

**HLIB Research**

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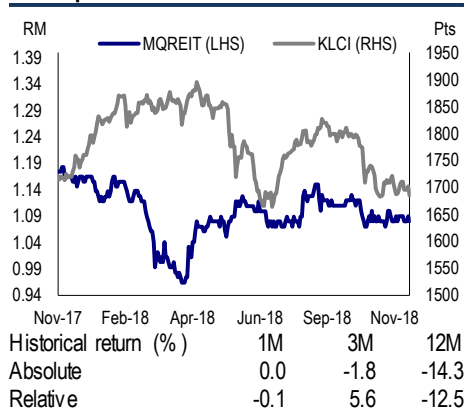
**BUY** (Maintain)

**Target Price:** **RM1.23**
**Previously:** **RM1.29**
**Current Price:** **RM1.08**

Capital upside	13.9%
Dividend yield	8.0%
Expected total return	21.9%

**Sector coverage:** REIT

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

**Share price**

**Stock information**

Bloomberg ticker	MQREITMK
Bursa code	5123
Issued shares (m)	1,072
Market capitalisation (RM m)	1,158
3-mth average volume ('000)	86
SC Shariah compliant	No

**Major shareholders**

MRCB	27.8%
Employees Provident Fund	12.0%
CapitalLand Ltd	10.9%

**Earnings summary**

FYE (Dec)	FY17	FY18f	FY19f
PAT – core (RM m)	88.1	86.2	86.3
EPU – core (sen)	6.5	8.0	8.0
P/E (x)	16.5	13.5	13.5

# MRCB-Quill REIT

## Nudge down by revenue

**MQREIT 9M18 core net profit RM62.9m (-5.6% YoY) was below both ours and consensus expectations due to lower-than-expected revenue contribution. The decline was mainly due to lower revenue contribution due to disposal of QB8 along with lower occupancy from Platinum Sentral and Menara Shell, and higher finance costs. Looking ahead, MQREIT will be focussing on cost management and tenant retention to ensure sustainability of yield. We reduce our FY18-20 forecast by 4%-6% to factor in lower revenue contribution. We reiterate BUY call with lower TP of RM1.23 based on targeted yield of 6.9%.**

**Below expectations.** 9M18 revenue of RM130.7m (-3.5% YoY) translated into core net profit of RM62.9m (-5.6% YoY). The results were below ours and consensus expectations, accounting for 70.1% and 71.4%, respectively. This was mainly due to lower-than-expected revenue contribution.

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

**QoQ/ YoY.** Revenue fell to RM43.3m (QoQ: -0.3%; YoY: -3.5%) followed by a decline in core net profit to RM20.6m (QoQ: -3.3%, YoY: -3.7%). The decline was mainly due to lower revenue contribution from Platinum Sentral and loss of revenue from QB8 – DHL XPJ (QB8). However it was slightly mitigated by lower property operating expenses thanks to tighter control on costs. Higher finance cost also contributed to the fall.

**YTD.** Revenue for 9M18 decreased by 3.5% to RM130.7m. The lower revenue was due to (1) loss of revenue from QB8 after disposal in April 2018; (2) lower occupancy rate from Platinum Sentral and Menara Shell. Nevertheless, the fall was slightly mitigated by the decrease in property operating expense attributable to lower expenses incurred by some properties. Likewise, core net profit of RM62.9m showed a decrement of 5.6%. This was due to higher administrative expenses incurred pertaining to the disposal of QB8 and increase in finance costs due to higher interest post OPR hike in January 2018.

**Occupancy and gearing.** Overall occupancy rate fell but remained healthy at 94% (2Q18: 96%). Average debt to maturity has increased slightly from 2.30 years to 2.73 years, followed by an increase in average cost of debt from 4.4% to 4.5%. The gearing level also increased slightly to 37.7% (2Q18: 37.3%), still comfortably below the 50% limit.

