6 February 2020

Property | REITS

Manulife US REIT (MUST SP)

Buy (Maintained)

Building a Robust Diversified Portfolio

Target Price (Return):	USD1.12 (8%)
Price:	USD1.04
Market Cap:	USD1,631m
Avg Daily Turnover (USD/USD)	5.78m/5.78m

- **BUY, new TP of SGD1.12 from SGD1.10, 8% upside with c.6% FY20F yield.** 4QFY19 numbers are in line with our (24%) and Street estimates. Its good-quality diversified US office portfolio still benefits from favourable market dynamics, remaining relatively immune to the coronavirus threat, with largely domestic-centric tenants. It has outperformed peers since its recent index inclusion (Dec 2019), and should sustain this near-term momentum on a possible capital rotation into US office REITs, which are less impacted by the recent virus outbreak.
- **4Q19 adjusted DPU declined 4.6% YoY**, mainly due to the timing difference from equity-raising and the lower contribution from Michelson. Manulife US REIT's portfolio occupancy rate declined 1.5ppt QoQ to 95.8%, dragged down by the occupancy decline in Michelson and Peachtree. For Peachtree, the vacant space was already backfilled in January, at a higher rental rate – bringing the occupancy back to 99%. We expect Michelson's occupancy to improve in the coming quarters. Overall demand supply dynamics remain favourable in sub-markets, with minimal comparable new supply coming on-stream. This should keep its occupancy rate steady.
- **Room for organic rental rate growth in 2020.** Management reiterated that most of its office assets' passing rental rates remain 5-10% below the market average, except Michelson where rates are likely to see downward pressure (~10-15% lower). With much of Michelson's large leases renewed in 2019, there are no chunky leases due in the next seven years. As such, we expect overall rental reversions to be healthy, in the mid-single digits this year. For 2019, its portfolio registered a rental reversion of 0.5%. Excluding Michelson, this would be much higher, at +12.1%. Note that rental rate growth is in addition to the average rental escalation of 2% pa.
- **Acquisitions likely in the near term.** Management continues to look out for yield-accretive acquisitions and noted that diversification is a key consideration for asset acquisitions in current market conditions. The recent yield compression (current trading yield: 6%) provides it with an opportunity to make good yield-accretive acquisitions, as US office cap rates are still trading in a wide range of ~5.5% to 7.5%. Gearing remains modest at 37.7% (~USD100m debt headroom, assuming a 40% cap) and we expect acquisitions to be funded by a combination of equity and debt.
- **The proposed US draft tax regulations** (Dec 2018) are still pending finalisation, with no final timeline available. Upon finalisation (barring adverse changes), this will enable MUST to roll back to its IPO tax structure – which should lead to additional tax savings of ~1.5%.
- **Earnings and assumption changes.** We tweak FY20-22F earnings by -1% to +1%, by fine-tuning our occupancy and rental assumptions. Our COE is also lowered by 20 bps to 7.6%.

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (USDm)	145	178	204	210	214
Net property income (USDm)	91	111	131	135	137
Reported net profit (USDm)	65	48	109	112	115
Total distributable income (USDm)	71	83	99	101	105
DPS (USD)	0.06	0.06	0.06	0.06	0.06
DPS growth (%)	(3.6)	7.1	4.1	2.1	2.2
P/B (x)	1.53	1.31	1.30	1.29	1.27
Dividend Yield (%)	5.3	5.7	6.0	6.1	6.2
Return on average equity (%)	6.7	4.1	8.6	8.6	8.7
Return on average assets (%)	4.1	2.4	5.0	5.0	5.1
Interest cover (x)	4.23	3.76	4.20	4.22	4.25

