

4 August 2020

Property | REITS

Manulife US Real Estate Investment Trust (MUST SP)

Buy (Maintained)

In a Good Position To Weather Challenges

- **Keep BUY and TP of USD0.90, 15% upside and c.8% yield.** 2Q/1H20 results were in line. Despite COVID-19 derailing the US economy, office assets have shown good resilience with occupancy uptick YTD and continued rental growth. With limited near-term lease expiries, strong assets, and good quality tenants, we believe Manulife US Real Estate Investment Trust is well positioned to weather market challenges. Its stable and attractive 8% dividend yield is attractive in current market conditions.
- **1H20 DPU +0.3% YoY** as lower Michelson contribution and car park income were offset by higher contributions from Centerpointe and Capitol. 2Q20 rent collection was healthy at 96% with MUST providing limited rent deferment of 0.3% and abatement of 0.3%, mostly to its retail tenants. We do not anticipate the need for further large rent abatement/deferment barring the re-imposition of stringent lockdown measures.
- **No discernible leasing impact so far from WFH trend.** Overall leasing momentum was fairly strong in 1H with ~217,300 sqf (1Q: 147,000, 2Q: 70,000 sqf) or c.5% of leases signed. About 50% were renewals, 8% expansion and 42% new leases, with demand stemming mainly from the finance and insurance, legal, real estate and technology sectors' tenants. Overall occupancy improved 0.4ppt from Dec 2019 to 96.2% (1Q20: 96.3%). Asked on the changes in leasing structure, management noted that it has not seen any noticeable changes in terms of leasing structure, with tenants still willing to sign longer leases. MUST also guided that based on the latest surveys, only 12% of employees prefer the work from home (WFH) option compared to 10% pre-pandemic. While flexible office space is likely to create some reduction in demand, it sees the impact to be partially offset by dedensification trends and limited supply.
- **Rent reversions were +7.9%** as market rents are holding up fairly well so far. Six of its nine assets' passing rents (Figure 4) are still 2-19% below current market average rents and we do not see much downside risks except Michelson. Only 9.6% of its leases (by gross rents) are due for renewal up until 2021 – we expect flattish to slight positive rent reversions.
- **Portfolio value declined 3%** (Figure 3) driven by lower rental growth assumptions by valuers (CBRE), with cap rates remaining largely steady.
- **Further savings in interest costs** with MUST securing a maiden USD100m 5-year green loan to refinance its Peachtree asset at 1.85% pa. Overall weighted average interest cost has fallen 16bps (from end-2019) to 3.21% pa with 42% of its assets now unencumbered. Gearing, however, inched up to 39.1% (from 37.7%) on the back of valuation decline but is still well below the 50% limit. While US office transactions have slowed down considerably on the back of COVID-19, we believe management could relook acquisition opportunities in 4Q20 if market conditions stabilise.

Target Price (Return): USD0.90 (+15%)
Price: USD0.78
Market Cap: USD1,219m
Avg Daily Turnover (USD/USD): 2.53m/2.53m

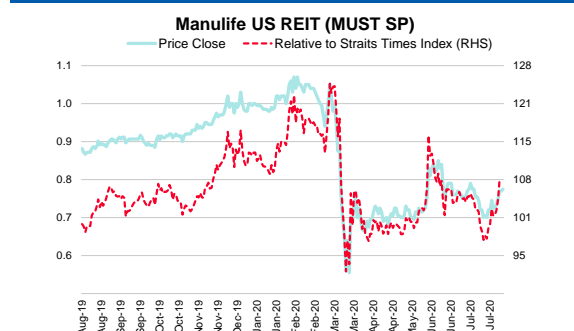
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Share Performance (%)

| | YTD | 1m | 3m | 6m | 12m |
|----------------------------|--------|-----|------|-------------|--------|
| Absolute | (22.5) | 0.0 | 6.9 | (24.8) | (13.1) |
| Relative | (1.0) | 4.7 | 10.5 | (6.0) | 9.3 |
| 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) | 1.14 | 0.99 | 1.00 | 1.01 | 1.00 |
| Dividend Yield (%) | 7.2 | 7.7 | 7.9 | 8.0 | 8.0 |
| 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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Property | REITS

