

Company Focus

Quill Capita Trust

Bloomberg: QUIL MK | Reuters: QCAP.KL

Refer to important disclosures at the end of this report

Malaysia Equity Research

24 Nov 2014

HOLD RM1.17 KLCI : 1,809.13

(Downgrade from Buy)

Price Target : 12-month RM 1.25 (Prev RM 1.35)

Shariah Compliance: No

Reason for Report : Include Platinum Sentral in forecasts

Potential Catalyst: Occupancy replenishment, yield-accretive injections

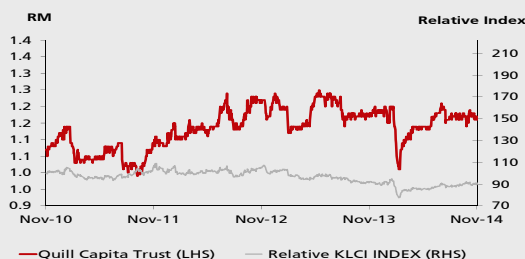
AllianceDBS vs Consensus: Inline

Analyst

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Price Relative



Forecasts and Valuation

FY Dec (RM m)	2013A	2014F	2015F	2016F
Gross Revenue	69	70	123	126
Net Property Inc	53	53	97	99
Total Return	37	34	56	57
Distribution Inc	33	33	56	57
EPU (sen)	9.4	8.7	8.4	8.5
EPU Gth (%)	(9)	(7)	(3)	1
DPU (sen)	8.4	8.4	8.4	8.5
DPU Gth (%)	0	0	0	1
NAV per shr (sen)	136.7	137.1	132.0	132.0
PE (X)	12.5	13.4	13.9	13.7
Distribution Yield (%)	7.2	7.2	7.2	7.2
P/NAV (x)	0.9	0.9	0.9	0.9
Aggregate Leverage (%)	36.6	36.9	44.6	44.7
ROAE (%)	6.9	6.4	8.0	6.5

Distn. Inc Chng (%)	(13)	42	37
Consensus DPU (sen)	8.5	9.3	10.0
Other Broker Recs:	B: 3	S: 0	H: 2

ICB Industry : Real Estate

ICB Sector: Real Estate Investment Trusts

Principal Business: An office-focused real estate investment trust with assets primarily in Petaling Jaya and Cyberjaya, with a small presence in Penang. The injection of Platinum Sentral gives it significant exposure to Kuala Lumpur..

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

Entering the Platinum age

- **Updated forecasts to include Platinum Sentral**
- **Inbound expansion of asset size & quality, though some dilution is expected**
- **Lukewarm growth outlook inadequate to quell office sector-related risks**
- **Downgrade to HOLD, but yield remains attractive at 7.2%**

Entering the big league. The injection of Platinum Sentral is expected to be completed late-2014 or early 2015. At RM740m, the property will account for 89% of Quill Capita's current asset base of RM828m. It will also see the entry of Malaysian Resources Corp (MRCB) as a major shareholder with a ~31% stake.

Some dilution expected. The injection involves the issue of a substantial number of new units to MRCB, new placements, and borrowings. Although the earnings base will expand, we estimate EPU will be diluted by about 3%. DPU should remain firm thanks to accommodative payout ratios and cash flow; but near-term organic DPU growth may be capped.

Office sector outlook still lacklustre. The outlook for office space rental in Kuala Lumpur, Klang Valley and Cyberjaya (where the REIT has exposure) remains challenging due to excess supply. The REIT is unlikely to see strong reversions and occupancy levels could drop. About 20% of tenancies in the REIT's current portfolio are expiring in 2015.

The REIT still has earnings growth opportunities in the vacant QB10 (68k sq ft NLA, Petaling Jaya) and the half-vacant retail portion of Platinum Sentral, but the overall growth outlook is relatively muted. Post-injection gearing of almost 45% will be a dampener on further acquisitions/injections in the near-term, although the REIT will obtain rights of first refusal to MRCB's investment properties.