Source: Company data, RHB

Analyst

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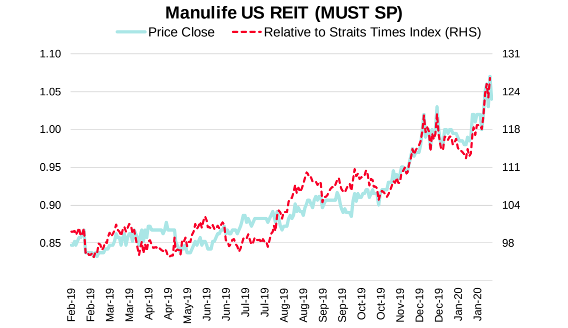
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	4.0	4.5	13.0	18.0	22.8
Relative	6.1	7.0	15.8	19.2	23.7
52-wk Price low/high (USD)					0.83 – 1.07



Source: Bloomberg

Financial Exhibits

Asia
Singapore
Property
Manulife US Real Estate Investment Trust
MUST SP
Buy

Valuation basis

DDM Methodology

Key drivers

i. Organic rental growth and rental escalation;
ii. Growth from yield-accretive acquisitions;
iii. Reversion to IPO tax structure

Key risks

i. Ability to retain key tenants;
ii. Adverse changes to tax structure;
iii. US economic growth falters

Company Profile

Manulife US Real Estate Investment Trust is the first pure-play US 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 US, as well as real estate-related assets.

Financial summary	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Recurring EPS (USD)	0.05	0.03	0.07	0.07	0.07
EPS (USD)	0.05	0.03	0.07	0.07	0.07
DPS (USD)	0.06	0.06	0.06	0.06	0.06
BVPS (USD)	0.68	0.79	0.80	0.81	0.82
Return on average equity (%)	6.7	4.1	8.6	8.6	8.7
Weighted avg adjusted shares (m)	1,422.50	1,579.24	1,596.61	1,610.23	1,624.12

Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Recurring P/E (x)	22.93	34.53	15.28	14.97	14.66
P/E (x)	22.93	34.53	15.28	14.97	14.66
P/B (x)	1.5	1.3	1.3	1.3	1.3
FCF Yield (%)	(22.6)	(15.4)	6.7	6.9	7.0
Dividend Yield (%)	5.3	5.7	6.0	6.1	6.2
EV/EBITDA (x)	26.16	25.23	21.19	20.72	20.47
EV/EBIT (x)	25.03	24.28	20.52	20.04	19.81

Income statement (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover	145	178	204	210	214
EBITDA	78	95	114	117	119
Depreciation and amortisation	4	4	4	4	4
Operating profit	81	98	117	121	123
Net interest	(19)	(26)	(27)	(28)	(29)
Pre-tax profit	79	58	111	114	116
Taxation	(15)	(10)	(2)	(2)	(1)
Recurring net profit	65	48	109	112	115

Cash flow (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Change in working capital	(8)	3	(1)	(1)	(0)
Cash flow from operations	66	102	122	126	129
Capex	(399)	(356)	(10)	(11)	(11)
Cash flow from investing activities	(399)	(356)	(10)	(10)	(10)
Dividends paid	(59)	(99)	(99)	(101)	(105)
Cash flow from financing activities	451	245	(80)	(85)	(87)
Cash at beginning of period	50	54	61	69	77
Net change in cash	117	(8)	32	31	32
Ending balance cash	167	46	92	100	108

Balance sheet (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total cash and equivalents	54	61	69	77	84
Tangible fixed assets	1,739	2,095	2,126	2,158	2,191
Total investments	0	0	0	0	0
Total assets	1,803	2,166	2,202	2,241	2,281
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	1,283	1,308	1,333
Total equity	1,064	1,258	1,283	1,308	1,333
Net debt	613	751	753	755	758
Total liabilities & equity	1,803	2,166	2,202	2,241	2,281

Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Revenue growth (%)	57.1	23.0	14.7	2.7	1.9
Recurrent EPS growth (%)	(17.5)	(33.6)	126.0	2.1	2.1
Operating EBITDA margin (%)	53.8	53.2	55.7	55.9	55.9
Net profit margin (%)	44.6	26.7	53.3	53.4	54.0
Capex/sales (%)	276.3	200.2	5.1	5.1	5.1
Interest cover (x)	4.23	3.76	4.20	4.22	4.25