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) | 17.09 | 25.81 | 14.32 | 14.06 | 11.46 |
| | P/E (x) | 17.09 | 25.81 | 14.32 | 14.06 | 11.46 |
| Key drivers | P/B (x) | 1.1 | 1.0 | 1.0 | 1.0 | 1.0 |
| i. Good quality assets mitigates recession threat; | FCF Yield (%) | (30.3) | (20.7) | 8.4 | 8.6 | 9.1 |
| ii. Organic rental growth through rent escalations; | Dividend Yield (%) | 7.2 | 7.7 | 7.9 | 8.0 | 8.0 |
| iii. Long WALE and strong credit profile of tenants. | EV/EBITDA (x) | 21.32 | 20.83 | 17.70 | 17.58 | 17.39 |
| | EV/EBIT (x) | 20.39 | 20.04 | 17.14 | 16.99 | 16.82 |
| 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 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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Figure 1: DDM valuation

| | FY20F | FY21F | FY22F | FY23F | FY24F | Terminal Value |
|------------------------------|-------|-------|-------|-------|-------|----------------|
| DPU (US Cents) | 6.13 | 6.23 | 6.26 | 6.32 | 6.49 | 99.58 |
| Target price (USD) | 0.90 | | | | | |
| Current Price (USD) | 0.78 | | | | | |
| Price Upside (%) | 17.0% | | | | | |
| Distribution Yield FY20F (%) | 7.9% | | | | | |
| Total Returns (%) | 24.9% | | | | | |
| Assumptions | | | | | | |
| Risk-free rate (%) | 3.0% | | | | | |
| Beta | 1.0 | | | | | |
| Cost of equity (%) | 8.6% | | | | | |
| Terminal growth (%) | 2.0% | | | | | |

Source: RHB

Figure 2: Asset details and summary

| | 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 | 2020 | 2018 | - | 2018 | 2016 |
| Property Value (US\$ m) ¹ | 329.1 | 335.0 | 205.8 | 114.7 | 338.0 | 180.2 | 215.2 | 120.5 | 196.0 |
| Occupancy (%) | 93.5 | 90.1 | 98.3 | 98.9 | 95.8 | 100.0 | 100.0 | 98.7 | 94.1 |
| NLA (sq ft) | 704,704 | 533,375 | 558,784 | 461,525 | 736,356 | 277,597 | 475,778 | 420,013 | 500,662 |
| WALE by NLA (years) | 3.7 | 5.6 | 5.3 | 7.0 | 6.3 | 4.5 | 7.6 | 5.8 | 5.3 |
| Land Tenure | Freehold | Freehold | Freehold | Freehold | Freehold | Freehold | Freehold ² | Freehold | Freehold |
| No. of Tenants | 30 | 14 | 25 | 7 | 24 | 11 | 10 | 20 | 41 |

Data as at 30 Jun 2020

(1) Based on 30 Jun 2020 appraisals

(2) 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: Portfolio value declined 3% on the back of lower rent growth assumptions

| Property | Valuation | | | | Implied Cap Rates | |
|------------------------|-------------------------|-------------------------|---------------|---|---------------------------------|---------------------------------|
| | 30 Jun 2020 (US\$ m) | 31 Dec 2019 (US\$ m) | Change (%) | 30 Jun 2020 (US\$ Per Sq Ft ¹) | 30 Jun 2020 ² (%) | 31 Dec 2019 ³ (%) |
| Figueroa | 329.1 | 337.6 | -2.5 | 467 | 5.2 | 4.8 |
| Michelson | 335.0 | 345.0 | -2.9 | 628 | 4.3 | 4.6 |
| Peachtree | 205.8 | 210.7 | -2.3 | 368 | 6.1 | 5.8 |
| Plaza | 114.7 | 119.9 | -4.3 | 249 | 6.8 | 6.6 |
| Exchange | 338.0 | 348.6 | -3.0 | 459 | 5.5 | 5.9 |
| Penn | 180.2 | 189.0 | -4.7 | 649 | 5.2 | 4.7 |
| Phipps | 215.2 | 220.1 | -2.2 | 452 | 5.4 | 5.8 |
| Centerpointe | 120.5 | 122.8 | -1.9 | 287 | 7.8 | 7.8 |
| Capitol | 196.0 | 201.3 | -2.6 | 391 | 7.1 | 7.1 |
| Total/ Weighted Ave | 2,034.5 | 2,095.0 | -2.9 | 436 | 5.6 | 5.7 |

(1) Based on NLA as at 30 Jun 2020

(2) Based on valuation by CBRE

(3) Based on valuation by Colliers, Newmark Knight Frank (Exchange) and Cushman Wakefield (Capitol)

Source: Company data

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Figure 4: Portfolio average rents were broadly below market

