

MRCB-Quill REIT (MQREIT MK)

Property - REITS

Market Cap: USD205m

Neutral (Maintained)

Target Price: MYR1.19

Price: MYR1.18

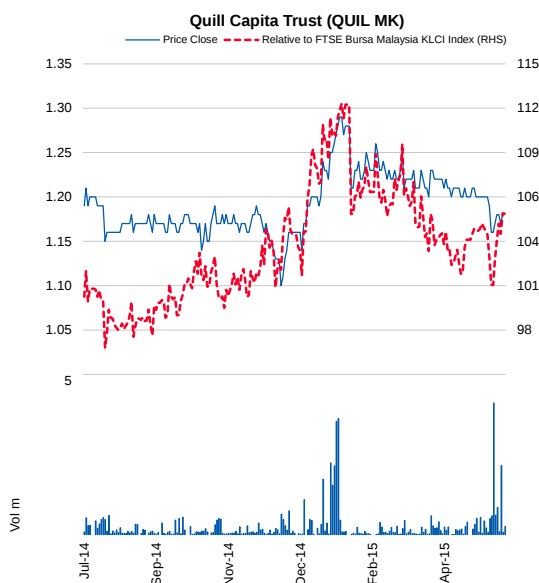
Earnings Hit By Higher Property Expenses

Macro

Risks

Growth

Value



Source: Bloomberg

Avg Turnover (MYR/USD)	0.31m/0.08m
Cons. Upside (%)	7.6
Upside (%)	0.8
52-wk Price low/high (MYR)	1.10 - 1.29
Free float (%)	40
Share outstanding (m)	661
Shareholders (%)	
Malaysian Resources Corp	31.2
Quill Group	30.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	0.9	(1.7)	(4.8)	0.0	3.5
Relative	2.3	4.7	(0.1)	4.7	10.7

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2Q15 earnings were below our/street estimates. Maintain NEUTRAL, with a lower DDM-derived MYR1.19 TP (0.8% upside). We expect the soft office market conditions to persist over the short term and property expenses to continue pressuring earnings in FY15. However, we note that earnings from Platinum Sentral will kick in from 3Q15 onwards. Its dividend yield remains decent, at 6.5%/7.1% for FY15F/FY16F.

- ◆ **Below expectations, on higher property expenses.** MRCB-Quill REIT (MQREIT) recorded a 2Q15 core net profit of MYR13.6m (+64.7% QoQ, +59.2% YoY). This brought 1H15 core profit to MYR21.9m, below our previous/street estimate of MYR55.8m, at 39%/41% respectively. Revenue increased 85.5% YoY on the back of an increased contribution from Platinum Sentral (PS) and Plaza Mont Kiara (PMK). However, property expenses surged by 98.9% owing to the acquisition of PS and higher repair and maintenance costs for PMK. A 2.22 sen dividend per unit (DPU) was also declared for the quarter, which brings the total 1H15 DPU to 4.10 sen, making up 46% of our previous 9.01 sen FY15 DPU forecast.
- ◆ **Recent developments.** Some pipeline assets including Quill Building 6 in Lebu Ampang, Quill Building 9 in Section 14, Petaling Jaya and Quill Building 18 in Cyberjaya are ready to be disclosed. However, the timeline on when these assets will be included in the REIT has yet to be revealed. Additionally, there are also other assets from its parent company Malaysian Resources Corp (MRCB) (MRC MK, NEUTRAL, TP: MYR1.31) that could be potentially included in the REIT as well. Therefore, we believe that the recent proposed disposal of the non-performing Quill Building 10, due to be completed by end-3Q15 – slightly later than initially expected – will aid in boosting the REIT's capacity to fund its future acquisitions.
- ◆ **Forecasts.** We trim our FY15-17 earnings forecasts by 5-14% to account for higher property expenses.
- ◆ **Still NEUTRAL.** Although MQREIT's short-term outlook remains challenging, we do believe that its recent addition, Platinum Sentral, will contribute more positively to its earnings going forward. Therefore, we maintain our NEUTRAL call. Our DDM-based TP falls to MYR1.19 (from MYR1.25, 0.8% upside) post our earnings revision. That said, the REIT's dividend yield remains decent at 6.5% and 7.1% for FY15F-16F.

