

1 July 2016

Property | REITS

MRCB-Quill REIT

Buy (Maintained)

Acquiring Menara Shell

Target Price: MYR1.29
Price: MYR1.16
Market Cap: USD190m
Bloomberg Ticker: MQREIT MK

We were not surprised by MRCB-Quill REIT's proposed Menara Shell acquisition, as the deal has been pending completion for a few months. We deem this acquisition as positive over the long run, enlarging the REIT's asset base and giving it higher exposure to the highly sought-after KL Sentral area. We expect the trust to continue to buck the trend in the challenging office segment and maintain high occupancy rates at its portfolio assets. Maintain BUY and DDM-based MYR1.29 TP (11% upside). This asset injection is a potential re-rating catalyst to the stock.

Acquiring Menara Shell from Malaysian Resources Corp (MRCB) (MRC MK, BUY, TP: MYR1.60). MRCB-Quill REIT entered into a sale & purchase agreement with MRCB on 30 June to acquire Menara Shell at Kuala Lumpur Sentral (KL Sentral) for a purchase consideration of MYR640m. This is to be fully satisfied in cash, funded by a combination of new share placements and borrowings. The acquisition is expected to be completed by end-2016.

Fully-occupied office tower in KL Sentral. Menara Shell is a 33-storey office tower in KL Sentral that is erected on a 5-storey podium with a 4-storey basement car park. Its gross built-up area stands at 820,917sqf, with a net lettable area of 557,053sqf. It is currently 99.9% occupied. It generated gross rental income of MYR46.4m in FY15.

Yield neutral in the short term. The estimated funding required in undertaking the acquisition is MYR656m, and MRCB-Quill REIT has proposed to fund the acquisition via a combination of new unit placements and additional borrowings. However, the actual funding breakdown has not been determined. Based on an assumed price of MYR1.05/unit and a maximum of 406.7m placement units, the gross proceeds from the placement will be MYR427m, with the remaining MYR229m balance required raised through borrowings. Based on these assumptions, we expect the acquisition to be yield neutral in the short term.

Positive over the long run. Post-acquisition, MRCB-Quill REIT's asset size will increase to MYR2.27bn from MYR1.63bn, enhancing its competitive position. With the property almost fully-occupied, the acquisition will improve its overall occupancy rate to 98% from 97%. The addition of Menara Shell will also boost the rental contributions from its KL Sentral assets as a percentage of the portfolio's total gross rental income to 56% (from 39%). We deem this positive, as the area is an integrated transit hub and a prime commercial area within Kuala Lumpur.

Maintain BUY. We make no changes to our DDM-based MYR1.29 TP and BUY call. We expect its future growth prospects to remain positive, mainly due to potential further asset injections from its sponsor. This includes Celcom Tower in PJ Sentral, Petaling Jaya. We believe the REIT's relatively high dividend yield is also an attractive investment merit, given the current market uncertainties. The downside risks include prolonged weak domestic consumer sentiment, while stronger demand for its assets (leading to higher occupancy rates) and its assets' rental reversion rates are upside risks.

Forecasts and Valuations	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover (MYRm)	70	110	124	174	178
Net property income (MYRm)	53	87	94	132	137
Reported net profit (MYRm)	34.1	53.9	60.5	86.4	91.5
Total distributable income (MYRm)	34.1	53.9	60.5	86.4	91.5
DPS (MYR)	0.08	0.08	0.09	0.08	0.08
DPS growth (%)	0.0	(1.3)	4.1	(9.3)	4.2
Recurring P/E (x)	13.3	12.8	12.7	14.3	13.5
P/B (x)	0.84	0.84	0.92	0.92	0.92
Dividend Yield (%)	7.2	7.1	7.4	6.7	7.0
Return on average equity (%)	6.3	7.4	5.4	6.4	6.8
Return on average assets (%)	3.9	4.3	3.1	3.8	4.0
Interest cover (x)	3.38	2.95	3.20	3.19	3.32
Our vs consensus EPS (adjusted) (%)			(1.6)	(15.7)	(10.8)

Source: Company data, RHB

Share Data

Avg Daily Turnover (MYR/USD) 0.22m/0.05m
52-wk Price low/high (MYR) 1.01 - 1.19
Free Float (%) 40
Shares outstanding (m) 661
Estimated Return 11%

