Singapore Company Guide

Manulife US Real Estate Inv

Version 6 | Bloomberg: MUST SP | Reuters: MANU.SI   **Refer to important disclosures at the end of this report**

DBS Group Research . Equity   10 Aug 2017

BUY

Last Traded Price (8 Aug 2017): US$0.93 (**STI :** 3,318.08)
Price Target 12-mth: US$1.07 (16% upside and 7% yield) (Prev US$1.01)

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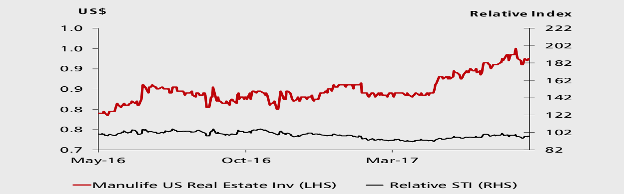
What's New

- 2Q17 DPU of 1.58 USCts in line with expectations
- Continues to benefit from US market upturn with passing rents up 0.8% q-o-q and 12.4% rental reversions
- DPU accretive acquisition of 500 Plaza Drive in New Jersey for US$115m and estimated 7.5% initial yield

Price Relative



Forecasts and Valuation

FY Dec (US$m)	2016A*	2017F	2018F	2019F
Gross Revenue	47.5	87.8	97.4	99.7
Net Property Inc	30.0	56.9	66.0	67.5
Total Return	51.7	36.8	44.7	46.8
Distribution Inc	22.3	44.7	52.7	55.8
EPU (US cts.)	8.25	5.02	6.02	6.23
EPU Gth (%)	99	(39)	20	3
DPU (US cts.)	3.55	6.52	7.10	7.43
DPU Gth (%)	(35)	84	9	5
NAV per shr (US cts.)	87.3	88.6	87.5	86.4
PE (X)	11.2	18.4	15.4	14.9
Distribution Yield (%)	3.8	7.0	7.7	8.0
P/NAV (x)	1.1	1.0	1.1	1.1
Aggregate Leverage (%)	33.8	33.7	34.1	34.7
ROAE (%)	10.0	6.1	6.9	7.2
DPU Chng (%):		2	10	13
Consensus DPU (US cts.):		6.30	6.40	6.40
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

Gaining from US upturn

Play on an improving US office market. We maintain our BUY call with a revised TP of US$1.07. We continue to like Manulife US REIT's (MUST) attractive prospective 7.0/7.7% yield in FY17/18, in-built annual rental escalations of around 3% and exposure to the favourable demand and supply fundamentals in various US office markets where MUST's properties are located. This translates to 7% DPU CAGR between FY17 to FY19, one of the highest among REITs in Singapore.

Where we differ – Ability to execute and growth premium. While consensus is bullish on MUST's US exposure, pegging their target prices at P/Bk of c.1.10x, we believe MUST deserves to trade at a higher P/Bk of c.1.20-1.25, given its ability to execute on DPU accretive acquisitions as seen by its latest 500 Plaza Drive purchase and upside risk to its portfolio values as demonstrated by portfolio revaluation gains over the past 12 months. Moreover, in our view an additional growth premium is justified, given MUST's DPU CAGR is two to three times higher that of other listed REITs in Singapore.

Acquisitions to be the next growth driver. With gearing expected to stabilised at the 33-34% level post the acquisition of 500 Plaza Drive, given the debt headroom available, we believe additional acquisitions will remain a key share price re-rating catalyst going forward. We understand 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 further acquisitions in our forecast beyond the announced 500 Plaza Drive purchase.

Valuation:

After incorporating the recent acquisition of 500 Plaza Drive, recent US$80.5m equity placement and rolling forward to FY18, we raised our DCF-based TP to US$1.07 from US$1.01.