Forecasts and Valuations	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total turnover (MYRm)	69	70	107	122	124
Net property income (MYRm)	53.2	53.3	75.2	92.4	93.9
Reported net profit (MYRm)	34.5	34.1	47.1	57.7	59.0
Total distributable income (MYRm)	34.5	34.1	47.1	57.7	59.0
DPS (MYR)	0.08	0.08	0.08	0.08	0.09
DPS growth (%)	0.0	0.0	(9.1)	10.0	2.2
Recurring P/E (x)	13.3	13.5	12.3	12.8	13.2
P/B (x)	0.86	0.85	0.77	0.86	0.85
Dividend Yield (%)	7.1	7.1	6.5	7.1	7.3
Return on average equity (%)	6.5	6.3	6.5	6.3	6.5
Return on average assets (%)	4.0	3.9	3.8	3.5	3.6
Interest coverage ratio (x)	3.47	3.38	3.04	2.98	3.02
Our vs consensus EPS (adjusted) (%)			8.8	0.0	0.0

Source: Company data, RHB

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Figure 1: MQREIT's earnings review

FYE Dec (MYRm)	2Q14	1Q15	2Q15	QoQ (%)	YoY (%)	1H14	1H15	YoY (%)	Comments
Revenue	17.3	18.6	32.2	72.9	85.5	34.5	50.8	47.1	Higher YoY revenue growth due to the additional contribution coming from Platinum Sentral, Plaza Mont Kiara and rental rate increases for some other properties.
Net property income (NPI)	13.4	13.7	24.3	77.7	81.5	26.4	38.0	43.9	MQREIT incurred higher property operating expenses due to additional repair and maintenance costs and the acquisition of Platinum Sentral.
Interest expense	(3.6)	(3.5)	(8.2)	131.5	129.7	(7.0)	(11.7)	67.6	Higher interest expense due to interest on additional borrowings drawn down on 30 Mar 2015.
Interest income	0.3	0.1	0.1	14.1	(51.0)	0.4	0.3	(33.8)	
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	(1.6)	(2.0)	(2.6)	32.5	68.8	(3.1)	(4.6)	49.4	
Pretax profit	8.6	8.3	13.6	81.6	75.6	16.7	23.3	39.4	
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	8.6	8.3	15.0	81.6	75.6	16.7	23.3	39.4	
Core Profit	8.6	8.3	13.6	64.7	59.2	16.7	21.9	31.0	Below expectations.
Core earnings per unit (sen)	2.19	2.11	2.20	4.3	0.2	4.29	4.31	0.5	
Dividends per unit (sen)	4.10	1.88	2.22	18.1	(45.9)	4.10	4.10	0.0	
NPI Margin (%)	77.2	73.5	75.6			76.5	74.8		
Pretax Margin (%)	49.4	44.5	42.4			48.4	45.9		
Net Margin (%)	49.4	44.5	42.4			48.4	45.9		

