

6 December 2023

Property | REITS

Manulife US REIT (MUST SP)

Buy (Maintained)

A Bitter Cure

- **Maintain BUY with a lower USD0.13 TP from USD0.25, 119% upside.** Manulife US REIT's much awaited sponsor-led debt restructuring package fell short of our and market expectations. Still, the deal – in our view – presents the best path to restore long-term value for unit holders amid a lack of other viable options. Key next steps would be the optimal execution of proposed asset dispositions and stabilisation, with signs of interest rates peaking. We believe such opportunities could arise as early as 2H24.
- **Proposed recapitalisation plan offers longer runway for redemption.** To cure loan covenant breaches, MUST will raise USD287m from: i) The divestment of Park Place, Arizona for USD98.7m (based on higher June independent valuations) to its sponsor, ii) sponsor will provide a USD137m 6-year unsecured loan at a fixed rate of 7.25% pa, with exit premium of 21.16% (effective interest: c.10% pa), and iii) a drawdown USD50m from the REIT's cash holdings. Proceeds will be used for partial debt repayment (c.28%) to all existing lenders, who in turn will extend all loan maturities by a year and relax financial covenants (until Dec 2025), unencumbered gearing limit to 80% (from 60%), and interest cover to 1.5x (from 2.5x).
- **MUST will also be embarking on asset dispositions** and has identified four non-core Tranche 1 assets for priority asset sales based on occupancy risk, high capex requirements, and low total return potential (Figure 1). The total value of these assets is USD436m (based on June valuations). MUST intends to divest the assets at no less than 90% of latest independent valuations. The disposition mandate will expire at end 2025 with MUST expecting a minimum of USD328.7m in proceeds from asset sales. Unitholder distributions will be halted until 2025 (may resume earlier if reinstatement conditions are achieved), and overall tax leakages from this are likely to be minimal. See our detailed management Q&A on Page 3.
- **Key market concern has been high fixed-interest costs for sponsor loans.** Sponsor's view is that this is a fair price, considering the challenging market conditions, and it being a listed entity across various regulatory regimes limits options to provide a sweeter deal. While other equity related alternatives were considered, MUST's complex tax structure limited these options (see Q&A). Independent directors and proxy advisors have recommended to vote in favour of all three resolutions at the 14 Dec EGM. We concur, as a negative outcome could result in immediate disorderly liquidation and potentially zero value for unitholders, which is the key risk.
- **Our revised TP is pegged at 0.35x FY25F book value**, compared to the previous DDM valuation. We reduced MUST's ESG score to 3.1 on a lower environmental score to factor in higher carbon emissions intensity across its assets, resulting in a lower 2% ESG premium to our TP.

Target Price (Return): USD0.13 (119%)
Price (Market Cap): USD0.06 (USD105m)
ESG score: 3.1 (out of 4)
Avg Daily Turnover (USD/USD) 1.18m/1.18m

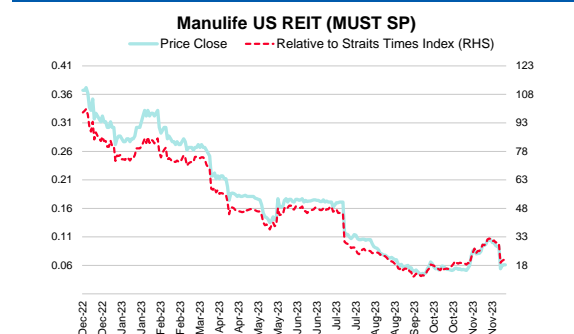
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(80.3)	1.7	3.5	(65.3)	(84.3)
Relative	(74.9)	3.8	8.1	(61.8)	(78.5)
52-wk Price low/high (USD)				0.04 – 0.37	



Source: Bloomberg

Overall ESG Score: 3.1 (out of 4)

E: EXCELLENT

Manulife US REIT targets to achieve 100% green certified portfolio by 2030 (currently 93% of portfolio by NLA are green certified). Target to achieve 38% reduction in GHG emissions by 2035 (vs.2018 base year) and 80% reduction by 2050. Similarly it plans to reduce energy intensity by 33% (from 2018 base year) and achieve 49% reduction by 2050.