HOLD for 7.2% yield, RM1.25 TP. We trimmed TP to RM1.25 based on the DDM valuation and assuming 8% cost of equity and 1% terminal growth. The stock will be supported by a 7.2% forward yield.

At A Glance

Issued Capital (m shrs)	390
Mkt. Cap (RMm/US\$m)	456 / 136
Major Shareholders	
Capitaland Financial Limited (%)	30.0
Quill Group of Companies (%)	30.0
Free Float (%)	40.0
Avg. Daily Vol.('000)	124

INVESTMENT THESIS

Profile	Rationale
<p>Quill Capita Trust (proposed to change to MRCB-Quill REIT) is a real estate investment trust with a focus on office property. Its assets are primarily in Petaling Jaya and Cyberjaya, with a small presence in Penang. The entry of Platinum Sentral and MRCB will not shift the REIT's focus, but will give it exposure to more prime assets in Kuala Lumpur.</p>	<p>'Upgrade' in asset base</p> <ul style="list-style-type: none"> The injection of Platinum Sentral is a significant milestone, first due to its size (property asset value to increase by 89%). The asset is also located in an arguably more "prime" location in the Kuala Lumpur city centre, which is reflected in the higher rents it commands. <p>MRCB sponsorship</p> <ul style="list-style-type: none"> The injection will see the entry of Malaysian Resources Corp (MRCB) as a major shareholder with a ~31% stake. This gives the REIT the first right of refusal to MRCB's stable of investment properties, as well as other assets under development. <p>Some dilution, DPU should be flat</p> <ul style="list-style-type: none"> We forecast some per-unit earnings dilution after the asset injection due to large placement and borrowings. Nonetheless, we anticipate DPU will be stable, supported by still strong payout capacity and cash flow.
Valuation	Risks
<p>We have a HOLD recommendation for Quill Capita Trust with RM1.25 price target based on the DDM model and assuming 8% cost of equity and 1% terminal growth rate. The TP is supported by a 5% discount to NAV (previously 14% discount); we feel the enlarged asset base and improvement in asset quality warrants a narrower discount. At current price the stock offers a 7.2% yield.</p>	<p>Near-term earnings dilution</p> <ul style="list-style-type: none"> The injection is likely to result in near-term earnings dilution, which means the REIT would need to increase payout to maintain DPU. Thus, the near-term DPU growth outlook is also uninspiring. <p>Soft office rental market</p> <ul style="list-style-type: none"> The office sector remains tepid due to excess supply, especially in Kuala Lumpur, Klang Valley and Cyberjaya, where the REIT has exposure. Reversion potential is relatively weak and occupancies could be a risk factor. <p>High gearing and borrowing costs</p> <ul style="list-style-type: none"> Despite the planned placements, the borrowings required to enable the Platinum Sentral injection would result in gearing rising to 45%, near the 50% cap. Borrowing costs will rise accordingly, although >95% of its borrowings are at fixed cost, and it will finalise a new MTN programme to keep rates at 4.6%-4.8% over the medium-term.

Source: AllianceDBS

Platinum Sentral details

Platinum Sentral is a 5-block, 4 to 7 storey commercial property consisting mostly of offices, some retail space, two levels of parking bays, and a multi-purpose hall. It is located in the Kuala Lumpur Sentral development, close to the major transit hub, Stesen Sentral.

The 445k sq ft NLA office segment is 100% occupied, mostly by government-linked corporations like SME Corp, SPAD (Land Public Transport Commission), PEMANDU, and others. Lease terms are long, ranging from 3-15 years, and monthly rents average RM8.70 psf. The 56K sq ft retail area has 50-60% occupancy rate, with monthly rents a RM4-RM5 psf.