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)	728
Mkt. Cap (US$m/US$m)	674 / 674
Major Shareholders (%)	
Manulife Financial Corp	7.7
Free Float (%)	92.3
3m Avg. Daily Val (US$m)	0.80
ICB Industry : Financials / Real Estate Investment Trusts	

DBS

ed: JS / sa:PY

WHAT'S NEW

Earnings play out as expected

Robust results continue

- MUST continue its trend of outperforming its IPO forecasts with 2Q17 DPU coming in at 1.58 UScts, beating its own projections by 7.5%. This took 1H17 DPU to 3.23 UScts which represented c.50% of our original FY17F DPU and which was in line with our expectations. The 1H17 DPU consist of 3.20 UScts advanced distributions which are to be paid to existing unitholders prior to the recent equity placement. The new unitholders from the equity placement are not entitled to this advanced distribution.

Increase in rents as expected

- As expected average passing rents for MUST's initial portfolio maintained its upward trajectory, rising 0.8% q-o-q to US$40.01.
- Within the portfolio, Figueroa had the highest increase at 1.4% q-o-q to US$38.63 psf per year, with Michelson and Peachtree rising 0.4% and 0.2% q-o-q to US$50.20 and US$31.53 respectively.
- Year to date, 12.4% positive rental reversions were achieved, owing to the under rented status of some of MUST's expiring leases and general increase in spot rents.

Portfolio occupancy remains high but some slippage

- Overall portfolio occupancy remains high at 95.9% although this was a slight decline from 97.2% achieved as at end 1Q17.
- The main culprit was Figueroa where occupancy fell from 98% to 95.3%. We understand Colliers had returned some space which it had temporarily used while it was renovating one of its other floors.
- Occupancy at Peachtree also dipped from 94.4% to 93.4% due to the exit of a tenant, space which has been now partially filled by an incoming tenant.
- Meanwhile, occupancy at Michelson remains stable at 99.1%

Positive revaluation gains

- MUST reported revaluations gains of c.US$20.2m over 2Q17. This largely reflects the 2.8% average uplift in property values on the back of higher income with cap rates remaining stable.
- Figueroa, Michelson and Peachtree recorded a 4%, 2.2% and 2% increase in valuations since the last valuation done at 31 December 2017.
- In addition, cap rates for Figueroa, Michelson and Peachtree now stand at 4.8%, 5.6% and 5.8% respectively, with the overall portfolio cap rate at 5.3%.
- As a result of this revaluation gain, recent US$80.5m equity placement, gearing fell to 30.4% from 34.2% as at 1Q17. However, gearing is expected to rise to 33.1% post the acquisition of 500 Plaza Drive acquisition.
- Average interest cost was stable at 2.46% with 100% of debt fixed.
- NAV per unit now stands at S$0.84 down from S$0.87 as at 31 December 2016, due to the recent equity placement.

Maiden acquisition and entry into the New Jersey market

- MUST recently announced its maiden acquisition for US$115m, which is at a discount to US$116m valuation.
- The property to be acquired is 500 Plaza Drive, which is a 11-storey Class A office building located in Secaucus, New Jersey, US. The property is 3 miles from Manhattan via the Lincoln Tunnel and is within the Hudson County office market and Meadowlands office submarket.
- The property is within the 550-acre mixed use amenity base of Harmon Meadow and is surrounded by 1m sqft of retail space – 25 restaurants, 7 hotels, leisure and sports facilities, cinema. With a hotel and residential apartments under construction nearby, the area is leveraged to the "Live, Work and Play" lifestyle where by tenants locate their operations where their employees live and play.
- The freehold property has a net lettable area of 461,525 sqft with an occupancy rate of 98.9%. The building was completed in 1985 but it has recently been renovated in 2015/2016 at a cost in excess of US$16m.
- The initial NPI yield for the property is estimated to be around 7.5%.
- Key tenants include (1) The Children's Place, the largest pure-play children's apparel retailer in North America, (2) Quest Diagnostics a Fortune 500 company and leading provider of clinical laboratory testing, (3) AXA, a French multinational insurance firm, (4) Xerox Business Services, an American global corporation that delivers knowledge-based services. 500 Plaza Drive has a WALE (by NLA) of 9.2 years with no expiries until 2020, which relates mainly to AXA (22.9% of cash rental income). 99.9% of leases by

NLA have built-in rental escalations of around 1.5% per annum.

