Singapore Company Guide

Manulife US Real Estate Inv

Version 4 | Bloomberg: MUST SP | Reuters: MANU.SI **Refer to important disclosures at the end of this report**

DBS Group Research . Equity 14 Feb 2017

BUY

Last Traded Price (13 Feb 2017): US$0.86 (STI : 3,111.63)
Price Target 12-mth: US$0.95 (11% upside and 7.2% yield) (Prev US$0.93)
Potential Catalyst: Exceeding IPO forecasts, and acquisitions
Where we differ: In line with consensus estimates

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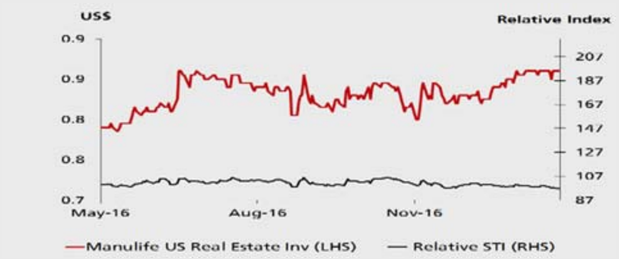
What's New

- **4Q16 DPU of 1.54 UScts ahead of expectations and IPO forecasts**
- **Double digit rental reversions and uplift in portfolio values points to strong US office market**
- **Gearing drops to 33.8%, provides additional debt headroom for acquisitions**

Price Relative



Forecasts and Valuation

FY Dec (US$m)	2016A*	2017F	2018F	2019F
Gross Revenue	47.5	78.7	80.0	81.8
Net Property Inc	30.0	48.7	49.5	50.6
Total Return	51.7	33.7	34.2	34.9
Distribution Inc	22.3	39.2	39.7	40.5
EPU (US cts.)	8.25	5.34	5.37	5.43
EPU Gth (%)	99	(35)	1	1
DPU (US cts.)	3.55	6.21	6.24	6.30
DPU Gth (%)	nm	nm	1	1
NAV per shr (US cts.)	87.3	86.6	85.9	85.2
PE (X)	10.4	16.1	16.0	15.8
Distribution Yield (%)	4.1	7.2	7.3	7.3
P/NAV (x)	1.0	1.0	1.0	1.0
Aggregate Leverage (%)	33.8	34.5	34.9	35.5
ROAE (%)	10.0	6.2	6.3	6.4
DPU Chng (%):		3	3	3
Consensus DPU (US cts.):		6.10	6.30	6.00
Other Broker Recs:		B: 4	S: 0	H: 0

** FY16 numbers between 20 May to 31 December 2016*

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Outperforming IPO estimates

Play on exposure to an improving US office market. We maintain our BUY call with a revised TP of US$0.95. We continue to like Manulife US REIT's (MUST) attractive prospective 7.2% yield, inbuilt annual rental escalations and exposure to the favourable demand and supply fundamentals in the various US office markets where MUST's properties are located. This translates to an 8% DPU growth in FY17 (on an annualised basis), one of the highest among REITs in Singapore.

Confidence on the REIT's ability to deliver. MUST's strong FY16 results and double digit rental reversions indicate that MUST's properties in Midtown Atlanta and Downtown Los Angeles submarkets continue to see steadily increasing rents, continued expansionary tenant demand, increased employment opportunities and also a lack of competitive new supply. Apart from upside when leases are due, c.84% of leases (by net lettable area (NLA)) have annual rental escalations of c. 3%.

Acquisitions to be the next growth driver. The Manager has a disciplined strategy towards acquisitions and with the recent decline in gearing to 33-34%, MUST is well placed to execute on DPU-accretive acquisitions. Apart from that, we expect any acquisitions to diversify the REIT's geographic earnings base and tenant concentration. Markets that are of interest are core submarkets that enjoy demand from a diversified type of industries (i.e. manufacturing, financial, technology and law firms) which imply stability across market cycles. We have not assumed any acquisitions in our forecasts.

Valuation:

On the back of the better than expected 4Q16 results, we raised our DCF-based TP to US$0.95 from US$0.93. The stock offers attractive FY17-18F yields of 7.2-7.3%.

Key Risks to Our View:

Lower-than-expected rental income. The key risk to our view is lower-than-expected rental income, arising from non-replacement/renewal of leases and/or slower-than-expected recovery of office rents in the US.