S: GOOD

High overall satisfaction rating of 4.36 out of 5 (excellent) in the 2022 tenant satisfaction survey. 100% of directors and 100% of employees have undergone ESG related training. Organizes a lot of community activities supporting the elderly and less privileged community as well as social enterprises

G: GOOD

The REIT has been transparent on earnings and operating metrics disclosures and has a majority independent board. However recent developments concerning potential sale of sponsor stake in REIT manager as well as a lack of timely support and costly debt restructuring package has raised several concerns among minority unitholders.

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (USDm)	185	203	188	187	194
Net property income (USDm)	110	113	107	106	108
Reported net profit (USDm)	39	(130)	(290)	57	85
Total distributable income (USDm)	85.6	87.9	81.5	78.4	75.5
DPS (USD)	0.05	0.05	na	na	0.02
DPS growth (%)	(5.4)	(11.5)	(100.0)	0.0	0.0
P/B (x)	0.08	0.10	0.16	0.17	0.16
Dividend Yield (%)	90.5	80.1	na	na	34.1
Return on average equity (%)	3.4	(11.7)	(34.5)	8.6	12.7
Return on average assets (%)	1.8	(5.9)	(15.0)	3.3	5.1

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Singapore	Recurring EPS (USD)	0.02	-	0.08	0.03	0.05
Property	EPS (USD)	0.02	-	0.08	0.03	0.05
Manulife US REIT	DPS (USD)	0.05	0.05	-	-	0.02
MUST SP	BVPS (USD)	0.74	0.58	0.36	0.36	0.36
Buy	Return on average equity (%)	3.4	(11.7)	(34.5)	8.6	12.7
	Weighted avg adjusted shares (m)	1,589.36	1,685.06	1,792.37	1,832.45	1,861.25
Valuation basis	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
DDM Methodology	Recurring P/E (x)	2.38	na	na	1.91	1.29
	P/E (x)	2.38	na	na	1.91	1.29
	P/B (x)	0.1	0.1	0.2	0.2	0.2
Key drivers	FCF Yield (%)	(135.0)	66.4	110.1	153.9	75.2
i. Stabilisation and recovery in the US office market;	Dividend Yield (%)	90.5	80.1	-	-	34.1
ii. Further asset sale and equity injections; and	EV/EBITDA (x)	9.72	8.75	9.50	8.99	9.01
iii. Trading at distressed valuations.	EV/EBIT (x)	9.91	9.12	9.92	9.37	9.38
Key risks	Income statement (USDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
i. Continued decline in office demand for gateway cities;	Total turnover	185	203	188	187	194
ii. Unexpected changes in the tax-efficient structure;	EBITDA	100	106	101	100	103
iii. Higher interest rates for longer, impacting interest costs and refinancing	Depreciation and amortisation	(2)	(4)	(4)	(4)	(4)
	Operating profit	98	102	97	96	99
	Net interest	(29)	(34)	(41)	(39)	(42)
	Pre-tax profit	41	(148)	(295)	58	87
	Taxation	(1)	18	4	(1)	(2)
	Recurring net profit	39	(130)	(290)	57	85
Company Profile	Cash flow (USDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
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	6	1	(9)	(9)	(9)
	Cash flow from operations	104	91	104	97	98
	Capex	(231)	(25)	13	69	(15)
	Cash flow from investing activities	(231)	(25)	13	69	(15)
	Dividends paid	(84)	(89)	0	0	(38)
	Cash flow from financing activities	196	(184)	(54)	(163)	(52)
	Cash at beginning of period	87	79	113	138	103
	Net change in cash	69	(118)	63	3	30
	Ending balance cash	156	(39)	175	141	133
	Balance sheet (USDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total cash and equivalents	79	113	138	103	92
	Tangible fixed assets	2,184	1,947	1,584	1,515	1,560
	Total investments	6	48	20	20	20
	Total assets	2,276	2,116	1,748	1,643	1,678
	Short-term debt	297	145	150	150	160
	Total long-term debt	675	884	874	774	774
	Total liabilities	1,088	1,096	1,085	987	999
	Shareholders' equity	1,188	1,020	663	656	680
	Total equity	1,188	1,020	663	656	680
	Net debt	893	916	886	822	842
	Total liabilities & equity	2,276	2,116	1,748	1,643	1,678
	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	(4.8)	9.5	(7.1)	(0.7)	4.0
	Recurrent EPS growth (%)	0.0	(410.4)	110.4	0.0	47.5
	Operating EBITDA margin (%)	54.1	52.3	53.7	53.8	52.9
	Net profit margin (%)	21.3	(64.0)	(154.2)	30.4	43.7
	Dividend payout ratio (%)	217.2	(64.4)	0.0	0.0	44.4
	Capex/sales (%)	124.8	12.5	(6.7)	(37.0)	7.8
	Interest cover (x)	3.37	3.00	2.36	2.48	2.35

Source: Company data, RHB

Management Q&A on recent debt restructuring and strategies ahead

Q1. Did the sponsor consider issuing other equity related options such as preferential shares and convertible bonds, instead of providing support via high-interest cost loans? What were the reasons for not proceeding with those other options?

