Singapore Company Guide

Manulife US Real Estate Inv

Version 5 | Bloomberg: MUST SP | Reuters: MANU.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

2 May 2017

BUY

Last Traded Price (28 Apr 2017): US$0.84 (**STI :** 3,175.44)
Price Target 12-mth: US$1.01 (20% upside and 7.6% yield) (Prev US$0.95)
Potential Catalyst: Exceeding IPO forecasts, and acquisitions
Where we differ: In line with consensus estimates

Analyst
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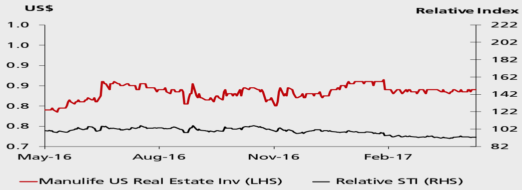
What's New

- **1Q17 DPU of 1.65 UScts above expectations**
- **Stronger-than-expected rents at Figueroa**
- **Positive rental reversions ahead on the back of the upturn in the US office market**

Price Relative



Forecasts and Valuation

FY Dec (US$m)	2016A*	2017F	2018F	2019F
Gross Revenue	47.5	80.9	82.4	84.5
Net Property Inc	30.0	50.0	51.1	52.3
Total Return	51.7	35.1	35.7	36.6
Distribution Inc	22.3	40.6	41.3	42.2
EPU (US cts.)	8.25	5.55	5.61	5.69
EPU Gth (%)	99	(33)	1	1
DPU (US cts.)	3.55	6.42	6.48	6.57
DPU Gth (%)	(35)	81	1	1
NAV per shr (US cts.)	87.3	86.6	85.9	85.2
PE (X)	10.2	15.1	15.0	14.8
Distribution Yield (%)	4.2	7.6	7.7	7.8
P/NAV (x)	1.0	1.0	1.0	1.0
Aggregate Leverage (%)	33.8	34.5	34.9	35.5
ROAE (%)	10.0	6.4	6.5	6.7
Distn. Inc Chng (%):		3	4	4
Consensus DPU (US cts.):		6.10	6.10	6.10
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.

US office exposure a winner

Play on an improving US office market. We maintain our BUY call with a revised TP of US$1.01. We continue to like Manulife US REIT's (MUST) attractive prospective 7.6% yield, in-built 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 12% 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 recent results as well as double-digit rental reversions achieved since its listing 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.86% 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 acquisitions, if any, 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 1Q17 results, we raised our DCF-based TP to US$1.01 from US$0.95. The stock offers attractive FY17-19F yields of 7.6-7.8%.

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)	629
Mkt. Cap (US$m)	528
Major Shareholders (%)	
Manulife Financial Corp	7.7
Free Float (%)	92.3
3m Avg. Daily Val (US$m)	0.74
ICB Industry : Financials / Real Estate Investment Trusts	

WHAT'S NEW

Strong start to the year

Robust uplift in passing rent

- MUST had a strong start to the year with 1Q17 DPU coming in at 1.65 UScts which was 8.6% above IPO forecasts. This was largely due to lower interest costs and better NPI margins.
- In addition, the results were above our expectations, representing c.27% of our FY17F DPU.
- The outperformance compared to our forecasts was due to higher-than-expected passing rents at Figueroa which rose 5% q-o-q to US$38.63 psf per year, as the property benefitted from recent rental escalation.
- MUST's other properties also had a decent quarter. Average property gross rents for Michelson and Peachtree rose 1.9% and 1.7% q-o-q to US$50.20 and US$31.53 respectively.
- Overall portfolio occupancy was stable at 97.2%.

Positive rental reversions expected for remainder of FY17

- MUST did not disclose any rental reversions for 1Q17 due to the small area that was renewed (0.4% of overall NLA) over the quarter. Nevertheless, we expect positive rental reversions to be achieved for 4.8% (by NLA) of the remaining leases that are up for renewal in FY17.
- The positive momentum is underpinned by the upturn in MUST's key markets of Downtown LA, Irvine Orange County and Midtown Atlanta, which recorded 7.6%, 7.7% and 5.3% y-o-y increases in spot rents over the quarter respectively. Vacancy rates of between 10-12% in the US context also indicate that it is a landlords' market, with less pressure on incentives.

