

3 January 2023

Property | REITS

## Manulife US REIT (MUST SP)

**Buy** (Maintained)

### Will The Sponsor Step Up?

- **Maintain BUY, new TP of USD0.43 from USD0.64, 45% upside with c.16% FY23F yield.** Manulife US REIT's sharp valuation decline indicates that the US office market remains in a state of flux, and that our earlier view of a potential recovery in 2H22 was misplaced. The REIT is undergoing a strategic review, and a positive outcome – in our view – would be its sponsor lending support by acquiring or taking stakes in its assets or via equity funding. It is trading at distressed valuations, ie at a >40% discount to marked-down book value.
- **Worse-than-expected asset value decline of c.11%...** This was driven mainly by Figueroa, Los Angeles which saw a 33% drop in value, accounting for 48% of total value decline. This was mainly due to: i) The imminent exit of the anchor tenant, TCW Group by end-2023, ii) downsizing of another Quinn Emanuel, and iii) the cap rate rising by 100bps. On a blended basis, discount rates and terminal cap rate assumption by valuers are c.40-50bps higher. This was on the back of a sharp spike in rates, office transactions coming to a near-standstill in 2H22 due to the lack of interest, and banks pulling back on financing. Other assets which saw a double-digit percentage valuation decline include Plaza, Exchange in New Jersey, Penn and Centerpointe in Virginia highlighting the greater impact in gateway cities while secondary markets fared relatively better.
- **...bringing its gearing to the edge of c.49%,** the highest currently among S-REITs and closer to the maximum allowed threshold limit of 50%. Its interest cover ratio (ICR) as at end-Dec 2022 was estimated at 3.1x. S-REITs are allowed a maximum gearing of up to 50%, provided the ICR is above 2.5x and up to 45% if the ICR is below 2.5x. As interest rates have spiked up sharply since 2H22, we think the ICR could drop below 2.5x by end-2023 – indicating that remedial measures are needed soon.
- **Will Manulife lend support?** MUST is currently in a strategic review to cut its gearing and unlock value. While the REIT has been on the active lookout for divestment opportunities, the current adverse market conditions has limited such options. Its sponsor, Manulife ([link](#)), currently manages global real estate worth of USD20.3bn (as of 1H23) and holds a c.9% stake in the REIT. We believe possible options for the sponsor are: Set up a real estate fund to buy some of MUST's assets, or take a stake in the assets based on their latest valuations. It could also underwrite equity fund-raising at a premium, although the maximum 10% stake cap limits such options.
- **We cut FY23-24F DPU by 15%** by trimming the dividend payout ratio to 90% (vs 100%) as we expect MUST to conserve cash, and also by adjusting occupancy rate and financing assumptions. We raise our COE estimate by 170bps and lower the terminal growth assumption to 1.5% (from 2.0%), resulting in a lower TP. MUST has a top ESG score of 3.3 out of 4.0, and, as such, we apply a 6% ESG premium to intrinsic value to derive our TP.

Target Price (Return): USD0.43 (+45%)  
 Price (Market Cap): USD0.30 (USD533m)  
 ESG score: 3.33 (out of 4)  
 Avg Daily Turnover (USD/USD): 1.20m/1.20m

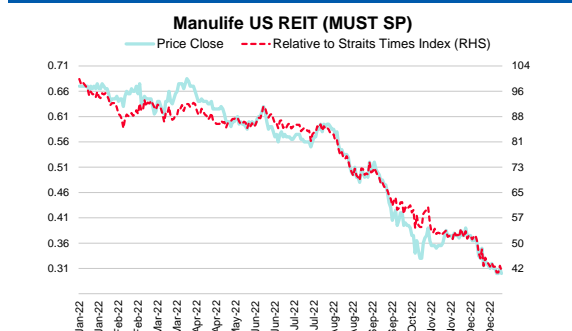
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(55.2)	(23.1)	(29.4)	(47.4)	(55.2)
Relative	(59.3)	(21.9)	(33.3)	(52.2)	(59.2)
52-wk Price low/high (USD)	0.30 – 0.69				



Source: Bloomberg

#### Overall ESG Score: 3.33 (out of 4)

##### E: EXCELLENT

Manulife US REIT targets to achieve 100% green certified portfolio by 2030. It was awarded five stars by the Global Real Estate Sustainability Benchmark (GRESB) benchmark for the second year running, and was rated "A" at the public disclosure level. It is committed to meeting its net-zero and 80% greenhouse gas emissions reduction targets by 2050.

##### S: EXCELLENT

The REIT's staff engagement score has been improving since 2019, and it has a good balance between the genders in its management team. Time spent on corporate social responsibility (CSR) activities rose 1% to 189 hours with higher CSR contributions.

