

17 Jan 2020

Sell

Price
RM1.00

Target Price
RM0.89

Market Data

Bloomberg Code	MQREIT MK
No. of shares (m)	1,071.8
Market cap (RMm)	1,071.8
52-week high/low (RM)	1.13 / 0.99
Avg daily turnover (RMm)	0.2
KLICI (pts)	1,587.9

Source: Bloomberg, KAF

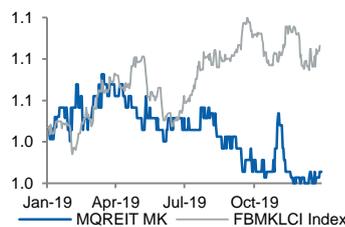
Major Shareholder (%)

MRCB	(27.8%)
KWSP	(12.1%)
CapitalLand Ltd	(10.9%)
Free Float	270.2

Source: Bloomberg, KAF

Performance

	3M	6M	12M
Absolute (%)	-	(6.5)	(9.9)
Rel Market (%)	(0.8)	(1.8)	(5.1)



Source: Bloomberg, KAF

MRCB-Quill REIT

Challenges still ahead

MRCB-Quill REIT (MQREIT)'s FY19 net property income (NPI) of RM122.8m (-9% yoy), on the back of lower revenue (-7%yoy), was within our expectation. FY19 DPU amounted to 6.8 sen, 15.8% lower than the 8.08 sen paid out in FY18. We are expecting FY20F to be weaker, on limited rental growth assumptions, capping DPU growth. Therefore, we downgrade our rating on MQREIT from Hold to Sell with a lower DDM-based TP of RM0.89.

Financial Highlights

FYE Dec	2017	2018	2019	2020F	2021F
Revenue (RM mil)	180.1	173.4	162.1	160.2	159.0
Net Property Income	140.0	133.7	122.8	121.4	120.5
Realised Net profit (RM mil)	87.0	82.5	72.1	70.7	69.9
EPU (sen)	8.1	7.7	6.7	6.6	6.5
EPU Growth (%)	48.7	(5.5)	(12.6)	(1.9)	(1.1)
DPU (sen)	8.4	8.1	6.8	6.7	6.6
PE (x)	12.3	13.0	14.9	15.2	15.4
Div yield (%)	8.4	8.1	6.8	6.7	6.6
ROE (%)	5.0	5.3	2.2	5.3	5.3
Gearing (%)	37.3	37.6	37.8	37.8	37.8

Source: Company, KAF

FY19 results were in-line

MRCB-Quill REIT (MQREIT)'s FY19 net property income (NPI) of RM122.8m, which saw a 9% decline yoy, was in line with our full-year forecasts (100%). The decline in NPI was not a surprise, given lower revenue generated from Platinum Sentral (PS), Wisma Technip (WT) and Quill Building 5 (QB5), and loss of income from the disposal of Quill Building 8 – DHL XPJ. Excluding a revaluation loss of RM36.7m, that mainly came from PS (-RM38.8m), FY19 core net profit declined by 13% yoy. This was also due to lower interest income (-26% yoy) registered during the period.

A final DPU of 3.37 sen was declared in 4Q19, bringing FY19 total DPU to 6.8 sen. This was 15.8% lower than the 8.08 sen paid out in FY18, but nonetheless, met our FY19 DPU projection of 6.74 sen.

Occupancy pressures persist

The REIT's portfolio occupancy stood at 90% as at 4Q19 (vs. 4Q18: 93%). As a recap, vacancies were mainly at PS and WT, because of tenant non renewals and downsize, respectively. Other than that, Quill Building 5 remains untenanted, after the key tenant, IBM, moved out from the building in 1Q19. Management had previously mentioned that they have received enquiries for replacement tenant(s) at the office building, but nothing has been finalized at this point of time.

Little to look forward in FY20

Moving forward, we believe there are further earnings risks at MQREIT's office buildings. Supply hikes will put further pressure on rental and occupancy rates, and it will take more time for landlords to fill up unoccupied office spaces.