Marginal uptick in gearing

- Gearing rose marginally to 34.2% from 33.8%, largely due to the payment of full-year distributions.
- Meanwhile, average costs of debt remains stable at 2.46% with 100% of debt fixed.
- MUST faces no refinancing until July 2019.
- NAV per unit stands at US$0.85, or US$0.83 excluding distributable income.

Incorporating higher rents – raise FY17-19F DPU by 3-4%

- After incorporating the higher-than-expected passing rents at Figueroa, we raised our FY17-19F DPU by 3-4%
- This in turn also results in our DCF-based TP increasing from S$0.95 to S$1.01. Our TP implies a P/B of 1.19x. We believe MUST will be able to trade above its book value given upside risks to its property value (property values have since risen 7% since its IPO) and as investors anticipate the continued upturn in the US office market.

Maintain BUY

- We maintain our BUY call with a revised TP of S$1.01. We continue to like MUST for its attractive yield (in excess of 7%), exposure to the upturn in the US office market, and inbuilt organic growth (c.86% of leases have annual rental escalations of around 3%).

Quarterly / Interim Income Statement (US$m)

FY Dec	4Q2016	1Q2017	% chg qoq
Gross revenue	19.3	19.8	2.7
Property expenses	(7.0)	(7.1)	1.8
Net Property Income	12.4	12.8	3.2
Other Operating expenses	(1.4)	(1.4)	(0.1)
Other Non Opg (Exp)/Inc	0.0	0.0	-
Net Interest (Exp)/Inc	(2.0)	(1.9)	4.4
Exceptional Gain/(Loss)	0.0	0.0	-
Net Income	8.94	9.42	5.4
Tax	(10.4)	(0.3)	(96.9)
Minority Interest	0.0	0.0	-
Net Income after Tax	(1.5)	9.10	nm
Total Return	18.0	8.51	(52.6)
Non-tax deductible Items	(8.2)	1.91	nm
Net Inc available for Dist.	9.71	10.4	7.2
Ratio (%)			
Net Prop Inc Margin	64.0	64.4	
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.

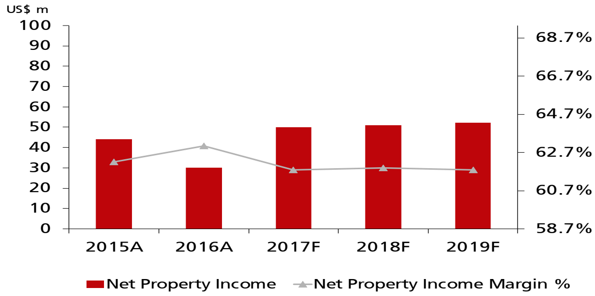
The sub-markets where Manulife US REIT's properties are located are also characterised by a lack of new competitive supply due to limited land availability and high construction costs. Given supportive market dynamics, management guided that market rents in MUST's three key markets could increase by 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.

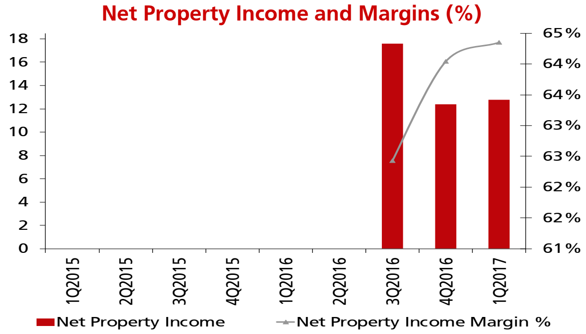
Long WALE of 5.6 years offers strong income visibility. With leases typically signed on a 3- to 10-year lease and some in excess of 10 years, the initial portfolio enjoys a long WALE of 5.6 years (by NLA) as at 31 March 2017. As such, the initial portfolio has minimal expiries in the following years - only 4.8% and 1.9% 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.

