

5 August 2022

Property | REITS

Manulife US Real Estate Investment Trust (MUST SP)

Buy (Maintained)

A Weak Quarter, But Largely Priced In

Target Price (Return): USD0.78 (+30%)
 Price (Market Cap): USD0.60 (USD1,050m)
 ESG score: 3.33 (out of 4)
 Avg Daily Turnover (USD/USD) 1.31m/1.31m

- **BUY, new TP of USD0.78 from USD0.83, 30% upside with c.9% FY22F yield.** Manulife US REIT's 2Q22 and 1H22 results came in slightly below our forecasts. Return-to-office activities involving its gateway portfolio have been much slower than expected and weak compared to that of secondary growth markets. This uncertainty has resulted in slow leasing momentum and downsizing by existing tenants, although MUST's long lease profile and limited upcoming lease expiries mitigates some of this impact. Overall, we believe that the current uncertainties are largely priced in.
- **1H DPU dropped by 3.3% YoY** due to lower occupancy rates and the absence of credit provision reversals. This was partially offset by acquisition contributions, lower rebates and higher carpark income. In 1H, MUST gave rental rebates amounting to c.USD200k (vs USD2m last year) – this is expected to taper off. Carpark income rose 75% YoY to USD6.3m. In July, it refinanced c.USD187m of loans at the trust level, leading to a c.11bps increase in overall interest costs to 2.97% pa. 86% of loans are currently hedged, with every 100bps hike in rates resulting in a c.1.5% DPU impact.
- **Portfolio occupancy down 1.7ppt QoQ to 90%** mainly on the occupancy rate decline at Exchange, Jersey City (85.4%, -10.2ppt QoQ) as a tenant moved out and consolidated at a nearby building. TCW, its second largest tenant (c.3.8% of income), will also be moving to another asset at the end of its lease in Dec 2023. This is done mainly to avoid major renovations at its current space, which it had been occupying since the 1990s. Another top 10 tenant, Quinn, will be downsizing space at Figueroa by 71k sqf from end-August, but renewed the lease for the remaining 64k sqf for another 5.4 years from Sep 2023, at a rental reversion of +2.5%. These moves indicate that large tenants – especially financial and law firms – have been re-evaluating their space usage and adopting more hybrid policies post-pandemic. That said, there are no other top 10 tenants with leases expiring before mid-2025. Overall rental reversion was flattish in 2Q.
- **MUST is evaluating more flex options** to cater to evolving trends in the US office market, and is in talks with various operators including JLL on the hotelisation of office space and maximising occupancy. This will likely be rolled out slowly across its assets depending on evolving market conditions.
- **Divestments are still on the cards** but management noted that the funding environment for big-ticket office buildings has dried up, due to the current uncertainty. MUST's net gearing is on the high side, at 42.4%, which leaves little room for acquisitions in the near term.
- **We cut FY22-24F DPU by 5-6%** after adjusting for early lease terminations and lower occupancy rates. MUST has a high ESG score of 3.3 out of 4.0 (based on our proprietary in-house methodology – so we apply a 6% premium to our intrinsic value to derive our TP).

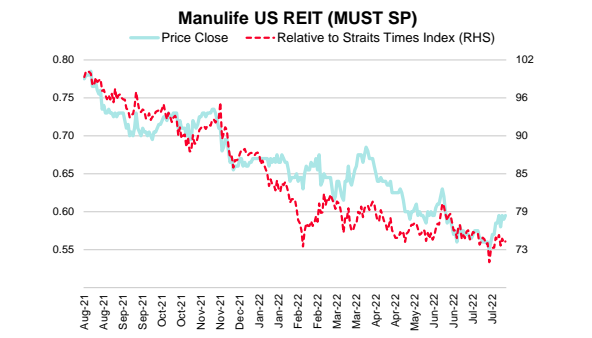
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(11.2)	4.4	(4.8)	(8.5)	(22.7)
Relative	(15.3)	(0.7)	(1.7)	(6.6)	(26.0)
52-wk Price low/high (USD)	0.55 – 0.79				



Source: Bloomberg

Overall ESG Score: 3.33 (out of 4)

E: EXCELLENT

The REIT targets to achieve a 100% green-certified portfolio by 2030. It was awarded five stars for the Global Real Estate Sustainability Benchmark (GRESB) benchmark for the second year running, and a rating of "A" at the public disclosure level. MUST also has a 80% Green House Gas emission reduction commitment by 2050.

