09 May 2019

Buy

Price
RM1.10

Target Price
RM1.25

Bloomberg code
MQREIT MK

Equity | Malaysia | REITs

Flashnote

MRCB-Quill REIT

In-line set of results; trading at 7.0% FY19F yield

Financial Highlights

FYE Dec	2017	2018	2019F	2020F	2021F
Revenue (RM mil)	180.1	173.4	176.7	180.3	184.9
Net Property Income	140.0	133.7	136.2	139.0	142.5
Realised Net profit (RM mil)	87.0	82.5	84.0	86.4	89.5
EPU (sen)	8.1	7.7	7.8	8.1	8.4
EPU Growth (%)	48.7	(5.4)	1.8	2.9	3.6
DPU (sen)	8.4	8.1	7.8	8.1	8.4
PE (x)	13.5	14.3	14.0	13.6	13.2
Div yield (%)	7.5	7.2	7.0	7.2	7.5
ROE (%)	5.0	5.3	6.1	6.3	6.5
Gearing (%)	37.3	37.5	37.5	37.5	37.5

Source: Company, KAF

- We maintain our Buy recommendation on MRCB-Quill REIT (MQREIT) with an unchanged DDM-derived target price of RM1.25.
- MQREIT's core net profit of RM19.4m (-8% yoy) was in-line with expectations, forming 23% of our and consensus full-year forecasts, respectively. The earnings decline was largely due to lower revenue (-6% yoy) and higher finance cost (+2% yoy) in 1Q19. No dividends were declared during the quarter, as they are payable semi-annually.
- The group's 1Q19 revenue and net property income (NPI) fell by 6% and 7% yoy, respectively, on account of: (i) the lower income contributions from three office buildings, namely Platinum Sentral, Wisma Technip and Quill Building 5, and (ii) loss of income from Quill Building 8 after the disposal took place in April 2018.

  Property operating cost declined by 4% yoy due to better cost management and lower expenses incurred after the disposal of Quill Building 8, and as a result, NPI margin remained stable at 77% (vs. 78% in 1Q18).
- We gather that about 19% of MQREIT's total net lettable are (NLA) is due for renewal in FY19, and active negotiations are currently in progress. The expiring leases in FY20 make up 18% of total NLA, and 19% in FY21.
- MQREIT's gearing ratio remains manageable at 37.5% as at end-1Q19. Based on SC's gearing limit of 50%, we estimate that the REIT could potentially raise up to c.RM282m in borrowings for acquisition opportunities.
- We think that any potential acquisition will likely be the Menara Celcom in PJ Sentral, which the group has the Right of First Refusal (ROFR) from its sponsor. As at 1Q19, the group has 10 assets under management (AUM), with TAV of RM2.2b.
- We leave our core net profit forecasts unchanged at RM84.0-86.4m for FY19-20F, given this in-line set of results.
- We continue to like MQREIT for its strategically located assets backed by long-term leases. Despite challenges in the overall office market, MQREIT's portfolio occupancy rate remains higher at 89%, as compared to the industry's average of 79%.
- At the current price level, MQREIT offers a yield of 7.0%, which Is the highest within our sector coverage (sector average: 5.5%). This translates to a comfortable yield spread of 320 bps against the 10-year MGS of 3.8%.

Analyst

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Exhibit 1: Earnings quarterly trends

(RM m)						Change		Cumulative			KAF	
FYE 31 Dec	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**	**Mar-19**	**% qoq**	**% yoy**	**3M18**	**3M19**	**% chg**	**2019F**	**3M/F**
Revenue	**44.0**	**43.7**	**43.6**	**42.7**	**41.4**	(3)	(6)	**44.0**	**41.4**	**(6)**	**176.7**	**23**
Property operating expenses	(9.8)	(10.0)	(9.9)	(10.0)	(9.3)	(7)	(4)	**(9.8)**	**(9.3)**	**(4)**	(40.5)	23
Net property income	**34.3**	**33.6**	**33.7**	**32.7**	**32.0**	(2)	(7)	**34.3**	**32.0**	**(7)**	**136.2**	**24**
Interest income	0.7	0.9	1.0	1.7	0.8	(51)	14	**0.7**	**0.8**	**14**	**3.5**	24
Trust expenses	(4.3)	(3.0)	(3.7)	(3.9)	(3.6)	(7)	(16)	**(4.3)**	**(3.6)**	**(16)**	(15.2)	24
Borrowing costs	(9.7)	(9.9)	(10.1)	(10.9)	(9.9)	(10)	2	**(9.7)**	**(9.9)**	**2**	(40.6)	24
Exceptional items		2.2		(11.6)							-	
Profit before tax	**21.0**	**23.8**	**20.9**	**8.0**	**19.4**	37	(8)	**21.0**	**19.4**	**(8)**	**84.0**	**23**
Tax	-	-	-	-	-							
Net profit	**21.0**	**23.8**	**20.9**	**8.0**	**19.4**	141	(8)	**21.0**	**19.4**	**(8)**	**84.0**	**23**
Normalized net profit	**21.0**	**21.6**	**20.9**	**19.6**	**19.4**	(1)	(8)	**21.0**	**19.4**	**(8)**	**84.0**	**23**

Source: Company, KAF

Disclosure Appendix

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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