

MRCB-Quill REIT (BUY ↔, EPS ↔)

INDUSTRY: OVERWEIGHT
EARNINGS EVALUATION
27 October 2016
Target Price: RM1.34 (↔)
Share Price: RM1.27

9MFY16 Results: Steady as it grows

Results

- Reported 9MFY16 gross revenue of RM97.7m (+18.3% yoy), which translated to normalised net profit of RM45.8m (+23.7% yoy), accounting for 77.8% and 78.8% of HLIB and consensus FY forecasts, respectively.

Deviations

- Lower than expected property operating expenses.

Dividends

- None as it is usually declared on a semi-annual basis.

Highlights

- Yoy**, higher revenue (+2.2%) recorded due to additional revenue from Platinum Sentral and higher rental income from step-up rent adjustment of some properties. Excluding one off gain from divestment of Quill Building 10 last year, net profit recorded a marginal increase of 0.6% given higher expenses incurred.
- Qoq**, lower revenue (-0.2%) was recorded due to lower rental income from QB8 while operating expenses were marginally higher, resulting net income contracted by 1%.
- YTD**, revenue grew (+18.3%) due to additional income from Platinum Sentral and step-up rent adjustments. Growth in bottom-line was higher (+23.7%) as operating expenses were well managed.
- Overall occupancy rate was healthy at 97.2%. In terms of renewals, 64% of lease expiry in FY16 (7% of total NLA) has been renewed with only 8% not renewed.
- Despite the lacklustre office market, MQREIT's office space is relatively stable and well-guarded from its long WALE (>5 years) with well-spread NLA expiry (13% and 26% expiring in FY17 and FY18, respectively).
- Once the acquisition of Menara Shell is concluded, asset size will grow to circa. RM2.27bn, which allows management to achieve greater scale in asset management. The potential yield accretive asset injection is expected to complete by end of year and will be funded via placement exercises with equity/debt ratio of circa 65/35.

Risks

- High gearing compare to industry average.
- Slower rental reversion rate for office market.

Forecasts

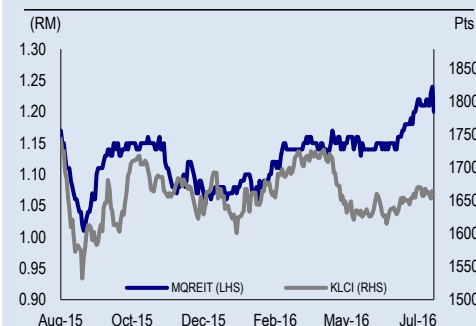
- We lower our property operating expenses assumption for FY16, resulting in higher PAT by 1.9% and higher DPU at 8.5 sen while leaving FY17 & 18 numbers unchanged.

Rating
BUY ↔, TP: RM1.34 ↔
Valuation

- Maintain **BUY** recommendation with unchanged TP of **RM1.34** based on targeted yield of 6.5% (2SD below 1 year historical average yield spread of MRCB-Quill REIT and 10-year government bond).

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KLCI	1673.9
Expected share price return	5.5%
Expected dividend return	6.9%
Expected total return	12.4%

Share price

Information

Bloomberg Ticker	MQREITMK
Bursa Code	5123
Issued Shares (m)	661
Market cap (RM m)	840
3-mth avg. volume ('000)	366
SC Shariah-compliant	No

Price Performance	1M	3M	12M
Absolute	0.8	5.0	9.5
Relative	0.2	4.3	11.0

Major Shareholders

MRCB	31.2%
Capita Commercial Trust	17.7%
Quill Group	17.7%

Summary Earnings Table

FYE Dec (RMm)	2015A	2016E	2017F	2018F
Revenue	115.2	132.6	185.9	189.6
NPI	90.3	99.9	139.2	142.0
Netinvestincome	98.5	101.2	140.7	143.6
PAT	60.7	60.0	85.0	88.7
EPU (sen)	10.2	9.1	7.9	8.2
Norm. PER (x)	14.2	14.0	16.1	15.5
FDPER (x)	14.2	14.0	16.1	15.5
EV/ EBITDA (x)	17.2	16.4	17.8	17.5
NetDPU (sen)	8.5	8.5	8.7	9.0
Distb. yield (%)	6.7	6.7	6.8	7.1
BVPS (RM)	1.5	1.4	1.2	1.2
P/B (x)	0.8	0.9	1.0	1.0