S: EXCELLENT

Corporate social responsibility (CSR) activity time rose by 1% to 189 hours, with higher CSR contributions clocked. MUST's staff engagement score has been improving since 2019. There is also a good balance between genders, in its management team

G: GOOD

It has incorporated links to sustainability performance in incentive pay policies for all employees. There is a high level of investor outreach and education via its Green Dot series, as well as using various technology tools. There are also good-quality earnings and operating metric disclosures in place.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (USDm)	194	185	196	204	208
Net property income (USDm)	116	110	123	128	130
Reported net profit (USDm)	(43.3)	39.4	98.9	91.3	88.9
Total distributable income (USDm)	89.0	85.6	91.4	95.5	98.2
DPS (USD)	0.06	0.05	0.05	0.05	0.05
DPS growth (%)	(5.2)	(5.4)	(3.3)	3.4	1.7
P/B (x)	0.81	0.80	0.87	0.87	0.88
Dividend Yield (%)	9.5	9.0	8.7	9.0	9.1
Return on average equity (%)	(3.6)	3.4	8.2	7.5	7.3
Return on average assets (%)	(2.0)	1.8	4.3	3.9	3.8

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Singapore	Recurring EPS (USD)	-	0.03	0.02	0.06	0.05
Property	EPS (USD)	-	0.03	0.02	0.06	0.05
Manulife US Real Estate Investment Trust	DPS (USD)		0.06	0.05	0.05	0.05
MUST SP	BVPS (USD)		0.73	0.74	0.69	0.68
Buy	Return on average equity (%)		(3.6)	3.4	8.2	7.5
	Weighted avg adjusted shares (m)		1,487.58	1,589.36	1,685.93	1,778.49
						1,798.02
Valuation basis	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
DDM	Recurring P/E (x)	na	23.99	10.14	11.59	12.04
	P/E (x)	na	23.99	10.14	11.59	12.04
	P/B (x)	0.8	0.8	0.9	0.9	0.9
	FCF Yield (%)	13.4	(13.4)	11.1	10.6	10.8
	Dividend Yield (%)	9.5	9.0	8.7	9.0	9.1
	EV/EBITDA (x)	15.56	18.23	16.54	17.37	17.12
	EV/EBIT (x)	15.46	18.58	16.83	17.07	16.83
Key drivers	Income statement (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Stabilisation and a recovery in the US office market segment;	Total turnover	194	185	196	204	208
ii. Growth from potential JVs, M&As and yield-accretive acquisitions;	EBITDA	103	100	112	113	116
iii. Attractive valuation and high yields.	Depreciation and amortisation	1	(2)	(2)	2	2
	Operating profit	104	98	110	115	118
	Net interest	(30)	(29)	(32)	(33)	(34)
	Pre-tax profit	(66)	41	100	93	90
	Taxation	23	(1)	(2)	(1)	(1)
	Recurring net profit	(43)	39	99	91	89
Key risks	Cash flow (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Structural decline in office space demand in gateway cities and from the financial sector;	Change in working capital	(9)	6	(3)	(3)	(3)
ii. Unexpected changes in the tax-efficient structure;	Cash flow from operations	143	104	122	123	126
iii. A steep hike in interest rates.	Capex	(24)	(231)	(11)	(11)	(11)
	Cash flow from investing activities	(24)	(231)	(11)	(11)	(11)
	Dividends paid	(71)	(84)	(91)	(95)	(98)
	Cash flow from financing activities	122	196	(82)	(82)	(85)
	Cash at beginning of period	61	87	79	82	84
	Net change in cash	242	69	29	30	30
	Ending balance cash	302	156	108	112	115
Company Profile	Balance sheet (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Manulife US Real Estate Investment Trust is the first pure-play US office REIT listed in Asia. It is a Singapore REIT established 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.	Total cash and equivalents	87	79	82	84	86
	Tangible fixed assets	1,993	2,184	2,217	2,239	2,257
	Total investments	0	6	0	0	0
	Total assets	2,088	2,276	2,304	2,329	2,350
	Short-term debt	234	297	285	285	285
	Total long-term debt	619	675	695	705	715
	Total liabilities	930	1,088	1,093	1,107	1,122
	Shareholders' equity	1,158	1,188	1,212	1,222	1,227
	Total equity	1,158	1,188	1,212	1,222	1,227
	Net debt	766	893	898	905	913
	Total liabilities & equity	2,088	2,276	2,304	2,329	2,350
Key metrics	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Revenue growth (%)	9.3	(4.8)	5.9	4.3	2.0
	Recurrent EPS growth (%)	(181.8)	0.0	136.6	(12.5)	(3.7)
	Operating EBITDA margin (%)	53.2	54.1	57.4	55.2	55.4
	Net profit margin (%)	(22.3)	21.3	50.5	44.7	42.6
	Dividend payout ratio (%)	(205.5)	217.2	92.4	104.6	110.5
	Capex/sales (%)	12.4	124.8	5.6	5.4	5.4
	Interest cover (x)	3.50	3.37	3.46	3.46	3.45

