Singapore Company Update

13 December 2019

Property | REITS

Manulife US REIT (MUST SP)

Buy (Maintained)

Moving Into The Next League; Top BUY

Target Price (Return)	USD1.10 (+10%)
Price:	USD1.00
Market Cap:	USD1,561m
Avg Daily Turnover (SGD/USD)	13.6m/10.1m

- **Keep BUY with new TP of USD1.10 from USD1.00, 10% upside plus c.6% yield.** MUST, one of our Top Picks, has outperformed YTD +30%, vs S-REITs Index +17%. Key reasons: continued momentum in US office demand, lower interest rates, strong earnings track record and better investor education. With the recent index inclusion increasing stock liquidity and visibility, we expect trading yield discount (c.150bps higher than office S-REIT peers) to narrow further. Post rally, valuations remain reasonably attractive at 1.2x P/BV.
- **Recent acquisitions and organic rent growth to drive DPU in 2020.** In FY19, Manulife US REIT made two accretive acquisitions of Centerpointe, Virginia and 400 Capitol, Sacramento which provide better income/tenant diversification and drive inorganic DPU growth. Overall portfolio rents are still 5-15% below the market barring Michelson, where negative rental reversion is likely to persist, aiding in organic rent growth. For 2020-2021, c.7% and 6% of leases by gross income are due for renewal. We expect positive mid-single digit rental reversions. Additionally 95% of leases have an in-built rent escalation of c.2% pa.
- **Potential upside from tax structure rollback and recent index inclusion**. MUST is currently awaiting the finalisation of the proposed US tax regulations, which we expect to be announced by 1H20. If there are no additional changes to the proposed draft regulations, the REIT will be able to roll back its existing tax structure to IPO tax structure. This will help in avoiding the income tax paid at its Barbados entity, and result in additional tax savings of c.1.5% pa, thereby lifting distributions. The stock's recent inclusion into the FTSE EPRA NAREIT Global Developed Index has helped raise visibility among institutional investors and improve liquidity, which should aid in further yield compression in our view.
- **US office outlook remains positive; co-working makes up <2% of total.** Based on Jones Lang LaSalle (JLL) latest US office sector report, office rents continue to remain on an uptrend, increasing 0.9% QoQ in 3Q19. The report also noted that continued flight to quality will keep top-end options limited despite a high supply pipeline. While co-working sector experience tapering office growth continued, demand from high-growth tech, creative, and life sciences tenants continued to drive occupancy gains. We also note that supply ahead in MUST's submarket remains limited. Overall, co-working spaces still account for only <2% of MUST's portfolio, thus we see limited impact from the potential fallout of co-working operators for now.
- **DPU and TP adjustments.** We revise our FY20F-21F earnings by 1-2% by fine-tuning our interest cost and tax. Our COE is also lowered by 40bps to 7.8% with recent index inclusion increasing liquidity and visibility, as we roll forward our DDM valuation to next year.

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (USDm)	92.0	144.6	179.4	205.5	209.6
Net property income (USDm)	58.4	90.7	114.0	132.3	134.8
Reported net profit (USDm)	58.0	64.5	92.9	109.5	113.7
Distributable income (USDm)	46.7	71.0	84.4	99.2	103.2
DPS (USD - cents)	5.8	5.6	6.1	6.3	6.5
DPS growth (%)	-	(3.6)	9.3	3.5	3.4
P/BV (x)	1.2	1.2	1.2	1.2	1.2
Dividend Yield (%)	5.8	5.6	6.1	6.3	6.5
Return on average equity (%)	6.8	6.1	7.1	8.2	8.4
Return on average assets (%)	4.2	3.6	4.3	5.0	5.1
Interest coverage (x)	7.1	4.4	4.8	5.1	5.2

Source: Company data, RHB

Analyst

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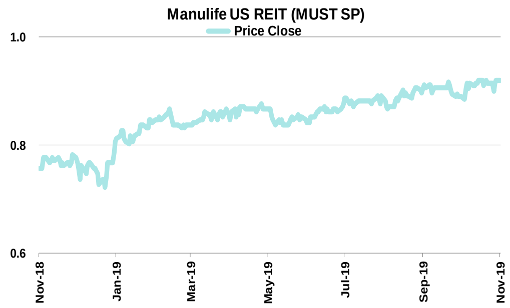
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	30.4	5.8	10.9	16.0	31.2
Relative	26.1	7.9	10.8	16.3	28.0
52-wk Price low/high (SGD)					0.71 - 1.03



Source: Bloomberg

Financial Exhibits

Asia
Singapore
Property
Manulife US REIT
Bloomberg MUST SP

Valuation basis

We use DDM:
i. COE of 7.8%;
ii. Risk-free rate of 3.0%;
iii. 2% terminal growth.

