

10 August 2017

Property | REITS

## Manulife US REIT

**Buy** (Maintained)

Target Price: USD1.00  
 Price: USD0.92  
 Market Cap: USD670m  
 Bloomberg Ticker: MUST SP

### Key Notes From Investor Luncheon

We hosted MUST management and its sponsor for a post results investor luncheon. Key questions during the meeting were on its organic growth ability, the US office dynamics, robustness of its tax structure, sponsor pipeline and relationship. Management sounded confident on future growth potential with market fundamentals remaining strong. Its recent acquisition demonstrates its ability to deliver inorganic growth via acquisitions from sponsor as well as third party. MUST offers a healthy FY18F yield of 7.1% which is attractive, at >100bps above the office S-REITs average. Maintain BUY with higher TP of USD1.00 (8% upside).

**Portfolio rents still 5-15% below market.** Manulife US REIT's (MUST) 1H17 portfolio rent reversions remained strong at +12.7% YoY, underpinned by healthy demand and the prime nature of its office properties. Management noted that average rents across its office properties are still 5-15% below the current passing rents thus, offering room for positive rent growth ahead. Other key drivers for organic growth are the inbuilt rent escalations (c.2.5% pa), occupancy improvements and the AEI contributions.

**US office demand supply dynamics remain strong** driven by a healthy labour market with an overall unemployment rate at record lows of 4.3% in July 2017. More importantly, unemployment for educated labour, which is the key driver for the prime office demand, remains at just 2.4%. On the supply front, upcoming supply for the micro-markets where its properties are located remains limited. With asking rents still well above its average rents, MUST doesn't see any near-term weakness.

**Tax structure.** Many investors expressed concerns on proposed changes to tax regulations and its potential implications on the REIT. Management sees no threats to its tax efficient structure. MUST's way of deriving income via a 'US Portfolio Interest Exemption Rule' is also commonly adopted by many of the global funds.

**On the lookout for acquisitions.** Despite yield compression and strong liquidity in the market, MUST sees a good potential to grow via acquisitions, with the recent "The Plaza" deal acting as a testimony to its ability. Overall the US office cap rates for tier-1 cities (Class A) properties currently range between 4.5% to 7%, based on CBRE research. Its acquisition targets could be Class A properties in the sub-urban market and Class B in core urban regions.

**Strong backing from sponsor 'Manulife'** who reiterated its full commitment to growing the REIT. Although MUST doesn't have an explicit ROFR to its portfolio, it expects to derive an advantage from knowledge about properties and its operational track record. Additionally, its sponsors' strong brand name and financial position should help MUST in closing third party deals.

**Maintain BUY, higher TP of USD1.00 (from USD0.99).** We tweak our FY18-19F DPU by 1-2% factoring in lower than expected financing costs and higher rent growth. MUST is a preferred pick in overseas mid-cap REITs for its high yield, organic rent growth and exposure to a rebounding US office market. Key risks: the ability to retain key tenants and changes in underlying tax structure.

#### Share Data

Avg Daily Turnover (USD/USD) 0.80m/0.80m  
 52-wk Price low/high (USD) 0.80 - 0.95  
 Free Float (%) 93  
 Shares outstanding (m) 628  
 Estimated Return 8%

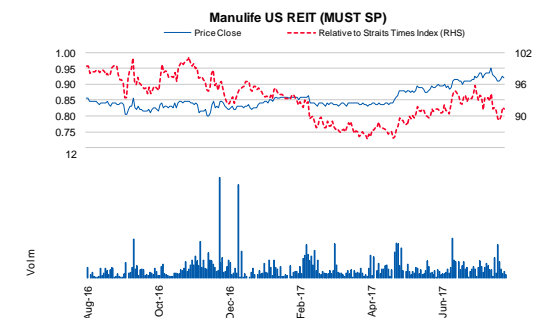
#### Shareholders (%)

Manulife Financial Corp 7.2  
 DBS Group Holdings LTD 5.5  
 Credit Suisse Group AG 2.7

#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	11.5	1.1	6.4	7.0	7.6
Relative	(3.8)	(1.7)	3.6	(1.1)	(9.8)

Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (USDm)	71	48	87	98	101
Net property income (USDm)	44.2	30.0	54.1	60.4	62.0
Reported net profit (USDm)	26.0	51.7	46.7	52.4	53.8
Total distributable income (USDm)	26.0	22.3	43.0	48.0	49.3
DPS (USD)	na	0.06	0.06	0.07	0.07
DPS growth (%)	0.0	0.0	10.7	2.1	2.0
Recurring P/E (x)	22.3	11.6	13.9	13.0	12.8
P/B (x)	1.18	1.13	1.06	1.06	1.05
Dividend Yield (%)	na	6.3	6.9	7.1	7.2
Return on average equity (%)	10.6	10.0	7.9	8.2	8.3
Return on average assets (%)	6.5	6.2	5.0	5.2	5.3
Interest cover (x)	4.01	5.27	6.40	6.36	6.40

Our vs consensus EPS (adjusted)

Source: Company data, RHB

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## Financial Exhibits

Financial model updated on : 2017-08-08.

Asia	<b>Financial summary</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
Singapore	Recurring EPS (USD)	0.04	0.08	0.07	0.07	0.07
Property	EPS (USD)	0.04	0.08	0.07	0.07	0.07
<b>Manulife US Real Estate Investment Trust</b>	DPS (USD)	0.00	0.06	0.06	0.07	0.07
Bloomberg MUST SP	BVPS (USD)	0.78	0.81	0.86	0.87	0.88
<b>Buy</b>	Weighted avg adjusted shares (m)	629	651	705	740	745
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
DDM Methodology	Recurring P/E (x)	22.3	11.6	13.9	13.0	12.8
	P/E (x)	22.3	11.6	13.9	13.0	12.8
	P/B (x)	1.18	1.13	1.06	1.06	1.05
	FCF Yield (%)	(127.5)	(125.5)	(13.9)	4.2	4.2
	Dividend Yield (%)	0.0	6.3	6.9	7.1	7.2
	EV/EBITDA (x)	20.9	36.0	20.9	19.4	19.1
	EV/EBIT (x)	22.1	31.5	19.6	18.4	18.0
<b>Key drivers</b>	<b>Income statement</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
i. Organic rental growth through rent escalations,	Total turnover (USDm)	70.9	47.5	87.3	98.1	100.7
ii. Growth from yield accretive acquisitions, and	EBITDA (USDm)	40.6	23.5	45.0	50.9	52.2
iii. Positive demand-supply dynamics in U.S office market	Depreciation and amortisation (USDm)	(2.1)	3.3	3.0	2.9	3.0
	Operating profit (USDm)	38.5	26.8	48.0	53.7	55.2
	Net interest (USDm)	(9.6)	(5.1)	(7.5)	(8.4)	(8.6)
	Pre-tax profit (USDm)	27.3	74.1	48.9	54.9	56.3
	Taxation (USDm)	(1.4)	(22.4)	(2.2)	(2.5)	(2.5)
	Recurring net profit (USDm)	26.0	51.7	46.7	52.4	53.8
<b>Key risks</b>	<b>Cash flow (USDm)</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
i. Ability to retain key tenants,	Change in working capital	(15)	(16)	(21)	(23)	(24)
ii. Changes in tax structure, and	Cash flow from operations	31	11	29	33	34
iii. U.S. economic growth falters	Capex	(769)	(763)	(119)	(5)	(5)
	Cash flow from investing activities	(769)	(763)	(119)	(5)	(5)
	Proceeds from issue of shares	491	492	82	0	0
	Dividends paid	(18)	0	(43)	(48)	(49)
	Cash flow from financing activities	762	786	77	(23)	(24)
	Cash at beginning of period	0	25	38	25	30
	Net change in cash	24	35	(14)	6	5
	Ending balance cash	24	59	25	30	35
<b>Company Profile</b>	<b>Balance sheet (USDm)</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</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 United States, as well as real estate-related assets.	Total cash and equivalents	25	38	25	30	35
	Tangible fixed assets	777	834	961	976	990
	Total assets	804	875	988	1,009	1,028
	Total long-term debt	294	294	331	338	345
	Other liabilities	4	23	5	6	9
	Total liabilities	314	328	352	362	372
	Shareholders' equity	490	547	637	646	656
	Total equity	490	547	637	646	656
	Net debt	269	256	307	308	310
	Total liabilities & equity	804	875	988	1,009	1,028
	<b>Key metrics</b>	<b>Dec-15</b>	<b>Dec-16</b>	<b>Dec-17F</b>	<b>Dec-18F</b>	<b>Dec-19F</b>
	Revenue growth (%)	0.0	(33.0)	83.8	12.3	2.7
	Recurrent EPS growth (%)	0.0	92.2	(16.7)	7.1	1.8
	Operating EBITDA margin (%)	57.2	49.5	51.6	51.8	51.8
	Net profit margin (%)	36.6	108.8	53.4	53.4	53.4
	Capex/sales (%)	1084.5	1605.5	136.5	4.9	4.8
	Interest cover (x)	4.01	5.27	6.40	6.36	6.40