Source: Company data, RHB

Figure 1: DDM valuation

	FY22F	FY23F	FY24F	FY25F	Terminal Value
DPU (US cents)	5.2	5.3	5.4	5.5	80.0
Intrinsic Value (USD)	0.74				
ESG Premium/(discount)	0.04				
Target Price (USD)	0.78				
Current Price (USD)	0.595				
Price Upside (%)	30.0%				
Dividend Yield FY22F (%)	8.7%				
Total Return (%)	38.7%				
Assumptions					
Risk-free rate (%)	3.0%				
Beta	1.0				
Cost of equity (%)	9.0%				
Terminal growth (%)	2.0%				

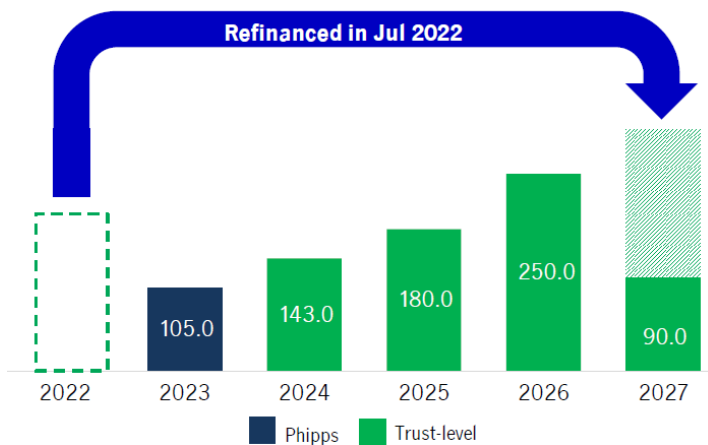
Source: RHB

Figure 2: Summary of the REIT's assets

	Figueroa	Michelson	Peachtree	Plaza	Exchange	Penn	Phipps	Centerpointe	Capitol	Diablo	Park Place	Tanasbourne
Location	Los Angeles	Irvine	Atlanta	Secaucus	Jersey City	Washington, D.C.	Atlanta	Virginia	Sacramento	Tempe	Chandler	Hillsboro
Property Type	Class A	Trophy	Class A	Class A	Class A	Class A	Trophy	Class A	Class A	Class B	Class A	Class B
Completion Date	1991	2007	1991	1985	1988	1964	2010	1987/1989	1992	1980 - 1998	2019	1986 - 1995
Last Refurbishment	2019	-	2015	2016	2020	2018	-	2018	2016	-	-	2015, 2017 & 2020