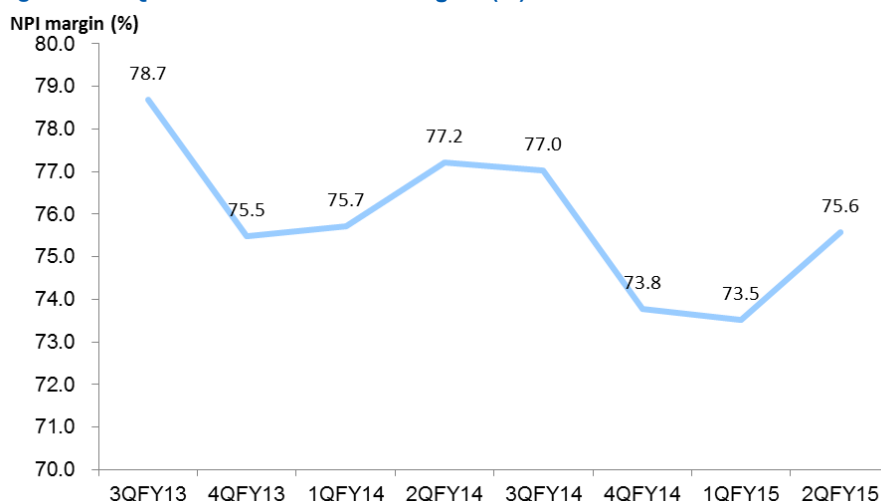
Source: RHB

Figure 2: MQREIT's historical eight quarters' earnings

FYE Dec (MYRm)	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15
Revenue	17.1	17.3	17.2	17.3	17.5	18.2	18.6	32.2
Net property income (NPI)	13.5	13.1	13.0	13.4	13.5	13.4	13.7	24.3
Interest expense	(3.5)	(3.3)	(3.4)	(3.6)	(3.6)	(3.5)	(3.5)	(8.2)
Interest income	0.2	0.1	0.1	0.3	0.2	0.1	0.1	0.1
Associates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EI	0.0	2.1	0.0	0.0	0.0	6.1	0.0	0.0
Others	(1.2)	(1.3)	(1.5)	(1.6)	(1.2)	(1.6)	(2.0)	(2.6)
Pretax profit	8.9	10.7	8.2	8.6	8.9	14.6	8.3	13.6
Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Profit	8.9	10.7	8.2	8.6	8.9	14.6	8.3	13.6
Core Profit	8.9	8.6	8.2	8.6	8.9	8.5	8.3	13.6
Core earnings per unit (sen)	2.29	2.20	2.09	2.19	2.29	2.18	2.11	2.20
Dividends per unit (sen)	0.00	4.28	0.00	4.10	0.00	4.28	1.88	2.22
NPI Margin (%)	78.7	75.5	75.7	77.2	77.0	73.8	73.5	75.6
Pretax Margin (%)	52.1	61.9	47.5	49.4	51.0	80.4	44.5	42.4
Net Margin (%)	52.1	49.7	47.5	49.4	51.0	46.8	44.5	42.4

Source: RHB

Figure 3: MQREIT's historical NPI margins (%)



Source: Company data

Figure 4: MQREIT's forecast assumptions

<u>Asset</u>	<u>NLA / GFA (sf)</u>	<u>Average Rental Rates (MYR psf)</u>		
		<u>FY15</u>	<u>FY16</u>	<u>FY17</u>
QB 1 - DHL 1	92,284	4.08	4.16	4.24
QB 4 - DHL 2	99,183	4.08	4.16	4.24
QB 2 - HSBC	184,453	4.08	4.16	4.24
QB 3 - BMW	117,198	4.08	4.16	4.24
QB 5 - IBM	81,602	3.03	3.06	3.09
Plaza MK	73,408	8.51	8.52	8.53
Wisma Technip	233,021	5.31	5.46	5.63
QB 10 - HSBC	68,377	3.03	3.06	3.09
QB 8 - DHL	65,205	3.03	3.06	3.09
Tesco Penang	275,020	2.92	2.97	3.03
Platinum Sentral	475,857	8.77	8.91	9.04
DPU (sen)		7.62	8.38	8.57

Source: RHB, Company data

Financial Exhibits

Profit & Loss (MYRm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total turnover	69	70	107	122	124
Property operating expenses	(16)	(17)	(32)	(29)	(30)
Net property income	53	53	75	92	94
Management fees	(5)	(5)	(6)	(6)	(6)
Trust expenses	(0)	(0)	(1)	(1)	(1)
Operating EBIT	47	47	69	86	87
Operating EBITDA	47	47	69	86	87
Interest income	1	1	1	1	1
Interest expense	(14)	(14)	(23)	(29)	(29)
Pre-tax profit	35	34	47	58	59
Profit after tax & minorities	35	34	47	58	59
Reported net profit	35	34	47	58	59
Total distributable income	35	34	47	58	59