- The acquisition will be funded through local USD debt (5-year tenure with interest rate of c.3.75%) as well as a US$80.5m equity placement (97m units at US$0.83).
- According to MUST, the acquisition will benefit unit holders in several ways.
    - Provide exposure to the North New Jersey office market which is in the early stages of a rising rental market as judged by Cushman & Wakefield. In addition, the office location is attractive to prospective tenants given it is a cost effective location and acts an alternative to the Manhattan Office Submarket.
    - Enhances the overall portfolio's income stability with the overall portfolio WALE increasing from 5.3 years to 6.1 years
    - Further diversifies the portfolio, with the addition of the North East US market as well as adding the medical & diagnostics (4% of the enlarged portfolio's cash rental income) and retail trade (7.3% of the enlarged portfolio's cash rental income) sectors. 500 Plaza Drive will represent c.18% of overall group NPI and c.12% of the enlarged portfolio by value.
    - In addition, the acquisition is expected to be DPU accretive.
    - We are generally positive on the acquisition and equity raising given the DPU accretion, diversification benefits as well as the increase in trading liquidity for the REIT. More importantly, the acquisition should allay fears that some investors have that MUST has been unable to find attractive assets to acquire on a DPU accretive basis.

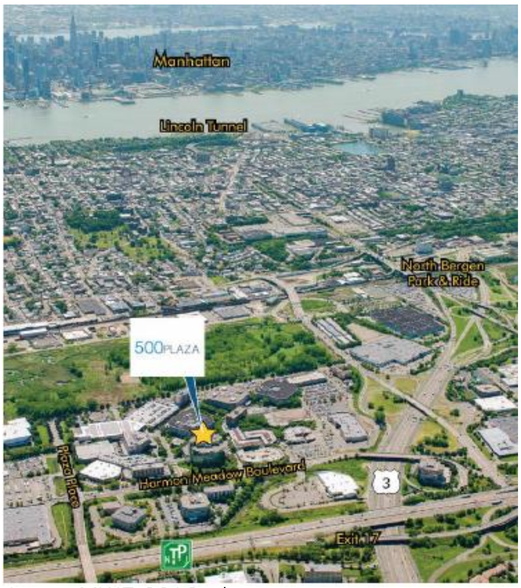
Raising DPU estimates and TP to US$1.07

- After incorporating the recent equity raising and acquisition, we raised our FY17-19F DPU by 2-13%
- We also raised our DCF-based TP to US$1.07 from US$1.01 as we roll forward our valuation to FY18.

Maintain BUY

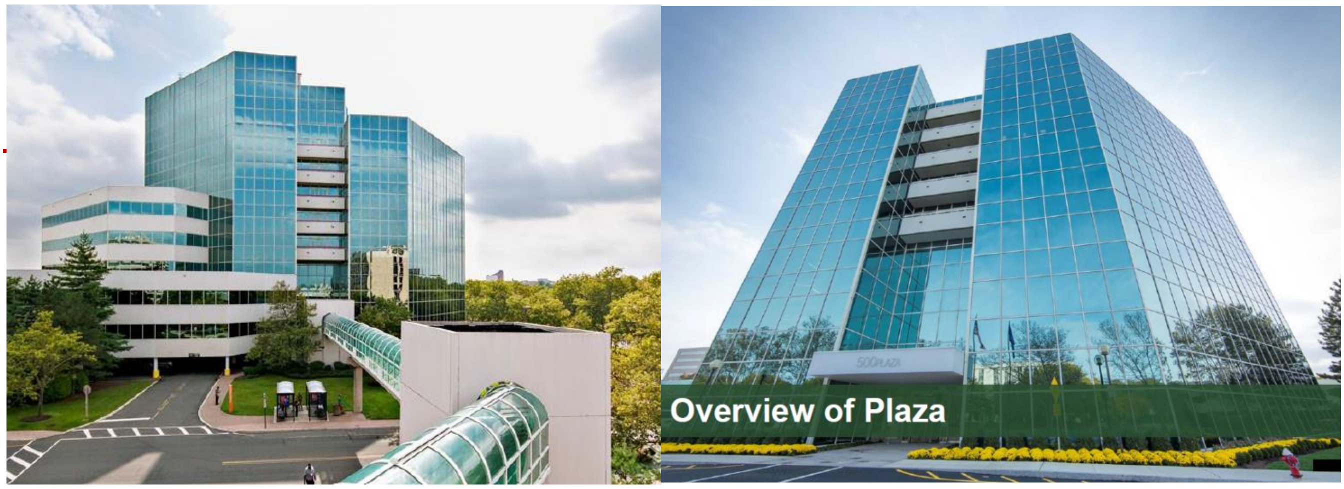
- With 16% capital upside and 7.0-7.7% yield, we maintain our BUY call with a revised TP of US$1.07. We continue to like MUST for its attractive yield (in excess of 7%), exposure to the upturn in the US office market, inbuilt organic growth (c.86% of leases have annual rental escalations of around 3%) and healthy 7% DPU CAGR over FY17-19.

