Singapore Company Update

Manulife US Real Estate Inv

Bloomberg: MUST SP | Reuters: MANU.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

18 May 2023

BUY

Last Traded Price (17 May 2023): US$0.136 (STI : 3,173.84)
Price Target 12-mth: US$0.24 (76% upside) (Prev US$0.45)

Analysts
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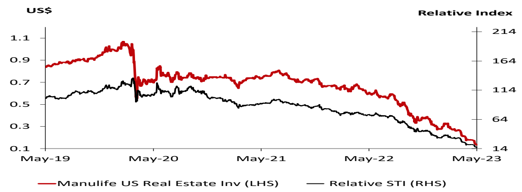
What's New

- Discussions with potential strategic investor, Mirae are still ongoing and expected to be completed by end-2Q23
- Our ideal capital injection scenario of US$175m or more to bring gearing down to 40% level will defend MUST against future uncertainties
- While dilution of up to 45% expected; price have substantially priced in this scenario
- Maintain BUY; lower TP to US$0.24 as we peg our target price to 0.8x on our assumed fully diluted NAV

Price Relative



Forecasts and Valuation

FY Dec (US$m)	2021A	2022A	2023F	2024F
Gross Revenue	185	203	193	190
Net Property Inc	110	113	109	108
Total Return	39.4	(130)	54.7	45.9
Distribution Inc	85.6	87.9	74.6	65.0
EPU (US cts.)	2.23	(7.3)	3.06	2.55
EPU Gth (%)	nm	nm	nm	(17)
DPU (US cts.)	5.33	4.75	3.80	3.29
DPU Gth (%)	(5)	(11)	(20)	(13)
NAV per shr (US cts.)	67.3	57.4	57.5	57.5
PE (X)	6.1	nm	4.4	5.3
Distribution Yield (%)	39.2	34.9	27.9	24.2
P/NAV (x)	0.2	0.2	0.2	0.2
Aggregate Leverage (%)	42.7	48.6	48.8	49.1
ROAE (%)	3.4	(11.7)	5.3	4.5
Distn. Inc Chng (%):			(8)	(21)
Consensus DPU (US			4.20	4.10
Other Broker Recs:		B: 6	S: 0	H: 0

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

Raising capital the right move for all

Investment Thesis:

Riding on "flight to quality" trends in US office market. Manulife US REIT's (MUST) portfolio comprises trophy/class A office buildings located in key cities in the US that are riding on the "flight to quality" trends as US corporates rationalise their office space in the midst of a new flexible working trends emerging post COVID-19.

Earnings declines given higher vacancy assumptions post 1Q23 update. We lower our FY23F-FY24F DPU by 9% to 21% to factor in higher vacancy, higher costs, and higher interest cost in our estimates. We have yet to factor in the potential impact from capital injection in our estimates, pending details. Stock current yields >25% yield which we believe have priced in the dilutive effects of a possible deleveraging exercise, waiting to be announced.

Headwinds largely priced in, we believe markets have priced in a "capital raise" at current levels. We see an optimal target gearing ratio of 40% (from current 49%) for MUST in order to better defend itself against possible asset valuation declines in the future. We estimate that US$175m of capital is needed, implying a rights issue. While dilutive, it will be the likely way out for the REIT. Based on our estimates, assuming capital raised at 10% discount to current price will still see MUST offering a fully diluted FY23F yield of c.19% (vs 28% currently), but still way above its historical mean. Every 10% discount in the new issue price will mean a further 3% ppt decline in yield.

Maintain BUY; lower TP to US$0.24 (vs. US$0.45 previously). We maintain our BUY rating but lower our TP to US$0.24, pegged to our fair value, pegged to 0.8x fully diluted NAV of 0.31Scts. Our TP assumed a target yield of 11%, which is at -1 standard deviation level of its historical pre-COVID mean.