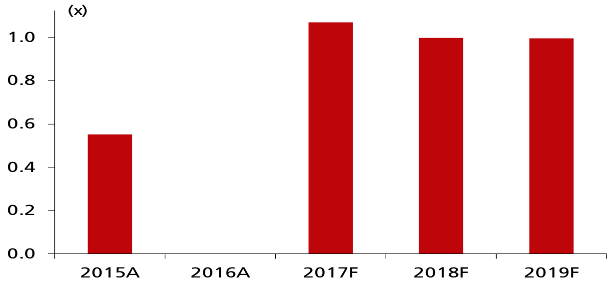
Net Property Income and Margins (%)



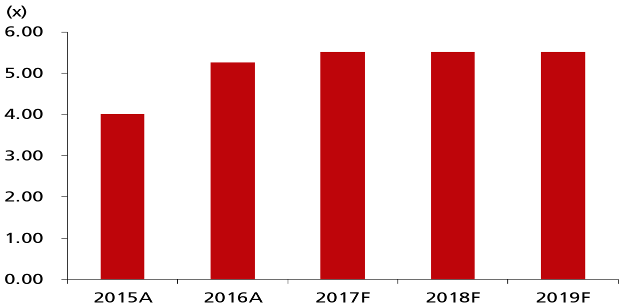
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Stable gearing. Post recent portfolio revaluation gains, MUST's gearing had fallen to 34.2% as at end-March 2017. 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.

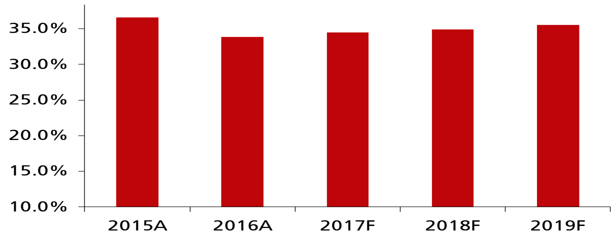
Foreign currency risks. All of the REIT's assets are located in the US and generate revenues in USD. Thus, investors who elect to receive distributions in SGD have exposure to volatility in the USD/SGD FX rate. This is mitigated should investors elect to receive distributions in USD.

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.

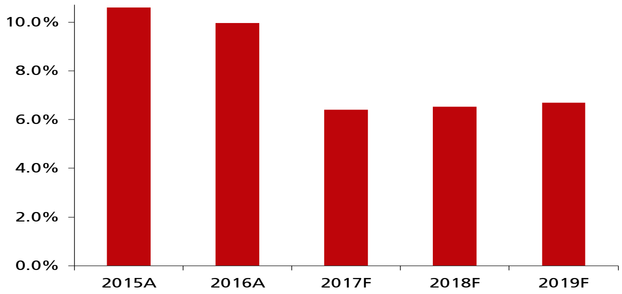
Company Background

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.

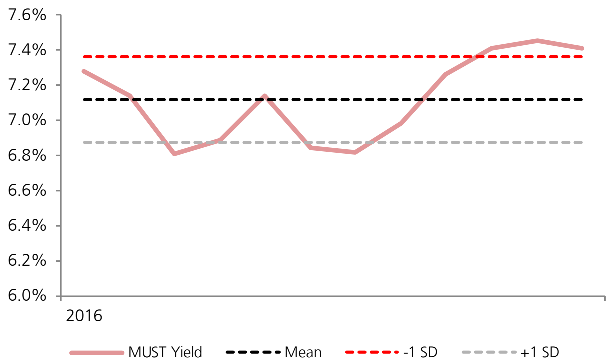
Aggregate Leverage (%)