Location of 500 Plaza Drive



Source: MUST, DBS Bank

View of 500 Plaza Drive

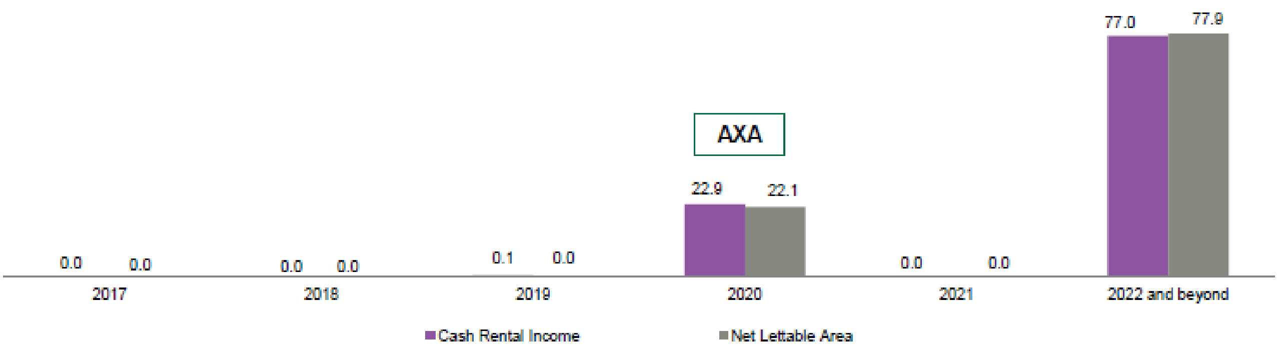


Source: MUST, DBS Bank

Overall vacancy rate and asking rents in Northern New Jersey

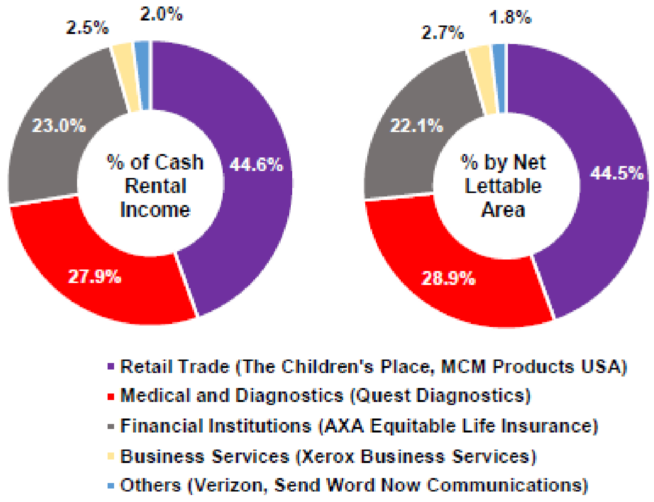
Source: MUST, DBS Bank

500 Plaza Drive lease expiry profile



Source: MUST, DBS Bank

500 Plaza Drive tenant breakdown by trade sector



Source: MUST, DBS Bank

Quarterly / Interim Income Statement (US$m)