##### G: GOOD

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

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (USDm)	194	185	196	192	200
Net property income (USDm)	116	110	123	121	126
Reported net profit (USDm)	(43)	39	(157)	81	79
Total distributable income (USDm)	89.0	85.6	95.3	86.3	89.1
DPS (USD)	0.06	0.05	0.05	0.05	0.05
DPS growth (%)	(5.2)	(5.4)	0.9	(10.4)	2.1
P/B (x)	0.41	0.40	0.56	0.56	0.56
Dividend Yield (%)	18.8	17.8	18.0	16.1	16.4
Return on average equity (%)	(3.6)	3.4	(14.7)	8.4	8.2
Return on average assets (%)	(2.0)	1.8	(7.3)	3.9	3.8

Source: Company data, RHB

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## Financial Exhibits

<b>Asia</b>	<b>Financial summary</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
Singapore	Recurring EPS (USD)	-	0.03	0.02	0.09	0.05
Property	EPS (USD)	-	0.03	0.02	0.09	0.05
<b>Manulife US REIT</b>	DPS (USD)		0.06	0.05	0.05	0.05
MUST SP	BVPS (USD)		0.73	0.74	0.54	0.53
Buy	Return on average equity (%)		(3.6)	3.4	(14.7)	8.4
	Weighted avg adjusted shares (m)		1,487.58	1,589.36	1,685.93	1,778.49
					1,778.49	1,798.02
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
DDM	Recurring P/E (x)	na	12.10	na	6.61	6.79
	P/E (x)	na	12.10	na	6.61	6.79
	P/B (x)	0.4	0.4	0.6	0.6	0.6
	FCF Yield (%)	26.6	(26.5)	22.8	20.1	20.8
	Dividend Yield (%)	18.8	17.8	18.0	16.1	16.4
	EV/EBITDA (x)	11.31	13.54	12.12	13.41	12.82
	EV/EBIT (x)	11.24	13.81	12.33	13.16	12.59
<b>Key drivers</b>	<b>Income statement (USDm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
i. Stabilisation and recovery in the US office market;	Total turnover	194	185	196	192	200
ii. Potential JVs, M&A or a buyout;	EBITDA	103	100	112	107	113
iii. The stock trading at distressed valuations.	Depreciation and amortisation	1	(2)	(2)	2	2
	Operating profit	104	98	110	109	115
	Net interest	(30)	(29)	(32)	(37)	(40)
	Pre-tax profit	(66)	41	(160)	82	81
	Taxation	23	(1)	2	(1)	(1)
	Recurring net profit	(43)	39	(157)	81	79
<b>Key risks</b>	<b>Cash flow (USDm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
i. Continued decline in office demand for gateway cities;	Change in working capital	(9)	6	(3)	(2)	(2)
ii. Unexpected changes in the tax-efficient structure;	Cash flow from operations	143	104	126	117	122
iii. Higher interest rates for the longer term.	Capex	(24)	(231)	(11)	(10)	(10)
	Cash flow from investing activities	(24)	(231)	(11)	(10)	(10)
	Dividends paid	(71)	(84)	(95)	(86)	(89)
	Cash flow from financing activities	122	196	(84)	(73)	(75)
	Cash at beginning of period	61	87	79	82	86
	Net change in cash	242	69	32	34	37
	Ending balance cash	302	156	110	116	123
<b>Company Profile</b>	<b>Balance sheet (USDm)</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
Manulife US Real Estate Investment Trust is the first pure-play US office REIT listed in Asia. It is a Singapore REIT established 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.	Total cash and equivalents	87	79	82	86	90
	Tangible fixed assets	1,993	2,184	1,957	1,977	1,993
	Total investments	0	6	0	0	0
	Total assets	2,088	2,276	2,045	2,068	2,088
	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	952	961	966
	Total equity	1,158	1,188	952	961	966
	Net debt	766	893	898	904	910
	Total liabilities & equity	2,088	2,276	2,045	2,068	2,088
	<b>Key metrics</b>	<b>Dec-20</b>	<b>Dec-21</b>	<b>Dec-22F</b>	<b>Dec-23F</b>	<b>Dec-24F</b>
	Revenue growth (%)	9.3	(4.8)	5.9	(2.1)	4.5
	Recurrent EPS growth (%)	(181.8)	0.0	(475.8)	0.0	(2.8)
	Operating EBITDA margin (%)	53.2	54.1	57.4	55.8	56.2
	Net profit margin (%)	(22.3)	21.3	(80.2)	42.1	39.6
	Dividend payout ratio (%)	(205.5)	217.2	(60.6)	106.8	112.2
	Capex/sales (%)	12.4	124.8	5.6	5.1	4.9
	Interest cover (x)	3.50	3.37	3.46	2.97	2.86