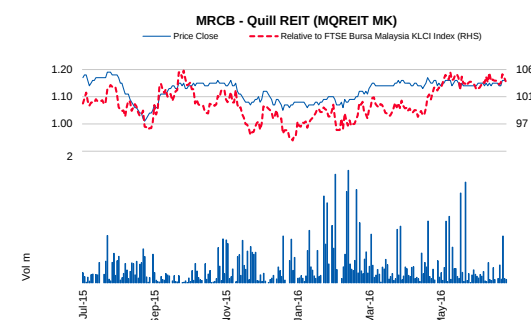
Shareholders (%)

CapitaCommercial Trust 30.0
Quill Group 30.0

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	7.4	1.8	0.0	8.4	(0.9)
Relative	9.7	0.3	3.7	10.7	2.2

Source: Bloomberg



Source: Bloomberg

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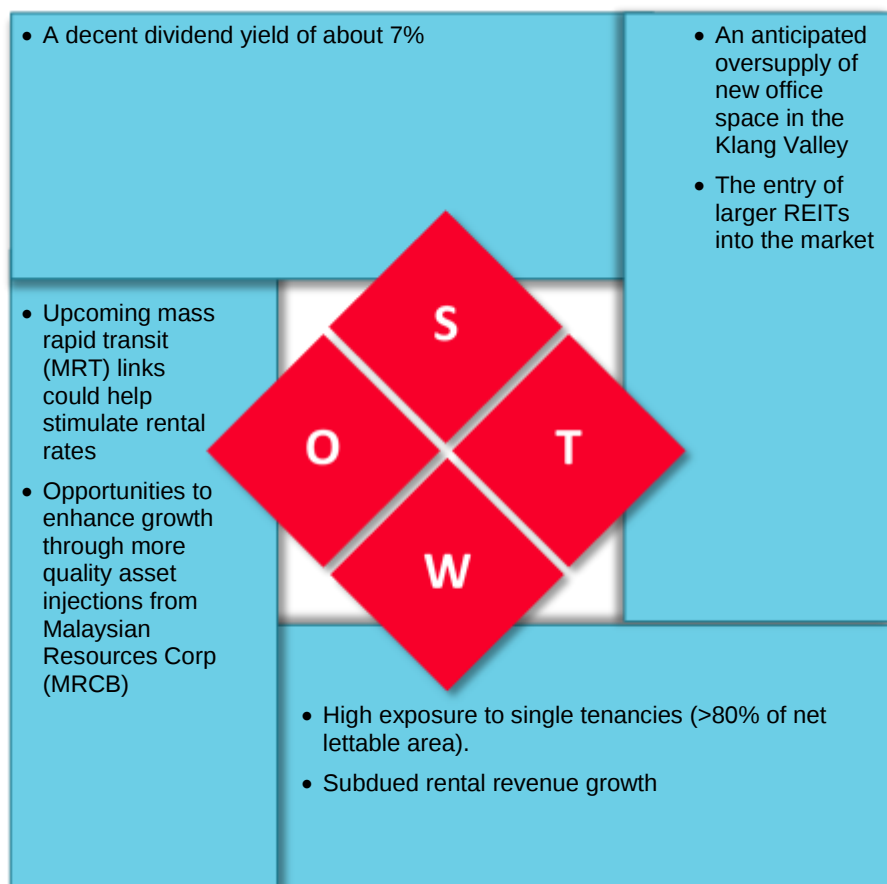
Financial Exhibits

Financial model updated on: 2016-07-01.

