

7 November 2018

Property | REITS

Manulife US REIT

Buy (Maintained)

Another Solid Quarter; BUY

Maintain BUY, TP still at USD0.92, 20% upside with 8.1% FY19F yield. MUST delivered another solid set of quarterly numbers, backed by contributions from acquired assets and organic growth. Portfolio occupancy rate improved in four of its properties, with double-digit rental reversions recorded in 3Q. Outlook of the US office market remains rosy, on strong jobs creation and limited micro-market supply. While there has been some concerns on potential tax reforms impacting its tax-efficient structure, we believe the probability of any drastic changes is low. MUST is one of our top sector picks.

Portfolio metrics improved. Manulife US REIT's portfolio occupancy rate rose 0.5ppt QoQ to 96.5%, backed by improvements in Figueroa, Michelson, Peachtree and Phipps. This was partially offset by a slight drop in Exchange's occupancy rate. More importantly, renewed leases registered a strong positive rental reversion of 13.5%, indicating continued strength in the US office market and its asset quality. Note that the rental reversions are on top of inbuilt annual rental rate escalations. Overall, the outlook for the US office sector remains positive, underpinned by strong jobs creation (569,000 in 3Q18), wage growth and limited micro-market supply across its property locations (Figure 4). We expect leasing momentum to remain positive in the coming quarters.

Some right-sizing of space by law firms. Portfolio lease expiry (as % of gross rental income) for 2019 rose to 10%, vs 7.9% in 2Q18. Management noted that the increase was due to mutual agreements to right-size some of space occupied by law firms across its buildings. The REIT has also received some compensation for the spaces that will be vacated. With continued strength in the office market, we see the move as a win-win – as MUST can potentially fetch higher market rental rates for smaller spaces.

Speculation surrounding tax changes seems overdone. Recently there has been speculation on potential tax reforms by the Trump administration which may impact the current tax-efficient structure used by MUST. It surrounds changes to the US portfolio interest exemption rule, which shields withholding tax on interest and principal on shareholder's loan. While we have no clear visibility on this, the probability of any drastic change is low as the existing structure is used by a large number of private funds and will have a broader impact on foreign investments in the US. Even if implemented, we believe management is proactively evaluating counter-measures, ie increasing depreciation charges or changing the tax domicile entity, to limit the impact. The worst-case impact is likely to be a 15% drop in distributable income.

Asset enhancement initiative (AEI) progress. AEI works at Figueroa and Exchange are progressing well, and are on track for completion in 2019.

Valuations are compelling. MUST currently offers FY18-19F yields of 7.7%/8.1% which we deem as highly attractive. In comparison, US-listed office REITs and office S-REITs offer average yields of 4.7%/5.7%. Our DDM-based TP is based on CoE of 8.5% and a 2% terminal growth rate. Key risks to our call are changes to its tax-efficient structure, ability to retain key tenants and an unexpected slowdown in office space demand.

Target Price: USD0.92
Price: USD0.765
Market Cap: USD967m
Bloomberg Ticker: MUST SP

Share Data

Avg Daily Turnover (USD/USD) 2.92m/2.92m
52-wk Price low/high (USD) 0.77 - 0.98
Free Float (%) 95
Shares outstanding (m) 628
Estimated Return 20%

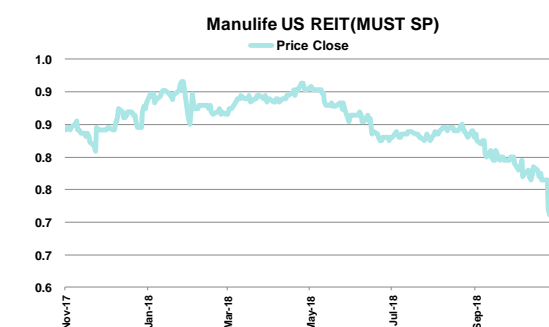
Shareholders (%)

Manulife Financial Corp 7.3
Prudential 5.3
DBS Group Holdings 3.2

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(14.6)	(3.2)	(10.0)	(17.8)	(14.6)
Relative	(4.6)	1.4	(3.8)	(4.2)	(5.2)

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-16	Dec-17	Dec 18 F	Dec 19 F	Dec 20 F
Total turnover (USDm)	48	92	147	165	168
Net property income (USDm)	30	58	91	103	105
Reported net profit (USDm)	52	8	9	30	68
Total distributable income (USDm)	22	47	47	37	62
DPS (USD)	0.06	0.06	0.06	0.06	0.06
DPS growth (%)		(4.0)	6.9	5.1	2.3
Recurring P/E (x)	9.3	11.0	11.7	10.7	10.6
P/B (x)	0.9	0.9	0.9	0.9	0.9
Dividend Yield (%)	7.5	7.2	7.7	8.1	8.3
Return on average equity (%)	9.4	6.8	7.9	8.6	8.5
Return on average assets (%)	5.9	4.2	3.8	4.2	4.2
Interest cover (x)	11.1	7.1	3.9	3.4	3.4
Our vs consensus EPS (adjusted) (%)					

Source: Company data, RHB

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Results And Operations Review

Debt profile. The REIT's gearing stands at 37.4%, with 100% of borrowings hedged. Overall borrowing cost currently stands at 3.27%. About USD108.5m of borrowings is due for renewal in Jul 2019, which should increase overall borrowing costs by 20-30bps. The impact, however, should be mitigated by organic rental growth and acquisition contributions.