FY Dec	1Q2017	2Q2017	% chg qoq
Gross revenue	19.8	19.9	0.4
Property expenses	(7.1)	(7.1)	0.7
Net Property Income	12.8	12.8	0.2
Other Operating expenses	(1.4)	(1.4)	2.4
Other Non Opg (Exp)/Inc	0.0	0.0	-
Net Interest (Exp)/Inc	(1.9)	(2.0)	(2.3)
Exceptional Gain/(Loss)	0.0	0.0	-
Net Income	9.42	9.37	(0.5)
Tax	(0.3)	(8.3)	nm
Minority Interest	0.0	0.0	-
Net Income after Tax	9.10	1.08	(88.2)
Total Return	8.51	21.3	149.8
Non-tax deductible Items	1.91	(11.3)	nm
Net Inc available for Dist.	10.4	9.99	(4.1)
Ratio (%)			
Net Prop Inc Margin	64.4	64.2	
Dist. Payout Ratio	100.0	100.0	

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Exposure to the recovery in the 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 initial portfolio of 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.

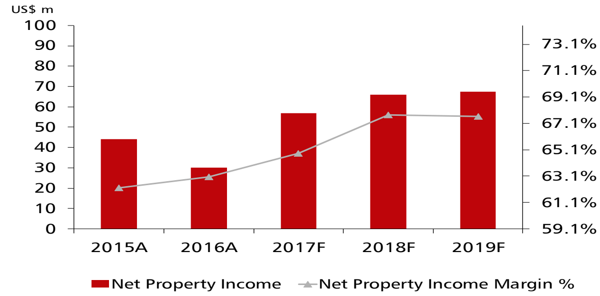
Boost from recent acquisition of 500 Plaza Drive. Going forward, we expect MUST's DPU to be boosted by recent acquisition of 500 Plaza Drive in New Jersey for US$115m, on an estimated initial yield of 7.5%. Beyond extending MUST's overall portfolio WALE as the property has a WALE of c.9 years, providing exposure to a submarket that is in the early stages of a recovery, and further geographically diversifying MUST's portfolio, it will assist MUST in delivering 4% DPU CAGR between FY17-19, making MUST one of the fastest growing REITs listed in Singapore.

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 86% of leases (by NLA) for MUST's portfolio has built-in annual rental escalations of around 3%, with c.13% of leases (by NLA) with mid-term or period rent increases, thus providing a visible and growing rental income stream.

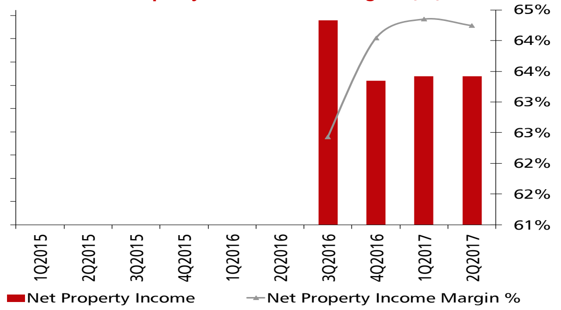
Long WALE offers strong income visibility. With leases typically signed on a 3- to 10-year lease and some in excess of 10 years, the initial portfolio enjoys a long WALE of 5.3 years (by NLA) as at 30 June 2017 which will extend to 6.1 years post the acquisition of 500 Plaza Drive. As such, the enlarged portfolio has minimal expiries in the following years - only 2.6% and 1.6% 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. A key growth driver is MUST's ability to leverage on its Sponsor's deep knowledge of the US office market and execution capability. With a modest gearing of between 33-34%, the REIT is in a strong position to pursue DPU-accretive acquisitions in the US.