The injection cost of RM740m is intended to be settled via:

- 1) Issue of 206.25m new units to MRCB at RM1.28 each;
- 2) Placement of 55m-85m new units at a price not less than 10% below the 5-day volume-weighted average price prior to price-fixing date; and
- 3) Borrowings to make up for the shortfall; it has initiated a RM450m MTN programme for this purpose.

Impact of MRCB connection

Besides the substantial REIT stake, MRCB also intends to wind up with a 41% stake in the REIT management company, Quill Capita Management Sdn. Bhd. Hence, there is a proposal to change the name to “MRCB-Quill REIT”.

The right of first refusal for MRCB’s stable of investment properties, as well as properties under development, presents an avenue for asset injection-driven growth going forward. The completed assets available at book value include: Menara Shell (office, RM447m); Ascott Sentral (service apartments, RM101m); Plaza Alam Sentral (retail, RM76m); Sooka Sentral (lifestyle/retail, RM51m); and Kompleks Sentral (industrial, RM31m).

Nonetheless, we deem further injections by MRCB to be a medium-term prospect given the substantial impact the Platinum Sentral injection will have on the REIT’s share base and gearing ratio (rising to almost 45%).

Near-term growth opportunities

Quill Building 10 (QB10) has been vacant since early 2013, as the previous tenant - HSBC’s credit card processing centre – had moved out after reorganising. Located in Petaling Jaya, the 68,377 sq ft NLA building could add RM3m-RM4m revenue when fully occupied again, assuming moderate monthly rents of RM4-RM5 psf. We understand management is actively seeking tenants.

Platinum Sentral’s 56k sq ft NLA retail portion occupancy is relatively weak at about 50%, mainly due to ongoing works to build pedestrian bridges to nearby office blocks. The gradual increase in occupancy would also lift revenues.

Valuation

Quill Capita Trust has been trading at a substantial 14% discount to NAV. We believe this is due to its relatively small asset size and market capitalisation, alongside a muted asset growth outlook.

With the injection and entry of MRCB, the size issue should abate and justify a narrower discount rate to support our TP. Our revised TP of RM1.25 indicates a reasonable forward yield of 6.7% and c.5% discount to NAV.

DDM Valuation

	2H14	FY15	FY16	FY17	
<i>Period</i>	<i>0.5</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>Terminal</i>
Payout (RM)	0.043	0.084	0.085	0.086	1.238
Discounted Dividend	0.041	0.078	0.073	0.068	0.982
Fair Value (RM)					1.25

Beta	0.55	Cost of Equity (RF + β *MRP) [^]	8.03%
Risk free rate	4%		
Market risk premium	6%	Terminal growth	1.00%