A: We have considered all equity options as stated above, but were constrained by the REIT's tax structure.

Q2. Why was the sponsor loan a fixed-rate one instead of a floating rate, considering that interest rates are peaking?

A: In North America, loans above five years are usually fixed, and come with pre-payment penalties. However, the sponsor provided a loan with pre-payment flexibility and no penalties.

Q3. Can you elaborate on tax implications for unit holders from the non-payment of distribution? Can unit holders be comforted by the fact that the REIT manager will try its best to reduce loss of value from further distributions?

A: There is no tax implication for unitholders as long as unitholders continue to submit their W8/W9 BEN forms. The withholding tax amount will be based on the percentage that did not submit the forms for MUST. In the past, this number was close to 1.5%. We will continue to remind unitholders to submit their tax forms.

Q4. How will the REIT manager plan the timing of the asset sale to ensure the best value for unit holders?

A: We will monitor the market closely and work with the best brokers in the market to ensure the disposition will be optimal for unitholders. One of the key features of the restructuring was to allow the REIT to have as much flexibility for the market to recover. As a result, we have until 30 Jun 2025 to effect the sales, and an additional six months until 31 Dec 2025 to bring our covenants back to normality.

Q5. What is the REIT manager's expectation on US office market conditions moving forward? What will be the strategies that unit holders can look forward to once the market conditions have stabilised?

A: We hope that the interest rates will start to taper and decline. Once the transaction market opens up, the US commercial market should be more stable as credit becomes available. As the REIT carried out its recapitalisation plan together with the sponsor, MUST will explore other real estate sectors that are less capex-intensive as part of our pivot strategy.

Q6. Is there a possibility of refinancing the sponsor loan if interest rates decline in the next two years? If so, under what scenario and conditions can this happen?




A: If interest rates start to decline, we could be in a position to refinance the loan with the lenders' approvals. There is no pre-payment penalty for this.

Q7. Would the sponsor consider waiving or adjusting the REIT's management fees during the restructuring period as there is no distribution to unitholders?

A: We have now accrued the last two semi-annual fees and will continue to evaluate the best way forward in the interest of unitholders.

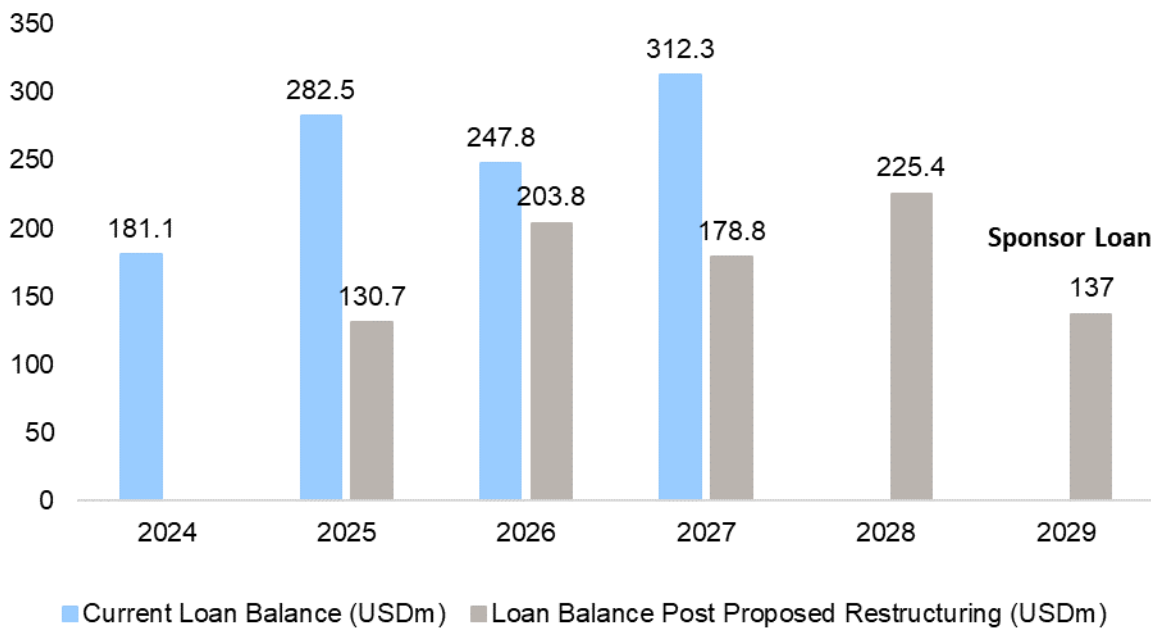
Figure 1: Asset classification based on order of priority for sale consideration