Key drivers

i. Continued momentum in office demand;
ii. Rollback of tax structure and index inclusions;
iii. Yield-accretive acquisitions.

Key risks

i. Failure of co-working model impacting demand;
ii. Adverse changes in tax structure;
iii. Inability to retain key tenants.

Company Profile

Manulife US REIT is a S-REIT established with the investment strategy to principally invest – directly or indirectly – in a portfolio of income-producing office real estate in key markets in the US, as well as real estate-related assets.

Financial summary	**Dec-17**	**Dec 18**	**Dec 19F**	**Dec 20F**	**Dec 21F**
Recurring EPS (USD)	0.07	0.05	0.07	0.07	0.07
EPS (USD)	0.07	0.05	0.07	0.07	0.07
DPS (USD)	0.06	0.06	0.06	0.06	0.07
BVPS (USD)	0.83	0.83	0.83	0.85	0.85
Weighted avg adjusted shares (m)	834	1,276	1,388	1,575	1,586

Valuation metrics	**Dec-17**	**Dec 18**	**Dec 19F**	**Dec 20F**	**Dec 21F**
Recurring P/E (x)	14.4	19.8	14.9	14.4	14.0
P/E (x)	14.4	19.8	14.9	14.4	14.0
P/B (x)	1.2	1.2	1.2	1.2	1.2
FCF Yield (%)	4.1	4.1	5.0	5.5	5.7
Dividend Yield (%)	5.8	5.6	6.1	6.3	6.5
EV/EBITDA (x)	29.0	21.1	17.6	15.3	15.1
EV/EBIT (x)	29.0	21.1	17.6	15.3	15.1

Income statement (USDm)	**Dec-17**	**Dec 18**	**Dec 19F**	**Dec 20F**	**Dec 21F**
Total turnover	92	145	179	206	210
Gross profit	58	91	114	132	135
EBITDA	0	0	0	0	0
Depreciation and amortisation	0	0	1	2	3
Operating profit	0	0	0	0	0
Net interest	(9)	(19)	(25)	(26)	(27)
Income from associates & JVs	0	0	0	0	0
Exceptional income - net	0	0	0	0	0
Pre-tax profit	74	79	96	114	116
Taxation	(16)	(15)	(3)	(5)	(2)
Minority interests	0	0	0	0	0
Recurring net profit (adj)	58	65	93	110	114

Cash flow (USDm)	**Dec-17**	**Dec 18**	**Dec 19F**	**Dec 20F**	**Dec 21F**
Change in working capital	(2)	(8)	(8)	(8)	(8)
Cash flow from operations	44	63	78	97	100
Capex	(9)	(11)	(9)	(10)	(11)
Cash flow from investing activities	(434)	(399)	(331)	(10)	(10)
Dividends paid	(42)	(59)	(84)	(99)	(103)
Cash flow from financing activities	402	341	263	(85)	(87)
Cash at beginning of period	38	50	54	64	66
Net change in cash	11	4	9	3	3
Ending balance cash	50	54	64	66	69

Balance sheet (USDm)	**Dec-17**	**Dec 18**	**Dec 19F**	**Dec 20F**	**Dec 21F**
Total cash and equivalents	50	54	64	66	69
Tangible fixed assets	1313	1739	2088	2119	2151
Intangible assets	0	0	0	0	0
Total investments	1313	1739	2088	2119	2151
Total other assets	7	10	5	6	6
Total assets	1369	1803	2156	2191	2225
Short-term debt	0	110	110	110	110
Total long-term debt	458	557	657	667	677
Other liabilities	59	72	75	79	82
Total liabilities	517	739	842	856	869
Shareholders' equity	852	1064	1314	1335	1356
Minority interests	0	0	0	0	0
Total equity	852	1064	1314	1335	1356
Net debt	409	613	704	711	718
Total liabilities & equity	1369	1803	2156	2191	2225

Key metrics	**Dec-17**	**Dec 18**	**Dec 19F**	**Dec 20F**	**Dec 21F**
Revenue growth (%)	94	57	24	15	2
Recurrent EPS growth (%)	(16)	(27)	32	4	3
Gross margin (%)	63	63	64	64	64
Operating EBITDA margin (%)	56	56	57	58	58
Net profit margin (%)	63	45	52	53	54
Dividend payout ratio (%)	100	100	100	100	100
Capex/sales (%)	10	14	6	6	5
Interest cover (x)	7	4	5	5	5