HLIB

Figure #1 Quarterly Results Comparison

FYE Dec (RMm)	3Q15	2Q16	3Q16	YoY (%)	QoQ (%)	Comments
Gross revenue	31.81	32.57	32.50	2.16	(0.21)	Yoy: Higher due to additional revenue from Platinum Sentral, higher rental income due to step up rent adjustment from QB2, QB3 and Wisma Technip. Qoq: Lower due to lower rental income from QB8.
Property operating expenses	(6.33)	(6.87)	(6.97)	10.17	1.52	Higher due to higher repairs & maintenance costs incurred.
Net property income	25.49	25.70	25.53	0.17	(0.67)	
Interest income	0.35	0.38	0.48	35.18	25.15	Higher due to higher bank balances.
Gain on divestment	0.59	0.00	0.00	NM	NM	
Net investment income	26.43	26.08	26.00	(1.62)	(0.29)	
Finance costs	(8.32)	(7.98)	(8.10)	(2.58)	1.57	Yoy: Lower borrowings after the redemption of RM140 Junior CPs. Qoq: Increase due to additional day in current quarter.
Valuation fees	(0.05)	(0.08)	(0.07)	36.85	(21.21)	
Administrative expenses	0.20	(0.06)	(0.02)	(110.90)	(62.67)	
Total Expenses	(10.70)	(10.70)	(10.78)	0.74	0.70	
Normalised PBT	15.14	15.38	15.23	0.58	(0.98)	
Normalised PAT	15.14	15.38	15.23	0.58	(0.98)	Yoy: As a result of higher revenue and lower finance cost (excl. gain on divestment). Qoq: Lower due to lower revenue and higher expenses & finance cost.
EPU (realised)	2.29	2.33	2.30	0.58	(0.98)	Normalised realized EPU.
DPU (sen)	0.00	4.23	0.00	NM	NM	

Company Data, HLIB

Figure #2 Cumulative Results Comparison

FYE Dec (RMm)	9MFY15	9MFY16	YoY (%)	Comments
Gross revenue	82.60	97.72	18.31	Higher attributable to additional revenue arising from the acquisition of Platinum Sentral on 30 Mar 2015, and higher rental rates for other properties.
Property operating expenses	(19.12)	(21.04)	10.07	Higher due to acquisition of Platinum Sentral.
Net property income	63.48	76.68	20.79	
Interest income	0.62	1.25	100.59	
Gain on divestment	0.59	NM	NM	
Net investment income	64.69	77.92	20.45	
Finance costs	(20.04)	(23.94)	19.42	Higher due to financial drawdown for acquisition.
Valuation fees	(0.14)	(0.18)	28.48	
Administrative expenses	(0.31)	(0.23)	(25.19)	
Total Expenses	(27.05)	(32.08)	18.60	
Normalised PBT	37.05	45.84	23.73	
Normalised PAT	37.05	45.84	23.73	Higher net property income, net cost and expense.
EPU (realised)	6.58	6.93	5.36	
DPU (sen)	4.10	4.23	3.17	