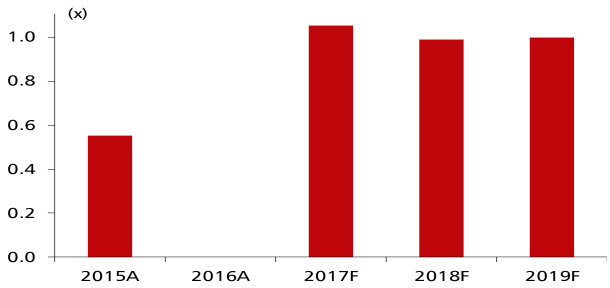
Net Property Income and Margins (%)



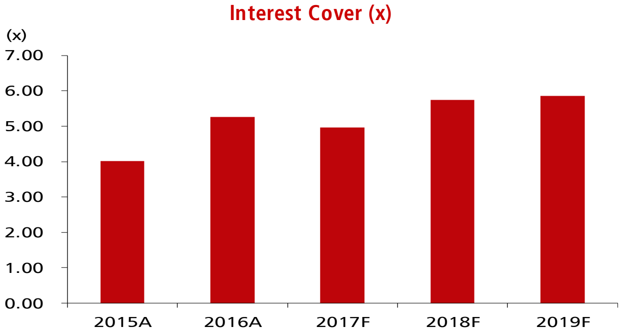
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Stable gearing. Post recent portfolio revaluation gains, equity placement and completion the 500 Plaza Drive acquisition, MUST's gearing is expected to settle around 33-34% level. 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% as at 30 June 2017.

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, we believe the delivery of a DPU accretive acquisition in the form of the 500 Plaza Drive purchase should also put to rest concerns over its Sponsor's execution capability and ability to source DPU accretive deals. These factors, we believe should result in MUST share price trading higher over the coming year.

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.

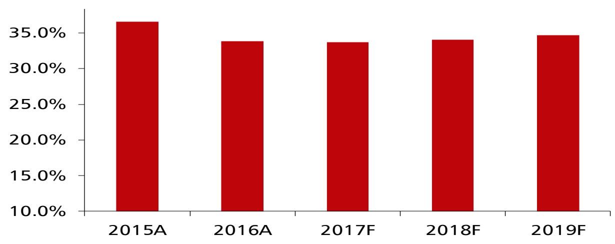
Foreign currency risks. All of the REIT's assets are located in the US and generate revenues in USD. Thus, investors who elect to receive distributions in SGD have exposure to volatility in the USD/SGD FX rate. This is mitigated should investors elect to receive distributions in USD.

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.

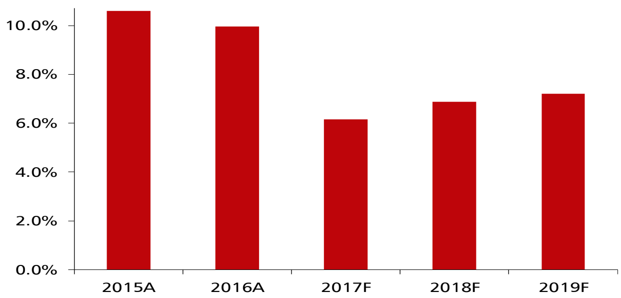
Company Background

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, New Jersey and Orange County with aggregate net lettable area (NLA) of c.2.25m square feet.

Aggregate Leverage (%)



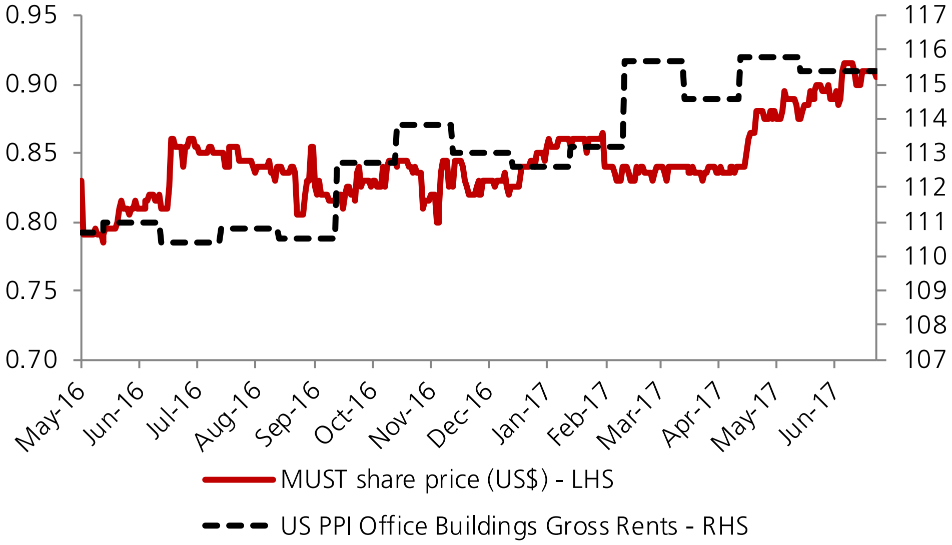
ROE (%)



