

HLIB Research

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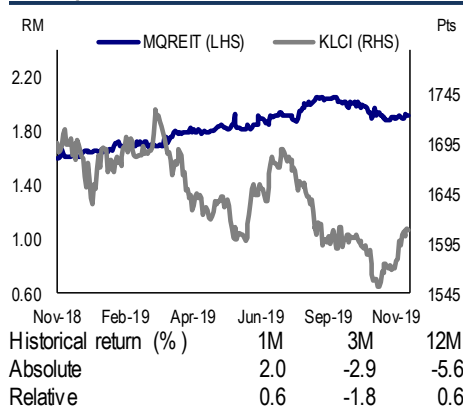
HOLD (Maintain)

Target Price: **RM1.05**
Previously: **RM1.10**
Current Price: **RM1.02**

Capital upside	2.9%
Dividend yield	6.5%
Expected total return	9.4%

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)	1,093
3-mth average volume ('000)	149
SC Shariah compliant	No

Major shareholders

MRCB	27.8%
Employees Provident Fund	12.1%
CapitalLand Ltd	10.9%

Earnings summary

FYE (Dec)	FY18	FY19f	FY20f
PAT – core (RM m)	84.7	71.5	74.8
EPU – core (sen)	7.9	6.7	7.0
P/E (x)	12.9	15.3	14.6

MRCB-Quill REIT

Slightly below expectation

MQREIT's 3Q19 core net profit of RM17.6m (+7.2% QoQ, -14.3% YoY) brought 9M19 sum to RM53.5m (-14.9% YoY); this was below both ours and consensus expectations due to lower than expected revenue contribution. We reduce our FY19/20/21 earnings forecasts by -6.4%/-4.1%/-2.1% respectively after factoring in lower rental income. We maintain our HOLD call with a lower TP of RM1.05 (from RM1.10) based on FY20 forward DPU on targeted yield of 6.6%

Below expectations. 3Q19 core net profit of RM17.6m (+7.2% QoQ, -14.3% YoY) brought 9M19 sum to RM53.5m (-14.9% YoY). The results were below both ours and consensus expectations, accounting for 70% and 71%, respectively. The deviation was due to lower than expected top-line (see YTD para).

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

QoQ. Total gross revenue increased marginally by 2.9% to RM39.9m, which then led to a rise in core net profit to RM17.6m (+7.2% QoQ). The increase was mainly due to lower income contribution in 2Q19 (due to repositioning of tenant).

YoY. Top line was decreased by 7.7% attributable to lower revenue contribution; mainly from Platinum Sentral, Wisma Technip and QB5; however this was slightly mitigated by decrease in property operating expense (-2%) due to tighten control on costs, which in turn brought down the net property income (NPI) by 9.4%. As a result, bottom line showed a decrement of 14.3%.

YTD. Revenue for 9M19 decreased by 8.1% to RM120.1m. Similarly, core net profit of RM53.5m showed a decline of 15.2%. The lower revenue was due to (i) loss of revenue from QB8 (disposed in April 2018); (ii) lower occupancy rate from Platinum Sentral (SPAD downsized & MyHSR moved out), Wisma Technip (tenant downsized) and QB5 (IBM moved out). Nevertheless, it was cushioned by marginally (i) lower property expenses (-3.2%) and (ii) lower finance costs (-1.3%).

Occupancy and gearing. Occupancy rate stayed at 89% (2Q19: 89%). The average debt to maturity decreased to 1.82 years from 2.07 years (2Q19), while average cost of financing was kept at 4.5%. As for gearing level, it edged up to 37.4% (2Q19: 37.1%), with a majority of its total borrowings being charged a fixed interest rate (76%).

Outlook. 19% of MQREIT's net lettable area are due for renewal for FY19 where: (i) 11% of it has been renewed as of 3Q19, (ii) 4% of leases is expiring in 4Q19, and management is still under negotiation with the tenants while (iii) the remaining 4% are not renewed. We envisage flattish reversion for its assets given lacklustre overall office market and flattish top line growth from these new leases by 4Q19. Going forward, management will focus on cost discipline and tenant retention. We believe MQREIT will continue to sustain with its long-term tenancy with Shell (comprising of 31% of its NLA), despite the moving out of tenants in a few assets.