**Outlook.** Management has achieved approximately 71% renewal rate for its lease expiries due up to 3Q18, and are currently in advanced negotiations with tenants for the balance of leases due in 2H18. Similarly, management has successfully secured new leases with demand driving from IT, business consultancy, medical and retail sectors in Plaza Mont' Kiara, Platinum Sentral as well as Menara Shell. Looking ahead, management will be focussing on cost management and tenant retention. We continue to like MQREIT given its attractive dividend yield of 7.9% (highest among REITs in our universe), stable assets in prime location of KL Sentral with high occupancy rate.

**Forecast.** We reduce our FY18-20 earnings forecasts by 4%, 5% and 6% respectively after factoring in lower revenue contribution.

**Maintain BUY, TP: RM1.23.** We maintain our BUY call with lower TP of RM1.23 (from RM1.29) based on targeted yield of 6.9% which is derived from 2 years historical average yield spread of MQREIT and 10-year MGS.

## Financial Forecast

All items in (RM m) unless otherwise stated

### Balance Sheet

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Cash	54.1	76.0	60.5	61.8	73.1
Receivables	18.3	6.0	5.9	6.0	6.0
Investment properties	2,222.0	2,179.2	2,181.2	2,183.2	2,185.2
PPE	0.2	0.2	0.1	0.1	0.1
Others	2.7	27.0	27.0	27.0	27.0
<b>Assets</b>	<b>2,297.3</b>	<b>2,288.4</b>	<b>2,274.8</b>	<b>2,278.1</b>	<b>2,291.4</b>
Payables	55.8	20.3	22.8	23.0	23.1
Debt	851.6	853.5	836.5	836.5	847.5
Security deposits	29.3	29.2	29.2	29.2	29.2
Derivatives	1.0	0.7	0.7	0.7	0.7
<b>Liabilities</b>	<b>937.6</b>	<b>903.7</b>	<b>889.2</b>	<b>889.3</b>	<b>900.5</b>
Unitholders' capital	1,231.9	1,231.9	1,231.9	1,231.9	1,231.9
Undistributed profit	127.8	152.8	153.7	156.8	159.0
<b>Equity</b>	<b>1,359.7</b>	<b>1,384.7</b>	<b>1,385.6</b>	<b>1,388.7</b>	<b>1,390.9</b>

### Cash Flow Statement

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Profit before taxation	62.8	69.9	86.2	86.3	86.9
Finance costs	33.0	40.5	0.0	0.0	0.0
Depreciation	0.1	0.1	0.1	0.0	0.0
Fair value gain of assets	-3.5	18.2	0.0	0.0	0.0
Interest income	-2.4	-3.6	0.0	0.0	0.0
Others	-19.7	4.0	2.5	0.1	0.1
<b>CFO</b>	<b>70.3</b>	<b>129.1</b>	<b>88.9</b>	<b>86.4</b>	<b>87.0</b>
Capex	-647.4	-0.4	-2.0	-2.0	-2.0
Disposal / (purchase)	-1.5	0.0	0.0	0.0	0.0
Others	0.0	2.2	0.0	0.0	0.0
<b>CFI</b>	<b>-648.9</b>	<b>1.8</b>	<b>-2.0</b>	<b>-2.0</b>	<b>-2.0</b>
Distribution paid	-56.9	-72.6	-85.4	-84.5	-85.1
Proceeds from borrowings	164.0	191.0	100.0	0.0	400.0
Repayment of borrowings	0.0	-190.0	-117.0	0.0	-389.0
Placement / new share	487.9	-37.2	0.0	0.0	0.0
<b>CFF</b>	<b>595.1</b>	<b>-108.8</b>	<b>-102.4</b>	<b>-84.5</b>	<b>-74.1</b>
<b>Net cash flow</b>	<b>16.5</b>	<b>22.0</b>	<b>-15.5</b>	<b>-0.2</b>	<b>10.9</b>

### Assumptions

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
<b>Gross rental income</b>					
Quill Building 1 - DHL 1			4.9	5.0	5.1
Quill Building 4 - DHL 2			5.3	5.4	5.5
Quill Building 2 - HSBC			9.8	9.9	10.1
Quill Building 3 - BMW			5.1	5.2	5.3
Wisma Technip			12.3	12.5	12.7
Part of Plaza Mont' Kiara			4.0	4.1	4.2
Quill Building 5 - IBM			3.9	4.0	4.0
Quill Building 8 - DHL XPJ			0.0	0.0	0.0
Tesco Building - Penang			14.5	14.7	14.9
Platinum Sentral			55.1	55.1	55.1
Menara Shell			46.0	46.0	46.0
<b>Total:</b>			<b>160.9</b>	<b>161.8</b>	<b>162.8</b>