[^]inc 10% premium on CoE due to high gearing

Source: AllianceDBS

Peer comparison

					DPU Growth (YoY)		DPU (sen)		Price/NAV		Dividend Yield		EPS (sen)	
	Call	TP	Price	Mkt Cap (RM m)	CY2014	CY2015	CY2014	CY2015	CY2014	CY2015	CY2014	CY2015	CY2014	CY2015
<u>AllianceDBS forecasts</u>														
KLCC Stapled Securities	Hold	6.80	6.79	12,258.2	0%	0%	34.3	34.3	1.03x	1.02x	5.1%	5.1%	36.8	38.2
IGB REIT	Hold	1.35	1.33	4,584.9	5%	2%	7.4	7.6	1.28x	1.28x	5.6%	5.7%	6.5	6.9
Pavilion REIT	Buy	1.55	1.50	4,520.7	6%	1%	7.8	7.9	1.29x	1.29x	5.2%	5.2%	7.5	7.6
Sunway REIT	Buy	1.60	1.47	4,308.5	2%	8%	8.5	9.2	1.16x	1.16x	5.8%	6.3%	8.1	8.7
CapitaMalls Malaysia Trust	Buy	1.60	1.39	2,472.8	3%	3%	9.1	9.4	1.12x	1.13x	6.5%	6.7%	8.5	8.8
Axis REIT	Hold	3.65	3.58	1,660.9	8%	1%	20.0	20.3	1.50x	1.49x	5.6%	5.7%	15.2	20.2
Quill Capita Trust	Hold	1.25	1.17	456.5	0%	0%	8.4	8.4	0.85x	0.89x	7.2%	7.2%	8.7	8.4
<u>Consensus forecasts</u>														
YTL Hospitality REIT	NR	NR	1.04	1,377.4	4%	(6%)	8.0	7.5	0.94x	0.93x	7.7%	7.2%	8.0	7.5
Al-'Aqar Healthcare REIT	NR	NR	1.40	974.7	8%	4%	8.5	8.8	1.20x	1.17x	6.1%	6.3%	8.5	8.9
AmFirst REIT	NR	NR	0.98	672.7	(2%)	9%	7.1	7.8	0.79x	0.79x	7.1%	7.9%	8.3	8.8
Hektar REIT	NR	NR	1.55	621.0	5%	0%	11.0	11.0	1.01x	1.00x	7.1%	7.1%	12.0	12.0
UOA REIT	NR	NR	1.41	596.2	3%	9%	11.0	12.0	0.94x	0.94x	7.8%	8.5%	11.0	12.0
Amanahraya REIT	NR	NR	0.87	498.7	10%	0%	8.0	8.0	0.85x	0.85x	9.2%	9.2%	8.0	8.0
Tower REIT	NR	NR	1.26	353.4	12%	0%	12.0	12.0	0.69x	0.69x	9.5%	9.5%	12.0	12.0
Atrium REIT	NR	NR	1.22	148.6	2%	11%	9.0	10.0	0.90x	0.90x	7.4%	8.2%	10.0	10.0
<i>ADBS total / weighted avg</i>				30,262.6	3%	2%	19.4	19.5	1.16x	1.15x	5.4%	5.6%	19.8	20.8
<i>Total / weighted avg</i>				35,505.3	3%	2%	17.8	18.0	1.12x	1.12x	5.7%	5.9%	18.3	19.1

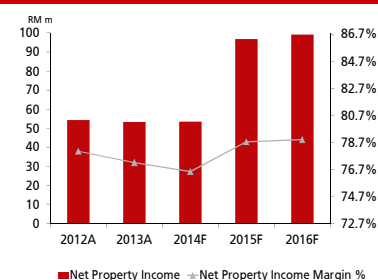
Income Statement (RM m)

FY Dec	2012A	2013A	2014F	2015F	2016F
Gross revenue	69	69	70	123	126
Property expenses	(15)	(16)	(16)	(26)	(27)
Net Property Income	54	53	53	97	99
Other Operating	(7)	(6)	(6)	(10)	(10)
Other Non Opg (Exp)/Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(13)	(13)	(13)	(31)	(32)
Exceptional Gain/(Loss)	6	2	0	0	0
Net Income	40	37	34	56	57
Tax	0	0	0	0	0
Minority Interest	0	0	0	0	0
Preference Dividend	0	0	0	0	0
Net Income After Tax	40	37	34	56	57
Total Return	40	37	34	56	57
Non-tax deductible Items	7	4	1	0	0
Net Inc available for Dist.	33	33	33	56	57
Growth & Ratio					
Revenue Gth (%)	(1.1)	(0.8)	1.4	76.0	2.3
N Property Inc Gth (%)	(1.2)	(1.9)	0.6	81.0	2.5
Net Inc Gth (%)	1.5	(8.6)	(7.1)	65.6	1.4
Dist. Payout Ratio (%)	94.9	94.7	96.1	99.3	99.4
Net Prop Inc Margins (%)	78.0	77.2	76.5	78.7	78.9
Net Income Margins (%)	57.7	53.2	48.7	45.8	45.4
Dist to revenue (%)	47.0	47.4	46.8	45.5	45.1
Managers & Trustee's fees to sales (%)	9.4	8.4	9.0	8.0	7.9
ROAE (%)	7.8	6.9	6.4	8.0	6.5
ROA (%)	4.7	4.3	3.9	4.5	3.5
ROCE (%)	5.7	5.6	5.5	7.1	5.6
Int. Cover (x)	3.6	3.7	3.6	2.8	2.8

