

HLIB Research

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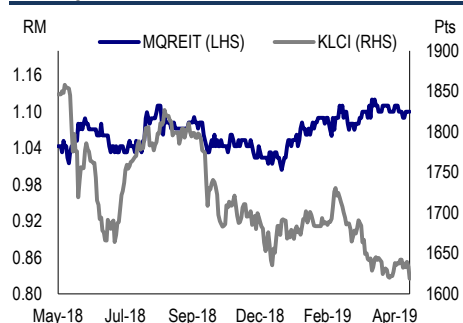
BUY (Maintain)

Target Price: **RM1.16**
Previously: **RM1.17**
Current Price: **RM1.10**

Capital upside 5.5%
Dividend yield 7.0%
Expected total return 12.5%

Sector coverage: REIT

Company description: MRCB-Quill REIT invests in office and retail buildings, business/technology parks, data processing centers, and car parking facilities primarily in Malaysia.

Share price


Historical return (%)	1M	3M	12M
Absolute	0.0	0.9	-1.8
Relative	1.4	5.2	12.0

Stock information

Bloomberg ticker	MQREIT MK
Bursa code	5123
Issued shares (m)	1,072
Market capitalisation (RM m)	1,179
3-mth average volume ('000)	170
SC Shariah compliant	No

Major shareholders

MRCB	27.8%
KWSP	12.0%
Capita Commercial Trust	11.0%

Earnings summary

FYE (Dec)	FY18	FY19f	FY20f
PAT – core	84.7	82.3	82.8
EPU – core (sen)	7.9	7.7	7.7
P/E (x)	13.9	14.3	14.2

MRCB-Quill REIT

Relatively steady office sector

MQREIT's 1Q19 core net profit RM19.4m (-1.0% QoQ, -7.6% YoY) was below both ours and consensus expectations. The decline was driven by lower revenue contribution, but slightly mitigated by lower property operating expenses and other expenses. We reduce our FY19-21 earnings forecasts by -1.7%, -1.6% and -1.8% respectively after factoring in lower interest income. We maintain BUY call with lower TP of RM1.16 (from RM1.17) based on targeted yield of 6.7%. We continue to like MQREIT given its attractive dividend yield of 7.0% (highest among REITs in our universe), stable assets in prime location of KL Sentral with stable occupancy rate.

Below expectations. 1Q19 gross revenue of RM41.4m (-3.0% QoQ, -6.0% YoY) translated into core net profit of RM19.4m (-1.0% QoQ, -7.6% YoY). The results were below both ours and consensus, accounting for 23.2% and 23.3%, respectively. The deviation was due to lower than expected interest income.

Dividend. None as dividend is usually payable semi-annually.

QoQ. Total gross revenue dipped by 3.0% to RM41.4m (from RM44.0m in 4Q18), followed by a decrease in core net profit at RM19.4m. The cutback was caused by poorer revenue contribution by Platinum Sentral, Wisma Technip and QB5. However, this was slightly cushioned by the decrease in property operating expenses (-6.5%) and other expenses (-8.8%).

YoY. Core net profit fell by 7.6% at RM19.4m. The decline was driven by lower revenue contribution; mainly from lower revenue from Platinum Sentral, Wisma Technip and QB5, as well as the loss of revenue after the disposal of QB8 back in April 2018. Nevertheless, the fall was marginally mitigated by the reduction in property operating expense attributed to lower expenses incurred by some properties.

Occupancy and gearing. Occupancy rate fell to 89% (FY18: 93%), relatively stable considering the average occupancy rate in Kuala Lumpur city stood at 78.7% in FY18 (Knight Frank). Average debt to maturity has decreased slightly from 2.47 years to 2.32 years, while average cost of debt was maintained at 4.5%. The gearing level decreased slightly to 37.5% (FY18: 37.7%), comfortably below the 50% limit, with a majority of its total borrowings being charged a fixed interest rate (76%).

Outlook. Despite the lacklustre overall office market, MQREIT's office space will remain relatively stable and well-guarded by its long weighted average term to expiry with well-spread NLA expiry. Going forward, management will be focusing on cost management as well as tenant retention over reversion growth. Also, with the expectations of a challenging office market, some properties will be scheduled for enhancement works; namely; Wisma Technip (washrooms and external façade), Quill Building 5 – IBM (air conditioning system), Platinum Sentral (several common area facilities upgrades) and Menara Shell (lift systems).