### Income Statement

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Gross rental income	115.9	162.1	160.9	161.8	162.8
Car park income	10.9	12.8	14.2	14.4	14.7
Other revenue	5.0	5.2	5.8	5.9	6.1
<b>Total revenue</b>	<b>136.6</b>	<b>181.5</b>	<b>180.9</b>	<b>182.2</b>	<b>183.6</b>
Assessment & quit rent	-5.3	-8.5	-13.8	-13.8	-13.9
Depreciation	-0.1	-0.1	-0.1	-0.1	-0.1
Insurance & Prop mgmt	-3.1	-3.9	-3.9	-3.9	-3.9
Service contracts	-9.6	-10.9	-10.9	-10.9	-11.0
Utilities	-11.5	-16.7	-16.6	-16.7	-16.8
<b>Total opex</b>	<b>-29.5</b>	<b>-40.2</b>	<b>-45.2</b>	<b>-45.4</b>	<b>-45.7</b>
<b>Net property income</b>	<b>77.7</b>	<b>101.2</b>	<b>90.5</b>	<b>91.3</b>	<b>92.2</b>
<b>Net investment income</b>	<b>108.2</b>	<b>125.4</b>	<b>140.7</b>	<b>140.8</b>	<b>142.0</b>
Pretax profit	62.8	69.9	86.2	86.3	86.9
Taxation	0.0	0.0	0.0	0.0	0.0
<b>Net profit</b>	<b>59.2</b>	<b>88.1</b>	<b>86.2</b>	<b>86.3</b>	<b>86.9</b>
No. of units (units)	1,068.0	1,068.0	1,074.2	1,081.6	1,089.0

### Valuation & Ratios

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Core EPU (sen)	5.9	6.5	8.0	8.0	8.0
P/E (x)	18.3	16.5	13.5	13.5	13.5
EBITDA	92.3	128.7	126.0	126.0	127.1
EBIT	92.3	128.6	126.0	126.0	127.1
EV	1,951.0	1,930.9	1,936.1	1,942.8	1,950.5
EV/EBITDA (x)	21.1	15.0	15.4	15.4	15.3
DPU (sen)	8.4	8.4	8.6	8.5	8.5
Dividend yield	7.8	7.8	7.9	7.9	7.9
NTA/ share (sen)	126.8	129.0	128.2	127.4	126.6
P/ NTA	0.9	0.8	0.8	0.8	0.9
BVPS (RM)	1.3	1.3	1.3	1.3	1.3
P/B (x)	0.8	0.8	0.8	0.8	0.8
EBITDA margin	67.6%	70.9%	69.7%	69.2%	69.2%
EBIT margin	67.5%	70.9%	69.6%	69.1%	69.2%
PBT margin	45.9%	38.5%	47.7%	47.3%	47.3%
Net margin	43.3%	48.5%	47.7%	47.3%	47.3%
ROE	4.6%	5.0%	6.2%	6.2%	6.3%
ROA	2.6%	3.8%	3.8%	3.8%	3.8%
Net gearing	34.7%	34.0%	34.1%	34.0%	33.8%