Source: Company, AllianceDBS

Assuming full year contribution from Platinum Sentral in FY15

Margins Trend



Quarterly / Interim Income Statement (RM m)

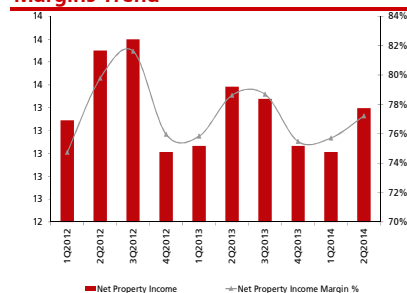
FY Dec	2Q2013	3Q2013	4Q2013	1Q2014	2Q2014
Gross revenue	17	17	17	17	17
Property expenses	(4)	(4)	(4)	(4)	(4)
Net Property Income	14	13	13	13	13
Other Operating	(1)	(1)	(1)	(2)	(2)
Other Non Opg (Exp)/Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(3)	(3)	(3)	(3)	(3)
Exceptional Gain/(Loss)	0	0	2	0	0
Net Income	9	9	11	8	9
Tax	0	0	0	0	0
Minority Interest	0	0	0	0	0
Net Income after Tax	9	9	11	8	9
Total Return	N/A	N/A	N/A	N/A	N/A
Non-tax deductible Items	N/A	N/A	N/A	N/A	N/A
Net Inc available for Dist.	16	0	17	0	16
Growth & Ratio					
Revenue Gth (%)	0	(1)	1	(1)	1
N Property Inc Gth (%)	4	(1)	(3)	0	3
Net Inc Gth (%)	10	0	20	(24)	5
Net Prop Inc Margin (%)	78.6	78.7	75.5	75.7	77.2
Dist. Payout Ratio (%)	94.0	0.0	95.3	0.0	95.6

Balance Sheet (RM m)

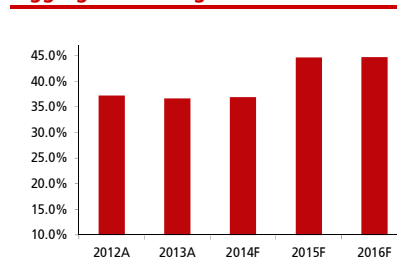
FY Dec	2012A	2013A	2014F	2015F	2016F
Investment Properties	821	826	831	1,576	1,581
Other LT Assets	0	1	1	1	1
Cash & ST Invt	30	31	33	34	36
Inventory	0	0	0	0	0
Debtors	9	3	3	5	5
Other Current Assets	0	0	0	0	0
Total Assets	860	860	867	1,615	1,623
ST Debt	125	5	5	5	5
Creditor	11	12	12	13	13
Other Current Liab	0	0	0	0	0
LT Debt	195	310	315	715	720
Other LT Liabilities	0	0	0	0	0
Unit holders' funds	529	533	535	882	884
Minority Interests	0	0	0	0	0
Total Funds & Liabilities	860	860	867	1,615	1,623
Non-Cash Wkg. Capital	(2)	(9)	(10)	(8)	(9)
Net Cash/(Debt)	(290)	(284)	(287)	(687)	(689)
Ratio					
Current Ratio (x)	0.3	2.0	2.0	2.1	2.2
Quick Ratio (x)	0.3	2.0	2.0	2.1	2.2
Aggregate Leverage (%)	37.2	36.6	36.9	44.6	44.7
Z-Score (X)	1.1	1.3	1.3	1.0	1.0