Source: Company data, RHB

Figure 1: DDM valuation

	FY20F	FY21F	FY22F	FY23F	FY24F	Terminal Value
DPU (US cents)	6.20	6.32	6.46	6.67	6.81	124.14
Target price (USD)	1.12					
Current Price (USD)	1.04					
Price Upside (%)	8.0%					
Distribution Yield FY20F (%)	6.0%					
Total Returns (%)	14.0%					
Assumptions						
Risk-free rate (%)	3.0%					
Beta	0.9					
Cost of equity (%)	7.6%					
Terminal growth (%)	2.0%					

Source: RHB

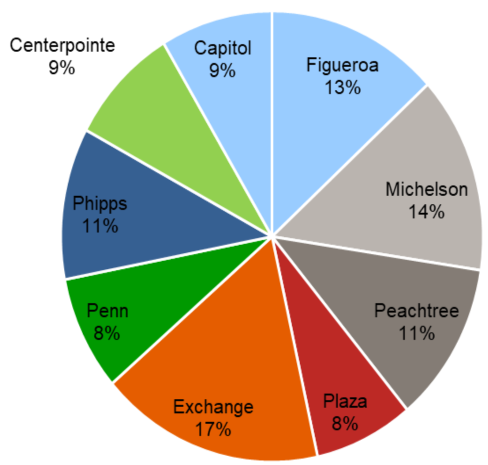
Figure 2: Summary and details of assets

	Figueroa	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

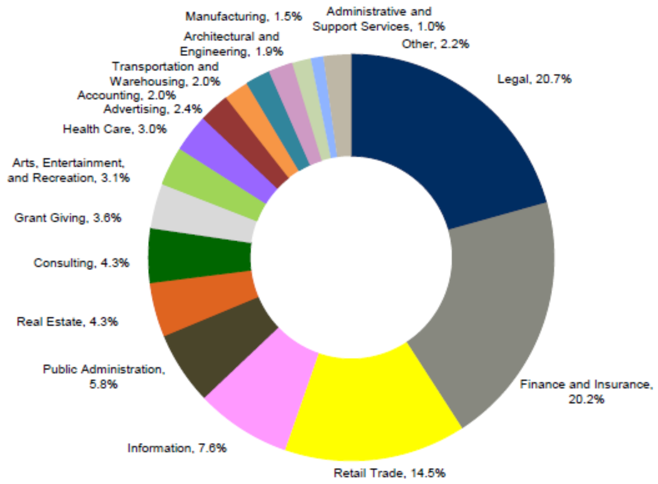
Source: Company data

Figure 3: NPI contributions by asset (4Q19)



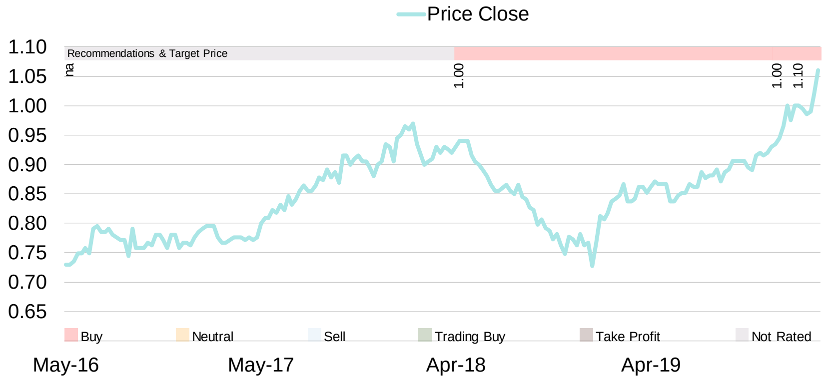
Source: Company data

Figure 4: Tenant sector breakdown by gross rental



Source: Company data

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-02-12	Buy	na	0.86
2018-11-07	Buy	na	0.78
2018-10-16	Buy	na	0.77

Source: RHB, Bloomberg

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Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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