

**HLIB Research**

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**BUY** (Maintain)

**Target Price:** **RM0.96**
**Previously:** **RM0.96**
**Current Price:** **RM0.86**

|                       |       |
|-----------------------|-------|
| Capital upside        | 11.6% |
| Dividend yield        | 8.3%  |
| Expected total return | 19.9% |

**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**


|                       |     |      |       |
|-----------------------|-----|------|-------|
| Historical return (%) | 1M  | 3M   | 12M   |
| Absolute              | 9.6 | 11.0 | -13.6 |
| Relative              | 2.0 | 3.3  | -16.9 |

**Stock information**

|                              |          |
|------------------------------|----------|
| Bloomberg ticker             | MQREITMK |
| Bursa code                   | 5123     |
| Issued shares (m)            | 1,072    |
| Market capitalisation (RM m) | 922      |
| 3-mth average volume ('000)  | 352      |
| SC Shariah compliant         | No       |

**Major shareholders**

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

**Earnings summary**

| FYE (Dec)         | FY19 | FY20f | FY21f |
|-------------------|------|-------|-------|
| PAT – core (RM m) | 72.1 | 78.3  | 79.5  |
| EPU – core (sen)  | 6.7  | 7.3   | 7.4   |
| P/E (x)           | 12.8 | 11.8  | 11.6  |

# MRCB-Quill REIT

## Earnings to remain resilient

MQREIT shared that the recently improved 3Q20 showing was mainly boosted by new tenancies, positive rental reversion in some of the properties as well as the absence of rental rebates to retail tenants. Portfolio occupancy remains strong at 90.5% and management expect it to remain stable. Although WFH practices have been implemented throughout some period of the year, MQREIT has not seen their tenants downsizing their space. Besides, management saw some of their MNCs tenants were undergoing renovation in view of physical distancing practices. We believe MQREIT will be able to sustain its earnings through high occupancies (at least in the near term), due to tenancy with big corporations and MNCs. Maintain our forecast, BUY call with an unchanged TP of RM0.96.

We recently organized a conference call with MQREIT. Following are some key takeaways.

**New tenancies have lifted their earnings...** Management shared the recently improved 3Q20 profit performance of RM21.5m (+12.6% QoQ, +21.8% YoY), which brought 9M20 core earnings to RM60.3m (+12.8% YoY), were partly buoyed by new tenancies of few properties. Such properties are (i) Menara Shell (Google has taken up c.30k sq ft of space), (ii) Platinum Sentral (co working space operator has increased its space of about 23k sq ft), and (iii) Plaza Mont Kiara.

**...as well as positive rental reversion.** Apart from new tenancies, the company also achieved a positive rental reversion YTD that contributed to the better performance during the year. This comes from step-up in rental reversion from their tenant, Shell in Menara Shell, Tesco buildings as well as anchor tenants SME Corp in Platinum Sentral. For FY21, management is expecting a marginal increase in reversion coming from the 21% of total net lettable area (NLA) that are due for renewal in FY21.

**Chances of tenancy renewal are high.** As at 3Q20, lease negotiations for approximately 241k sq ft were concluded with 216k sq ft renewed while 25ksq ft not renewed. This translates to a total renewal rate to 90% as at 3Q 2020. About 130k sq ft of leases is due in 4Q20 predominantly from SBM Malaysia in Platinum Sentral (c.67k sq ft). For Menara Shell, c.25k sq ft of NLA are due for renewal, of which 18k sq ft is coming from Saipem Asia. The rest are from Wisma Technip (c.16k sq ft) as well as a tenant in QB3 (c.14k sqft) which is due for renewal. Active negotiations for renewal of the remaining leases are currently in progress and management assured that majority of this will be renewed due to their tenants' nature of business (big corporations and MNCs).

**Occupancy remains strong at 90.5%,** as of 3Q20 (a slight uptick from 90.4% in 2Q20). Out of 9 properties (excluding recently proposed disposal of QB5), 4 properties have 100% occupancy. The rest of properties, for instances, Menara Shell, QB3 BMW, Wisma TechnipFMC, Plaza Mont Kiara and Platinum Sentral have occupancy of approximately 99%, 91%, 90%, 89% and 84% respectively. Although WFH practices have been implemented throughout some periods of the year, MQREIT has not seen their tenants downsizing their space. Besides, management observed that some of their MNCs tenants were undergoing renovation in view of physical distancing practices, to prepare their employees when they come back to office. After all, management believes that certain work discussions are more efficient to be done at office, hence ensuring a resilient demand in office space.