Forecast. We reduce our FY19/20/21 earnings forecasts by -6.4%/-4.1%/-2.1% respectively after factoring in lower rental income.

Maintain HOLD, TP: RM1.05. We maintain our HOLD call with a lower TP of RM1.05 (from RM1.10) based on FY20 forward DPU on targeted yield of 6.6% which is derived from 2 years historical average yield spread of MQREIT and 10-year MGS. Although MQREIT provides investors with attractive dividend yield of 6.5% (highest among REITs in our universe), we are vigilant on market outlook for office REITs as it remain lacklustre due to unabated oversupply of office in KL city.

Financial Forecast

All items in (RM m) unless otherwise stated

Balance Sheet

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Cash	76.0	85.8	83.7	93.2	91.7
Receivables	6.0	6.7	6.2	6.4	6.5
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	2,271.2	2,282.7	2,283.3
Payables	20.3	16.1	15.6	16.2	15.7
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	898.9	910.5	911.0
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	140.9	145.9	146.9
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	160.2	165.6	167.0
Property opex	-40.2	-39.7	-38.4	-39.8	-38.7
Net property income	141.3	132.8	121.8	125.8	128.4
Other income	-16.0	1.9	2.8	2.7	3.0
Net invest income	125.4	134.7	124.6	128.5	131.4
Manager's fee	-13.5	-13.3	-12.8	-13.0	-13.1
Trustee's fee	-0.7	-0.7	-0.7	-0.7	-0.7
Finance costs	-40.5	-40.6	-38.9	-39.4	-39.4
Other non opex	-0.8	-0.9	-0.7	-0.7	-0.7
Profit before tax	69.9	79.3	71.5	74.8	77.5
Taxation	0.0	-6.1	0.0	0.0	0.0
Profit after tax	69.9	73.1	71.5	74.8	77.5
Core net profit	88.1	84.7	71.5	74.8	77.5
Distributable income	92.1	87.1	71.5	74.8	77.5

Consensus core net profit		74.5	75.5	78.5
HLIB/ Consensus		96%	99%	99%

Cash Flow Statement

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Profit before taxation	69.9	79.3	71.5	74.8	77.5
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	-0.1	0.4	-0.5
CFO	128.8	106.5	71.5	75.2	77.0
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	-71.5	-74.8	-77.5
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	-71.5	-63.8	-76.5
Net cash flow	22.0	9.7	-2.0	9.4	-1.5
Beginning cash	54.1	76.0	85.8	83.7	93.2
Ending cash	76.0	85.8	83.7	93.2	91.7

Valuation & Ratios

FYE Dec	FY17	FY18	FY19f	FY20f	FY21f
Core EPU (sen)	8.2	7.9	6.7	7.0	7.2
P/E (x)	12.4	12.9	15.3	14.6	14.1
EBITDA	128.7	125.4	110.4	114.2	117.0
EBIT	128.6	125.3	110.4	114.1	116.9
EV	1,866.8	1,861.1	1,863.2	1,864.8	1,867.2
EV/EBITDA (x)	14.5	14.8	16.9	16.3	16.0
DPU (sen)	8.4	8.1	6.7	7.0	7.2
Dividend yield	8.2	7.9	6.5	6.8	7.1
NTA/ share (sen)	129.0	127.3	127.3	127.3	127.3
P/ NTA	0.8	0.8	0.8	0.8	0.8
BVPS (RM)	1.30	1.28	1.28	1.28	1.28
P/B (x)	0.8	0.8	0.8	0.8	0.8
EBITDA margin	70.9%	72.7%	68.9%	69.0%	70.0%
EBIT margin	70.9%	72.6%	68.9%	68.9%	70.0%
PBT margin	38.5%	45.9%	44.6%	45.1%	46.4%
Net margin	48.5%	49.1%	44.6%	45.1%	46.4%
ROE	5.0%	5.3%	5.2%	5.4%	5.6%
ROA	3.8%	3.7%	3.1%	3.3%	3.4%
Net gearing	33.97%	37.70%	33.90%	33.80%	33.90%

