

5 November 2019

Property | REITS

## Manulife US REIT (MUST SP)

**Buy** (Maintained)

### More Goodies To Come; Maintain BUY

Target Price (Return)	USD1.00 (+10%)
Price:	USD0.92
Market Cap:	USD1,440m
Avg Daily Turnover (SGD/USD)	1.1m/0.8m

#### Analyst

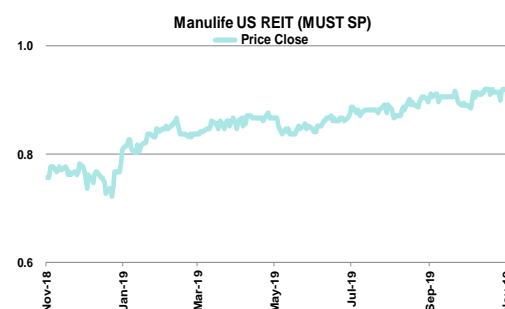
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- **Maintain BUY and USD1.00 TP, 10% upside plus c.7% yield.** MUST, which remains one of our Top Picks, had 3Q/9M19 results that were in line. Key takeaways are the continued occupancy improvement and positive rent growth. Post recent acquisitions and placement, the REIT is likely to meet the criteria for the FTSE EPRA NAREIT Index inclusion, which should act as a near-term catalyst. Valuations are still attractive at 1.1x P/BV.
- **3Q adjusted DPU down marginally by 2.6%YoY.** Gross revenue/NPI grew 13.3%/11.8% YoY on the Centerpointe acquisition. DPU, however, was slightly lower YoY due to higher financing costs, rent-free periods for leases signed, and slightly higher income tax. The adjusted DPU came in line with 3Q/9M19, accounting for 24%/74% of our full-year forecasts. Looking ahead, financing costs are expected to moderate with recent loans secured ~40bps lower than weighted average interest cost. Portfolio occupancy inched up 0.1ppt QoQ to 97.3% due to occupancy improvement in Figueroa and Penn.
- **Co-working makes up only 1.9% of rental income.** Addressing concerns on co-working spaces, management noted that this segment is still small and made up c.1.8% of total office spaces in the US. Manulife US REIT has ~1% exposure to WeWork, which is one of the key tenants in its recently acquired 400 Capitol. Management noted that the WeWork lease for the property is fairly long at 15 years with a break clause available only at the end of the ninth year. Thus, it does not see any risk from co-working operators in its portfolio.
- **Expecting mid-single digit rent reversions for FY20F.** In 3Q, only a few leases were signed (~33,000 sqf) – management noted that there was good positive rent growth. YTD, c.400,000 sqf of leases were signed with slight positive rent reversions (low single digits in our view). The key reason for the lower YTD rent reversions is mainly due to Michelson's leases, which were marked to market. Overall, the current portfolio average rents are still 5-15% below market level except for Michelson. For 4Q19/2020, about 2.2%/6.9% of leases by rental income are pending renewal – we expect mid-single digit rental reversions.
- **Key near-term catalysts are Index inclusion and tax structure rollback.** Post completion of 400 Capitol acquisition and associated equity fund raising MUST is likely to meet the index inclusion criteria for the FTSE EPRA Nareit Developed Asia Index. This should help in the REIT's re-rating, in terms of liquidity and visibility. MUST is also awaiting the finalisation of proposed US tax regulations – the REIT should be able to roll back to its IPO tax structure, resulting in additional tax savings of 1.5%.

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	19.9	3.4	3.2	6.1	23.1
Relative	14.5	(1.7)	4.0	10.8	19.3
52-wk Price low/high (SGD)	0.71 - 0.93				



Source: Bloomberg

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	111.0
Distributable income (USDm)	46.7	71.0	84.4	99.2	102.0
DPS (USD - cents)	5.8	5.6	6.1	6.3	6.4
DPS growth (%)	-	-3.6	9.3	3.5	2.1
P/BV (x)	1.1	1.1	1.1	1.1	1.1
Dividend Yield (%)	6.3	6.0	6.6	6.8	7.0
Return on average equity (%)	6.8	6.1	7.1	8.2	8.2
Return on average assets (%)	4.2	3.6	4.3	5.0	5.0
Interest coverage (x)	7.1	4.4	4.8	5.1	5.0