Source: Company data, RHB

Figure 1: DDM valuation

	FY20F	FY21F	FY22F	FY23F	Terminal Value
DPU (US cents)	6.29	6.51	6.67	6.80	119.54
Target price (USD)	1.10				
Current Price (USD)	1.00				
Price Upside (%)	10.0%				
Distribution Yield FY20F (%)	6.3%				
Total Yield (%)	16.3%				
Assumptions					
Risk-free rate (%)	3.0%				
Beta	0.9				
Cost of equity (%)	7.8%				
Terminal growth (%)	2.0%				

Source: RHB

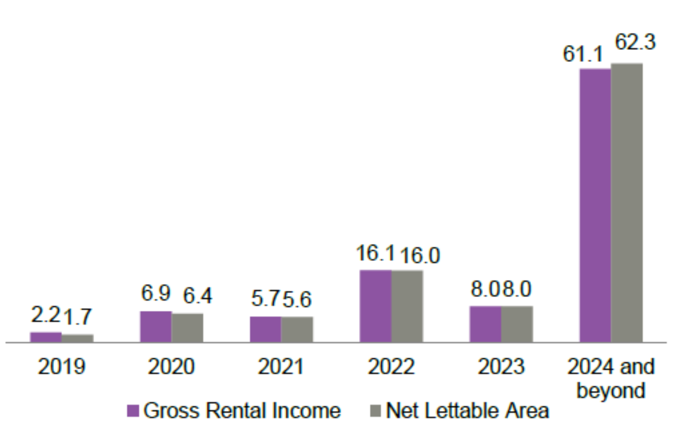
Figure 2: MUST's portfolio assets

	Figueroa	Michelson	Peachtree	Plaza	Exchange	Penn	Phipps	Centerpointe	Capitol[2]
Location	Los Angeles	Irvine	Atlanta	Secaucus	Jersey City	Washington, D.C.	Atlanta	Virginia	Sacramento
Property Type	Class A	Trophy	Class A	Class A	Class A	Class A	Trophy	Class A	Class A
Completion Date	1991	2007	1991	1985	1988	1964	2010	1987 / 1989	1992
Last refurbishment	2015	-	2015	2016	-	2018	-	2018	2016
Property Value (US$ m)[3]	331.3	345.2	207.2	119.8	345.5	189.1	218.4	122.8	198.8[4]
Occupancy (%)	93.6	96.0	99.4	98.9	95.8	100.0	100.0	98.7	94.9[5]
NLA (sq ft)	702,621	532,933	557,758	461,525	736,383	277,597	475,199	419,981	500,662
WALE by NLA (years)	3.9	5.9	5.0	6.7	7.0	5.0	8.4	6.4	5.9
Land Tenure	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold[1]	Freehold	Freehold
No. of Tenants	28	15	26	7	23	11	10	21	44

Data as at 30 Sep 2019
(1) The property is held in a leasehold until the end of 2020 to afford it certain real estate tax advantages but will be converted to a freehold for a nominal sum of US$100.0 thereafter
(2) Capitol's data as at 11 Sep 2019
(3) Investment properties are stated at fair value based on 30 Jun 2019 appraisals plus capitalisation of capital expenditures and leasing cost (including tenant improvement allowances)
(4) Based on purchase price announced on 19 Sep 2019
(5) Based on committed leases as of 11 Sep 2019

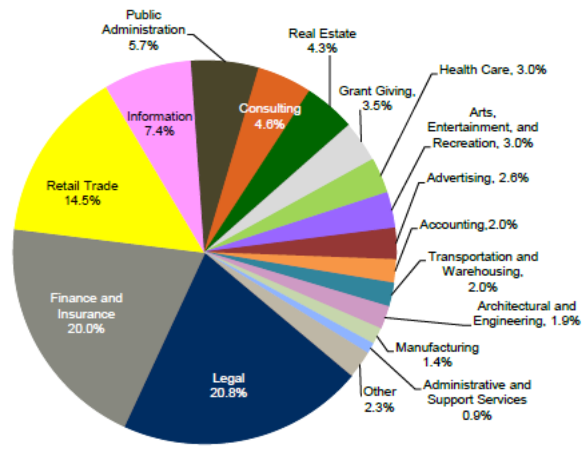
Source: Company data

Figure 3: Lease expiry profile (As of 3Q19)



Source: Company data

Figure 4: Trade sector by rental income (3Q19)



Source: Company data

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