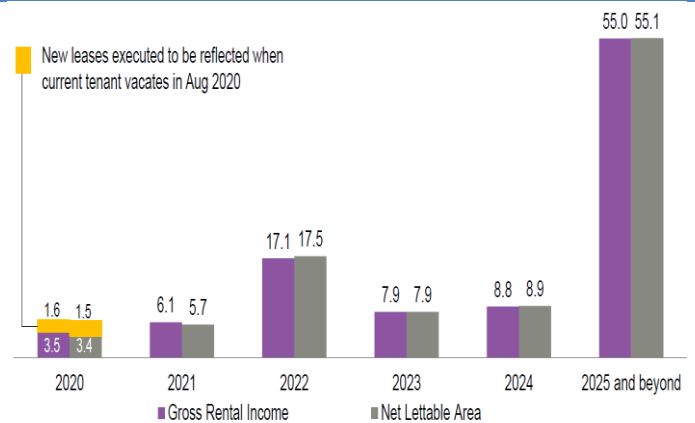
| Property | Passing Rent | Average Market Rent | 2020 – 2021 expiries (%) ¹ | Below/Above Market Rent |
|--------------|------------------|---------------------|---------------------------------------|-------------------------|
| Figuroa | US\$42.67 | US\$44.20 | 1.8% | ▼ 4% |
| Michelson | US\$49.40 | US\$36.66 | 1.3% | ▲ 35% |
| Peachtree | US\$35.99 | US\$44.53 | 1.8% | ▼ 19% |
| Plaza | US\$33.12 | US\$35.53 | 0.2% | ▼ 7% |
| Exchange | US\$41.96 | US\$42.75 | 0.5% | ▼ 2% |
| Penn | US\$55.00 | US\$58.09 | 0.6% | ▼ 5% |
| Phipps | US\$38.26 | US\$39.66 | 0.4% | ▼ 4% |
| Centerpointe | US\$35.11 | US\$33.31 | 1.4% | ▲ 5% |
| Capitol | US\$41.24 | US\$40.67 | 1.6% | ▲ 1% |
| Total | US\$40.93 | US\$41.30 | 9.6% | |

Source: CoStar Market Analysis & Forecast – As at 1 Jul 2020

(1) By GRI of portfolio

Source: Company data

Figure 5: Minimal lease expiries until 2021



Source: Company data

Figure 6: Good quality blue chip Top 10 tenants

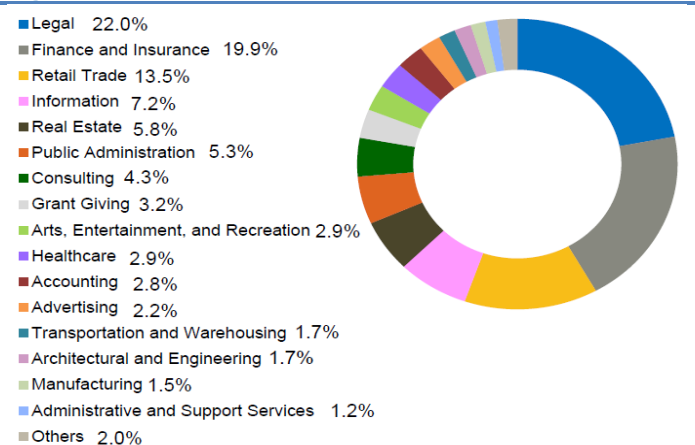
| Tenant | Sector | NLA (sq ft) | % of GRI |
|-----------------------------|-----------------|------------------|--------------|
| The William Carter | Retail Trade | 304,013 | 6.2% |
| TCW Group | Finance and Ins | 188,835 | 4.0% |
| Kilpatrick Townsend | Legal | 184,653 | 3.6% |
| The Children's Place | Retail Trade | 197,949 | 3.5% |
| US Treasury | Public Admin | 120,324 | 3.2% |
| United Nations | Grant Giving | 94,988 | 3.2% |
| Amazon | Retail Trade | 129,259 | 2.9% |
| Hyundai Motor Finance | Finance and Ins | 97,587 | 2.9% |
| Quinn Emanuel Trial | Legal | 126,505 | 2.9% |
| Quest Diagnostics | Health Care | 131,612 | 2.3% |
| Total Top 10 Tenants | | 1,575,725 | 34.7% |

(1) U.S. Department of Commerce – Bureau of Economic Analysis

(2) U.S. Census Bureau – Jul 2020

Source: Company data

Figure 7: Tenants spread across more than 15 sectors



(1) U.S. Bureau of Labor Statistics – Jul 2020

Source: Company data

Recommendation Chart



Source: RHB, Bloomberg

| Date | Recommendation | Target Price | Price |
|------------|----------------|--------------|-------|
| 2020-05-10 | Buy | 0.90 | 0.71 |
| 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 |

Source: RHB, Bloomberg

RHB Guide to Investment Ratings

| | |
|---------------------|--|
| 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 |
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