Source: Company data, RHB

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## Financial Exhibits

<b>Asia</b>	<b>Financial summary</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
Singapore	Recurring EPS (USD)	0.07	0.05	0.07	0.07	0.07
Property	EPS (USD)	0.07	0.05	0.07	0.07	0.07
<b>Manulife US REIT</b>	DPS (USD)	0.06	0.06	0.06	0.06	0.06
Bloomberg MUST SP	BVPS (USD)	0.82	0.83	0.83	0.85	0.85
	Weighted avg adjusted shares (m)	834	1,276	1,389	1,577	1,589
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
We use DDM:	Recurring P/E (x)	13.2	18.2	13.8	13.2	13.2
i. COE of 8.2%;	P/E (x)	13.2	18.2	13.8	13.2	13.2
ii. Risk-free rate of 3.0%;	P/B (x)	1.1	1.1	1.1	1.1	1.1
iii. 2% terminal growth.	FCF Yield (%)	4.5	4.4	5.4	6.0	6.1
<b>Key drivers</b>	Dividend Yield (%)	6.3	6.0	6.6	6.8	7.0
i. Continued momentum in office demand;	EV/EBITDA (x)	27.4	20.1	16.8	14.6	14.4
ii. Rollback of tax structure and inclusion into the NAREIT index;	EV/EBIT (x)	27.4	20.1	16.8	14.6	14.4
iii. Yield-accretive acquisitions.						
<b>Key risks</b>	<b>Income statement (USDm)</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
i. Failure of co-working model impacting demand;	Total turnover	92	145	179	206	210
ii. Adverse changes in tax structure; and	Gross profit	58	91	114	132	135
iii. Inability to retain key tenants.	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)	(5)
	Minority interests	0	0	0	0	0
	Recurring net profit (adj)	58	65	93	110	111
<b>Company Profile</b>	<b>Cash flow (USDm)</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
Manulife US REIT (MUST) is a SREIT 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.	Change in working capital	(2)	(8)	(8)	(8)	(8)
	Cash flow from operations	44	63	78	97	99
	Capex	(9)	(11)	(9)	(10)	(11)
	Cash flow from investing activities	(434)	(399)	(331)	(10)	(10)
	Dividends paid	(42)	(59)	(84)	(99)	(102)
	Cash flow from financing activities	402	341	263	(85)	(88)
	Cash at beginning of period	38	50	54	64	66
	Net change in cash	11	4	9	3	1
	Ending balance cash	50	54	64	66	67
	<b>Balance sheet (USDm)</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
	Total cash and equivalents	50	54	64	66	67
	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	2224
	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	1355
	Minority interests	0	0	0	0	0
	Total equity	852	1064	1314	1335	1355
	Net debt	409	613	704	711	720
	Total liabilities & equity	1369	1803	2156	2191	2224
	<b>Key metrics</b>	<b>Dec-17</b>	<b>Dec 18</b>	<b>Dec 19F</b>	<b>Dec 20F</b>	<b>Dec 21F</b>
	Revenue growth (%)	94	57	24	15	2
	Recurrent EPS growth (%)	(16)	(27)	32	4	1
	Gross margin (%)	63	63	64	64	64
	Operating EBITDA margin (%)	56	56	57	58	58
	Net profit margin (%)	63	45	52	53	53
	Dividend payout ratio (%)	100	100	100	100	100
	Capex/sales (%)	10	14	6	6	5
	Interest cover (x)	5	4	4	5	4

Source: Company data, RHB

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Figure 1: DDM valuation

	FY19F	FY20F	FY21F	FY22F	Terminal Value
DPU (US cents)	6.08	6.29	6.42	6.62	109.04
Target price (USD)	1.00				
Current Price (USD)	0.92				
Price Upside (%)	10.0%				
Distribution Yield FY19F (%)	6.6%				
Total Yield (%)	16.6%				
<b>Assumptions</b>					
Risk-free rate (%)	3.0%				
Beta	0.9				
Cost of equity (%)	8.2%				
Terminal growth (%)	2.0%				

Source: RHB

Figure 2: MUST's portfolio assets

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

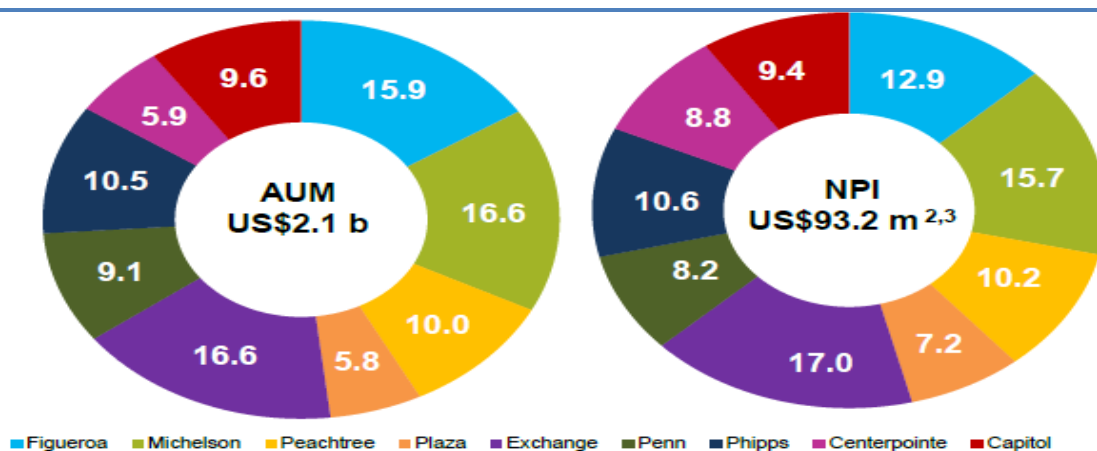
(3) Investment properties are stated at fair value based on 30 Jun 2019 appraisals plus capitalisation of capital expenditures and leasing cost (including tenant improvement allowances)

(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: MUST's AUM and NPI (YTD-9M19) contribution by asset



(1) Includes acquisition of Centerpointe completed on 10 May 2019 (U.S. time) and Capitol completed on 29 Oct 2019 (U.S. time)

(2) NPI for Centerpointe was extrapolated based on actual results (for the period 10 May to 30 Sep 2019) to full period YTD Sep 2019

(3) NPI for Capitol was based on 1H 2019 Pro Forma and was extrapolated to full period YTD Sep 2019

Source: Company data

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<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
<b>Take Profit:</b>	Target price has been attained. Look to accumulate at lower levels
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<b>Not Rated:</b>	Stock is not within regular research coverage

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