

10 May 2022

Property | REITS

Manulife US Real Estate Investment Trust (MUST SP)

A Slow Return To The Office; Keep BUY

Buy (Maintained)

Target Price (Return): USD0.83 (38.3%)
 Price (Market Cap): USD0.60 (USD1,058m)
 ESG score: 3.33 (out of 4)
 Avg Daily Turnover (USD/USD) 1.54m/1.54m

- **BUY, new TP of USD0.83 from USD0.86, 38% upside.** Manulife US REIT's 1Q business update shows that return-to-office trends across its key markets have been a bit slower than anticipated, and leasing momentum has been impacted by Omicron. More employees are starting to return to the office (since April) with a pick-up seen in leasing tours, but its outlook is slightly dampened by macroeconomic headwinds. Despite a slow start to 2022, its valuation remains undemanding at 0.9x P/BV with c.9% yields.
- **Portfolio metrics stabilising.** Portfolio occupancy rate dipped 0.6ppts QoQ to 91.7%, mainly from downsizing/non-renewal of two tenants on c.20k sqf at Peachtree, Atlanta and Figueroa, Los Angeles. Leasing velocity fell in 1Q to c.68k sqf (-66% QoQ), which management attributed to Omicron and the pushback on offices reopening. On a positive note, about 54% of leases were new (FY21:28%) with demand coming from the accounting, real estate, and financial sectors. Physical occupancy at its assets has been gradually improving since April to 34%, the highest since the start of the pandemic. Office leasing tours have picked up (+30%) too, indicating that the US office sector could finally be emerging from pandemic-led restrictions. The limited office supply and need for quality office space post-COVID-19 has led to overall rents holding firm and rising slightly, with rent reversion at +3.9% (1Q) – expected to remain positive for the rest of 2022.
- **No material impact from interest rate, utility increase.** MUST has hedged 86.5% of its debt – every 1% increase in rates should have a marginal 1.4% impact on DPU. It has secured commitments for USD207m of loans expiring this year and, with expiring loans' interest costs being relatively high at 3.4% pa, we do not see any significant increase to current borrowing costs. As for utility charges, these are all recovered from tenants on a usage basis. As such, the impact – if any – would be marginal on the vacant spaces in the buildings.
- **Tripp Gantt takes over as new CEO** with the retirement of Jill Smith who was CEO since listing (2016). Gantt, an American, has >23 years of experience in real estate including 16 years overseeing real estate companies on behalf of Washington State Investment Board, a US pension fund with USD25bn in real estate. He highlighted his key focus would be on improving MUST's operational performance – boosting occupancy, income and valuation of assets. We believe his vast experience could bring in more M&A opportunities for the REIT in the medium term.
- **We trim FY22-24F DPU by 2-3%** by fine-tuning occupancy assumptions. On the ESG front, MUST has been a flagbearer among US office REITs and has the highest ESG score of 3.3 out of 4.0 (based on our proprietary in-house methodology), among REITs we cover. As this is three notches above the country median, we apply a 6% premium to its intrinsic value.

Analysts

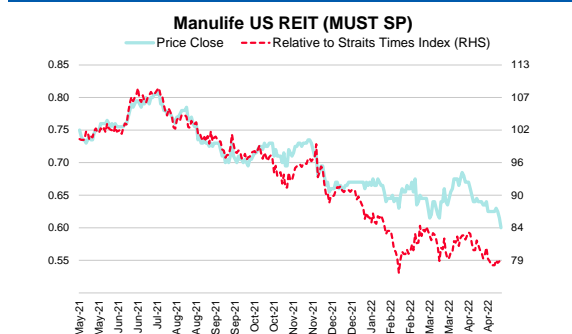
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(10.5)	(10.5)	(4.8)	(15.5)	(19.5)
Relative	(15.9)	(7.8)	(1.0)	(17.0)	(22.4)
52-wk Price low/high (USD)	0.60 – 0.81				



Source: Bloomberg

Overall ESG Score: 3.33 (out of 4)

E: EXCELLENT

MUST targets to have a 100% green-certified portfolio by 2030. She was awarded five stars for the Global Real Estate Sustainability Benchmark (GRESB) benchmark for the second year running, and has an "A" rating at the public disclosure level. It has a net-zero and 80% greenhouse gas emission reduction commitment by 2050.

S: EXCELLENT

MUST's time spent on corporate social responsibility activities rose 1% to 189 hours, with higher contributions. MUST's staff engagement score has been improving since 2019. Its management team is also well-balanced, in terms of gender spread.

