

10 May 2019

Property | REITs

MRCB-Quill REIT (MQREIT MK)

Neutral (Maintained)

Office Occupancy Rates Still Under Pressure

Target Price (Return) MYR1.02 (-7%)
 Price: MYR1.10
 Market Cap: USD285m
 Avg Daily Turnover (MYR/USD) 0.18m/0.04m

- **Maintain NEUTRAL with new MYR1.02 TP from MYR1.05, 7% downside.** Dividend yield was above sector average but we believe this is fair, given its high occupancy risk. 1Q19 earnings met our but slightly below market expectations. With the oversupply of office space in Klang Valley, we expect occupancy rate to remain under pressure.
- **Earnings met.** MRCB-Quill's 1Q19 core net profit of MYR19.4m was in line making up 25 and 23% of ours and consensus full year estimates. 1Q19 revenue fell 6% YoY, mainly due to the lower income generated from Platinum Sentral, Wisma Technip and Quill Building 5 (QB5) as well as loss of revenue from the disposal of Quill Building 8 – DHL (QB8), which was sold in Apr 2018. In line with the drop in revenue, core net profit declined by 7.6% YoY. No dividend was declared during the quarter as the REIT distributes its income on semi-annual basis.
- **3% non-renewal for 1Q19.** Overall occupancy rate for all MQREIT's assets dropped to 89% as at Mar 2019 (from 96% in Mar 2018). In 1Q19, of the 3.1% of the REIT's total NLA up for renewal, only 0.1% was renewed. This was mainly due to the non-renewal of SPAD in Platinum Sentral. Having said that, we understand that the REIT has identified a new tenant to occupied the space. Currently, occupancy in Platinum Sentral and Menara Shell stands at 86% and 90%, down from 94% and 96% in Mar 2018.
- **16% still up for renewal this year.** We remain cautious on the REIT, with 16% of leases (from the total NLA) still up for renewal this year. This is mainly from the whole QB2- HSBC, which is due for renewal in 4Q19 with a total NLA of 184,000 sqf and some smaller tenants in Plaza Mont Kiara (27,000 sqf) and Menara Shell (30,000 sqf). Meanwhile, MyHSR (28,000 sqf) in the Platinum Sentral is also under short extension until 2Q19. We are concerned that the REIT may have to give in to rental rates in order to retain its tenants.
- **Potential acquisition.** Menara Celcom, Petaling Jaya was completed last year and is currently tenanted by Celcom. As this is one of the sponsor's assets, we think the asset is likely to be injected to the REIT in FY19, the earliest. Having said that, we understand negotiations between the asset sponsor and the REIT has yet to commence.
- **Updating our numbers.** With the continued drop in occupancy rates, we trim our FY19F-21F earnings by 1-3%. As such, our DDM-based TP is revised down to MYR1.02. Upside risk includes yield accretive acquisition, while downside risk includes prolong oversupply of office space that could lead to lower occupancy rates and negative rental reversion.

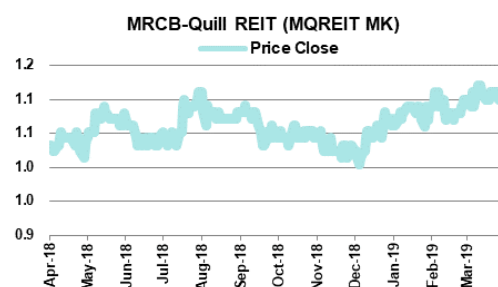
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	3.8	0.0	0.0	1.9	(0.9)
Relative	7.8	2.6	3.9	6.3	12.8
52-wk Price low/high (MYR)				1.04	1.19



Source: Bloomberg

Forecasts and Valuations	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (MYRm)	180	173	155	153	152
Net property income (MYRm)	140	134	119	118	117
Reported net profit (MYRm)	70	73	76	75	74
Total distributable income (MYRm)	88	85	76	75	74
DPS (MYR)	0.1	0.1	0.1	0.1	0.1
DPS growth (%)	0.1	(3.1)	(13.6)	(1.5)	(1.9)
P/BV (x)	0.90	0.91	0.91	0.91	0.91
Dividend Yield (%)	7.6	7.4	6.4	6.3	6.2
Return on average equity (%)	5.0	5.3	5.5	5.5	5.3
Return on average assets (%)	3.1	3.2	3.3	3.3	3.2
Interest cover (x)	3.5	3.3	3.3	3.3	3.3

Source: Company data, RHB

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Results At a Glance

Figure 1: MQREIT's 1Q19 results summary

FYE Dec (MYRm)	1Q18	4Q18	1Q19	QoQ (%)	YoY (%)	Comments
Revenue	44.0	42.7	41.4	(3.0)	(6.0)	Lower YoY due to loss of revenue from QB8 and lower revenue generated from Platinum Sentral, Wisma Technip and QB5
Net property income (NPI)	34.3	32.7	32.0	(1.9)	(6.5)	
Interest expense	(9.7)	(10.9)	(9.9)	(9.5)	1.7	
Interest income	0.7	1.7	0.8	(51.3)	13.5	
Associates	0.0	0.0	0.0	nm	nm	
EI	0.0	(5.4)	0.0	nm	nm	
Others	(4.3)	(3.9)	(3.6)	(6.6)	(16.4)	
Pretax profit	21.0	14.2	19.4	36.9	(7.6)	
Tax	0.0	(6.1)	0.0	nm	nm	
Minority Interest	0.0	(6.1)	0.0	nm	nm	
Net Profit	21.0	8.0	19.4	141.2	(7.6)	
Core Profit	21.0	19.6	19.4	(0.8)	(7.6)	Within expectations
Core earnings per unit (sen)	1.97	1.83	1.82	(0.7)	(7.6)	
Dividends per unit (sen)	0.00	3.85	0.00	nm	nm	
<i>NPI Margin (%)</i>	<i>77.8</i>	<i>76.6</i>	<i>77.4</i>			
<i>Pretax Margin (%)</i>	<i>47.7</i>	<i>33.2</i>	<i>46.9</i>			
<i>Net Margin (%)</i>	<i>47.7</i>	<i>45.9</i>	<i>46.9</i>			

Source: Company data, RHB

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