### Quarterly financial summary

FYE Dec	3Q17	2Q18	3Q18	QoQ (%)	YoY (%)
Gross revenue	44.8	43.4	43.3	-0.3	-3.5
Property opex	-10.5	-10.0	-9.9	1.2	5.8
<b>Net property income</b>	<b>34.3</b>	<b>33.4</b>	<b>33.3</b>	<b>-0.1</b>	<b>-2.8</b>
Interest income	0.7	0.9	1.0	16.5	36.6
Revaluation gains	0.0	0.0	0.0	0.0	0.0
<b>Net investment income</b>	<b>35.0</b>	<b>36.4</b>	<b>34.4</b>	<b>-5.7</b>	<b>-1.9</b>
Finance costs	-10.0	-9.9	-10.1	-1.4	-1.2
Valuation fees	-0.1	-0.1	-0.1	-57.5	-6.1
Administrative expenses	0.0	0.6	-0.1	>100	-47.6
<b>TOTAL EXPENSES</b>	<b>-13.7</b>	<b>-12.9</b>	<b>-13.8</b>	<b>-6.3</b>	<b>-0.9</b>
<b>Normalised PBT</b>	<b>21.4</b>	<b>21.3</b>	<b>20.6</b>	<b>-3.3</b>	<b>-3.7</b>
<b>Normalised PAT</b>	<b>21.4</b>	<b>21.3</b>	<b>20.6</b>	<b>-3.3</b>	<b>-3.7</b>
EPU (realised)	2.3	2.0	1.9	-3.3	-16.9
DPU (sen)	0.0	4.2	0.0	NM	0.0

**Figure #1**      **Quarterly results comparison**

<b>FYE Dec (RM m)</b>	<b>3Q17</b>	<b>2Q18</b>	<b>3Q18</b>	<b>QoQ</b>	<b>YoY</b>	<b>9M17</b>	<b>9M18</b>	<b>YoY</b>
Gross revenue	44.8	43.4	43.3	-0.3%	-3.5%	135.5	130.7	-3.5%
Property operating expenses	-10.5	-10.0	-9.9	1.2%	5.8%	-30.1	-29.7	1.3%
<b>Net property income</b>	<b>34.3</b>	<b>33.4</b>	<b>33.3</b>	<b>-0.1%</b>	<b>-2.8%</b>	<b>105.3</b>	<b>101.0</b>	<b>-4.1%</b>
Interest income	0.7	0.9	1.0	16.5%	36.6%	1.8	2.6	42.1%
Gain on divestment	0.0	2.2	0.0	NM	NM	0.0	2.2	NM
Net investment income	35.0	36.4	34.4	-5.7%	-1.9%	107.2	105.8	-1.3%
Finance costs	-10.0	-9.9	-10.1	-1.4%	-1.2%	-29.5	-29.7	0.6%
Valuation fees	-0.1	-0.1	-0.1	-57.5%	-6.1%	-0.2	-0.3	24.9%
Administrative expenses	0.0	0.6	-0.1	>100%	-47.6%	-0.1	-0.1	51.0%
Total expenses	-13.7	-12.9	-13.8	-6.3%	-0.9%	-40.6	-40.7	0.4%
Core PBT	21.4	21.3	20.6	-3.3%	-3.7%	66.6	62.9	-5.6%
<b>Core PAT</b>	<b>21.4</b>	<b>21.3</b>	<b>20.6</b>	<b>-3.3%</b>	<b>-3.7%</b>	<b>66.6</b>	<b>62.9</b>	<b>-5.6%</b>
Distributable adjustments	0.0	1.0	1.4	40.0%	NM	0.0	3.8	NM
<b>Distributable income</b>	<b>21.4</b>	<b>22.3</b>	<b>22.0</b>	<b>-1.4%</b>	<b>2.8%</b>	<b>66.6</b>	<b>66.7</b>	<b>0.1%</b>
Core EPU (sen)	2.3	2.2	1.9	-3.3%	-16.9%	6.8	5.9	-12.8%
DPU (sen)	0.0	4.2	0.0	NM	NM	4.2	4.2	0.0%

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## Stock rating definitions

<b>BUY</b>	Expected absolute return of +10% or more over the next 12-months.
<b>HOLD</b>	Expected absolute return of -10% to +15% over the next 12-months.
<b>SELL</b>	Expected absolute return of -10% or less over the next 12-months.
<b>UNDER REVIEW</b>	Rating on the stock is temporarily under review which may or may not result to a change from the previous rating.
<b>NOT RATED</b>	Stock is not or no longer within regular coverage.

## Sector rating definitions

<b>OVERWEIGHT</b>	Sector expected to outperform the market over the next -12 months.
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