G: GOOD

There are incorporated links to its sustainability performance, in incentive pay policies for all employees. There is also a high level of investor outreach and education via its Green Dot series, as well as via various technology tools. MUST practices 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	203	211	218
Net property income (USDm)	116	110	126	131	135
Reported net profit (USDm)	(43)	39	103	96	94
Total distributable income (USDm)	89	86	95	100	104
DPS (USD)	0.06	0.05	0.05	0.06	0.06
DPS growth (%)	(5.2)	(5.4)	0.7	4.0	2.7
P/B (x)	0.82	0.81	0.88	0.88	0.88
Dividend Yield (%)	9.4	8.9	9.0	9.3	9.6
Return on average equity (%)	(3.6)	3.4	8.6	7.9	7.7
Return on average assets (%)	(2.0)	1.8	4.5	4.1	4.0

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	0.06
MUST SP	BVPS (USD)		0.73	0.74	0.69	0.68
Buy	Return on average equity (%)		(3.6)	3.4	8.6	7.9
	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	24.20	9.86	11.14	11.43
	P/E (x)	na	24.20	9.86	11.14	11.43
Key drivers	P/B (x)	0.8	0.8	0.9	0.9	0.9
i. Stabilisation and anticipated recovery in the US office market;	FCF Yield (%)	13.3	(13.3)	11.4	10.9	11.1
ii. Growth from potential JVs, M&As and yield-accretive acquisitions;	Dividend Yield (%)	9.4	8.9	9.0	9.3	9.6
iii. Attractive valuation and high yields.	EV/EBITDA (x)	15.63	18.31	16.14	16.97	16.59
	EV/EBIT (x)	15.53	18.67	16.41	16.68	16.32
Key risks	Income statement (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Structural decline in office demand in gateway cities and from the financial sector;	Total turnover	194	185	203	211	218
ii. Unexpected changes in the tax-efficient structure;	EBITDA	103	100	116	116	120
iii. A steep hike in interest rates	Depreciation and amortisation	1	(2)	(2)	2	2
	Operating profit	104	98	114	118	122
	Net interest	(30)	(29)	(32)	(32)	(33)
	Pre-tax profit	(66)	41	104	97	95
	Taxation	23	(1)	(1)	(1)	(1)
	Recurring net profit	(43)	39	103	96	94
Company Profile	Cash flow (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Manulife US REIT is the first pure-play US office REIT listed in Asia. Its investment strategy is 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.	Change in working capital	(9)	6	(3)	(3)	(3)
	Cash flow from operations	143	104	126	127	131
	Capex	(24)	(231)	(11)	(11)	(11)
	Cash flow from investing activities	(24)	(231)	(11)	(11)	(11)
	Dividends paid	(71)	(84)	(95)	(100)	(104)
	Cash flow from financing activities	122	196	(86)	(87)	(90)
	Cash at beginning of period	61	87	79	82	84
	Net change in cash	242	69	29	29	30
	Ending balance cash	302	156	108	111	114
	Balance sheet (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	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	2,305	2,330	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	1,108	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	2,305	2,330	2,350
	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Revenue growth (%)	9.3	(4.8)	9.9	4.0	3.0
	Recurrent EPS growth (%)	(181.8)	0.0	145.5	(11.6)	(2.5)
	Operating EBITDA margin (%)	53.2	54.1	56.9	54.8	55.0
	Net profit margin (%)	(22.3)	21.3	50.5	45.3	43.3
	Dividend payout ratio (%)	(205.5)	217.2	92.6	104.4	109.9
	Capex/sales (%)	12.4	124.8	5.4	5.2	5.1
	Interest cover (x)	3.50	3.37	3.57	3.66	3.69

Source: Company data, RHB

Figure 1: DDM valuation

	FY22F	FY23F	FY24F	FY25F	Terminal Value
DPU (US cents)	5.4	5.6	5.7	5.8	84.6
Intrinsic Value (USD)	0.78				
ESG Premium/(discount)	0.05				
TP (USD)	0.83				
Current Price (USD)	0.63				
Price Upside (%)	38.3%				
Dividend Yield FY22F (%)	9.0%				
Total Return (%)	47.3%				
Assumptions					
Risk-free rate (%)	3.0%				
Beta	1.0				
Cost of equity (%)	9.0%				
Terminal growth (%)	2.0%				