Source: Company data, RHB

## Results Review

**Slight dip in portfolio occupancy due to tenant resizing.** Overall portfolio occupancy dipped 2.1ppt QoQ to 95.9% on the back of tenant resizing in Figueroa (95.3%, down 2.7ppt QoQ) and Peachtree (93.4%, down 1ppt QoQ). Management noted that the drop in occupancy in Figueroa was due to its tenant 'Colliers' vacating one of its floors. As the vacated floor sits among top floors, it expects healthy demand for the space. On Peachtree, MUST has recently signed a new tenant that would be taking up about 10,000 sq ft of office space.

**100% fixed-rate loans eliminate impact of interest rate increase.** MUST announced that it has entered into an USD40m, 5-year fully fixed loan facility, which would be used to partly fund 'The Plaza' acquisition. The borrowing cost of 3.6% for the loan came in slightly lower than its expected 3.75%. Post acquisition gearing remains healthy at 33.1% offering healthy debt headroom of c.USD135m for acquisitions (assuming a comfortable level of 40%).

**2Q17 DPU beats IPO forecast by 7.5%; Results in-line.** 2Q17 gross revenue were 1.3% lower than its IPO forecasts due to a lower recovery revenue. However NPI exceeded forecasts by 3.7% on the higher car-park income, rental escalations and lower property taxes and utility expenses. Distributable income exceeded the IPO forecasts by 6.9%, driven by higher NPI and interest cost savings from lower refinancing cost for its bridge loan. The results were in-line with 1H17 DPU accounting for 51% of our full-year forecasts.

Figure 1: 2Q17 results summary

(USDm)	2Q17	1Q17	QoQ	IPO Forecast 2Q17	% Change	Comments
Revenue	19.9	19.8	0.4%	20.0	-0.3%	Due to lower recoveries income, partially offset by higher rental and other income
NPI	12.8	12.8	0.2%	12.3	3.7%	Largely due to higher rental and other income, and lower property expenses
NPI (%)	64.2%	64.4%	-0.2ppt	61.8%	2.4ppt	
Net income	21.2	8.5	149.8%	7.4	185.8%	Due to higher net property income, lower finance expenses and fair value gains
Unit holders Distribution	10.0	10.4	-4.1%	9.3	6.9%	Due to higher net property income and lower interest costs
DPU (cents)	1.58	1.65	-4.2%	1.47	7.5%	

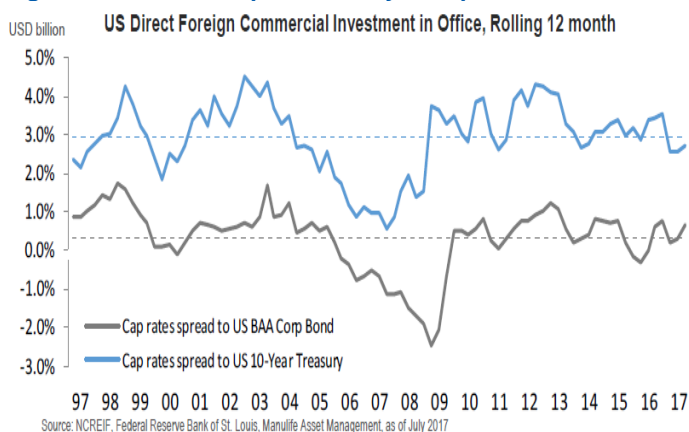
Source: RHB, Company

Figure 2: DDM valuation table

	FY17F	FY18F	FY19F	FY20F	FY21F	Terminal Value
DPU (USD Cts)	6.4	6.5	6.6	6.7	6.8	110.9
Target price (USD)	1.00					
Current Price (USD)	0.92					
Price Upside (%)	8%					
Distribution Yield FY17F (%)	6.9%					
<b>Assumptions</b>						
Risk-free rate (%)	3%					
Beta	0.98					
Cost of equity (%)	8.3%					
Terminal growth (%)	2%					