At A Glance

Issued Capital (m shrs)	628
Mkt. Cap (US$m)	540
Major Shareholders (%)	
Manulife Financial Corp	7.7
Free Float (%)	92.3
3m Avg. Daily Val (US$m)	0.95
ICB Industry : Financials / Real Estate Investment Trusts	

WHAT'S NEW

Leveraging on the US office upturn

Outperforms expectations

- 4Q16 DPU came in at 1.54 UScts, resulting in DPU from listing date (20 May 2016) to 31 December 2016 of 3.55 UScts. On an annualised basis, MUST delivered a FY16 DPU of 5.75 UScts which was above our estimate of 5.61 UScts. This was also 4.8% higher than annualised IPO forecast of 5.50 UScts.
- Compared to the IPO forecast, the better than expected results was due to lower interest costs (effective interest rate of 2.46% versus 2.80%). Lower property expenses also contributed to the stronger results which saw FY16 net property income (NPI) exceeding IPO forecasts by 1%.
- The outperformance relative to our forecast was attributed to lower than expected property related non-cash items (such as amortisation of incentives) and units on issue.

Healthy portfolio occupancy maintained with strong rental reversions

- Occupancies at MUST's three properties, Figueroa, Michelson and Peachtree were maintained at 97.5%, 99.1% and 94.4% respectively, with overall portfolio occupancy at 97%.
- Owing to the strength of the US office market, MUST delivered rental reversion of 10.5% during 2016, the strongest of which was reported at Figueroa at 11.6%. This was followed by Michelson at 9.9% and 5.8% at Peachtree.
- On the back of the healthy uplift from new leases signed, passing rents at Figueroa, Michelson and Peachtree, rose 4.8%, 3.7% and 3.4% y-o-y to US$36.78 per square foot (psf) per year, US$49.27 and US$31.01 respectively.

Long WALE

- MUST continues to provide good cashflow visibility with a portfolio weighted average lease expiry (WALE) of 5.8 years.
- It also faces minimal expiries, with only 5.3% and 1.7% of leases by cash rental income up for renewal in 2017 and 2018.
- In 2019, there is a jump in leases up for renewal (14.6% of leases by cash rental income). This mainly relates to Hyundai Capital which is located in the Michelson building. However, we understand that ongoing discussions with Hyundai indicate their willingness to remain as an anchor tenant at Michelson. Hyundai occupies the top floor in the building, and the building provides ample car parking spaces and ready access to nearby amenities.

Further increase in portfolio valuations with minimal exposure to rising interest rates

- With further compression in portfolio cap rates since September 2016, down to 5.1% from 5.3% (and 5.7% at IPO) and an increase in passing rents, MUST's overall portfolio value rose 2.5%. Valuations at Figueroa, Michelson and Peachtree rose 3.3%, 1.8% and 2.5% q-o-q.
- As a result, gearing fell to 33.8% from 34.7% which provides additional debt headroom to pursue acquisitions. In addition, NAV per unit now stands at US$0.87, from US$0.84 as at end 3Q16.
- Meanwhile, MUST's DPU is immune to an increase in interest rates in the near term as 100% of its debt fixed until 2019 at 2.46%.

Positive tailwinds still in place

- On the back of favourable demand and supply fundamentals, management guided that market rents in Atlanta could potentially increase by 4-6% in 2017, with Downtown Los Angeles and Orange County rising by 3-5%. Rental growth in Atlanta is expected to be strong due to increased demand across various industries especially the IT sector. Meanwhile, limited supply in Downtown Los Angeles and Orange County combined with decent demand should lead to rising rents. This follows the 7-8% increase in spot rents in Atlanta, Downtown Los Angeles and Orange County in 2016.
- To better reflect the stronger spot rental market (we had previously incorporated 2-3% increase in market rents) and incorporating the better than expected results, we raised our FY17-19F DPU by 3% p.a. and lifted our DCF-based TP to US$0.95 from US$0.93.
- With the Atlanta, Los Angeles and Orange County office markets still on an uptrend and the majority of MUST's leases having annual escalations of around 3%, we believe MUST will continue to deliver healthy set of results going forward with annualised FY17 DPU projected to increase by around 8% y-o-y.

Maintain BUY and revised TP of US$0.95

- With the better than expected 4Q16 results, we maintain our BUY call with a revised TP of US$0.95.