Company Data, HLIB

Figure #3 9MFY16 Results vs. HLIB's Estimates and Consensus

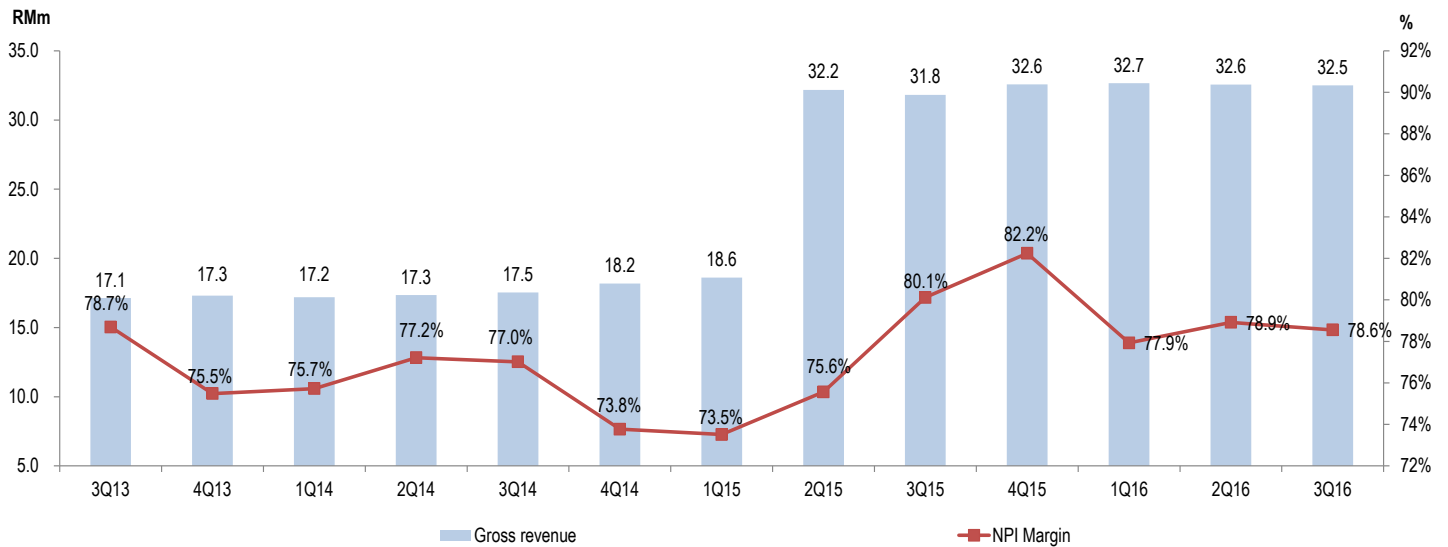
	Actual FY16	HLIB FY16	Actual vs. HLIB (%)	Consensus FY16	Actual vs. Consensus (%)	Comments
Revenue	97.7	132.6	73.7	126.6	77.2	In line.
Normalised PAT	45.8	58.9	77.8	58.7	78.1	Slightly above.
EPU (sen)	6.9	8.9	77.8	8.8	78.8	Slightly above.
DPU (sen)	4.2	8.4	50.2	8.5	49.8	In line.

Company Data, HLIB, Bloomberg

Figure #4 HLIB Forecasts vs. Consensus

RMm	FY17E			FY18F		
	HLIB	Consensus	%	HLIB	Consensus	%
Normalised PAT	85.1	88.4	(3.7)	92.1	92.1	0.0
DPU (sen)	8.7	8.1	7.3	9.0	8.3	8.0

HLIB, Bloomberg

Figure #5 Gross Revenue & NPI Margin

HLIB, Bloomberg

Figure #6 Peers Comparison

Company	FYE	Price	Market Cap (m)	P/E (x)		P/B (x)		Gross DY (%)
				2016	2017	2016	2017	2016
Amanah Harta Tanah PNB	Dec	MYR 1.02	102.0	NA	NA	NA	NA	NA
Al'Aqar Healthcare REIT	Dec	MYR 1.55	1,128.8	17.8	17.6	1.3	1.3	5.5
AmFIRST Real Estate Investment Trust	Mar	MYR 0.83	566.3	20.6	20.6	0.7	0.7	4.8
Amanahraya Real Estate Investment Trust	Dec	MYR 0.95	541.7	14.5	14.1	NA	NA	7.0
Atrium Real Estate Investment Trust	Dec	MYR 1.11	135.2	NA	NA	NA	NA	NA
Axis Real Estate Investment Trust	Dec	MYR 1.74	1,923.0	20.7	19.9	1.5	1.5	5.0
CapitalMalls Malaysia Trust	Dec	MYR 1.55	3,148.8	18.9	17.8	1.2	1.2	5.5
Hektar Real Estate Investment Trust	Dec	MYR 1.64	657.0	14.3	13.7	1.1	1.1	6.7
IGB Real Estate Investment Trust	Dec	MYR 1.62	5,651.0	16.5	16.2	1.5	1.6	5.3
KLCCP Stapled Group	Dec	MYR 7.80	14,081.6	19.3	18.3	1.0	0.9	4.6
MRCB-Quill Real Estate Investment Trust	Dec	MYR 1.27	840.0	14.0	16.1	0.9	1.1	6.7
Pavilion Real Estate Investment Trust	Dec	MYR 1.75	5,289.4	20.6	18.2	1.3	1.3	4.9
Al-Salam Real Estate Investment Trust	Mar	MYR 1.04	603.2	19.6	16.5	1.0	1.0	4.8
Sunway Real Estate Investment Trust	Jun	MYR 1.75	5,153.9	19.9	19.2	1.3	1.3	5.2
Tower Real Estate Investment Trust	Dec	MYR 1.20	336.6	NA	NA	NA	NA	NA
UOA Real Estate Investment Trust	Dec	MYR 1.73	731.6	15.7	15.7	1.0	1.0	6.4
YTL Hospitality REIT	Jun	MYR 1.20	1,589.3	26.7	22.6	1.0	1.0	6.3
Average				18.5	17.6	1.1	1.2	5.6