Property Value (US\$ m)	315.2	317.0	212.9	106.0	324.0	177.3	216.0	112.7	197.0	65.0	106.9	34.4
Occupancy (%)	87.4	89.2	89.1	96.7	85.4	90.9	94.5	92.1	84.3	85.7	100.0	100.0
NLA (sq ft)	715,024	534,430	558,972	466,496	737,414	278,063	475,778	420,429	501,436	354,434	274,700	132,851
WALE by NLA (years)	3.3	5.0	4.4	6.2	5.3	4.5	6.4	4.7	5.0	4.0	7.4	4.3
Land Tenure	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold
No. of Tenants	29	16	25	9	21	8	10	19	36	7	3	3

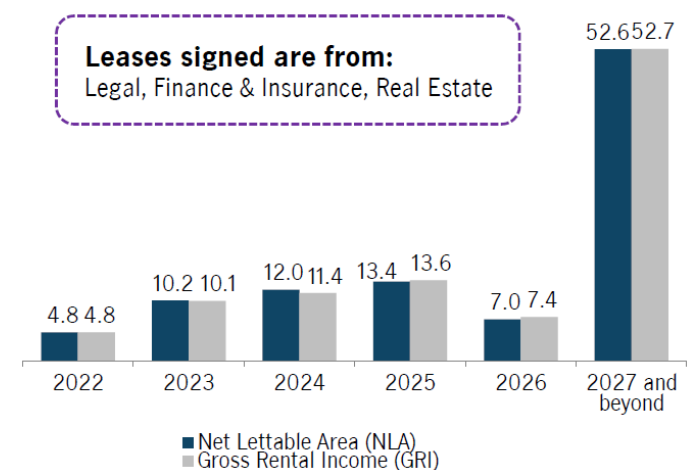
Source: Company data

Figure 3: 2022 Debt has been refinanced to 2027



Source: Company data

Figure 4: <5% of leases are due for renewal in FY22



Source: Company data

Recommendation Chart

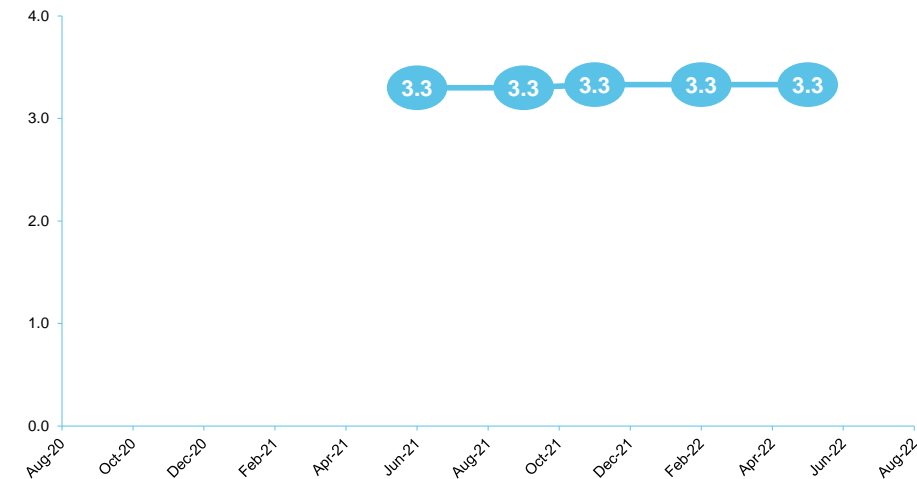


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
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

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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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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