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	7.5	8.9	9.0
Part of Plaza Mont' Kiara	3.7	3.8	3.9
Quill Building 5 - IBM	0.0	0.0	0.1
Tesco Building - Penang	14.7	14.9	15.2
Platinum Sentral	45.5	48.3	48.3
Menara Shell	43.5	43.5	43.5
Total:	140.9	145.9	146.9

Quarterly financial summary

FYE Dec	3Q18	2Q19	3Q19	QoQ (%)	YoY (%)
Gross revenue	43.3	38.8	39.9	3%	-8%
Property opex	-9.9	-9.7	-9.7	0%	-2%
Net property income	33.3	29.1	30.2	4%	-9%
Interest income	1.0	0.6	0.7	24%	-31%
Revaluation gains	0.0	0.0	0.0	0%	0%
Net investment income	34.4	29.6	30.9	4%	-10%
Finance costs	-10.1	-9.7	-9.7	0%	-3%
Valuation fees	-0.1	-0.1	-0.1	0%	0%
Administrative expenses	-0.1	0.0	0.0	14%	-47%
TOTAL EXPENSES	-13.8	-13.2	-13.3	1%	-4%
Normalised PBT	20.6	16.5	17.6	7%	-14%
Normalised PAT	20.6	16.5	17.6	7%	-14%
EPU (realised)	1.9	1.5	1.6	7%	-14%
DPU (sen)	0.0	3.4	0.0	NM	NM

Figure #1 **Quarterly results comparison**

FYE Dec (RM m)	3Q18	2Q19	3Q19	QoQ	YoY	9M18	9M19	YoY
Gross revenue	43.3	38.8	39.9	2.9%	-7.7%	130.7	120.1	-8.1%
Property operating expenses	-9.9	-9.7	-9.7	0.3%	-2.0%	-29.7	-28.8	-3.2%
Net property income	33.3	29.1	30.2	3.8%	-9.4%	101.0	91.3	-9.6%
Interest income	1.0	0.6	0.7	24.2%	-31.2%	2.6	2.1	-20.2%
Gain on divestment	0.0	0.0	0.0	N.M	N.M	2.2	0.0	N.M
Net investment income	34.4	29.6	30.9	4.2%	-10.1%	105.8	93.4	-11.7%
Finance costs	-10.1	-9.7	-9.7	0.2%	-3.3%	-29.7	-29.3	-1.3%
Valuation fees	-0.1	-0.1	-0.1	0.0%	0.0%	-0.3	-0.3	3.8%
Administrative expenses	-0.1	-0.0	-0.0	14.4%	-46.6%	-0.1	-0.1	-19.5%
Total expenses	-13.8	-13.2	-13.3	0.5%	-3.7%	-40.7	-39.9	-2.0%
Core PBT	20.6	16.5	17.6	7.2%	-14.3%	62.9	53.5	-14.9%
Core PAT	20.6	16.5	17.6	7.2%	-14.3%	62.9	53.5	-14.9%
Distributable adjustments	1.4	0.9	0.0	N.M	N.M	3.8	0.9	-76.2%
Distributable income	22.0	17.4	17.6	1.6%	-19.8%	66.7	54.4	-18.4%
Core EPU (sen)	1.9	1.5	1.6	7.2%	-14.3%	5.9	5.0	-14.9%
DPU (sen)	0.0	3.4	0.0	N.M	N.M	4.2	3.4	-18.9%

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BUY	Expected absolute return of +10% or more over the next 12 months.
HOLD	Expected absolute return of -10% to +10% 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 in a change from the previous rating.
NOT RATED	Stock is not or no longer within regular coverage.

Sector rating guide

OVERWEIGHT	Sector expected to outperform the market over the next 12 months.
NEUTRAL	Sector expected to perform in-line with the market over the next 12 months.
UNDERWEIGHT	Sector expected to underperform the market over the next 12 months.

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