Forecast. We reduce our FY19-21 earnings forecasts by -1.7%, -1.6% and -1.8% respectively after factoring in lower interest income

Maintain BUY, TP: RM1.16. We maintain BUY with lower TP of RM1.16 (from RM1.17) based on targeted yield of 6.7%. To note, our valuation model is based on the targeted yield of 2-year historical average yield spread between dividend yield and 10-year MGS yield.

Financial Forecast

All items in (RM m) unless otherwise stated

Balance Sheet

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Cash	76.0	85.8	83.6	92.7	91.8
Receivables	6.0	6.7	6.7	6.7	6.8
Investment properties	2,179.2	2,177.6	2,179.6	2,181.6	2,183.6
PPE	0.2	0.3	0.3	0.2	0.2
Others	27.0	1.3	1.3	1.3	1.3
Assets	2,288.4	2,271.7	2,271.5	2,282.6	2,283.8
Payables	20.3	16.1	15.9	16.0	16.2
Debt	853.5	853.7	853.7	864.7	865.7
Security deposits	29.2	29.2	29.2	29.2	29.2
Derivatives	0.7	0.4	0.4	0.4	0.4
Liabilities	903.7	899.4	899.2	910.3	911.5
Unitholders' capital	1,231.9	1,235.9	1,235.9	1,235.9	1,235.9
Undistributed profit	152.8	136.4	136.4	136.4	136.4
Equity	1,384.7	1,372.3	1,372.3	1,372.3	1,372.3

Income Statement

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Gross rental income	163.5	155.0	154.2	155.2	156.2
Car park income	12.8	13.2	13.9	14.2	14.4
Other revenue	5.2	4.4	5.4	5.6	5.7
Total revenue	181.5	172.5	173.5	174.9	176.3
Property opex	-40.2	-39.7	-39.2	-39.4	-39.8
Net property income	141.3	132.8	134.3	135.5	136.5
Other income	-16.0	1.9	3.4	3.3	3.7
Net invest income	125.4	134.7	137.8	138.8	140.2
Manager's fee	-13.5	-13.3	-13.2	-13.3	-13.3
Trustee's fee	-0.7	-0.7	-0.7	-0.7	-0.7
Finance costs	-40.5	-40.6	-40.6	-41.1	-41.2
Other non opex	-0.8	-0.9	-1.0	-1.0	-1.0
Profit before tax	69.9	79.3	82.3	82.8	84.1
Taxation	0.0	-6.1	0.0	0.0	0.0
Profit after tax	69.9	73.1	82.3	82.8	84.1
Core net profit	88.1	84.7	82.3	82.8	84.1
Distributable income	92.1	87.1	82.3	82.8	84.1
Consensus core net profit			82.3	84.1	87.6
HLIB/ Consensus			100%	98%	96%

Cash Flow Statement

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Profit before taxation	69.9	79.3	82.3	82.8	84.1
Finance costs	40.5	40.6	0.0	0.0	0.0
Depreciation	0.1	0.1	0.1	0.1	0.1
Fair value gain of assets	18.2	5.4	0.0	0.0	0.0
Interest income	-3.6	-4.3	0.0	0.0	0.0
Others	3.8	-14.6	-0.3	0.1	0.1
CFO	128.8	106.5	82.1	82.9	84.2
Capex	-0.4	-3.8	-2.0	-2.0	-2.0
Disposal / (purchase)	0.0	-0.2	0.0	0.0	0.0
Others	2.2	31.7	0.0	0.0	0.0
CFI	1.8	27.6	-2.0	-2.0	-2.0
Distribution paid	-72.6	-89.8	-82.3	-82.8	-84.1
Proceeds frm borrow'g	189.7	117.0	0.0	400.0	165.0
Repayment of borrow'g	-190.0	-117.0	0.0	-389.0	-164.0
Others	-35.7	-34.6	0.0	0.0	0.0
CFF	-108.6	-124.3	-82.3	-71.8	-83.1
Net cash flow	22.0	9.7	-2.2	9.1	-0.9