Source: Company data, RHB

Figure 1: DDM valuation table

	FY22F	FY23F	FY24F	FY25F	FY26F	Terminal value
DPU (US cents)	5.1	4.3	4.4	4.4	4.5	43.1
<b>FV (USD)</b>	0.41					
ESG premium/(Disc) (US cents)	0.02					
TP (USD)	0.43					
Current price (USD)	0.30					
Price upside	45.0%					
Distribution yield (FY23F)	16.1%					
<b>Total return</b>	61.1%					
<b>Assumptions</b>						
Risk-free rate: (%)	3.0%					
Beta	1.2					
Cost of equity (%)	12.0%					
Terminal growth: (%)	1.5%					

Source: RHB

Figure 2: Latest asset valuations

Property Name	Address	Valuation (USDm) as of Dec 2021	Valuation (USDm) as of Dec 2022 (5)	% Change
Figueroa	865 South Figueroa Street, Los Angeles, California	315.2 (2)	211.0 (1)	(33.1)
Michelson	3161 Michelson Drive, Irvine, California	317.0 (2)	292.0	(7.9)
Peachtree	1100 Peachtree Street NE, Atlanta, Georgia	212.9 (2)	205.0	(3.7)
Plaza	500 Plaza Drive, Secaucus, New Jersey	106.0 (2)	92.0	(13.2)
Exchange	10 Exchange Place, Jersey City, New Jersey	324.0 (2)	290.0	(10.5)
Penn	1750 Pennsylvania Avenue NW, Washington DC	177.3 (2)	156.0	(12.0)
Phipps	3438 Peachtree Road NE, Atlanta, Georgia	216.0 (2)	210.0	(2.8)
Centerpointe	4000 & 4050 Legato Road, Fairfax, Virginia	112.7 (2)	101.0	(10.4)
Capitol	400 Capitol Mall, Sacramento, California	197.0 (2)	190.0	(3.6)
Tanasbourne	3175 and 3188 NE Alcock Drive and 3300 NE 83 <sup>rd</sup> Avenue, Hillsboro, Oregon	34.4 (3)	33.5	(2.6)
Park Place	1650 and 1700 South Price Road, Chandler, Arizona	106.9 (4)	103.0	(3.6)
Diablo	2900 South Diablo Way, Tempe, Arizona	65.0 (4)	63.5	(2.3)
<b>Total</b>		<b>2,184.4</b>	<b>1,947.0</b>	<b>(10.9)</b>

Notes:

(1) In the case of Figueroa, the valuation as at end-2022 is reflective of the occupancy plans of the property's two largest tenants, Quinn Emmanuel and TCW Group, with the former executing a renewal and downsize while the latter plans to vacate at the end of its lease (31 Dec 2023). Figueroa accounts for 44% of the portfolio valuation decline as at end-2022.

(2) Valuation conducted by CBRE, Inc. as at 31 Dec 2021.

(3) Valuation conducted by JLL Valuation & Advisory Services as at 1 Nov 2021 during the acquisition of the portfolio comprising Tanasbourne, Park Place and Diablo.

(4) Valuation conducted by JLL Valuation & Advisory Services as at 9 Nov 2021 during the acquisition of the portfolio comprising Tanasbourne, Park Place and Diablo.

(5) Valuation by JLL Valuation & Advisory Services.

Source: Company data

Recommendation Chart

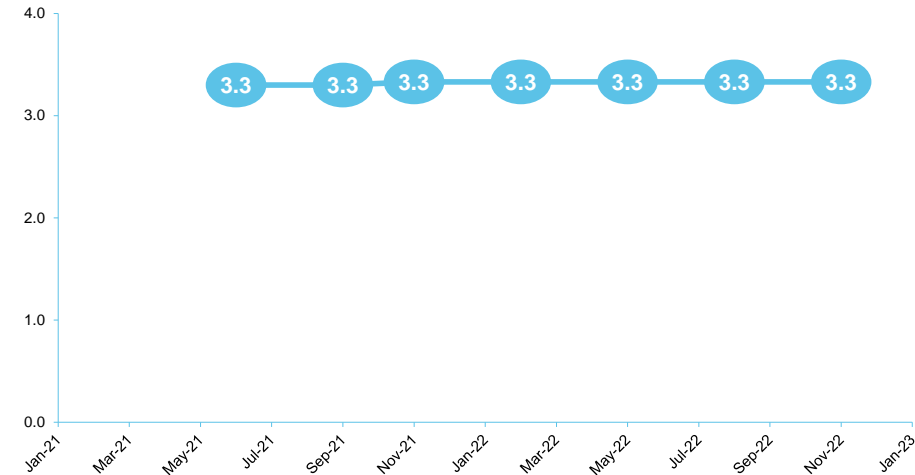


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
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

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Analyst	Company
-	-

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