Quarterly / Interim Income Statement (US$m)

FY Dec	3Q2016	4Q2016	% chg yoy	% chg qoq
Gross revenue	28.2	19.3	nm	(31.5)
Property expenses	(10.6)	(7.0)	nm	(34.4)
Net Property Income	17.6	12.4	nm	(29.7)
Other Operating expenses	(1.7)	(1.4)	nm	(18.8)
Other Non Opg (Exp)/Inc	0.0	0.0	-	-
Net Interest (Exp)/Inc	(3.1)	(2.0)	nm	33.7
Exceptional Gain/(Loss)	0.0	0.0	-	-
Net Income	12.8	8.94	nm	(30.3)
Tax	(12.0)	(10.4)	nm	(12.8)
Minority Interest	0.0	0.0	-	-
Net Income after Tax	0.85	(1.5)	nm	nm
Total Return	33.7	18.0	nm	(46.8)
Non-tax deductible Items	(21.1)	(8.2)	nm	(61.0)
Net Inc available for Dist.	12.6	9.71	nm	(22.9)
Ratio (%)				
Net Prop Inc Margin	62.4	64.0		
Dist. Payout Ratio	100.0	100.0		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

Exposure to the recovery of US real estate market. According to Colliers International (Colliers), the office market outlook for Downtown Los Angeles, Orange County and Atlanta are attractive given (i) rising demand due to projected falling unemployment rates on the back of a pick-up in business activities, and (ii) a deep pool of local talents and skilled workers which attract companies to set up and maintain their presence there.

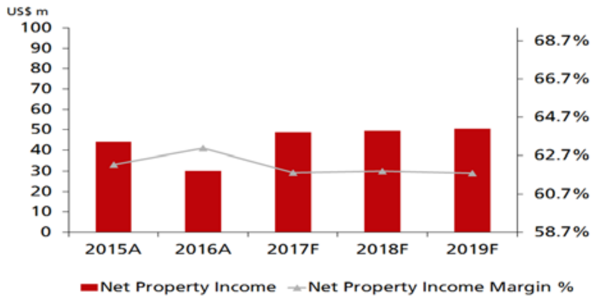
The sub-markets where Manulife US REIT's properties are located are also characterised by a lack of new competitive supply due to limited land availability and high construction costs. Given supportive market dynamics, management guided that market rents in MUST's three key markets could potentially increase by 3-6% in 2017. Through the initial portfolio and potential acquisitions in the future, we believe that MUST offers a cyclical recovery story, with rents and capital values at or close to an upswing, underpinned by improved business activity in the US and real estate values that are off previous highs.

Inbuilt organic growth. MUST's properties are well positioned to experience strong organic growth delivered through built-in rental escalations embedded into their lease contracts. Approximately 84% of leases (by NLA) for MUST's portfolio has built-in annual rental escalations, mostly between 2.5% and 3.5%, with c.15% of leases (by NLA) with mid-term or period rent increases, thus providing a visible and growing rental income stream.

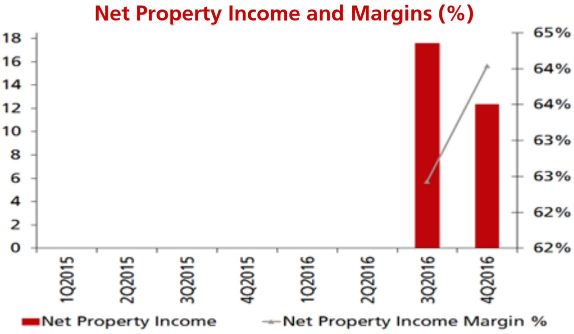
Long WALE of 5.8 years offers strong income visibility. With leases typically signed on a 3- to 10-year lease and some in excess of 10 years, the initial portfolio enjoys a long WALE of 5.8 years (by NLA) as at 31 December 2016. As such, the initial portfolio has minimal expiries in the following years - only 5.3% and 1.7% of its leases (by cash rental income) are expiring in 2017 and 2018 respectively, and we are expecting these leases to revert positively when leases are due for renewal.

Growth through acquisitions by tapping into the expertise of its Sponsor. MUST's Sponsor is The Manufacturer's Life Insurance Company, which is part of Manulife Financial Group, a Canada-based financial services group. Through its subsidiary, Manulife Real Estate (MRE), the Sponsor has a strong acquisition capability and track record, demonstrated by the acquisition of 85 properties worth US$6.2bn since 2010. This has resulted in a CAGR of 17.5% per annum in the value of MRE's AUM. Therefore, we believe MUST will be able to tap on its Sponsor's real estate platform to source deals, access local market expertise and gain assistance in securing financing to grow its portfolio through DPU-accretive acquisitions in the US.