Valuation & Ratios

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Core EPU (sen)	8.2	7.9	7.7	7.7	7.8
P/E (x)	13.3	13.9	14.3	14.2	14.0
EBITDA	128.7	125.4	123.0	123.9	125.3
EBIT	128.6	125.3	122.9	123.9	125.2
EV	1,952.2	1,946.9	1,949.1	1,951.0	1,952.8
EV/EBITDA (x)	15.2	15.5	15.8	15.7	15.6
DPU (sen)	8.4	8.1	7.7	7.7	7.8
Dividend yield	7.6	7.3	7.0	7.0	7.1
NTA/ share (sen)	129.0	127.3	127.3	127.3	127.3
P/ NTA	0.9	0.9	0.9	0.9	0.9
BVPS (RM)	1.30	1.28	1.28	1.28	1.28
P/B (x)	0.8	0.9	0.9	0.9	0.9
EBITDA margin	70.9%	72.7%	70.9%	70.9%	71.0%
EBIT margin	70.9%	72.6%	70.8%	70.8%	71.0%
PBT margin	38.5%	45.9%	47.4%	47.3%	47.7%
Net margin	48.5%	49.1%	47.4%	47.3%	47.7%
ROE	5.0%	5.3%	6.0%	6.0%	6.1%
ROA	3.8%	3.7%	3.6%	3.6%	3.7%
Net gearing	33.97%	37.70%	33.90%	33.82%	33.89%

Assumptions

FYE Dec	FY19f	FY20f	FY21f
Gross rental income			
Quill Building 1 - DHL 1	5.0	5.1	5.2
Quill Building 4 - DHL 2	5.4	5.5	5.6
Quill Building 2 - HSBC	9.9	10.1	10.2
Quill Building 3 - BMW	5.8	5.9	6.0
Wisma Technip	12.5	12.7	12.8
Part of Plaza Mont' Kiara	3.7	3.8	3.9
Quill Building 5 - IBM	2.6	2.7	2.7
Tesco Building - Penang	14.7	14.9	15.2
Platinum Sentral	51.1	51.1	51.1
Menara Shell	43.5	43.5	43.5
Total:	154.2	155.2	156.2

Quarterly financial summary

FYE Dec	1Q18	4Q18	1Q19	QoQ (%)	YoY (%)
Gross revenue	44.0	42.7	41.4	-3.0	-6.0
Property opex	-9.8	-10.0	-9.3	6.5	4.3
Net property income	34.3	32.7	32.0	-1.9	-6.5
Interest income	0.7	1.7	0.8	-51.3	13.5
Revaluation gains	0.0	-5.4	0.0	0.0	0.0
Net investment income	35.0	28.9	32.9	13.6	-6.1
Finance costs	-9.7	-10.9	-9.9	9.5	-1.7
Valuation fees	-0.1	-0.1	-0.1	5.5	20.2
Administrative expenses	-0.7	-0.3	-0.1	>100	91.1
TOTAL EXPENSES	-14.0	-14.8	-13.5	8.8	3.9
Normalised PBT	21.0	19.6	19.4	-1.0	-7.6
Normalised PAT	21.0	19.6	19.4	-1.0	-7.6
EPU (realised)	2.0	1.8	1.8	-1.0	-7.6
DPU (sen)	0.0	3.9	0.0	NM	NM

Figure #1 **Quarterly results comparison**

FYE Dec (RM m)	1Q18	4Q18	1Q19	QoQ	YoY
Gross revenue	44.0	42.7	41.4	-3.0%	-6.0%
Property operating expenses	-9.8	-10.0	-9.3	-6.5%	-4.3%
Net property income	34.3	32.7	32.0	-1.9%	-6.5%
Interest income	0.7	1.7	0.8	-51.3%	13.5%
Gain on divestment	0.0	0.0	0.0	<i>NM</i>	<i>NM</i>
Net investment income	35.0	28.9	32.9	13.6%	-6.1%
Finance costs	-9.7	-10.9	-9.9	-9.5%	1.7%
Valuation fees	-0.1	-0.1	-0.1	5.5%	20.2%
Administrative expenses	-0.7	-0.3	-0.1	-76.8%	-91.1%
Total expenses	-14.0	-14.8	-13.5	-8.8%	-3.9%
Core PBT	21.0	19.6	19.4	-1.0%	-7.6%
Core PAT	21.0	19.6	19.4	-1.0%	-7.6%
Distributable adjustments	1.4	-1.4	0.0	>100%	>100%
Distributable income	22.4	18.2	19.4	6.5%	-13.3%
Core EPU (sen)	2.0	1.8	1.8	-1.0%	-7.6%
DPU (sen)	0.0	3.9	0.0	<i>NM</i>	<i>NM</i>

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Stock rating definitions

BUY	Expected absolute return of +10% or more over the next 12-months.
HOLD	Expected absolute return of -10% to +15% over the next 12-months.
SELL	Expected absolute return of -10% or less over the next 12-months.
UNDER REVIEW	Rating on the stock is temporarily under review which may or may not result to a change from the previous rating.
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