Source: Company data, RHB

Cash flow (MYRm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Operating profit	47	47	69	86	87
Change in working capital	(8)	(3)	(3)	(3)	(4)
Other operating cash flow	3	0	2	2	2
Operating cash flow	42	44	68	84	85
Interest received	1	1	1	1	1
Interest paid	(14)	(14)	(23)	(29)	(29)
Cash flow from operations	29	31	46	56	57
Capex	(2)	(6)	(2)	(2)	(2)
Cash flow from investing activities	(2)	(6)	(2)	(2)	(2)
Dividends paid	(33)	(33)	(39)	(50)	(56)
Proceeds from issue of shares	-	0	-	-	-
Increase in debt	116	0	-	-	-
Other financing cash flow	-	0	-	-	-
Cash flow from financing activities	84	(32)	(39)	(50)	(56)
Cash at beginning of period	30	31	23	55	32
Total cash generated	111	(7)	5	4	(1)
Implied cash at end of period	141	24	28	59	31

Source: Company data, RHB

Financial Exhibits

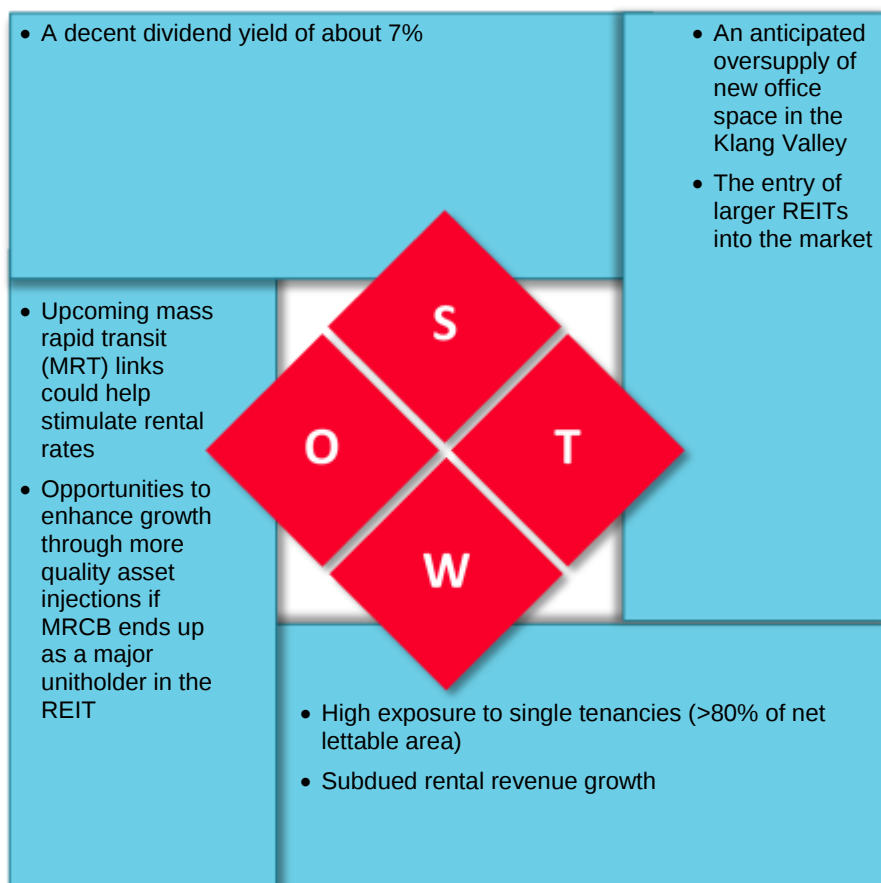
Balance Sheet (MYRm)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total cash and equivalents	31	23	55	32	31
Accounts receivable	3	6	6	6	6
Other current assets	-	-	20	46	49
Total current assets	34	29	81	84	86
Total investments	827	839	1,552	1,552	1,552
Total other assets	0	0	0	0	0
Total non-current assets	827	839	1,552	1,552	1,552
Total assets	860	868	1,634	1,636	1,639
Accounts payable	12	12	12	12	12
Other current liabilities	5	2	2	2	2
Total current liabilities	17	15	15	15	15
Total long-term debt	305	305	703	703	703
Other liabilities	5	8	8	8	8
Total non-current liabilities	310	313	711	711	711
Total liabilities	327	327	725	725	726
Share capital	412	412	676	676	676
Retained earnings reserve	122	130	233	235	237
Shareholders' equity	533	541	908	911	913
Total equity	533	541	908	911	913
Total liabilities & equity	860	868	1,634	1,636	1,639

