

19 July 2023

Property | REITS

## Manulife US REIT (MUST SP)

**Buy** (Maintained)

### In Urgent Need Of Active Sponsor Support

Target Price (Return): USD0.25 (+48%)  
 Price (Market Cap): USD0.17 (USD300m)  
 ESG score: 3.2 (out of 4)  
 Avg Daily Turnover (USD/USD) 0.97m/0.97m

- **Keep BUY, with new USD0.25 TP from USD0.40, 48% upside and c.23% yield.** Manulife US REIT announced worse-than-expected double-digit portfolio valuation cuts reflecting the harsh US office investment landscape. The steep decline has resulted in a breach of official gearing limits and a slightly breach in loan covenants. MUST is in active discussion with its sponsor and lenders to remedy the situation. Post revaluation, the REIT still trades at c.60% discount to book. Hence, we believe there is some upside potential, even in an orderly liquidation scenario.
- **Portfolio valuation declined 15%**, which is more than double that of what we anticipated, and this is on top of a 11% decline announced end of last year. 60% of the USD280m decline came from five key gateway city assets in the markets of California, New York, Washington and Atlanta (Figure 2) with valuation declines ranging from 4-27%. Key reasons driving the decline include a change in assumption by valuers with discount rates widening by 50-125bps and terminal cap rates increasing 25-100bps as well as asset specific vacancies, highlighting market uncertainty and higher interest rate outlook. NAV post revaluation is expected to be ~USD0.40.
- **In discussion with banks to waive the breach in financial covenants**, with the ratio of consolidated total unencumbered debt to consolidated total unencumbered assets at 60.2:100 (marginally above the stipulated 60:100). If the banks do not agree to waive, this will result in MUST not being able to rely on its existing interest rate swaps and lead to higher interest costs. The REIT will also be unlikely to be able to pay its 1H unitholder distributions until the above is resolved. Gearing will rise to c.57% (from 49.5% in 1Q). The breach of gearing and bank covenants will hamper its ability to borrow debt and impact funding capex and tenant incentives.
- **High time for sponsor to show more active and immediate support.** The Sponsor, Manulife, with its strong financial position could help offer support in the form of i) the completion of the proposed acquisition of The Phipps from the REIT, preferably at an average of year end (Dec 2022) and latest valuation as well as potentially buying back few more assets from the REIT, and ii) working with the lenders in resolving and offering continued financial support to the REIT, and, if needed, provide a shareholder loan or act as a lender of the last resort. The REIT manager also guided that it is considering seeking a disposition mandate from unitholders that would help in providing more flexibility to dispose certain assets as long as the disposition meets certain conditions. This, in our view, is reasonable as the current buyers' market conditions need a speedy execution process.
- **We lower FY24F-25F DPU by 5% and 3%**, adjusting occupancy assumptions and raising our COE assumptions by 5ppts amid increased uncertainty. ESG score of 3.2 (out of 4.0) is two notches above the country median score. As such, we apply a 4% ESG premium.

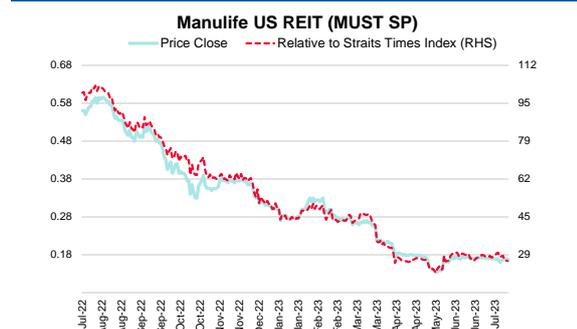
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(43.7)	(0.6)	(7.2)	(39.7)	(69.8)
Relative	(43.8)	(0.4)	(5.2)	(38.9)	(74.8)
52-wk Price low/high (USD)	0.13 – 0.60				



Source: Bloomberg

#### Overall ESG Score: 3.2 (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

The REIT is fairly transparent on earnings and operating metrics disclosures. But recent issues surrounding slow sponsors support, minority consideration and potential change of REIT manager has raised our concerns on governing standards.

