

11 May 2020

Property | REITS

Manulife US Real Estate Investment Trust (MUST SP)

Buy (Maintained)

Remains Operationally Strong; Top Pick

Target Price (Return): USD0.90 (+28%)
 Price: USD0.71
 Market Cap: USD1,100m
 Avg Daily Turnover (USD/USD): 5.21m/5.21m

Analyst

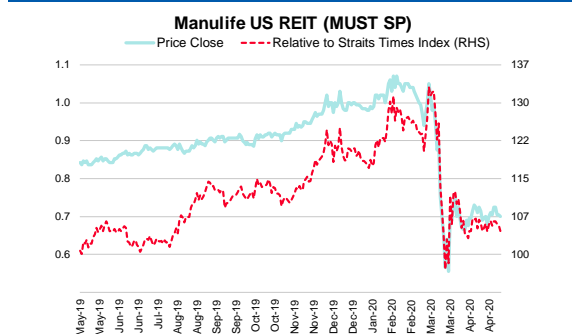
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- **Maintain BUY with new TP of USD0.90 from USD0.88, 28% upside and c.9% yield.** Manulife US Real Estate Investment Trust's 1Q operational updates point to a healthy US office market prior to the rapid escalation of COVID-19 in the US. While the US economic and office outlook have deteriorated sharply, recent easing of lockdown raises some hope. Good asset quality, strong tenant profile and minimal near-term lease expiries mitigate risks. Recent rollback of tax structure provides additional savings.
- **Occupancy improves and positive rent reversion of 8%.** MUST signed leases for 147,000 sqf (3% of total) in 1Q with 65% of them being new leases. Demand came from legal, technology, finance & insurance and real estate-related sectors with higher expansionary demand. The leases signed also have an in-built annual rent escalations of 2-3.5% pa. Leasing demand has understandably come to a halt since March but MUST is in a good position with only 4% and 6% of leases due for renewal in FY20F-21F.
- **Minimal impact so far from COVID-19 but a clearer picture likely to emerge in coming months.** MUST has received some rent relief requests from tenants but it does not see merit in all. It has so far provided rental deferment for only 2% of tenants (by rental income) – majority in the F&B segment in its office buildings – and currently, does not intend to provide rental waiver. A vast majority of April rents has been collected. Two of three co-working tenants have paid April rent, with another paying partial amount, which we believe is Wework (~2% of MUST's total income). All nine of its office assets remain operational but physical occupancy by employees remain low at 5-10%. MUST is currently focusing on cost reduction at its buildings and has deferred all non-essential capex to reduce operating expense. Positively, most of the US states have started easing some of the lockdown measures, which should revive some economic activity.
- **Refinancing of 2020 loans at lower interest rates.** MUST has secured commitments for its Peachtree loan (~USD70m) with an all-in interest cost expected to be lower than the current rate of 2.46% pa. Management noted that banks have eased liquidity post initial knee-jerk reaction in March and spreads have not widened. 95% of its debt is currently fixed.
- **Finalisation of tax regulations to result in tax savings of ~1% pa.** The final regulations relating to Section 267A of the United States Internal Revenue Code were announced on 20 Apr. Based on the final regulations, MUST would be able to revert its tax structure to that which was in place during its listing ie without the need for a Barbados entity it currently has. The move should result in an annual tax savings of 0.7% pa from 2021.
- **Earnings changes.** We revise up our FY21-22 forecasts by 1-2%, factoring in tax savings and lower interest costs resulting in a TP uplift.

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(30.0)	5.3	(34.6)	(23.9)	(19.2)
Relative	(10.4)	0.4	(14.8)	(3.3)	2.1
52-wk Price low/high (USD)				0.56 – 1.07	



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (USDm)	145	178	203	206	211
Net property income (USDm)	91	111	131	133	135
Reported net profit (USDm)	65	48	87	90	112
Total distributable income (USDm)	71	83	98	101	102
DPS (USD)	0.06	0.06	0.06	0.06	0.06
DPS growth (%)	(3.6)	7.1	2.7	1.4	0.3
P/B (x)	1.03	0.89	0.90	0.91	0.91
Dividend Yield (%)	7.9	8.5	8.7	8.9	8.9
Return on average equity (%)	6.7	4.1	6.9	7.1	8.8
Return on average assets (%)	4.1	2.4	4.0	4.1	5.1