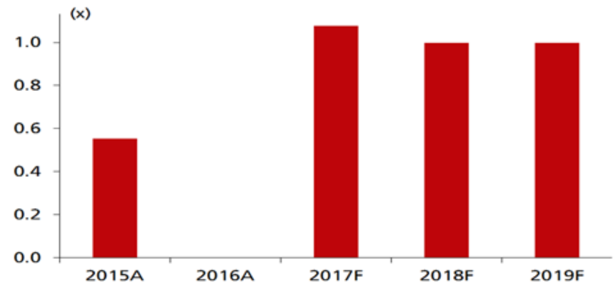
Net Property Income and Margins (%)



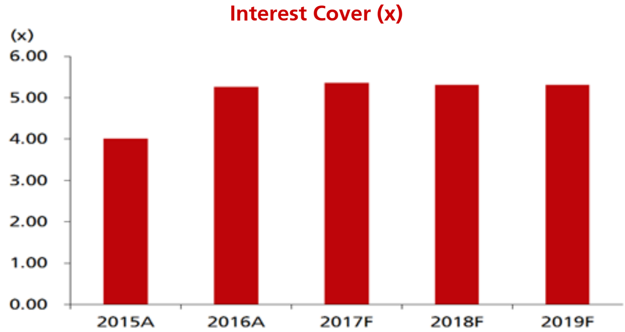
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Stable gearing. Post recent portfolio revaluation gains, MUST's gearing has fallen to 33.8% as at end-December 2016. This provides additional debt headroom for MUST when it explores acquisition opportunities.

Conservative interest rate profiles. To manage its interest rate risks, MUST has hedged 100% of its interest exposure at an average interest rate of 2.46% till 2019.

Share Price Drivers:

Establishing a track record. A key pushback from potential investors is the lack of familiarity with the US office market, which we believe after a few quarters of strong results, will allay most of investors' concerns. This may lead to a re-rating of the stock. In addition, while MUST has outperformed its IPO forecasts in 2016, another key share price driver is the continued outperformance of its IPO forecasts in 2017. This could be driven by stronger-than-expected recovery of the US office market leading to higher rental reversions.

Key Risks:

Risk of non-renewal and non-replacement of leases. MUST's financials, results of operations, and capital growth may be adversely affected by bankruptcy, insolvency or downturn in the businesses of one or more of the tenants, as well as the decision by one or more of these tenants not to renew their lease/s at the end of a lease cycle.

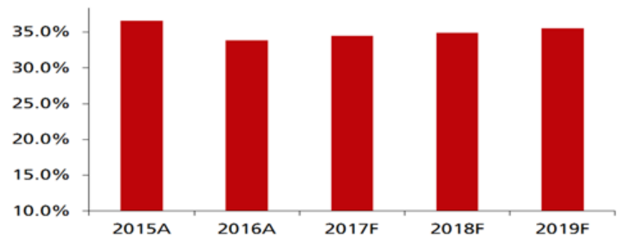
Foreign currency risks. All of the REIT's assets are located in the US and generate revenues in USD. Thus, investors who elect to receive distributions in SGD have exposure to volatility in the USD/SGD FX rate. This is mitigated should investors elect to receive distributions in USD.

Regulatory risks. MUST's tax efficiency relies in part on its Parent US REIT and Sub-US REITs being able to maintain their status as US REITs as well as qualifying for US portfolio interest exemption when repatriating cashflows back to Singapore as interest. Distributions paid to MUST's unitholders may be adversely impacted if there be any changes in tax or REIT regulations in either the US or Singapore which affects the current REIT structure or ability to repatriate cash in a tax-efficient manner.

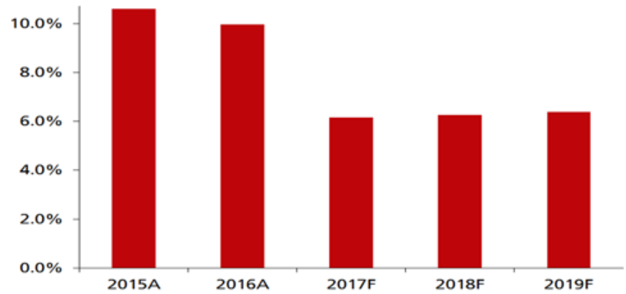
Company Background

Manulife US REIT (MUST) is the first pure-play US office REIT listed in Asia. Its portfolio consists of three freehold, Class A or Trophy quality office properties in Atlanta, Los Angeles, and Orange County with aggregate net lettable area (NLA) of c.1.8m square feet.