Source: RHB

Figure 3: US office cap rates and yield spreads



Source: Company Data

Figure 5: Portfolio valuation uplift – 2Q17

Property	Acquisition Price as at 20 May 2016 (US\$ million)	Valuation as at 31 Dec 2016 (US\$ million)	Valuation as at 30 Jun 2017 (US\$ million)	Change since 20 May 2016 (%)	Change since 31 Dec 2016 (%)	Current Cap Rate <sup>(1)</sup> (%)
Figueroa	284.7	312.5	325.0	14.2	4.0	4.8
Michelson	317.8	334.6	342.0	7.6	2.2	5.6
Peachtree	175.0	186.7	190.5	8.9	2.0	5.8
<b>Total/ Weighted Average</b>	<b>777.5</b>	<b>833.8</b>	<b>857.5</b>	<b>10.3</b>	<b>2.8</b>	<b>5.3</b>

(1) As at 30 Jun 2017 by CBRE

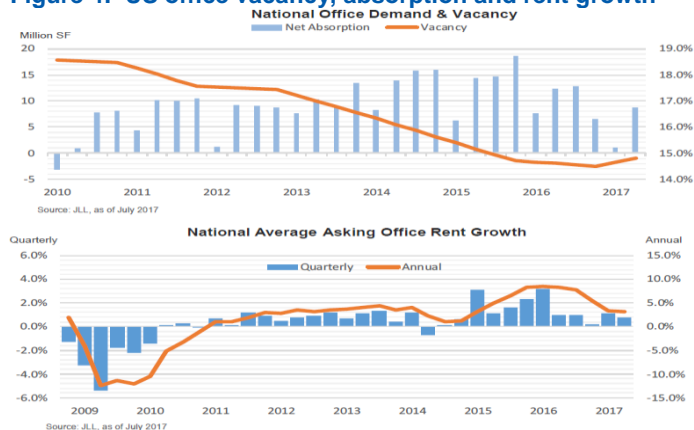
Source: Company Data

Figure 7: Top 10 tenants – enlarged portfolio

Tenant <sup>1</sup>	Sector	Leased Area (sq ft)	% of CRI <sup>1</sup>
Kilpatrick	Law Firms	227,134	8.8%
TCW	Financial Institutions	188,835	8.4%
Hyundai Capital	Financial Institutions	96,921	7.4%
The Children's Place	Retail Trade	197,949	7.1%
Quinn Emanuel	Law Firms	146,432	6.8%
Gibson, Dunn	Law Firms	87,305	5.9%
Quest Diagnostics	Medical & Diagnostic	131,612	4.6%
LA Fitness	Personal Services	91,023	4.0%
AXA Equitable	Financial Institutions	100,993	3.8%
Bryan Cave	Law Firms	47,824	3.4%
<b>Total Top 10 Tenants</b>		<b>1,316,028</b>	<b>60.4%</b>

Source: Company Data

Figure 4: US office vacancy, absorption and rent growth



Source: JLL, Company Data

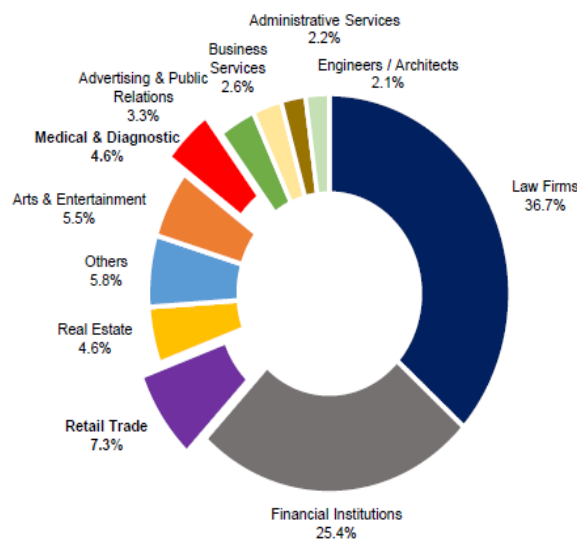
Figure 6: Office portfolio passing rents