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS (USD)	0.05	0.03	0.05	0.06	0.07
Property	EPS (USD)	0.05	0.03	0.05	0.06	0.07
Manulife US Real Estate Investment Trust	DPS (USD)	0.06	0.06	0.06	0.06	0.06
MUST SP	BVPS (USD)	0.68	0.79	0.78	0.77	0.77
Buy	Return on average equity (%)	6.7	4.1	6.9	7.1	8.8
	Weighted avg adjusted shares (m)	1,422.50	1,584.07	1,610.99	1,634.00	1,657.19
Valuation basis	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
DDM Methodology	Recurring P/E (x)	15.43	23.31	12.94	12.70	10.35
	P/E (x)	15.43	23.31	12.94	12.70	10.35
Key drivers	P/B (x)	1.0	0.9	0.9	0.9	0.9
i. Good quality assets mitigates recession threat;	FCF Yield (%)	(33.5)	(22.9)	9.3	9.6	10.1
ii. Organic rental growth through rent escalations;	Dividend Yield (%)	7.9	8.5	8.7	8.9	8.9
iii. Long WALE and strong credit profile of tenants	EV/EBITDA (x)	19.95	19.57	16.63	16.52	16.34
	EV/EBIT (x)	19.08	18.83	16.10	15.97	15.80
Key risks	Income statement (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. Prolonged economic recession in the US;	Total turnover	145	178	203	206	211
ii. Changes in tax structure;	EBITDA	78	95	113	115	118
iii. Collapse of co-working office space players.	Depreciation and amortisation	4	4	4	4	4
	Operating profit	81	98	117	119	122
	Net interest	(19)	(26)	(28)	(29)	(30)
	Pre-tax profit	79	58	89	91	113
	Taxation	(15)	(10)	(2)	(1)	(1)
	Recurring net profit	65	48	87	90	112
Company Profile	Cash flow (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Manulife US Real Estate Investment Trust (MUST) is the first pure-play U.S. office REIT listed in Asia. It is a Singapore REIT established with the investment strategy principally to invest, directly or indirectly, in a portfolio of income-producing office real estate in key markets in the United States, as well as real estate-related assets.	Change in working capital	(8)	3	(1)	(1)	(0)
	Cash flow from operations	66	102	122	125	128
	Capex	(399)	(356)	(17)	(16)	(11)
	Cash flow from investing activities	(399)	(356)	(16)	(15)	(10)
	Dividends paid	(59)	(99)	(98)	(101)	(102)
	Cash flow from financing activities	451	245	(79)	(83)	(85)
	Cash at beginning of period	50	54	61	63	65
	Net change in cash	117	(8)	26	27	33
	Ending balance cash	167	46	87	90	98
	Balance sheet (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	54	61	63	65	72
	Tangible fixed assets	1,739	2,095	2,112	2,128	2,160
	Total investments	0	0	0	0	0
	Total assets	1,803	2,166	2,181	2,199	2,237
	Short-term debt	110	79	79	79	79
	Total long-term debt	557	733	743	753	763
	Total liabilities	739	908	919	933	947
	Shareholders' equity	1,064	1,258	1,262	1,266	1,290
	Total equity	1,064	1,258	1,262	1,266	1,290
	Net debt	613	751	759	767	770
	Total liabilities & equity	1,803	2,166	2,181	2,199	2,237
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	57.1	23.0	14.0	1.7	2.1
	Recurrent EPS growth (%)	(17.3)	(33.8)	80.2	1.8	22.7
	Operating EBITDA margin (%)	53.8	53.2	55.8	55.9	56.0
	Net profit margin (%)	44.6	26.7	43.0	43.6	53.2
	Capex/sales (%)	276.3	200.2	8.3	7.7	5.1
	Interest cover (x)	4.23	3.76	4.12	4.10	3.96

Source: Company data, RHB

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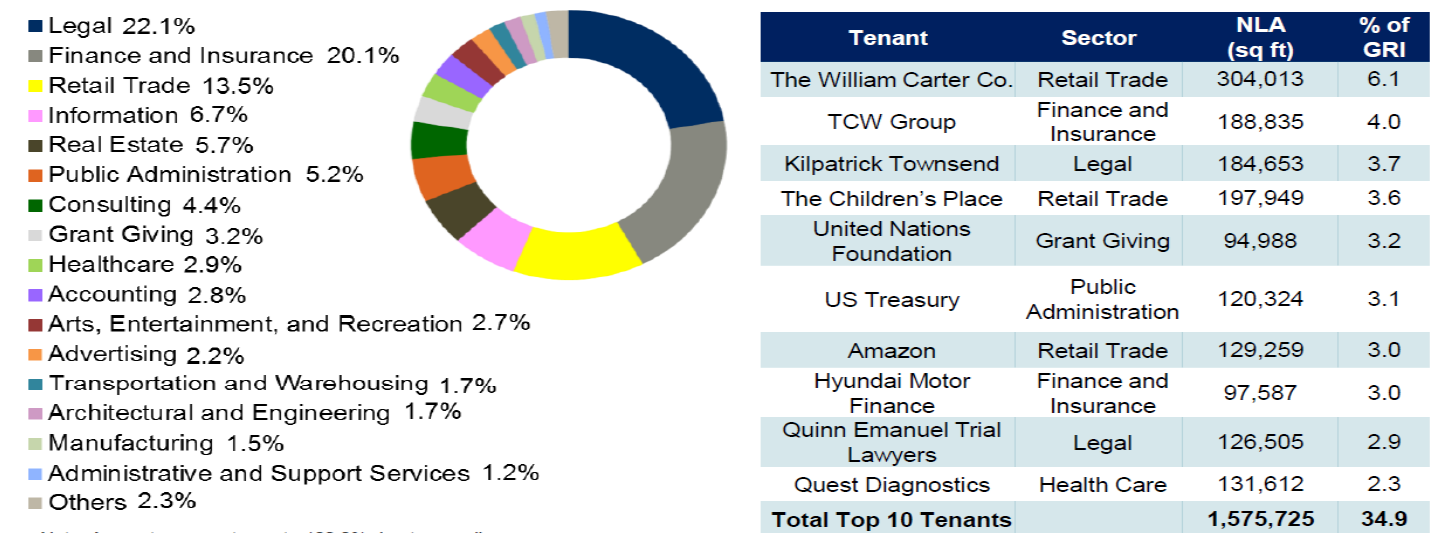
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Figure 1: DDM valuation