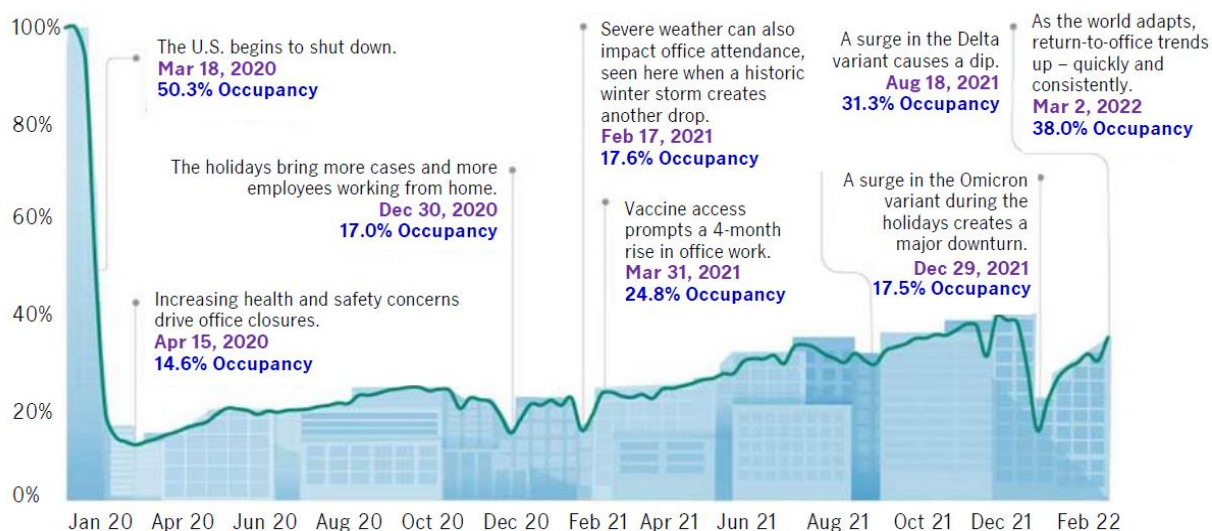
Source: RHB

Figure 2: Portfolio assets overview

	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	95.6	93.8	94.5	90.6	87.4	85.7	100.0	100.0
NLA (sq ft)	715,024	533,567	558,835	466,496	737,060	278,063	475,778	420,434	500,661	354,434	274,700	132,851
WALE by NLA (years)	3.0	5.1	4.7	5.8	4.8	4.7	6.6	4.8	4.8	4.2	7.7	4.5
Land Tenure	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold	Freehold
No. of Tenants	28	14	25	9	23	9	10	18	36	7	3	3

Source: Company data

Figure 3: The US's return-to-office trends since the pandemic, and physical occupancy rates



Source: Company data, Kastle

Recommendation Chart

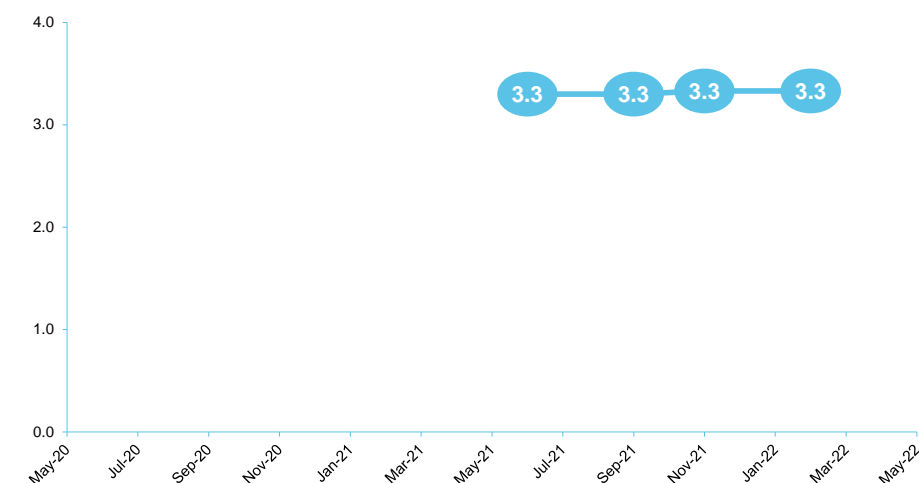


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-02-10	Buy	0.86	0.65
2021-11-04	Buy	0.90	0.70
2021-02-09	Buy	0.87	0.72
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
2019-04-26	Buy	na	0.87

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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