

MRCB-Quill REIT

1Q18 Well Within Expectations

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1Q18 realised net income (RNI) of RM21.0m is well within our and market expectations at 23% each. No dividend, as expected. FY18-19 will see minimal lease expiries of 28-15%. Maintain FY18-19E CNP of RM90.4-90.7m. Downgrade to MARKET PERFORM on an unchanged TP of RM1.15 as our OP conviction call has been favourable with MQREIT rallying 12% since our 2Q18 Strategy and most positives priced in.

1Q18 realised net income (RNI) of RM21m came in within both our and consensus expectations at 23% each. No dividend, as expected.

Results Highlights. YoY-Ytd, top-line was down by 3% mainly from lower revenue generated from Platinum Sentral and Menara Shell, likely due to tenant incentives. Additionally, higher operating cost (+3%) from slightly higher routine operating expenses for some properties, and higher expenditure (+17%) due to; (i) increased administrative expense from the disposal of QB8-DHL, and (ii) higher valuation fees, caused RNI to decline by 9%. QoQ, top-line was rather flattish (-1%) likely due to similar reasons mentioned above, but operating cost also declined (-3%) allowing NPI margins to remain flat at 78%. All in, RNI declined by 2% on the back of higher expenditure (+12%) on increased administrative expense from the disposal of QB8-DHL despite lower finance cost (-12%) on lesser number of days in 1Q18 vs. 4Q17.

Outlook. FY18-19E leases up for expiry are minimal at 28-15% of net lettable assets (NLA) which is preferable under current market condition where the office market is facing an oversupply situation, and risk of tenant attrition. As such, we are expecting flattish to mildly negative reversion in FY18-19 (*refer overleaf*).

We maintain FY18-19E CNP of RM90.4-90.7m. Our FY18-19E GDPU of 8.30-8.20 sen (NDPU of 7.50-7.40 sen), suggest gross yields of 7.4-7.3% (net yields of 6.7-6.6%).

Downgrade to MARKET PERFORM (from OP) on an unchanged TP of RM1.15. We maintain our +3.3ppt spread to the 10-year MGS target of 4.00%, based on FY18E GDPS of 8.30 sen. Our applied MREITs' spread is +0.5SD above historical averages to encapsulate investors' concerns of oversupply issues and OPR hikes, but we may look to remove this going forward once confidence returns to the sector (i.e. consistent earnings delivery suggesting that oversupply fears are exaggerated, and confirmation of a low probability of a second OPR hike).

We are comfortable with our MP call as our conviction OP call has been favourable with MQREIT rallying 12% since being named our Top Pick in our 2Q18 MREITs Strategy (*dated 4th April 2018*) vs. *other MREITs peers* of (7-17%). That said, we believe most positives are priced in at current levels, while we remain cautiously optimistic as we are still pricing in oversupply and OPR concerns that may affect valuations. At current levels, MQREIT's FY18E gross yield of 7.4% (net: 6.7%) remains above large cap MREITs' (>RM1b) average of 6.0% (net: 5.3%) but we believe this is likely due to the fact that; (i) MQREIT is slightly smaller than large cap REITs, and (ii) the office segment is still being weighed down by perceptions of an oversupply situation (vs. retail and industrial assets), which we have priced in our spreads.

Risks to our call include bond yield expansions or compressions and weaker-than-expected rental reversions.

MARKET PERFORM

Price: **RM1.12** ↓
Target Price: **RM1.15** ↔

Share Price Performance



KLCI	1854.44
YTD KLCI chg	3.2%
YTD stock price chg	-10.4%

Stock Information

Shariah Compliant	No
Bloomberg Ticker	MQREIT MK Equity
Market Cap (RM m)	1,200.4
Issued shares	1,071.8
52-week range (H)	1.36
52-week range (L)	1.00
3-mth avg daily vol:	656,925
Free Float	54%
Beta	0.8

Major Shareholders

Malaysian Resources Corporation Berhad	27.8%
CapitaCommercial Trust	10.9%
Employees Provident Fund Board	7.2%

Summary Earnings Table

FY Dec (RM'm)	2017A	2018E	2019E
Turnover	180.1	184.3	184.1
EBIT	126.4	128.0	127.8
PBT	71.3	91.6	90.7
Net Profit	71.3	91.6	90.7
Core NP*	88.0	90.4	90.7
Consensus (CNP)	n.a.	90.9	93.2
Earnings Revision	n.a.	n.a.	n.a.
Core EPS (sen)	8.2	8.4	8.3
Core EPS growth (%)	-17%	1%	-1%
NDPS (sen)	7.6	7.5	7.4
BVPS (RM)	1.29	1.28	1.28
Core PER	13.6	13.4	13.5
Price/BV (x)	0.9	0.9	0.9
Gearing (x)	0.37	0.38	0.38
Net Div. Yield (%)	6.7	6.7	6.6

*Core NP refers to RNI

*FY18-19E per share data is based on our enlarged share base of 1081-1094m on additions from managers fee's



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OTHER POINTS

Outlook. We expect capex in FY18-19 of RM12-10m, mostly for maintenance. MQREIT's disposal of QB8-DHL was completed in mid-April 2018, but this is mostly neutral to FY18E CNP as we expect the net gains on disposal of 0.12 sen per unit to offset the loss of income, while the impact to our FY19 forecast is negligible at <2% of RNI.