In terms of lease expiries, FY20 will see about 18% of MQREIT's total net lettable area (NLA) due for renewal, with the bulk of it due in 4Q20. We are expecting reversion rates to be unexciting when re-contracting these leases, as management continues to focus on tenant retention.

Furthermore, we do not expect Menara Celcom, which the group has ROFR from sponsor, to be injected anytime soon.

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Downgrade to Sell; lower DDM-derived TP of RM0.89

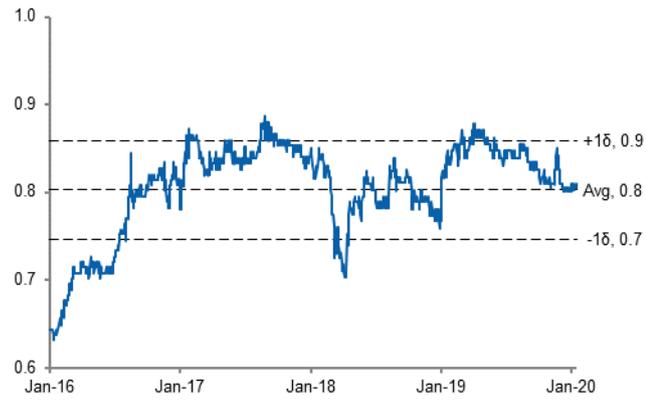
Our FY20-21F estimates are lower than FY19, on limited rental growth assumptions, given challenging office market segment, capping the REIT's ability to grow DPU. Therefore, we downgrade MQREIT to Sell from Hold.

Exhibit 1: Quarterly trends

(RM m)	4Q18	1Q19	2Q19	3Q19	4Q19	Change		Cumulative			KAF	
	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	% qoq	% yoy	12M18	12M19	% chg	2019F	4Q/F
FYE 31 Dec												
Revenue	42.7	41.4	38.8	39.9	42.0	5	(2)	174.0	162.1	(7)	160.0	101
Property operating expenses	(10.0)	(9.3)	(9.7)	(9.7)	(10.5)	8	5	(39.7)	(39.2)	(1)	(36.7)	107
Net property income	32.7	32.0	29.1	30.2	31.5	4	(4)	134.3	122.8	(9)	123.3	100
Interest income	1.7	0.8	0.6	0.7	1.1	60	(34)	4.3	3.2	(26)	3.2	99
Trust expenses	(3.9)	(3.6)	(3.2)	(3.5)	(3.8)	7	(2)	(14.9)	(14.1)	(5)	(13.7)	103
Borrowing costs	(10.9)	(9.9)	(10.0)	(9.7)	(10.3)	5	(6)	(40.6)	(39.8)	(2)	(40.6)	98
Exceptional items	(5.4)	-	-	-	(36.7)			(3.2)	(36.7)	nm		
Profit before tax	14.2	19.4	16.5	17.6	(18.1)	nm	nm	79.9	35.4	(56)	72.3	49
Tax	(6.1)	-	-	-	(6.2)			(6.1)	(6.2)		-	
Net profit	8.0	19.4	16.5	17.6	(24.4)	nm	nm	73.7	29.1	(61)	72.3	40
Normalized net profit	19.6	19.4	16.5	17.6	18.6	5	(5)	83.1	72.1	(13)	72.3	100