3Q18 DPU adjusted upwards by 3.4% YoY. YTD 9M18 adjusted DPU (accounting for preferential offering and rights issue) increased by 2.5% YoY to 4.5 US cents. The results are in line, accounting for 26% and 77% of our full-year forecasts. 3Q18 gross revenue and NPI rose 75% YoY, mainly on the back of contributions from acquired assets. Its NPI margin was stable, at 62.3%.

Figure 1: 3Q18 results summary

(USDm)	3Q18	3Q17	YoY	9m18	YoY	Comments
Revenue	40.4	23.0	75.3%	104.1	65.8%	Driven by contributions from newly-acquired assets
NPI	25.1	14.4	74.9%	65.2	63.2%	In line with revenue growth
NPI (%)	62.3%	62.4%	-0.1ppt	62.6%	-1.0ppt	
Net income	13.5	9.3	45.3%	44.0	12.8%	
Unit holders Distribution	19.3	11.7	64.9%	51.4	60.2%	
Adjusted DPU (cents)	1.52	1.47	3.4%	4.53	2.5%	Adjusted for enlarged unit base from rights and preferential offering

Source: RHB

Figure 2: DDM valuation

	FY18F	FY19F	FY20F	FY21F	Terminal Value
DPU (USD Cts)	5.91	6.21	6.36	6.41	101.23
Target price (USD)	0.92				
Current Price (USD)	0.77				
Price Upside (%)	20.0%				
Distribution Yield FY18F (%)	7.7%				
Assumptions					
Risk-free rate (%)	3.5%				
Beta	0.95				
Cost of equity (%)	8.5%				
Terminal growth (%)	2.0%				

Source: RHB

Figure 3: Location and statistics of Manulife US REIT's properties



Source: Company

Figure 4: Office sub-market supply pipeline

Market	Properties Under Construction to be delivered from 2018 – 2020 ('000 sq ft)	Class A Inventory		Manulife US REIT ¹		
		Vacancy (%)	Gross Asking Rent per sq ft (US\$)	Properties	Vacancy (%)	Gross Passing Rent (US\$)
Downtown Los Angeles	0	13.5	43.15	Figueroa	5.7	40.81
Irvine, Orange County	0	17.6	35.72	Michelson	4.0	51.19
Midtown Atlanta	1,131 ²	9.1	38.59	Peachtree	6.7	32.48
Meadowlands ³	0	11.2 ⁴	29.78	Plaza	1.1	30.74
Hudson Waterfront ⁵	0	17.4	42.18	Exchange	3.8	39.36
Washington, D.C.	1,264 ⁶	11.6	54.98	Penn	0.0	52.02
Buckhead Atlanta	0	14.1	37.40	Phipps	0.0	35.52

Source: Cushman Market Analysis & Forecast – As at 4 Oct 2018

(1) Data as at 30 Sep 2018

(2) Approximately 50% pre-leased

(3) Secaucus is within the Meadowlands submarket

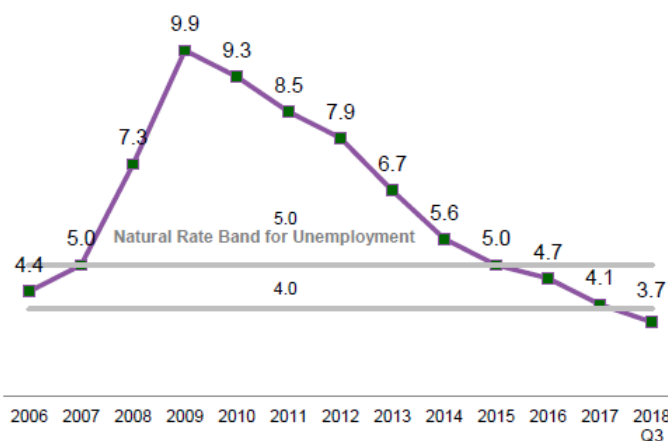
(4) Plaza's competitive set has vacancy rate of only 5%

(5) Jersey City is within the Hudson Waterfront submarket

(6) Of the properties under construction, only ~154,000 is directly comparable to Penn and is approximately 100% pre-leased