#### 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	195
Net property income (USDm)	110	113	107	106	108
Reported net profit (USDm)	39	(130)	(230)	105	66
Total distributable income (USDm)	85.6	87.9	79.8	77.5	78.5
DPS (USD)	0.05	0.05	0.04	0.04	0.04
DPS growth (%)	(5.4)	(11.5)	(16.4)	(4.4)	(0.3)
P/B (x)	0.23	0.29	0.42	0.41	0.41
Dividend Yield (%)	31.6	28.0	23.4	22.4	22.3
Return on average equity (%)	3.4	(11.7)	(26.3)	14.1	8.6
Return on average assets (%)	1.8	(5.9)	(11.7)	5.7	3.5

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	-	0.13
Property	EPS (USD)	0.02	-	0.08	-	0.13
<b>Manulife US REIT</b>	DPS (USD)	0.05	0.05	0.04	0.04	0.04
MUST SP	BVPS (USD)	0.74	0.58	0.40	0.42	0.41
Buy	Return on average equity (%)	3.4	(11.7)	(26.3)	14.1	8.6
	Weighted avg adjusted shares (m)	1,589.36	1,685.06	1,792.37	1,832.45	1,861.25
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
DDM Methodology	Recurring P/E (x)	6.82	na	na	2.94	4.75
	P/E (x)	6.82	na	na	2.94	4.75
	P/B (x)	0.2	0.3	0.4	0.4	0.4
<b>Key drivers</b>	FCF Yield (%)	(47.1)	23.2	39.9	26.3	27.5
i. Stabilisation and recovery in the US office market;	Dividend Yield (%)	31.6	28.0	23.4	22.4	22.3
ii. Further asset sale and equity injections;	EV/EBITDA (x)	11.46	10.50	11.45	12.29	11.80
iii. Trading at distressed valuations.	EV/EBIT (x)	11.69	10.95	11.96	12.29	12.28
<b>Key risks</b>	<b>Income statement (USDm)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
i. Continued decline in office demand for gateway cities;	Total turnover	185	203	188	187	195
ii. Unexpected changes in the tax-efficient structure;	EBITDA	100	106	101	96	103
iii. Higher interest rates for the longer.	Depreciation and amortisation	(2)	(4)	(4)	0	(4)
	Operating profit	98	102	96	96	99
	Net interest	(29)	(34)	(37)	(39)	(39)
	Pre-tax profit	41	(148)	(233)	107	68
	Taxation	(1)	18	3	(2)	(2)
	Recurring net profit	39	(130)	(230)	105	66
<b>Company Profile</b>	<b>Cash flow (USDm)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
Manulife US Real Estate Investment Trust is the first pure-play US 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 US, as well as real estate-related assets.	Change in working capital	6	1	(9)	(9)	(9)
	Cash flow from operations	104	91	108	98	104
	Capex	(231)	(25)	13	(16)	(17)
	Cash flow from investing activities	(231)	(25)	13	(16)	(17)
	Dividends paid	(84)	(89)	(80)	(78)	(78)
	Cash flow from financing activities	196	(184)	(85)	(70)	(57)
	Cash at beginning of period	87	79	113	114	93
	Net change in cash	69	(118)	35	11	30
	Ending balance cash	156	(39)	148	126	123
	<b>Balance sheet (USDm)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Total cash and equivalents	79	113	114	93	91
	Tangible fixed assets	2,184	1,947	1,642	1,708	1,734
	Total investments	6	48	48	48	48
	Total assets	2,276	2,116	1,810	1,855	1,878
	Short-term debt	297	145	150	150	160
	Total long-term debt	675	884	874	874	884
	Total liabilities	1,088	1,096	1,085	1,087	1,109
	Shareholders' equity	1,188	1,020	725	768	770
	Total equity	1,188	1,020	725	768	770
	Net debt	893	916	910	931	953
	Total liabilities & equity	2,276	2,116	1,810	1,855	1,878
	<b>Key metrics</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Revenue growth (%)	(4.8)	9.5	(7.1)	(0.7)	4.4
	Recurrent EPS growth (%)	0.0	(410.4)	66.4	0.0	(38.0)
	Operating EBITDA margin (%)	54.1	52.3	53.5	51.6	52.7
	Net profit margin (%)	21.3	(64.0)	(122.0)	56.3	33.9
	Dividend payout ratio (%)	217.2	(64.4)	(31.3)	66.3	106.7
	Capex/sales (%)	124.8	12.5	(6.7)	8.8	8.8
	Interest cover (x)	3.37	3.00	2.57	2.47	2.52

Source: Company data, RHB

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Figure 1: DDM valuation table