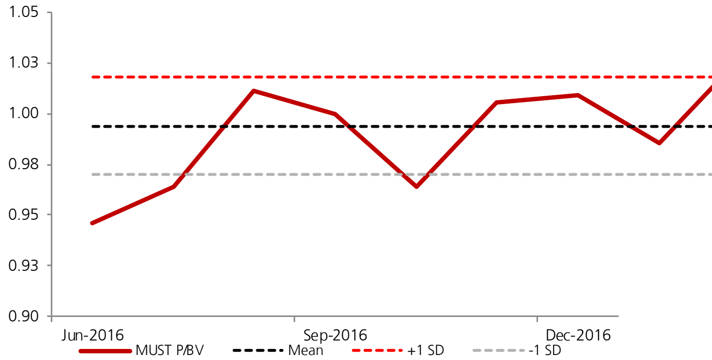
ROE (%)



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	80.9	82.4	84.5
Property expenses	(26.8)	(17.5)	(30.9)	(31.4)	(32.3)
Net Property Income	44.2	30.0	50.0	51.1	52.3
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	36.4	37.0	37.9
Tax	(1.4)	(22.4)	(1.3)	(1.3)	(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	35.1	35.7	36.6
Total Return	26.0	51.7	35.1	35.7	36.6
Non-tax deductible Items	6.78	(29.4)	5.49	5.56	5.64
Net Inc available for Dist.	34.3	22.3	40.6	41.3	42.2
Growth & Ratio					
Revenue Gth (%)	N/A	(33.0)	70.2	1.9	2.6
N Property Inc Gth (%)	nm	(32.1)	66.8	2.1	2.4
Net Inc Gth (%)	nm	99.0	(32.2)	1.9	2.3
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	43.4	43.4	43.3
Dist to revenue (%)	48.3	47.0	50.1	50.1	49.9
Managers & Trustee's fees	8.0	6.6	6.9	7.1	7.1
ROAE (%)	10.6	10.0	6.4	6.5	6.7
ROA (%)	6.5	6.2	4.0	4.0	4.1
ROCE (%)	9.6	2.4	5.3	5.3	5.4
Int. Cover (x)	4.0	5.3	5.5	5.5	5.5

Growth driven by upturn in the US office market and built-in-rental escalations

** FY15 are proforma numbers while FY16 are for the period between 20 May to 31 December 2016*
Source: Company, DBS Bank

Quarterly / Interim Income Statement (US$m)

FY Dec	3Q2016	4Q2016	1Q2017
Gross revenue	28.2	19.3	19.8
Property expenses	(10.6)	(7.0)	(7.1)
Net Property Income	17.6	12.4	12.8
Other Operating expenses	(1.7)	(1.4)	(1.4)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0
Net Interest (Exp)/Inc	(3.1)	(2.0)	(1.9)
Exceptional Gain/(Loss)	0.0	0.0	0.0
Net Income	**12.8**	**8.94**	**9.42**
Tax	(12.0)	(10.4)	(0.3)
Minority Interest	0.0	0.0	0.0
Net Income after Tax	**0.85**	**(1.5)**	**9.10**
Total Return	33.7	18.0	8.51
Non-tax deductible Items	(21.1)	(8.2)	1.91
Net Inc available for Dist.	12.6	9.71	10.4
Growth & Ratio			
Revenue Gth (%)	N/A	(32)	3
N Property Inc Gth (%)	nm	(30)	3
Net Inc Gth (%)	nm	(276)	(710)
Net Prop Inc Margin (%)	62.4	64.0	64.4
Dist. Payout Ratio (%)	100.0	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	35.8	35.9	36.0
Inventory	0.0	0.0	0.0	0.0
Debtors	2.31	3.23	3.30	3.38
Other Current Assets	0.68	0.68	0.68	0.68
Total Assets	**875**	**884**	**890**	**899**
ST Debt	0.0	0.0	0.0	0.0
Creditor	9.82	8.09	8.24	8.45
Other Current Liab	0.20	0.20	0.20	0.20
LT Debt	294	305	311	320
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**	**899**
Non-Cash Wkg. Capital	(7.0)	(4.4)	(4.5)	(4.6)
Net Cash/(Debt)	(256)	(269)	(275)	(284)
Ratio				
Current Ratio (x)	4.1	4.8	4.7	4.6
Quick Ratio (x)	4.1	4.8	4.7	4.6
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