**Other updates.** Notably, no rental rebates were given to retail tenants in Plaza Mont Kiara during 3Q20. Management has not laid out any possibility of rental rebates in 4Q20 as they observed that some of the businesses have already picked up during end-Nov and early-Dec. Other than that, weighted average lease expiry (WALE) has

increased to 4.62 years in 3Q20 (from 4.4 years in 2Q20) attributable from renewal of tenancies by DHL in QB1 and QB4.

**Outlook.** We believe MQREIT will continue to register resilient earnings in 4Q supported by stable occupancy across its assets. We note that the current office market outlook for office REITs remains lacklustre due to unabated oversupply of office in KL city. However, we believe MQREIT will be able to sustain its earnings, at least in the near term, due to their tenancy with big corporations and MNCs.

**Forecast.** Unchanged as the meeting yielded no surprises.

**Maintain BUY, with unchanged of TP: RM0.96** based on FY21 forward DPU on targeted yield of 7.6%, derived from its 2 years historical average yield spread of MQREIT and 10-year MGS. We like MQREIT for its attractive dividend yield of 8.3% (highest among REITs in our universe) and its relatively more resilient earnings amid Covid-19 given minimal retail exposure unlike other mall based REITs.

## Financial Forecast

All items in (RM m) unless otherwise stated

### Balance Sheet

| FYE Dec                               | FY18           | FY19           | FY20f          | FY21f          | FY22f          |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Cash                                  | 85.8           | 63.3           | 73.3           | 74.5           | 74.6           |
| Receivables                           | 6.7            | 6.3            | 6.4            | 6.6            | 6.6            |
| Investment properties                 | 2,177.6        | 2,143.0        | 2,145.0        | 2,147.0        | 2,149.0        |
| PPE                                   | 0.3            | 0.4            | 0.2            | 0.1            | 0.1            |
| Others                                | 1.3            | 0.8            | 0.8            | 0.8            | 0.8            |
| <b>Assets</b>                         | <b>2,271.7</b> | <b>2,213.7</b> | <b>2,225.7</b> | <b>2,229.0</b> | <b>2,231.1</b> |
| Payables                              | 16.1           | 15.7           | 15.2           | 15.8           | 15.4           |
| Debt                                  | 853.7          | 835.7          | 846.7          | 847.7          | 848.7          |
| Security deposits                     | 29.2           | 38.5           | 38.5           | 38.5           | 38.5           |
| Derivatives                           | 0.4            | 0.0            | 0.0            | 0.0            | 0.0            |
| <b>Liabilities</b>                    | <b>899.4</b>   | <b>889.9</b>   | <b>900.3</b>   | <b>902.0</b>   | <b>902.5</b>   |
| Unitholders' capital                  | 1,235.9        | 1,235.9        | 1,235.9        | 1,235.9        | 1,235.9        |
| Undistributed profit                  | 136.4          | 87.6           | 89.2           | 90.8           | 92.4           |
| <b>Equity</b>                         | <b>1,372.3</b> | <b>1,323.5</b> | <b>1,325.1</b> | <b>1,326.6</b> | <b>1,328.3</b> |
| <b>Total Liabilities &amp; Equity</b> | <b>2,271.7</b> | <b>2,213.7</b> | <b>2,225.7</b> | <b>2,229.0</b> | <b>2,231.1</b> |