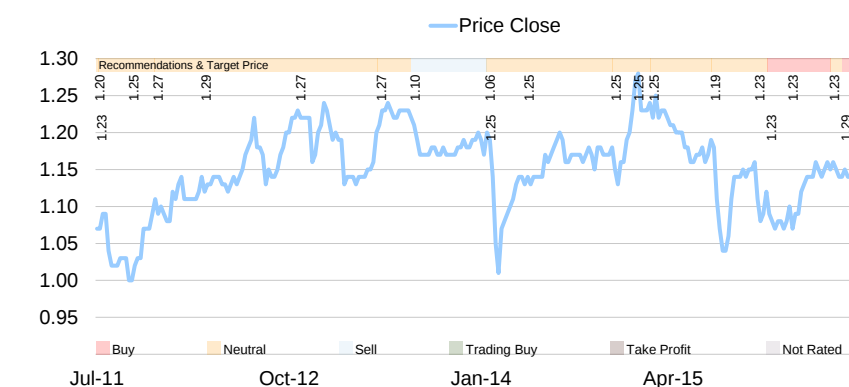
Asia	Financial summary	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Malaysia	Recurring EPS (MYR)	0.09	0.09	0.09	0.08	0.09
Property	EPS (MYR)	0.09	0.09	0.09	0.08	0.09
MRCB-Quill REIT	DPS (MYR)	0.08	0.08	0.09	0.08	0.08
Bloomberg	BVPS (MYR)	1.39	1.38	1.26	1.26	1.26
MQREIT MK	Weighted avg adjusted shares (m)	390	594	661	1,068	1,068
Buy						
Valuation basis	Valuation metrics	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
DDM-based.	Recurring P/E (x)	13.3	12.8	12.7	14.3	13.5
	P/E (x)	13.3	12.8	12.7	14.3	13.5
	P/B (x)	0.84	0.84	0.92	0.92	0.92
Key drivers	FCF Yield (%)	5.5	7.4	(48.0)	6.7	7.1
Improvement in domestic consumer sentiment leading to strong consumer spending.	Dividend Yield (%)	7.2	7.1	7.4	6.7	7.0
	EV/EBITDA (x)	(2.20)	(1.59)	(1.91)	(2.26)	(2.19)
	EV/EBIT (x)	(2.20)	(1.59)	(1.91)	(2.26)	(2.19)
Key risks	Income statement	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Downside risks include prolonged weak domestic consumer sentiment, while upside risks include:	Total turnover (MYRm)	70.2	109.6	123.9	174.3	177.8
i. Stronger demand for its assets leading to higher occupancy rates;	EBITDA (MYRm)	47.4	80.4	87.0	124.8	129.9
ii. Rental reversion rates at its assets.	Operating profit (MYRm)	47.4	80.4	87.0	124.8	129.9
	Net interest (MYRm)	(13.3)	(26.5)	(26.5)	(38.4)	(38.4)
	Pre-tax profit (MYRm)	34.1	53.9	60.5	86.4	91.5
	Recurring net profit (MYRm)	34.1	53.9	60.5	86.4	91.5
Company Profile	Cash flow (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
MRCB-Quill REIT is a mid-cap MREIT that focuses on office/commercial assets. These assets are largely concentrated in the Klang Valley and Cyberjaya areas.	Change in working capital	(3.1)	(3.3)	(3.5)	(3.6)	(3.8)
	Cash flow from operations	31.1	52.6	59.1	84.8	89.6
	Capex	(6.0)	(2.0)	(427.0)	(2.0)	(2.0)
	Cash flow from investing activities	(6.0)	(2.0)	(427.0)	(2.0)	(2.0)
	Proceeds from issue of shares	0.2	365.3	0.0	0.0	0.0
	Dividends paid	(32.7)	(40.9)	(53.0)	(70.2)	(85.1)
	Cash flow from financing activities	(32.2)	722.4	176.0	(70.2)	(85.1)
	Balance sheet (MYRm)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
	Total cash and equivalents	23	60	248	260	263
	Total investments	839	1,552	2,192	2,192	2,192
	Total other assets	0	0	0	0	0
	Total assets	868	1,637	2,296	2,300	2,304
	Other liabilities	8	8	8	8	8
	Total liabilities	327	725	954	955	955
	Shareholders' equity	541	911	1,342	1,345	1,350
	Total equity	541	911	1,342	1,345	1,350
	Net debt	282	643	684	672	669
	Total liabilities & equity	868	1,637	2,296	2,300	2,304
	Key metrics	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
	Revenue growth (%)	1.9	56.0	13.1	40.7	2.0
	Recurrent EPS growth (%)	(1.2)	3.8	0.8	(11.6)	5.8
	Operating EBITDA margin (%)	67.5	73.4	70.2	71.6	73.1
	Net profit margin (%)	48.6	49.2	48.9	49.6	51.4
	Dividend payout ratio (%)	95.8	91.0	91.0	91.0	91.0
	Capex/sales (%)	8.6	1.8	344.6	1.1	1.1
	Interest cover (x)	3.38	2.95	3.20	3.19	3.32

Source: Company data, RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2016-05-31	Buy	1.29	1.14
2016-05-03	Neutral	1.23	1.14
2016-01-25	Buy	1.23	1.08
2015-12-04	Buy	1.23	1.12
2015-11-06	Neutral	1.23	1.16
2015-07-23	Neutral	1.19	1.19
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

Source: RHB, Bloomberg

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

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