At a Glance

Figure 1: MRCB-Quill REIT's 4Q18 and FY18 results summary

FYE Dec (MYRm)	4Q17	3Q18	4Q18	QoQ (%)	YoY (%)	FY17	FY18	YoY (%)	Comments
Revenue	44.7	43.3	42.7	(1.4)	(4.5)	180.1	173.4	(3.7)	Lower YoY, due to the loss of revenue from QB8 and lower revenue generated from Platinum Sentral
Net property income (NPI)	34.6	33.3	32.7	(2.0)	(5.7)	140.0	133.7	(4.5)	Lower operating expenses incurred after the disposal of QB8
Interest expense	(11.0)	(10.1)	(10.9)	8.2	(0.9)	(40.5)	(40.6)	0.2	
Interest income	1.7	1.0	1.7	66.4	(2.4)	3.6	4.3	20.5	
Associates	0.0	0.0	0.0	nm	nm	0.0	0.0	nm	
EI	(18.2)	0.0	(5.4)	nm	(70.1)	(18.2)	(3.2)	(82.2)	Disposal gain of QB8 and revaluation loss
Others	(3.9)	(3.7)	(3.9)	4.5	(0.5)	(14.9)	(14.9)	(0.3)	
Pretax profit	3.3	20.6	14.2	(31.1)	326.9	69.9	79.3	13.4	
Tax	0.0	0.0	(6.1)	nm	nm	0.0	(6.1)	nm	
Minority Interest	0.0	0.0	(6.1)	nm	nm	0.0	(6.1)	nm	
Net Profit	3.3	20.6	8.0	(60.9)	142.2	69.9	73.1	4.6	
Core Profit	21.4	20.6	19.6	(4.9)	(8.6)	88.0	82.5	(6.3)	Within expectations
Core earnings per unit (sen)	2.01	1.92	1.83	(4.7)	(9.0)	8.24	7.91	(4.0)	
Dividends per unit (sen)	4.16	0.00	3.85	nm	(7.5)	8.39	8.08	(3.7)	
NPI Margin (%)	77.6	77.1	76.6			77.7	77.1		
Pretax Margin (%)	7.4	47.6	33.2			38.8	45.7		
Net Margin (%)	48.0	47.6	45.9			48.9	47.6		

Source: Company data, RHB

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