	FY23F	FY24F	FY25F	FY26F	FY27F	Terminal value
DPU (US cents)	4.0	3.8	3.8	3.9	4.2	27.0
<b>FV (USD)</b>	0.24					
ESG premium/(Disc) (US cents)	0.01					
TP (USD)	0.25					
Current price (USD)	0.169					
Price upside	48.0%					
Distribution yield (FY23F)	23.4%					
<b>Total return</b>	71.4%					
<b>Assumptions</b>						
Risk-free rate: (%)	3.0%					
Beta	1.2					
Cost of equity (%)	17.4%					
Terminal growth: (%)	1.5%					

Source: RHB

Figure 2: Latest asset valuations and percentage change

Property Name	Address	Valuation (US\$ million) (31 December 2022) <sup>(1)</sup>	Valuation (US\$ million) (30 June 2023) <sup>(1)</sup>	% Change
Figueroa	865 South Figueroa Street, Los Angeles, California	211.0	174.0	-17.5
Michelson	3161 Michelson Drive, Irvine, California	292.0	256.0	-12.3
Peachtree	1100 Peachtree Street NE, Atlanta, Georgia	205.0	175.0	-14.6
Plaza	500 Plaza Drive, Secaucus, New Jersey	92.0	67.1	-27.1
Exchange	10 Exchange Place, Jersey City, New Jersey	290.0	258.0	-11.0
Penn	1750 Pennsylvania Avenue NW, Washington, DC	156.0	124.0	-20.5
Phipps	3438 Peachtree Road NE, Atlanta, Georgia	210.0	178.15 <sup>(2)</sup>	-15.2
Centerpointe I & II	4000 & 4050 Legato Road, Fairfax, Virginia	101.0	79.0	-21.8
Capitol	400 Capitol Mall, Sacramento, California	190.0	165.0	-13.2
Park Place	1650 and 1700 South Price Road, Chandler, Arizona	103.0	98.7	-4.2
Diablo	2900 South Diablo Way, Tempe, Arizona	63.5	58.6	-7.7
<b>Total</b>		<b>1,913.5</b>	<b>1,633.55</b>	<b>-14.6</b>

Notes:

(1) Valuation by JLL Valuation &amp; Advisory Services, LLC.

(2) Average of valuations by JLL Valuation &amp; Advisory Services, LLC and Colliers International Valuation &amp; Advisory Services, LLC. is in connection with the proposed disposal to The Manufacturers Life Insurance Company.

Source: Company data

## Recommendation Chart

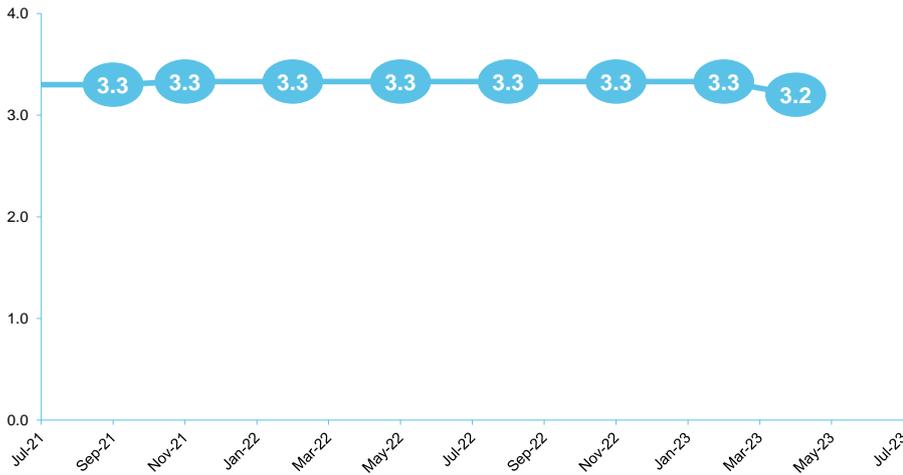


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-12-13	Buy	1.10	0.98

Source: RHB, Bloomberg

## ESG Rating History



Source: RHB

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<b>Buy:</b>	Share price may exceed 10% over the next 12 months
<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
<b>Take Profit:</b>	Target price has been attained. Look to accumulate at lower levels
<b>Sell:</b>	Share price may fall by more than 10% over the next 12 months
<b>Not Rated:</b>	Stock is not within regular research coverage

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