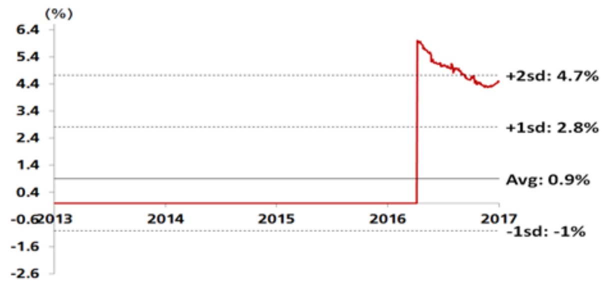
Aggregate Leverage (%)



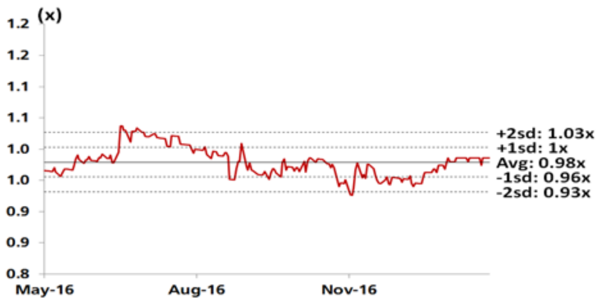
ROE (%)



Distribution Yield (%)



PB Band (x)



Source: Company, DBS Bank

Income Statement (US$m)

FY Dec	2015A*	2016A*	2017F	2018F	2019F
Gross revenue	71.0	47.5	78.7	80.0	81.8
Property expenses	(26.8)	(17.5)	(30.0)	(30.5)	(31.3)
Net Property Income	44.2	30.0	48.7	49.5	50.6
Other Operating expenses	(5.7)	(3.1)	(5.6)	(5.8)	(6.0)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(9.6)	(5.1)	(8.1)	(8.2)	(8.4)
Exceptional Gain/(Loss)	(1.5)	52.3	0.0	0.0	0.0
Net Income	27.3	74.1	35.0	35.5	36.2
Tax	(1.4)	(22.4)	(1.3)	(1.2)	(1.3)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	26.0	51.7	33.7	34.2	34.9
Total Return	26.0	51.7	33.7	34.2	34.9
Non-tax deductible Items	6.78	(29.4)	5.49	5.51	5.59
Net Inc available for Dist.	34.3	22.3	39.2	39.7	40.5
Growth & Ratio					
Revenue Gth (%)	N/A	(33.0)	65.6	1.7	2.3
N Property Inc Gth (%)	nm	(32.1)	62.3	1.8	2.1
Net Inc Gth (%)	nm	99.0	(34.8)	1.5	1.9
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	62.2	63.1	61.8	61.9	61.8
Net Income Margins (%)	36.6	108.8	42.8	42.8	42.7
Dist to revenue (%)	48.3	47.0	49.8	49.7	49.5
Managers & Trustee's fees	8.0	6.6	7.1	7.3	7.3
ROAE (%)	10.6	10.0	6.2	6.3	6.4
ROA (%)	6.5	6.2	3.8	3.9	3.9
ROCE (%)	9.6	2.4	5.1	5.2	5.2
Int. Cover (x)	4.0	5.3	5.4	5.3	5.3

** FY15 are proforma numbers while FY16 are for the period between 20 May to 31 December 2016*

Source: Company, DBS Bank

Growth driven by recovery in the US office market

Quarterly / Interim Income Statement (US$m)

FY Dec	3Q2016	4Q2016
Gross revenue	28.2	19.3
Property expenses	(10.6)	(7.0)
Net Property Income	17.6	12.4
Other Operating expenses	(1.7)	(1.4)
Other Non Opg (Exp)/Inc	0.0	0.0
Net Interest (Exp)/Inc	(3.1)	(2.0)
Exceptional Gain/(Loss)	0.0	0.0
Net Income	**12.8**	**8.94**
Tax	(12.0)	(10.4)
Minority Interest	0.0	0.0
Net Income after Tax	**0.85**	**(1.5)**
Total Return	33.7	18.0
Non-tax deductible Items	(21.1)	(8.2)
Net Inc available for Dist.	12.6	9.71
Growth & Ratio		
Revenue Gth (%)	N/A	(32)
N Property Inc Gth (%)	nm	(30)
Net Inc Gth (%)	nm	nm
Net Prop Inc Margin (%)	62.4	64.0
Dist. Payout Ratio (%)	100.0	100.0