Portfolio analysis conducted to tier assets

			Occupancy Risk	CapEx Requirements	Total Return Potential
Tranche 1 assets (28.4% of Portfolio ⁽¹⁾)		Centerpointe Diablo Figueroa Penn	High	High	Low
Tranche 2 assets (43.3% of Portfolio ⁽¹⁾)		Capitol Exchange Peachtree Plaza	Medium	Medium to High	Medium
Tranche 3 assets (28.3% of Portfolio ⁽¹⁾)		Michelson Phipps	Low	Low to Medium	Medium to High

Legend: Positive ■ ■ ■ Negative

Source: Company

Figure 2: Revised debt profile post proposed restructuring – weighted average debt maturity of 3.8 years vs 2.3 years currently


Source: Company

Emissions And ESG

Trend analysis

Total Scope 1 and 2 emissions rose 12% YoY while carbon emissions intensity rose 2% YoY. This was due to colder winters in submarket such as New Jersey and Washington DC leading to a higher consumption of natural gas. Compared with the 2018 baseline year, energy intensity has fallen by 27.3%.

Emissions (tCO2e)

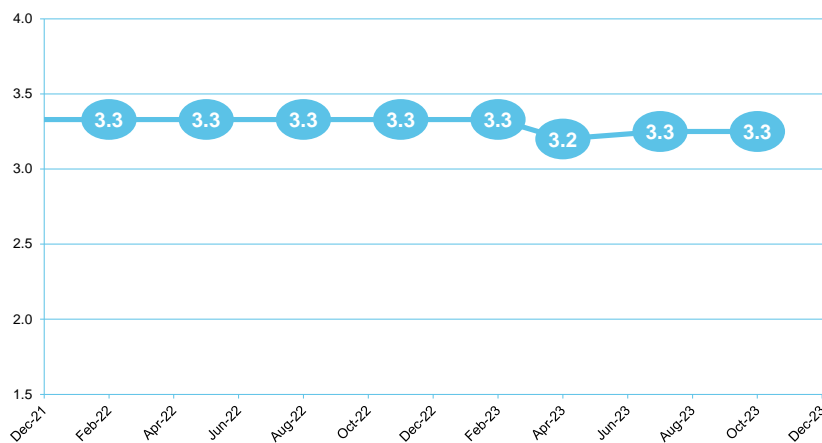
	Dec-20	Dec-21	Dec-22
Scope 1	1,893	1,626	2,129
Scope 2	20,058	18,047	19,888
Scope 3	na	na	na
Total emissions	21,951	19,673	22,017

Source: Company data, RHB

Latest ESG-Related Developments

- Achieved high 5-Star rating in the GRESB 2022 Real Estate Assessment.
- Achieved new Fitwel certifications for five properties and Fitwel Viral Response certifications for seven properties.
- In 2022, renewable energy accounted for about 13% of MUST's total energy consumption.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-07-19	Buy	0.25	0.12
2023-04-12	Buy	0.40	0.18
2023-02-09	Buy	0.43	0.30
2023-01-02	Buy	0.43	0.30
2022-11-02	Buy	0.64	0.36
2022-08-04	Buy	0.78	0.60
2022-05-10	Buy	0.83	0.60
2022-02-10	Buy	0.86	0.65
2021-12-01	Buy	0.90	0.68
2021-11-04	Buy	0.90	0.70
2021-02-09	Buy	0.87	0.72
2020-11-05	Buy	0.90	0.74
2020-05-10	Buy	0.90	0.71
2020-03-24	Buy	0.88	0.70
2020-02-05	Buy	1.12	1.04

Source: RHB, Bloomberg

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