Key Risks

Slower-than-expected economic recovery and potential recession in the US. This situation would impact businesses, and that may cause a rising risk of vacancy.

Non-renewal of leases. MUST's financials, operations, and capital growth may be adversely affected by bankruptcy, insolvency, or downturns in the businesses of its tenants, which may lead to the non-renewal of their leases.

At A Glance

Issued Capital (m shrs)	1,777
Mkt. Cap (US$m/US$m)	242 / 242
Major Shareholders (%)	
Manulife Financial C	5.5
Prudential PLC	4.4
Manufacturers Life R	3.7
Free Float (%)	94.5
3m Avg. Daily Val (US$m)	0.91

GIC Industry : Real Estate / Equity Real Estate Investment (REITs)

DBS Insights Direct

Watchlist the stock on Insights Direct to receive prompt updates

ed: BM/ sa: AS, PY, CS

WHAT'S NEW

Is rights issue a possible win-win for all?

Awaiting news of capital injection from new strategic shareholder. Following from the recent release of Manulife US REIT's (MUST) 1Q2023 Business Update, the discussions with Mirae are still ongoing (Mirae deal). We understand that due diligence by Mirae on MUST is substantially completed, with both parties currently negotiating the key terms, which we await more clarity.

With 1Q23 gearing at 49.5%, just a tad below the 50% limit, the need and urgency of a capital injection becomes more apparent, though the hike in gearing could be due to some timing difference in the payout of distributions and proceeds from the divestment of the Tanasbourne property to the sponsor, Manulife.

Overall, key highlights from the business update include :

- Mirae intends to subscribe for more than 9.8% of new units to capitalise MUST and reduce gearing
- Manulife (sponsor) intends to retain its 9.1% stake in MUST
- May see gearing reduce to the low 40% level

Is the rumoured US$150m investment by Mirae enough to solve capital structure pressure faced by MUST?

While yet to be confirmed by the manaager, assuming that earlier media reports of Mirae intending to acquire a stake in MUST and the REIT manager for US$150m/c.S$200m were true, we estimate that a likely scenario of how the capital could be split as follows:

- A US$109m capital injection by Mirae into MUST (c.32% stake of the enlarged entity) while the remaining US$41m would be used to acquire the REIT manager (ballpark estimate of c.6x PE)
- MUST would undertake a new issuance of shares valued at c.US$11m (or a c.3.2% stake of the enlarged entity) (to Manulife Sponsor) to retain its stake of 9.1% in the enlarged entity
- With the estimated US$41m in proceeds from the sale of the REIT manager, Manulife (sponsor) will likely channel the proceeds to fund the acquisition of Tanasbourne and an additional placement to retain its stake in MUST

In such a scenario above,

- Gearing would be reduced to 42.8%
- ICR ratio will increase to 3.4x
- If the new issuance is priced at a 10% discount to the current share price, we estimate that DPU dilution would be 39% or 42%, assuming a further 5% discount to distributions.

However, we believe that the capital structure remains at a level which could still cause investors' concerns that gearing may be stretched if capital values continue to fall again by end 2023. This may may turn out to be true, depending on how the current turmoil pans out with the US commercial real estate space.

MUST may need to raise further capital to bring gearing to a more comfortable level of less than 40%.

Additional capital of US$55m to bring gearing to 40%, a level that brings much flexibility to the REIT. While the above is sufficient to bring gearing to a level which is below both the MAS gearing level of 50% and 45% (if ICR is below that of 2.5x), we believe a gearing of above 40% is still not a comfortable level for investors, in view of the potential valuation decline considering the challenging US office market.

As such, we take a step further to evaluate if a rights issue should be considered to bring the gearing a notch lower to ensure a sufficient buffer. In addition, this could be an opportunity and equity solution for existing shareholders who could look to average down on their stake, given the significant decline in the share price.