HLIB, Bloomberg

MRCB-Quill REIT (BUY, TP: RM1.34, CP: RM1.27)**Income Statement**

FYE Dec (RM m)	2014A	2015A	2016E	2017F	2018F
Gross rental income	59.3	99.5	116.8	166.3	169.7
Car park income	5.2	10.3	10.3	13.9	14.2
Other revenue	5.7	5.4	5.6	5.7	5.8
Total Revenue	97.7	115.2	132.6	185.9	189.6
Assessment & quit rent	(2.8)	(4.5)	(5.5)	(7.8)	(8.0)
Depreciation	0.0	(0.0)	(0.0)	(0.0)	(0.0)
Insurance	(0.4)	(0.7)	(0.9)	(1.2)	(1.3)
Property management fees	(2.0)	(2.2)	(3.5)	(5.0)	(5.1)
Service contracts	(4.7)	(7.3)	(8.9)	(12.6)	(12.9)
Utilities	(7.0)	(10.2)	(14.0)	(20.0)	(20.4)
Total Opex	(21.0)	(24.9)	(32.8)	(46.7)	(47.6)
Net property income	76.7	90.3	99.9	139.2	142.0
Net investment income	77.9	98.5	101.2	140.7	143.6
Pretax profit	45.8	60.7	60.0	85.0	88.7
Taxation	0.0	0.0	0.0	0.0	1.0
Net profit	34.2	53.4	60.0	85.0	88.7
No of units (m)	390.1	596.0	661.4	1,075.4	1,082.8
EPU (sen)	10.3	10.2	9.1	7.9	8.2

Cash Flows

FYE Dec (RM m)	2014A	2015A	2016E	2017F	2018F
PBT	40.3	60.7	60.0	85.0	88.7
Finance costs	14.1	28.0	0.0	0.0	0.0
Depreciation	0.0	0.0	0.0	0.0	0.0
Fair value gain of assets	(6.1)	(7.3)	0.0	0.0	0.0
Interest income	(0.7)	(0.9)	0.0	0.0	0.0
Others	(16.4)	(21.5)	3.4	5.0	0.3
Operating cashflow	31.1	59.0	63.4	90.0	89.0
Capex	(6.0)	(751.9)	(2.0)	(658.0)	(2.0)
Disposal / (purchase)	(0.0)	(0.2)	(0.0)	(0.0)	(0.0)
Others	0.0	24.9	0.0	0.0	0.0
Investing Cashflow	(6.0)	(727.3)	(2.0)	(658.0)	(2.0)
Distribution paid	(32.7)	(38.7)	(56.4)	(84.2)	(87.8)
Proceeds from borrowings	15.0	534.0	190.0	229.0	100.0
Repayment of borrowings	(15.0)	(145.0)	(190.0)	0.0	(117.0)
Financing cashflow	0.0	342.0	0.0	427.0	0.0
Net cash flow	(32.7)	350.3	(56.4)	144.8	(104.8)

Balance Sheet

FYE Dec (RM m)	2014A	2015A	2016E	2017F	2018F
PPE	0.0	0.2	0.2	0.2	0.2
Investment properties	837.7	1,569.8	1,571.8	2,229.8	2,231.8
Derivatives	1.2	1.6	1.6	1.6	1.6
Non-current assets	838.9	1,571.6	1,573.6	2,231.6	2,233.6
Trade receivables	6.1	5.7	6.6	9.3	9.5
Cash	23.3	44.9	49.9	53.7	35.9
Total Current Assets	29.4	51.3	57.2	63.6	46.0
Total assets	868.4	1,622.9	1,630.8	2,295.3	2,279.7
Unitholders' capital	411.7	751.3	751.3	1,178.3	1,178.3
Undistributed profit	129.5	152.6	156.2	157.0	157.9
Total Equity	541.3	903.9	907.5	1,335.3	1,336.2
Borrowings	305.1	689.7	689.7	918.7	901.7
Security Deposits	9.8	18.1	18.1	18.1	18.1
Derivatives	0.0	0.0	0.0	0.0	0.0
Trade payables	12.2	13.6	17.9	25.6	26.1
Total liabilities	327.1	721.5	725.8	962.4	945.9
Total liabilities & equity	868.4	1,625.3	1,633.2	2,297.7	2,282.1