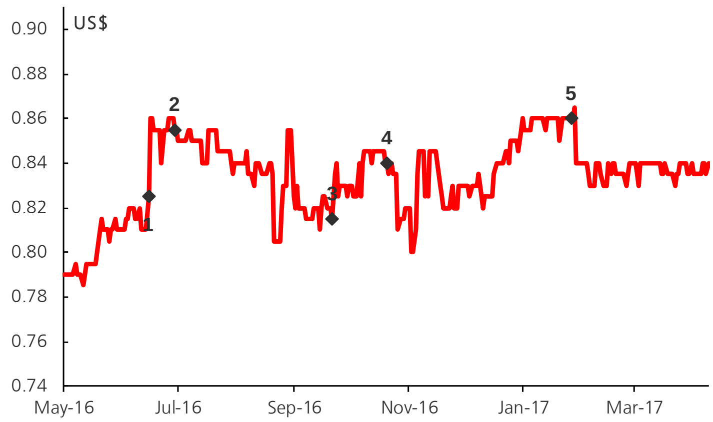
Cash Flow Statement (US$m)

FY Dec	2016A	2017F	2018F	2019F
Pre-Tax Income	21.8	36.4	37.0	37.9
Dep. & Amort.	0.0	0.0	0.0	0.0
Tax Paid	(22.4)	(1.3)	(1.3)	(1.3)
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	23.1	(2.7)	0.09	0.13
Other Operating CF	(11.4)	5.49	5.56	5.64
Net Operating CF	**11.0**	**37.9**	**41.4**	**42.3**
Net Invt in Properties	(759)	(2.1)	(0.8)	(0.9)
Other Invts (net)	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0
Other Investing CF	0.0	(8.4)	(5.2)	(8.0)
Net Investing CF	**(759)**	**(10.6)**	**(6.0)**	**(8.9)**
Distribution Paid	0.0	(40.6)	(41.3)	(42.2)
Chg in Gross Debt	294	10.6	6.04	8.86
New units issued	492	0.0	0.0	0.0
Other Financing CF	0.41	0.0	0.0	0.0
Net Financing CF	**786**	**(30.0)**	**(35.3)**	**(33.3)**
Currency Adjustments	0.0	0.0	0.0	0.0
Chg in Cash	38.4	(2.7)	0.09	0.13
Operating CFPS (US cts.)	(1.9)	6.42	6.48	6.57
Free CFPS (US cts.)	(119)	5.66	6.37	6.46

Source: Company, DBS Bank

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

Target Price & Ratings History



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
5:	14 Feb 17	0.86	0.95	BUY

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

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: 2 May 2017 11:54:50 (SGT)
Dissemination Date: 2 May 2017 15:52:29 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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1. DBS Bank Ltd, DBS Vickers Securities (Singapore) Pte Ltd (''DBSVS''), their subsidiaries and/or other affiliates have a proprietary position in Manulife US Real Estate Inv recommended in this report as of 31 Mar 2017.
2. Neither DBS Bank Ltd, DBS HK nor DBSV HK market makes in equity securities of the issuer(s) or company(ies) mentioned in this Research Report.
3. DBS Bank Ltd, DBS Vickers Securities (Singapore) Pte Ltd (''DBSVS''), their subsidiaries and/or other affiliates have a net long position exceeding 0.5% of the total issued share capital in Manulife US Real Estate Inv recommended in this report as of 31 Mar 2017.
4. DBS Bank Ltd, DBSVS, DBSVUSA, their subsidiaries and/or other affiliates beneficially own a total of 1% of any class of common equity securities of Manulife US Real Estate Inv as of 31 Mar 2017.

Compensation for investment banking services:

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