PB Band (x)

Source: Company, DBS Bank

MUST share price versus US office rents



Source: Bloomberg Finance L.P., STB, DBS Bank

Remarks

While MUST has a short trading history, we believe that its share price should track movements in office rents in the US.

With the US economy remaining on an uptrend and office rents expected to rise going forward, we expect MUST's share price to continue to rally going forward.

Income Statement (US$m)

FY Dec	2016A*	2017F	2018F	2019F
Gross revenue	47.5	87.8	97.4	99.7
Property expenses	(17.5)	(30.9)	(31.4)	(32.3)
Net Property Income	**30.0**	**56.9**	**66.0**	**67.5**
Other Operating expenses	(3.1)	(9.0)	(9.9)	(9.0)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(5.1)	(9.7)	(9.8)	(10.0)
Exceptional Gain/(Loss)	52.3	0.0	0.0	0.0
Net Income	**74.1**	**38.3**	**46.3**	**48.5**
Tax	(22.4)	(1.5)	(1.6)	(1.7)
Minority Interest	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0
Net Income After Tax	**51.7**	**36.8**	**44.7**	**46.8**
Total Return	51.7	36.8	44.7	46.8
Non-tax deductible Items	(29.4)	7.87	8.03	9.01
Net Inc available for Dist.	22.3	44.7	52.7	55.8
Growth & Ratio				
Revenue Gth (%)	(33.0)	84.8	10.9	2.4
N Property Inc Gth (%)	(32.1)	90.0	15.9	2.2
Net Inc Gth (%)	99.0	(28.8)	21.4	4.8
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	63.1	64.9	67.8	67.7
Net Income Margins (%)	108.8	41.9	45.9	47.0
Dist to revenue (%)	47.0	50.9	54.1	56.0
Managers & Trustee's fees	6.6	10.2	10.2	9.0
ROAE (%)	10.0	6.1	6.9	7.2
ROA (%)	6.2	3.9	4.3	4.5
ROCE (%)	2.4	5.2	5.6	5.8
Int. Cover (x)	5.3	5.0	5.7	5.9

Increase in earnings on the back of annual rental escalations and acquisition of 500 Plaza Drive

** 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	2Q2017
Gross revenue	28.2	19.3	19.8	19.9
Property expenses	(10.6)	(7.0)	(7.1)	(7.1)
Net Property Income	17.6	12.4	12.8	12.8
Other Operating expenses	(1.7)	(1.4)	(1.4)	(1.4)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(3.1)	(2.0)	(1.9)	(2.0)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0
Net Income	**12.8**	**8.94**	**9.42**	**9.37**
Tax	(12.0)	(10.4)	(0.3)	(8.3)
Minority Interest	0.0	0.0	0.0	0.0
Net Income after Tax	**0.85**	**(1.5)**	**9.10**	**1.08**
Total Return	33.7	18.0	8.51	21.3
Non-tax deductible Items	(21.1)	(8.2)	1.91	(11.3)
Net Inc available for Dist.	12.6	9.71	10.4	9.99
Growth & Ratio				
Revenue Gth (%)	N/A	(32)	3	0
N Property Inc Gth (%)	nm	(30)	3	0
Net Inc Gth (%)	nm	(276)	(710)	(88)
Net Prop Inc Margin (%)	62.4	64.0	64.4	64.2
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0

Balance Sheet (US$m)