Valuation Ratios

FYE Dec (RM m)	2014A	2015A	2016E	2017F	2018F
EPU before mgr's fee	8.8	9.0	9.1	7.9	8.2
EPU after mgr's fee	10.3	10.2	9.1	7.9	8.2
PER (x)	14.5	14.2	14.0	16.1	15.5
No of units	390.1	596.0	661.4	1,075.4	1,082.8
Net DPU	8.4	8.5	8.5	8.7	9.0
Net DY (%)	6.6	6.7	6.7	6.8	7.1
NTA/ share (sen)	137.7	151.0	136.3	123.5	122.7
P/NTA (x)	0.9	0.8	0.9	1.0	1.0
FCF/ share (sen)	17.9	16.2	18.4	16.4	18.1
FCF yield (%)	14.1	12.7	14.5	12.9	14.2
Enterprise value	777.3	1,401.8	1,479.8	2,230.9	2,241.1
EV/ EBITDA (x)	16.1	17.2	16.4	17.8	17.5
ROE (%)	7.4	6.7	6.6	6.4	6.6
Net gearing (x)	0.3	0.4	0.4	0.4	0.4
Total gearing (x)	0.4	0.4	0.4	0.4	0.4
BVPS (RM)	1.4	1.5	1.4	1.2	1.2
P/B (x)	0.9	0.8	0.9	1.0	1.0

Assumption metrics

Gross Rental Income	2016E	2017F	2018F
Quill Building 1 - DHL 1	4.7	4.8	4.9
Quill Building 4 - DHL 2	5.1	5.2	5.3
Quill Building 2 - HSBC	9.4	9.6	9.8
Quill Building 3 - BMW	4.9	5.0	5.1
Wisma Technip	11.9	12.2	12.4
Part of Plaza Mont' Kiara	3.8	3.9	4.0
Quill Building 5 - IBM	3.8	3.9	4.0
Quill Building 6 - DHL XPJ	3.1	3.1	3.2
Tesco Building - Penang	14.1	14.4	14.6
Platinum Sentral	55.9	57.0	58.2
Menara Shell	0.0	47.2	48.1
Total	116.8	166.3	169.7

Quarterly Financial Summary

FYE Dec (RM m)	3Q15	2Q16	3Q16	YoY (%)	QoQ (%)
Gross revenue	31.8	32.6	32.5	2.2	(0.2)
Property operating expenses	(6.3)	(6.9)	(7.0)	10.2	1.5
Net property income	25.5	25.7	25.5	0.2	(0.7)
Interest income	0.4	0.4	0.5	35.2	25.2
Revaluation gains	0.0	0.0	0.0	NM	NM
Net investment income	26.4	26.1	26.0	(1.6)	(0.3)
Finance costs	(8.3)	(8.0)	(8.1)	(2.6)	1.6
Valuation fees	(0.0)	(0.1)	(0.1)	36.8	(21.2)
Administrative expenses	0.2	(0.1)	(0.0)	(110.9)	(62.7)
Total Expenses	(10.7)	(10.7)	(10.8)	0.7	0.7
Normalised PBT	15.1	15.4	15.2	0.6	(1.0)
Normalised PAT	15.1	15.4	15.2	0.6	(1.0)
EPU after mgmt fee	2.3	2.3	2.3	0.6	(1.0)
DPU (sen)	0	4	0	NM	NM

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2. As of 27 October 2016, the analyst, Lee Meng Horng who prepared this report, has interest in the following securities covered in this report:

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Published & Printed by
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Equity rating definitions

BUY	Positive recommendation of stock under coverage. Expected absolute return of more than +10% over 12-months, with low risk of sustained downside.
TRADING BUY	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between -10% and +10% over 12-months, with low risk of sustained downside.
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NOT RATED	No research coverage, and report is intended purely for informational purposes.

Industry rating definitions

OVERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of more than +5% over 12-months.
NEUTRAL	The sector, based on weighted market capitalization, is expected to have absolute return between -5% and +5% over 12-months.
UNDERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of less than -5% over 12-months.