### Income Statement

| FYE Dec                     | FY18         | FY19         | FY20f        | FY21f        | FY22f        |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|
| Gross rental income         | 155.0        | 144.1        | 151.0        | 154.7        | 155.6        |
| Car park income             | 13.2         | 13.0         | 10.6         | 10.9         | 11.2         |
| Other revenue               | 4.4          | 3.9          | 3.0          | 3.0          | 3.1          |
| <b>Total revenue</b>        | <b>172.5</b> | <b>161.0</b> | <b>164.6</b> | <b>168.7</b> | <b>169.8</b> |
| Property opex               | -39.7        | -39.2        | -37.9        | -39.6        | -38.4        |
| <b>Net property income</b>  | <b>132.8</b> | <b>121.7</b> | <b>126.7</b> | <b>129.1</b> | <b>131.5</b> |
| Other income                | 1.9          | -32.4        | 2.4          | 2.8          | 2.8          |
| <b>Net invest income</b>    | <b>134.7</b> | <b>89.3</b>  | <b>129.1</b> | <b>131.9</b> | <b>134.3</b> |
| Manager's fee               | -13.3        | -12.8        | -12.8        | -13.0        | -13.0        |
| Trustee's fee               | -0.7         | -0.7         | -0.7         | -0.7         | -0.7         |
| Finance costs               | -40.6        | -39.6        | -36.4        | -37.7        | -37.8        |
| Other non opex              | -0.9         | -0.9         | -0.9         | -0.9         | -0.9         |
| Profit before tax           | <b>79.3</b>  | <b>35.4</b>  | <b>78.3</b>  | <b>79.5</b>  | <b>81.9</b>  |
| Taxation                    | -6.1         | -6.2         | 0.0          | 0.0          | 0.0          |
| <b>Profit after tax</b>     | <b>73.1</b>  | <b>29.1</b>  | <b>78.3</b>  | <b>79.5</b>  | <b>81.9</b>  |
| <b>Core net profit</b>      | <b>84.7</b>  | <b>72.1</b>  | <b>78.3</b>  | <b>79.5</b>  | <b>81.9</b>  |
| <b>Distributable income</b> | <b>87.1</b>  | <b>73.0</b>  | <b>78.3</b>  | <b>79.5</b>  | <b>81.9</b>  |
| Consensus core net profit   |              |              | 74.8         | 75.5         | 76.7         |
| HLIB/ Consensus             |              |              | 105%         | 105%         | 107%         |

### Cash Flow Statement

| FYE Dec                   | FY18          | FY19          | FY20f        | FY21f        | FY22f        |
|---------------------------|---------------|---------------|--------------|--------------|--------------|
| Profit before taxation    | 79.3          | 35.4          | 78.3         | 79.5         | 81.9         |
| Finance costs             | 40.6          | 39.6          | 0.0          | 0.0          | 0.0          |
| Depreciation              | 0.1           | 0.2           | 0.2          | 0.1          | 0.1          |
| Fair value gain of assets | 5.4           | 36.7          | 0.0          | 0.0          | 0.0          |
| Interest income           | -4.3          | -3.2          | 0.0          | 0.0          | 0.0          |
| Others                    | -14.6         | 2.2           | -0.7         | 0.5          | -0.5         |
| <b>CFO</b>                | <b>106.5</b>  | <b>110.9</b>  | <b>77.7</b>  | <b>80.1</b>  | <b>81.5</b>  |
| Capex                     | -3.8          | -2.1          | -2.0         | -2.0         | -2.0         |
| Disposal / (purchase)     | -0.2          | -0.2          | 0.0          | 0.0          | 0.0          |
| Others                    | 31.7          | 2.7           | 0.0          | 0.0          | 0.0          |
| <b>CFI</b>                | <b>27.6</b>   | <b>0.4</b>    | <b>-2.0</b>  | <b>-2.0</b>  | <b>-2.0</b>  |
| Distribution paid         | -89.8         | -78.0         | -76.7        | -77.9        | -80.3        |
| Proceeds frm borrow'g     | 117.0         | 35.0          | 400.0        | 165.0        | 165.0        |
| Repayment of borrow'g     | -117.0        | -54.0         | -389.0       | -164.0       | -164.0       |
| Others                    | -34.6         | -36.8         | 0.0          | 0.0          | 0.0          |
| <b>CFF</b>                | <b>-124.3</b> | <b>-133.8</b> | <b>-65.7</b> | <b>-76.9</b> | <b>-79.3</b> |
| <b>Net cash flow</b>      | <b>9.7</b>    | <b>-22.5</b>  | <b>10.0</b>  | <b>1.2</b>   | <b>0.2</b>   |
| Beginning cash            | 76.0          | 85.8          | 63.3         | 73.3         | 74.5         |
| Ending cash               | 85.8          | 63.3          | 73.3         | 74.5         | 74.6         |