A possible one-for-six rights issue? Based on our calculation above, a rights issue of US$55m (to bring the total capital injection up to US$175m) could be executed via a one-for-six rights issue. Any additional amount from the rights issue, i.e., above US$55m, would bring gearing down to a more comfortable level of below 40% with ample buffer for a potential asset valuation decline, which we believe would be a win-win scenario to all parties – the sponsor, new sponsor, and unitholders.

Ample defence against the risk of further asset devaluation. With new equity capital raised to bring gearing to a more platable gearing level of 40%, we believe this will provide MUST with sufficient flexibility to defend against further asset declines in the future, which will need an assumed further 20% decline in asset values to bring gearing back up to 50% level. This implies that MUST balance sheet can withstand a possible "through-cycle" asset devaluation of 32% or a further 120 basis points expansion in cap rates from FY22 levels.

Our scenario analysis with capital injection.

Capital injection a key catalyst for the stock. As the potential strategic injection by Mirae into Manulife US REIT (Mirae deal) remains the key datapoint for most investors and a further clarity will be needed to stem the fall in share price for MUST. Overall, we estimate and calculate the potential scenarios and impact to the share price, DPU, and gearing (table below).

In our scenario analysis, we estimate;

- **An overall US$175m capital injection** would be needed to bring gearing to 40% with the repayment of debt (to be issued to strategic shareholders and current unitholders)
- Depending on the share price of the new issuance, **DPU dilution (from FY22) is estimated to be 42% to 47%**
- **The impact to the share price is more muted** with a -4% to +4% impact
- In addition, assuming a **further 5% decline in distributable income (DI),** we estimate that **DPU dilution would be 45% to 49%**
- At a share price of S$0.14, the stock's fully diluted dividend yield could be around c.19%, levels that are still above historical trading levels.

Maintain BUY; lower TP to US$0.24. We maintain our BUY rating but lower our TP to US$0.24, pegged our fair value for MUST post the possible capital injection, which implies a target P/B of 0.8x and a target fully diluted yield of 11%, based on our estimates.

That said, our estimates have not fully reflect this scenario but drop our FY23F-FY24F DPU by c.9% and 21%, respectively, to factor in higher vacancy, higher cost, and higher interest cost (to 4.3% and 5% from 4% and 4.5% previously for FY23F and FY24F, respectively). We have yet to factor in any potential capital injection until further details are revealed.

We believe we are closer to MUST's potential, and able to recap its balance sheet and provide a better platform to weather potential headwinds. As such, all eyes are on the announcement of the potential Mirae deal.

Scenario analysis of potential capital injection (from price of US$14 scts/unit)

				Assumed Capital Injection	Key metrics Post Capital Injection	
US$'m	FY22	Divest Tanasbourne (Est)	Post Divestment	of US$175m	New units Issued at 10% discount	New Units Issued at 10% premium
Total Debt	1,029	-33.5	995	-175	820	820
Assets	2,079	-33.5	2,045		2,045	2,045
EBITDA	105	- 2.0	103		103	103
Interest Expense	34	-0.4	34	-5.3	28	28
Distributable Income (91% payout)	76		75	5.3	80	80
no. of shares	1,777		1,777	1,389	3,165	2,913
Gearing (from 1Q23) (%)	49.5%		48.7%		40.1%	40.1%
ICR (x)	3.1		3.1		3.6	3.6
DPU (US cts)	4.75		4.23		2.54	2.76
DPU Dilution			-11%		-47%	-35%
Share price (US$)	0.14		0.14		0.13	0.15
Fully diluted Yield (%)	34%		30%		19%	19%
NAV per share (US$)	0.55		0.55		0.31	0.34
DBS TP	0.33		0.33		0.24	0.25
P/B at target	0.6x		0.6x		0.8x	0.8x
Yield at target					11%	11%

Source: Company, DBS Bank

Scenario analysis of potential capital injection depending on share price of new issuance