Source: Company data

Figure 5: Unemployment rate in the US (%)

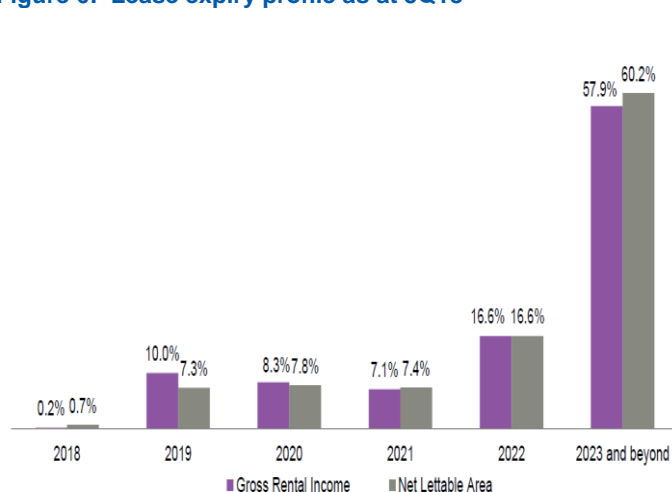


Source: Company data

7 November 2018

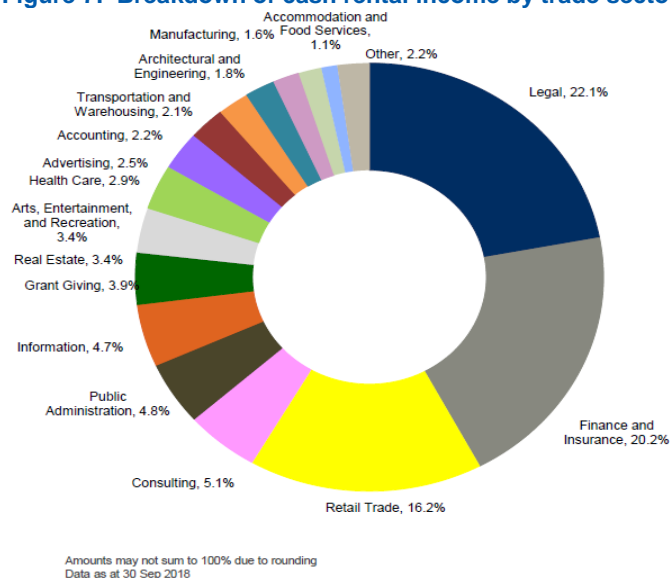
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Figure 6: Lease expiry profile as at 3Q18



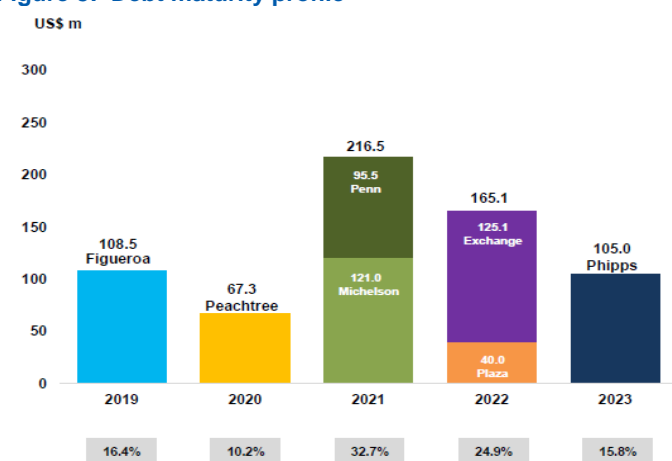
Source: Company data

Figure 7: Breakdown of cash rental income by trade sector



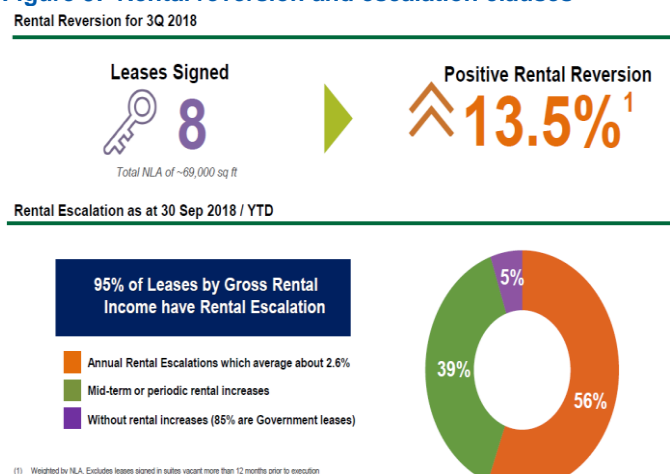
Source: Company data

Figure 8: Debt maturity profile



Source: Company data

Figure 9: Rental reversion and escalation clauses



Source: Company data

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