Source: Company data, RHB

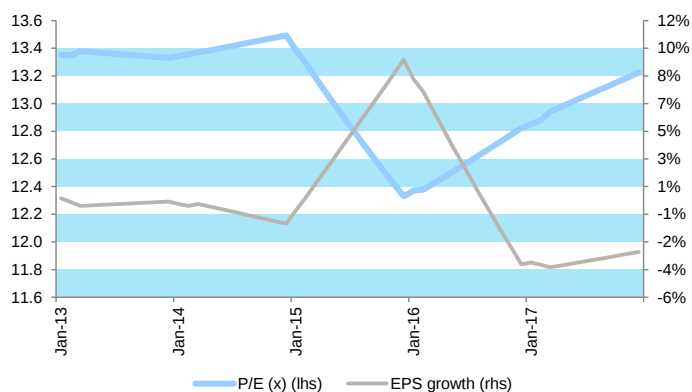
Key Ratios (MYR)	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Revenue growth (%)	(0.8)	1.9	53.0	13.1	1.6
Net profit growth (%)	0.2	(1.2)	38.0	22.7	2.2
EPS growth (%)	0.2	(1.2)	9.4	(3.9)	(3.0)
BVPS growth (%)	0.9	1.5	10.3	(10.0)	0.3
Net profit margin (%)	50.1	48.6	43.8	47.5	47.8
Return on average assets (%)	4.0	3.9	3.8	3.5	3.6
Return on average equity (%)	6.5	6.3	6.5	6.3	6.5
Net debt to equity (%)	51.4	52.1	71.3	73.7	73.6
DPS	0.08	0.08	0.08	0.08	0.09
Recurrent cash flow per share	0.07	0.08	0.09	0.09	0.09

Source: Company data, RHB

SWOT Analysis

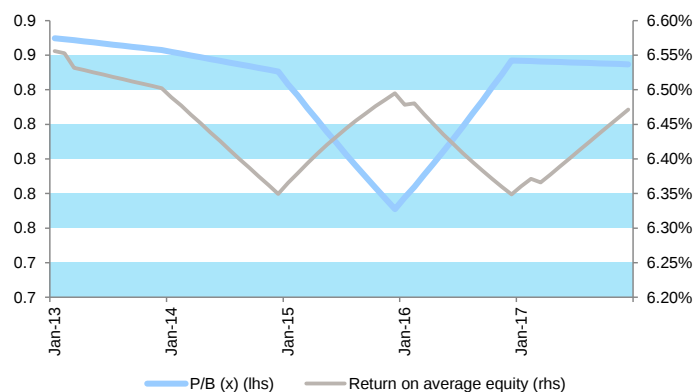


P/E (x) vs EPS growth



Source: Company data, RHB

P/BV (x) vs ROAE



Source: Company data, RHB

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.

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-02-26	Neutral	1.25	1.23
2015-01-20	Neutral	1.25	1.25
2014-11-27	Neutral	1.25	1.18
2014-05-02	Neutral	1.25	1.13
2014-01-30	Neutral	1.25	1.20
2014-01-29	Sell	1.06	1.20
2013-08-02	Sell	1.10	1.22
2013-05-13	Neutral	1.27	1.21
2013-03-06	Neutral	1.27	1.14
2013-02-04	Neutral	1.27	1.20

Source : RHB, Bloomberg

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Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

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