	Stable DPU from FY22		5% further decline in DPU	
Scenarios	DPU (UScts)	Share Price (US$)	DPU (UScts)	Share Price (US$)
10% discount	2.54	0.13	2.41	0.13
Current Price	2.66	0.14	2.52	0.14
10% premium	2.76	0.15	2.61	0.15
Dilution from FY22	4.75	0.14	4.75	0.14
10% discount	-47%	-4%	-49%	-4%
Current Price	-44%	0%	-47%	0%
10% premium	-42%	4%	-45%	4%

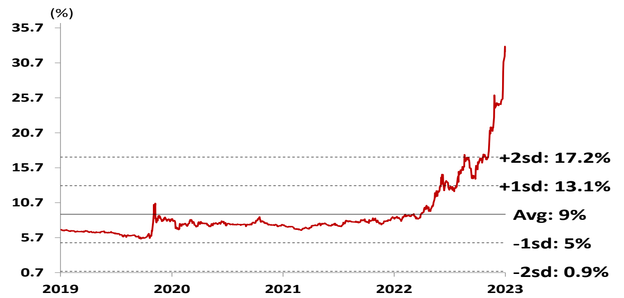
Source: Company, DBS Bank

Company Background

Manulife US REIT (MUST) is the first pure-play US office REIT listed in Asia. Its portfolio consists of eight freehold, class A, or trophy-quality office properties in Atlanta, Los Angeles, New Jersey, Washington DC, Virginia, and Orange County.

Historical PE and PB band

Distribution yield (%)



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

PB band (x)

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

Income Statement (US$m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Gross revenue	194	185	203	193	190
Property expenses	(78.5)	(75.6)	(89.4)	(83.4)	(82.3)
Net Property Income	116	110	113	109	108
Other Operating expenses	(11.8)	(11.3)	(11.5)	(8.8)	(7.8)
Other Non Opg (Exp)/Inc	0.0	0.0	48.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(29.6)	(29.1)	(33.9)	(45.4)	(53.4)
Exceptional Gain/(Loss)	(140)	(28.5)	(264)	0.0	0.0
Net Income	(66.0)	40.6	(148)	55.2	46.3
Tax	22.7	(1.1)	18.1	(0.6)	(0.5)
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	(43.3)	39.4	(130)	54.7	45.9
Total Return	(43.3)	39.4	(130)	54.7	45.9
Non-tax deductible Items	132	46.2	218	19.9	19.2
Net Inc available for Dist.	89.0	85.6	87.9	74.6	65.0
Growth & Ratio					
Revenue Gth (%)	9.3	(4.7)	9.4	(4.8)	(1.5)
N Property Inc Gth (%)	4.6	(5.4)	3.3	(3.4)	(1.7)
Net Inc Gth (%)	nm	nm	nm	nm	(16.1)
Dist. Payout Ratio (%)	100.0	100.0	95.7	91.0	91.0
Net Prop Inc Margins (%)	59.6	59.2	55.9	56.7	56.7
Net Income Margins (%)	(22.3)	21.3	(64.0)	28.4	24.2
Dist to revenue (%)	45.8	46.2	43.4	38.7	34.3
Managers & Trustee's fees	6.1	6.1	5.7	4.5	4.1
ROAE (%)	(3.6)	3.4	(11.7)	5.3	4.5
ROA (%)	(2.0)	1.8	(5.9)	2.6	2.1
ROCE (%)	5.3	4.8	5.1	5.1	5.0
Int. Cover (x)	3.5	3.4	3.0	2.2	1.9

Source: Company, DBS Bank

Interim Income Statement (US$m)