### Valuation & Ratios

| FYE Dec          | FY18    | FY19    | FY20f   | FY21f   | FY22f   |
|------------------|---------|---------|---------|---------|---------|
| Core EPU (sen)   | 7.9     | 6.7     | 7.3     | 7.4     | 7.6     |
| P/E (x)          | 10.9    | 12.8    | 11.8    | 11.6    | 11.2    |
| EBITDA           | 125.4   | 111.8   | 114.8   | 117.3   | 119.8   |
| EBIT             | 125.3   | 111.7   | 114.7   | 117.2   | 119.7   |
| EV               | 1,689.7 | 1,694.2 | 1,695.2 | 1,695.0 | 1,695.8 |
| EV/EBITDA (x)    | 13.5    | 15.1    | 14.8    | 14.4    | 14.2    |
| DPU (sen)        | 8.1     | 6.8     | 7.2     | 7.3     | 7.5     |
| Dividend yield   | 9.4     | 7.9     | 8.3     | 8.5     | 8.7     |
| NTA/ share (sen) | 127.3   | 122.7   | 122.9   | 123.0   | 123.2   |
| P/ NTA           | 0.7     | 0.7     | 0.7     | 0.7     | 0.7     |
| BVPS (RM)        | 1.28    | 1.23    | 1.24    | 1.24    | 1.24    |
| P/B (x)          | 0.7     | 0.7     | 0.7     | 0.7     | 0.7     |
| EBITDA margin    | 72.7%   | 69.5%   | 69.8%   | 69.6%   | 70.5%   |
| EBIT margin      | 72.6%   | 69.4%   | 69.7%   | 69.5%   | 70.5%   |
| PBT margin       | 45.9%   | 22.0%   | 47.6%   | 47.1%   | 48.2%   |
| Net margin       | 49.1%   | 44.8%   | 47.6%   | 47.1%   | 48.2%   |
| ROE              | 5.3%    | 2.1%    | 5.9%    | 6.0%    | 6.2%    |
| ROA              | 3.7%    | 3.3%    | 3.5%    | 3.6%    | 3.7%    |
| Net gearing      | 33.80%  | 34.89%  | 34.75%  | 34.69%  | 34.69%  |

### Assumptions

| FYE Dec                    | FY19  | FY20f | FY21f | FY22f |
|----------------------------|-------|-------|-------|-------|
| <b>Gross rental income</b> |       |       |       |       |
| Quill Building 1 - DHL 1   | 5.0   | 5.0   | 5.1   | 5.1   |
| Quill Building 4 - DHL 2   | 5.4   | 5.4   | 5.5   | 5.6   |
| Quill Building 2 - HSBC    | 9.9   | 9.9   | 10.1  | 10.1  |
| Quill Building 3 - BMW     | 5.8   | 5.8   | 5.8   | 5.9   |
| Wisma Technip              | 8.0   | 8.4   | 8.9   | 8.9   |
| Part of Plaza Mont' Kiara  | 3.7   | 3.0   | 3.0   | 3.1   |
| Quill Building 5 - IBM     | 0.0   | 0.0   | 0.0   | 0.0   |
| Tesco Building - Penang    | 14.7  | 14.9  | 15.2  | 15.3  |
| Platinum Sentral           | 48.3  | 50.2  | 51.7  | 52.0  |
| Menara Shell               | 44.4  | 48.4  | 49.4  | 49.6  |
| Total:                     | 145.2 | 151.0 | 154.7 | 155.6 |

### Quarterly financial summary

| FYE Dec                  | 3Q19  | 2Q20  | 3Q20  | QoQ (%) | YoY (%) |
|--------------------------|-------|-------|-------|---------|---------|
| Gross Revenue            | 39.9  | 40.1  | 42.1  | 5%      | 5%      |
| Property operating expen | -9.7  | -9.1  | -9.3  | 2%      | -4%     |
| Net Property Income      | 30.2  | 31.0  | 32.7  | 6%      | 8%      |
| Interest income          | 0.7   | 0.5   | 0.6   | 16%     | -10%    |
| Net Investment Income    | 30.9  | 31.5  | 33.4  | 6%      | 8%      |
| Total Expenses           | -13.3 | -12.4 | -11.9 | -4%     | -10%    |
| Normalised PBT           | 17.6  | 19.1  | 21.5  | 13%     | 22%     |
| Normalised PAT           | 17.6  | 19.1  | 21.5  | 13%     | 22%     |
| Distributable income     | 17.6  | 19.1  | 21.5  | 13%     | 22%     |
| EPU (realised)           | 1.6   | 1.8   | 2.0   | 13%     | 22%     |
| DPU (sen)                | 0.0   | 3.4   | 0.0   | N.M.    | N.M.    |

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## Stock rating guide

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

## Sector rating guide

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

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