Result Highlight						
	FYE 31 Dec (RM'm)	1Q18	4Q17	QoQ	1Q17	YoY
Gross revenue		44.0	44.7	-1%	45.6	-3%
Prop Opex		-9.8	-10.0	-3%	-9.4	3%
NPI excl unrealised rental income		34.3	34.6	-1%	36.1	-5%
Interest Income		0.7	1.7	-58%	0.5	61%
Gain on divestment prop		0.0	0.0	n.a.	0.0	n.a.
Surplus on revaluation		0.0	-18.2	-100%	0.0	n.a.
Total Trust Income		35.0	18.2	92%	36.6	-4%
Expenditure		-4.3	-3.9	12%	-3.7	17%
Finance Cost		-9.7	-11.0	-12%	-9.7	0%
Income Before Tax		21.0	3.3	529%	23.2	-9%
Tax		0.0	0.0	n.a.	0.0	n.a.
Net Income		21.0	3.3	529%	23.2	-9%
Realised Net income (RNI)		21.0	21.4	-2%	23.2	-9%
EPU (sen)		1.97	2.01	-2%	2.17	-9%
DPU (sen)		0.00	4.16	-100%	0.00	n.a.
NAV/unit (RM)		1.27	1.30		1.30	
Gearing (x)		0.38	0.37		0.37	
NPI Margins		78%	78%		79%	
RNI Margins		48%	48%		51%	

Source: Company, Kenanga Research

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Peer Comparison

NAME	Price (17/5/18)	Mkt Cap	PER (x)			Est. NDiv. Yld. **	Historical ROE	P/BV	Net Profit (RMm)			FY18/19 NP Growth (%)	FY19/20 NP Growth (%)	Target Price	Rating
	(RM)	(RMm)				(%)	(%)	(x)							
			FY17/18	FY18/19	FY19/20					FY17/18	FY18/19	FY19/20			(RM)
M-REIT & PROPERTY INVESTMENT UNDER COVERAGE															
KLCCSS *	7.82	14,118	21.0	19.6	19.3	4.5%	5.2%	1.1	671.5	719.2	731.7	7.1%	1.7%	7.00	UNDERPERFORM
Pavilion REIT	1.46	4,430	19.0	17.5	16.6	5.3%	6.0%	1.1	232.4	251.8	266.6	8.3%	5.9%	1.55	OUTPERFORM
IGB REIT*	1.57	5,534	18.0	18.3	17.8	5.5%	8.1%	1.5	303.4	303.9	312.2	0.2%	2.7%	1.50	MARKET PERFORM
Sunway REIT*	1.70	5,007	18.5	17.0	16.8	5.3%	8.0%	1.1	267.4	294.0	298.0	9.9%	1.4%	1.60	MARKET PERFORM
CapitaMalls (M) Trust*	1.15	2,347	14.7	14.4	14.2	6.3%	6.3%	1.0	167.4	164.0	165.0	-2.0%	0.6%	1.30	OUTPERFORM
Axis REIT*	1.47	1,812	19.9	18.1	16.5	5.0%	8.1%	1.1	90.8	99.6	110.1	9.7%	10.5%	1.30	MARKET PERFORM
MRCB-Quill REIT	1.12	1,200	13.7	13.3	13.5	6.7%	6.1%	0.9	88.0	90.4	90.7	2.7%	0.3%	1.15	MARKET PERFORM
* Core NP and Core PER															
CONSENSUS NUMBERS															
YTL Hospitality REIT	1.12	1,909	16.9	13.5	13.0	7.6%	5.0%	0.8	141.3	147.0	151.5	4.1%	3.1%	1.36	BUY
Al-'Aqar Healthcare REIT	1.24	903	10.7	21.0	n.a.	7.1%	9.3%	1.0	64.3	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
AmanahRaya REIT	0.85	484	15.3	11.7	n.a.	8.2%	4.5%	0.7	41.0	n.a.	n.a.	n.a.	n.a.	0.96	BUY
AmFIRST REIT	0.61	415	36.4	n.a.	n.a.	n.a.	1.3%	0.5	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
Hektar REIT	1.22	563.6	15.9	n.a.	n.a.	n.a.	5.3%	0.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
Tower REIT	0.99	277.7	15.7	n.a.	n.a.	n.a.	3.3%	0.5	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
UOA REIT	1.45	613.2	16.2	n.a.	n.a.	n.a.	5.4%	0.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
Atrium REIT	1.07	130.3	7.1	n.a.	n.a.	n.a.	10.3%	0.7	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY
Al-Salam REIT	0.85	493.0	12.1	13.7	13.5	6.2%	6.6%	0.8	36.1	36.6	38.9	1.4%	6.3%	1.00	BUY
KIP REIT	0.78	394	n.a.	n.a.	n.a.	n.a.	n.a.	0.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	BUY

Source: Bloomberg, Kenanga Research

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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