Source: Company, AllianceDBS

Margins Trend



Aggregate Leverage



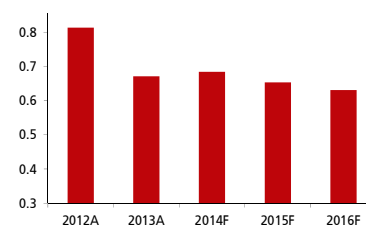
Large increase in gearing after debt issuance, nearing 50% limit for Malaysian REITs

Cash Flow Statement (RM m)

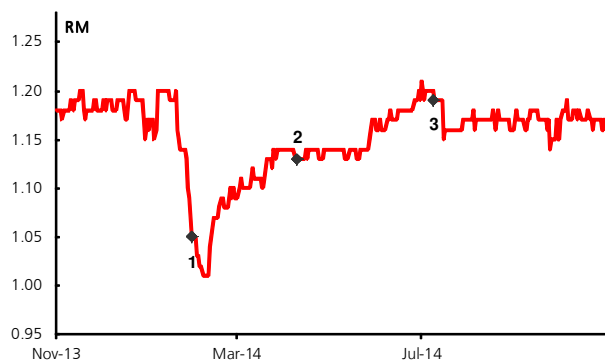
FY Dec	2012A	2013A	2014F	2015F	2016F
Pre-Tax Income	40	37	34	56	57
Dep. & Amort.	0	0	0	0	0
Tax Paid	0	0	0	0	0
Associates & JV Inc/(Loss)	0	0	0	0	0
Chg in Wkg.Cap.	(7)	1	1	(1)	1
Other Operating CF	8	11	13	31	32
Net Operating CF	40	49	48	86	90
Net Invnt in Properties	0	(3)	(5)	(745)	(5)
Other Invts (net)	0	0	0	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc. & JVs	0	0	0	0	0
Other Investing CF	1	1	1	1	1
Net Investing CF	1	(2)	(4)	(744)	(4)
Distribution Paid	(33)	(33)	(33)	(56)	(57)
Chg in Gross Debt	0	0	5	401	5
New units issued	0	0	0	345	0
Other Financing CF	(14)	(13)	(14)	(32)	(33)
Net Financing CF	(46)	(46)	(42)	657	(85)
Currency Adjustments	0	0	0	0	0
Chg in Cash	(5)	0	2	(1)	1
Operating CFPS (sen)	12.2	12.2	12.1	13.0	13.3
Free CFPS (sen)	10.3	11.7	11.0	(98.7)	12.7

Source: Company, AllianceDBS

Distribution Paid / Net Operating CF



Target Price & Ratings History



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

S.No.	Date	Closing Price	Target Price	Rating
1:	21 Feb 14	1.05	1.35	Buy
2:	02 May 14	1.13	1.35	Buy
3:	31 Jul 14	1.19	1.35	Buy

Source: AllianceDBS

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	EPS = earnings per share	PBT = profit before tax
bn = billion	EV = enterprise value	P/B = price / book ratio
BV = book value	FCF = free cash flow	P/E = price / earnings ratio
CF = cash flow	FV = fair value	PEG = P/E ratio to growth ratio
CAGR = compounded annual growth rate	FY = financial year	q-o-q = quarter-on-quarter
Capex = capital expenditure	m = million	RM = Ringgit
CY = calendar year	M-o-m = month-on-month	ROA = return on assets
Div yld = dividend yield	NAV = net assets value	ROE = return on equity
DCF = discounted cash flow	NM = not meaningful	TP = target price
DDM = dividend discount model	NTA = net tangible assets	trn = trillion
DPS = dividend per share	NR = not rated	WACC = weighted average cost of capital
EBIT = earnings before interest & tax	p.a. = per annum	y-o-y = year-on-year
EBITDA = EBIT before depreciation and amortisation	PAT = profit after tax	YTD = year-to-date

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