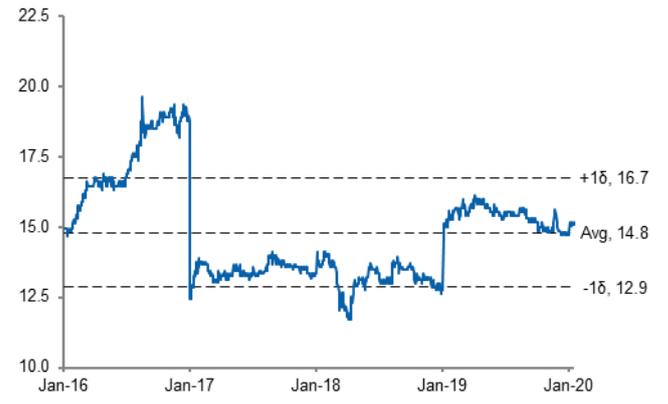
Source: Company, KAF

Exhibit 2: PB Band chart



Source: Company, KAF, Bloomberg

Exhibit 3: PE Band chart



Source: Company, KAF, Bloomberg

MRCB-Quill REIT

Income Statement

FYE Dec (RMm)	2017	2018	2019	2020F	2021F
Gross rental income	180.1	173.4	162.1	160.2	159.0
Property operating expenses	(40.2)	(39.7)	(39.2)	(38.8)	(38.5)
Net property income	140.0	133.7	122.8	121.3	120.5
Non-property expenses	(14.9)	(14.9)	(14.4)	(14.2)	(14.1)
PBITDA	125.0	118.8	108.5	107.2	106.4
PBIT	125.0	118.8	108.5	107.2	106.4
Interest expense	(40.5)	(40.6)	(39.6)	(39.2)	(39.2)
Exceptional item	(18.2)	(3.2)	(36.7)	-	-
PBT	68.8	79.3	35.4	70.7	69.9
Tax	-	(6.1)	(6.2)	-	-
Distributable Income	68.8	73.1	29.1	70.7	69.9
Core Net Profit	87.0	82.5	72.1	70.7	69.9

Balance Sheet

FYE Dec (RMm)	2017	2018	2019	2020F	2021F
Investment Properties	2,181.4	2,179.3	2,144.1	2,144.1	2,144.1
Trade and other receivables	31.0	6.7	6.3	6.2	6.2
Cash and cash equivalents	76.0	85.8	63.3	62.4	61.5
Inventories	-	-	-	-	-
Total Assets	2,288.4	2,271.7	2,213.7	2,212.7	2,211.8
Payables and accruals	33.1	26.2	21.1	20.9	20.8
Short-term Borrowings	116.9	-	332.7	332.7	332.7
Long-term Borrowings	736.6	853.7	503.0	503.0	503.0
Payables and accruals	17.1	19.6	33.1	33.1	33.1
Unit holder's capital	1,231.9	1,235.9	1,235.9	1,235.9	1,235.9
Undistributed income to Reserves	152.8	136.4	87.6	86.8	86.1
Total unit holder's fund	1,384.7	1,372.3	1,323.5	1,322.7	1,322.0
Total liabilities and shareholder's fund	2,288.4	2,271.7	2,213.4	2,212.4	2,211.5

Cash flow Statement

FYE Dec (RMm)	2017	2018	2019	2020F	2021F
Pretax profit	68.8	79.3	35.4	70.7	69.9
Working Capital	124.8	118.8	108.6	107.1	106.4
Others	nm	nm	nm	nm	nm
Operating cash flows	128.2	107.2	112.6	107.1	106.4
Acquisitions	(0.4)	-	-	-	-
Enhancement exp.	2.1	(0.4)	0.4	2.7	2.7
Others	(6.6)	28.0	-	-	-
Investing cash flows	(4.8)	27.6	0.4	2.7	2.7
Issue of shares	-	4.0	-	-	-
Dividend paid	(72.6)	(89.8)	(78.0)	(71.5)	(70.7)
Borrowings	(0.3)	-	35.0	-	-
Others	(35.7)	(39.2)	(92.5)	(39.2)	(39.2)
Financing cash flow	(108.6)	(125.0)	(135.5)	(110.7)	(109.9)
Net inflows/(outflows)	14.7	9.7	(22.5)	(0.9)	(0.8)
Change in receivables	13.5	0.6	1.5	0.1	0.0
Change in payables	(10.1)	(12.2)	2.4	(0.2)	(0.1)

Source: Bloomberg, KAF

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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