Balance Sheet (US$m)

FY Dec	2016A	2017F	2018F	2019F
Investment Properties	834	844	850	859
Other LT Assets	0.0	0.0	0.0	0.0
Cash & ST Invts	38.4	35.6	35.7	35.8
Inventory	0.0	0.0	0.0	0.0
Debtors	2.31	3.15	3.20	3.27
Other Current Assets	0.68	0.68	0.68	0.68
Total Assets	**875**	**884**	**890**	**898**
ST Debt	0.0	0.0	0.0	0.0
Creditor	9.82	7.87	8.00	8.18
Other Current Liab	0.20	0.20	0.20	0.20
LT Debt	294	305	311	319
Other LT Liabilities	24.0	24.0	24.0	24.0
Unit holders' funds	547	547	547	547
Minority Interests	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**875**	**884**	**890**	**898**
Non-Cash Wkg. Capital	(7.0)	(4.2)	(4.3)	(4.4)
Net Cash/(Debt)	(256)	(269)	(275)	(283)
Ratio				
Current Ratio (x)	4.1	4.9	4.8	4.7
Quick Ratio (x)	4.1	4.9	4.8	4.7
Aggregate Leverage (%)	33.8	34.5	34.9	35.5
Z-Score (X)	1.3	1.2	1.3	1.2

Source: Company, DBS Bank

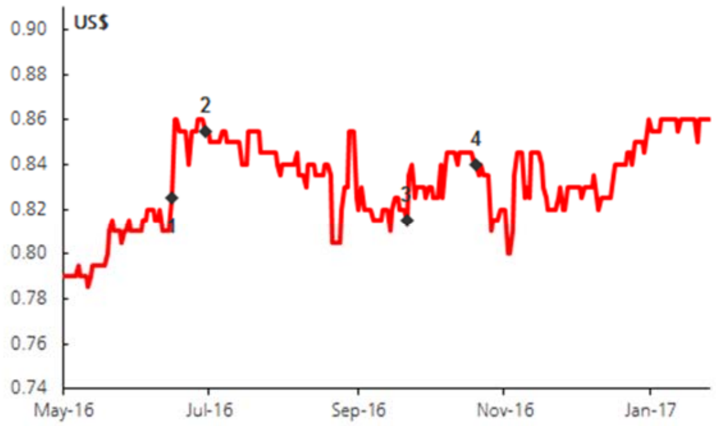
Cash Flow Statement (US$m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Pre-Tax Income	28.9	21.8	35.0	35.5	36.2
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	0.0	(22.4)	(1.3)	(1.2)	(1.3)
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(14.6)	23.1	(2.8)	0.08	0.11
Other Operating CF	17.6	(11.4)	5.49	5.51	5.59
Net Operating CF	**31.9**	**11.0**	**36.4**	**39.8**	**40.6**
Net Invt in Properties	(769)	(759)	(2.1)	(0.8)	(0.8)
Other Invts (net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.0	0.0	(8.4)	(5.0)	(7.6)
Net Investing CF	**(769)**	**(759)**	**(10.6)**	**(5.8)**	**(8.5)**
Distribution Paid	(17.6)	0.0	(39.2)	(39.7)	(40.5)
Chg in Gross Debt	304	294	10.6	5.77	8.46
New units issued	491	492	0.0	0.0	0.0
Other Financing CF	(8.3)	0.41	0.0	0.0	0.0
Net Financing CF	**769**	**786**	**(28.7)**	**(34.0)**	**(32.0)**
Currency Adjustments	(0.1)	0.0	0.0	0.0	0.0
Chg in Cash	31.7	38.4	(2.8)	0.08	0.11
Operating CFPS (US cts.)	7.42	(1.9)	6.21	6.24	6.30
Free CFPS (US cts.)	(118)	(119)	5.43	6.13	6.19

Source: Company, DBS Bank

Minimal capex as buildings were recently refurbished. This excludes expenditure for tenant improvements

Target Price & Ratings History



***Note**: Share price and Target price are adjusted for corporate actions.*

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	04 Jul 16	0.83	0.91	BUY
2:	18 Jul 16	0.86	0.93	BUY
3:	10 Oct 16	0.82	0.93	BUY
4:	08 Nov 16	0.84	0.93	BUY

Source: DBS Bank

Analyst: Mervin SONG CFA
Derek TAN

DBS Bank recommendations are based an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 14 Feb 2017 08:17:57 (SGT)
Dissemination Date: 14 Feb 2017 08:25:55 (SGT)

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