Property	As at 31 Mar 2017 (US\$)	As at 30 Jun 2017 (US\$)	Change (%)
Figueroa	38.63	39.16	1.4
Michelson	50.20	50.41	0.4
Peachtree	31.53	31.58	0.2
<b>Weighted Average</b>	<b>40.01</b>	<b>40.33</b>	<b>0.8</b>

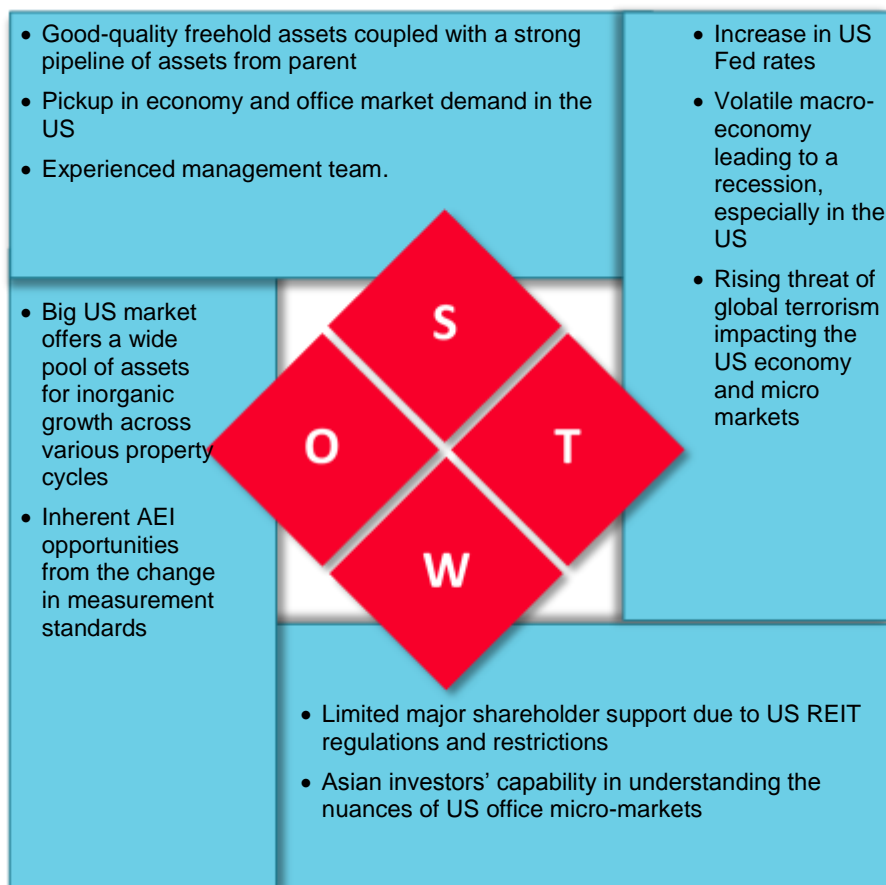
(1) Based on new leases signed from 1 Jan 2017 to 30 Jun 2017 with a total NLA of 8,382 sq ft

Source: Company Data

Figure 8: Cash rental income by trade sector



## SWOT Analysis



## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2017-06-20	Buy	0.99	0.89
2017-02-14	Buy	0.96	0.86
2017-01-05	Buy	0.96	0.84
2016-11-23	Buy	0.96	0.81

Source: RHB, Bloomberg

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**Buy:** Share price may exceed 10% over the next 12 months

**Trading Buy:** Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

**Neutral:** Share price may fall within the range of +/- 10% over the next 12 months

**Take Profit:** Target price has been attained. Look to accumulate at lower levels

**Sell:** Share price may fall by more than 10% over the next 12 months

**Not Rated:** Stock is not within regular research coverage

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