FY Dec	2016A	2017F	2018F	2019F
Investment Properties	834	989	995	1,006
Other LT Assets	0.0	0.0	0.0	0.0
Cash & ST Invts	38.4	36.2	36.8	36.9
Inventory	0.0	0.0	0.0	0.0
Debtors	2.31	3.51	3.89	3.99
Other Current Assets	0.68	0.68	0.68	0.68
Total Assets	**875**	**1,029**	**1,037**	**1,047**
ST Debt	0.0	0.0	0.0	0.0
Creditor	9.82	8.78	9.74	9.97
Other Current Liab	0.20	0.20	0.20	0.20
LT Debt	294	347	353	363
Other LT Liabilities	24.0	24.0	24.0	24.0
Unit holders' funds	547	650	650	650
Minority Interests	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**875**	**1,029**	**1,037**	**1,047**
Non-Cash Wkg. Capital	(7.0)	(4.8)	(5.4)	(5.5)
Net Cash/(Debt)	(256)	(310)	(316)	(326)
Ratio				
Current Ratio (x)	4.1	4.5	4.2	4.1
Quick Ratio (x)	4.1	4.5	4.2	4.1
Aggregate Leverage (%)	33.8	33.7	34.1	34.7
Z-Score (X)	1.3	1.4	1.3	1.3

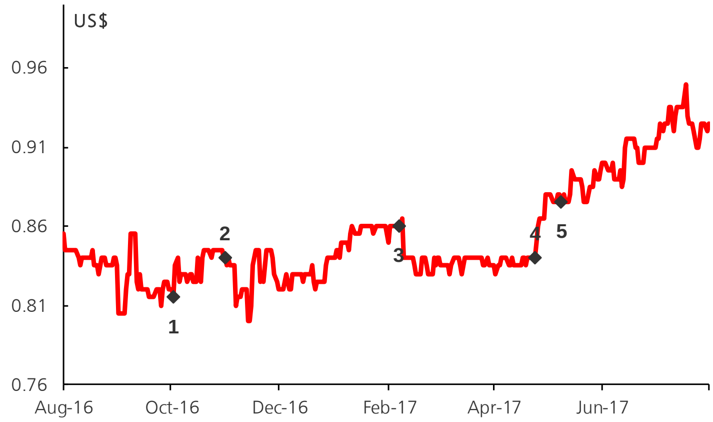
Source: Company, DBS Bank

Cash Flow Statement (US$m)

FY Dec	2016A	2017F	2018F	2019F
Pre-Tax Income	21.8	38.3	46.3	48.5
Dep. & Amort.	0.0	0.0	0.0	0.0
Tax Paid	(22.4)	(1.5)	(1.6)	(1.7)
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	23.1	(2.3)	0.57	0.14
Other Operating CF	(11.4)	7.87	8.03	9.01
Net Operating CF	**11.0**	**42.4**	**53.3**	**56.0**
Net Invt in Properties	(759)	(123)	(1.0)	(2.0)
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	(8.8)	(5.5)	(8.3)
Net Investing CF	**(759)**	**(131)**	**(6.5)**	**(10.3)**
Distribution Paid	0.0	(44.7)	(52.7)	(55.8)
Chg in Gross Debt	294	52.4	6.50	10.3
New units issued	492	78.9	0.0	0.0
Other Financing CF	0.41	0.0	0.0	0.0
Net Financing CF	**786**	**86.6**	**(46.2)**	**(45.5)**
Currency Adjustments	0.0	0.0	0.0	0.0
Chg in Cash	38.4	(2.3)	0.57	0.14
Operating CFPS (US cts.)	(1.9)	6.09	7.10	7.43
Free CFPS (US cts.)	(119)	(10.9)	7.05	7.18

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	10 Oct 16	0.82	0.93	BUY
2:	08 Nov 16	0.84	0.93	BUY
3:	14 Feb 17	0.86	0.95	BUY
4:	02 May 17	0.84	1.01	BUY
5:	17 May 17	0.88	1.01	BUY

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

Source: DBS Bank

Analyst: Mervin SONG CFA
Derek TAN

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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: 10 Aug 2017 07:45:31 (SGT)
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