	FY20F	FY21F	FY22F	FY23F	FY24F	Terminal Value
DPU (US cents)	6.13	6.22	6.25	6.30	6.48	99.40
Target price (USD)	0.90					
Current Price (USD)	0.71					
Price Upside (%)	28.0%					
Distribution Yield FY20F (%)	8.7%					
Total Yield (%)	36.7%					
Assumptions						
Risk-free rate (%)	3.0%					
Beta	1.0					
Cost of equity (%)	8.6%					
Terminal growth (%)	2.0%					

Source: RHB

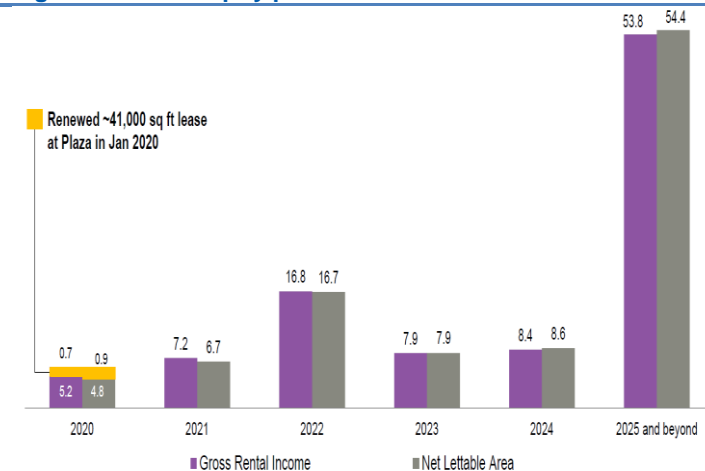
Figure 2: Tenant trade sectors and Top 10 tenants by gross rental income



Note: Amounts may not sum to 100.0% due to rounding

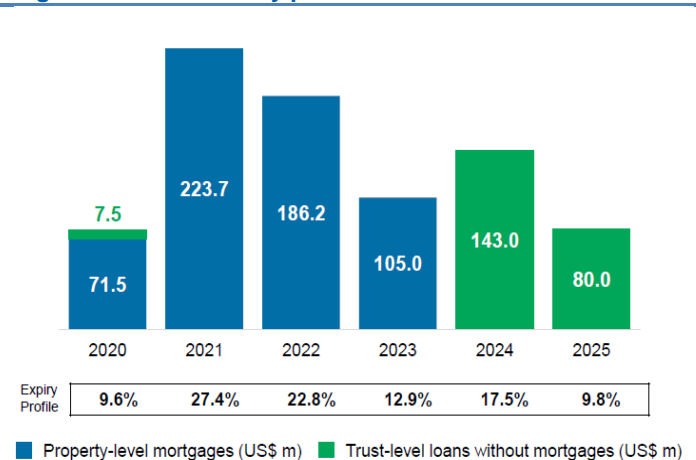
Source: Company data

Figure 3: Lease expiry profile



Source: Company data

Figure 4: Debt maturity profile



Source: Company data

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Figure 5: Asset details and summary

	Figuroa	Michelson	Peachtree	Plaza	Exchange	Penn	Phipps	Centerpointe	Capitol
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	2019	-	2015	2016	-	2018	-	2018	2016
Property Value (US\$ m)¹	337.6	345.0	210.7	119.9	348.6	189.0	220.1	122.8	201.3
Occupancy (%)	93.8	90.1	95.0 ²	98.9	95.8	100.0	100.0	98.7	94.2
NLA (sq ft)	702,951	532,933	558,784	461,525	736,383	277,597	475,629	420,013	500,662
WALE by NLA (years)	3.7	6.1	5.0	6.4	6.7	4.9	8.1	6.1	5.8
Land Tenure	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold ³	Freehold	Freehold
No. of Tenants	29	14	25	7	23	11	10	21	42

Data as at 31 Dec 2019

(1) Valuation as at 31 Dec 2019

(2) A new lease was executed at Peachtree in Jan 2020, bringing the property's occupancy to 99.0%

(3) 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

Source: Company data

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-03-24	Buy	0.88	0.70
2020-02-05	Buy	1.12	1.04
2019-12-13	Buy	1.10	0.98
2019-11-05	Buy	1.00	0.92
2019-09-20	Buy	na	0.91
2019-08-15	Buy	na	0.88
2019-07-12	Buy	na	0.88
2019-05-02	Buy	na	0.87
2019-04-26	Buy	na	0.87

Source: RHB, Bloomberg

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

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