FY Dec	2H2020	1H2021	2H2021	1H2022	2H2022
Gross revenue	95.7	90.8	94.3	100	102
Property expenses	(42.0)	(34.7)	(40.8)	(42.8)	(46.6)
Net Property Income	53.7	56.1	53.5	57.6	55.5
Other Operating	(5.2)	(5.7)	(5.6)	(6.2)	(5.3)
Other Non Opg (Exp)/Inc	2.20	4.21	9.69	32.8	15.2
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(14.9)	(14.7)	(14.5)	(15.3)	(18.6)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	35.8	39.9	43.1	68.9	46.9
Tax	7.74	4.13	(5.3)	(7.7)	25.8
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	43.5	44.0	37.8	61.2	72.7
Total Return	(7.7)	6.70	32.7	62.8	(192)
Non-tax deductible Items	(2.5)	(1.0)	9.90	(15.2)	(30.8)
Net Inc available for Dist.	41.0	43.0	42.6	46.0	41.9
Growth & Ratio					
Revenue Gth (%)	(3)	(5)	4	6	2
N Property Inc Gth (%)	(14)	4	(5)	8	(4)
Net Inc Gth (%)	4	1	(14)	62	19
Net Prop Inc Margin (%)	56.1	61.8	56.7	57.4	54.4
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	91.0

Balance Sheet (US$m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Investment Properties	1,993	2,184	1,947	1,965	1,984
Other LT Assets	0.0	5.65	47.7	47.7	47.7
Cash & ST Invts	86.7	78.6	113	113	115
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	6.93	5.55	5.40	8.25	8.13
Other Current Assets	1.66	1.44	2.93	2.93	2.93
Total Assets	2,088	2,276	2,116	2,136	2,158
ST Debt	234	297	145	145	145
Creditor	18.1	58.8	31.3	29.1	28.7
Other Current Liab	6.88	8.25	8.50	8.50	8.50
LT Debt	619	675	884	900	916
Other LT Liabilities	52.9	49.6	26.8	26.8	26.8
Unit holders' funds	1,158	1,188	1,020	1,027	1,033
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	2,088	2,276	2,116	2,136	2,158
Non-Cash Wkg. Capital	(16.4)	(60.0)	(31.4)	(26.4)	(26.1)
Net Cash/(Debt)	(766)	(893)	(916)	(932)	(946)
Ratio					
Current Ratio (x)	0.4	0.2	0.7	0.7	0.7
Quick Ratio (x)	0.4	0.2	0.7	0.7	0.7
Aggregate Leverage (%)	40.8	42.7	48.6	48.8	49.1
Z-Score (X)	1.0	1.0	1.0	1.0	NA

Source: Company, DBS Bank

Cash Flow Statement (US$m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Pre-Tax Income	74.4	40.6	(148)	55.2	46.3
Dep. & Amort.	(0.7)	1.93	4.35	0.0	0.0
Tax Paid	(1.9)	(0.1)	(0.1)	(0.6)	(0.5)
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(36.6)	(20.8)	1.25	(5.0)	(0.3)
Other Operating CF	187	69.1	234	19.9	19.2
Net Operating CF	222	90.6	92.0	69.6	64.7
Net Invt in Properties	(24.2)	(231)	(25.4)	(1.9)	(2.8)
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	0.17	0.02	0.05	(16.1)	(15.9)
Net Investing CF	(24.0)	(231)	(25.4)	(18.0)	(18.8)
Distribution Paid	(70.7)	(84.0)	(88.6)	(67.9)	(59.2)
Chg in Gross Debt	38.6	215	56.0	16.1	15.9
New units issued	0.0	0.70	0.25	0.0	0.0
Other Financing CF	0.0	0.0	0.0	0.0	0.0
Net Financing CF	(32.2)	132	(32.4)	(51.8)	(43.3)
Currency Adjustments	0.05	0.0	0.03	0.0	0.0
Chg in Cash	166	(8.1)	34.3	(0.2)	2.68
Operating CFPS (US cts.)	16.4	6.32	5.11	4.18	3.62
Free CFPS (US cts.)	12.5	(8.0)	3.75	3.79	3.44

Source: Company, DBS Bank

Target Price & Ratings 12-mth 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:	26 May 22	0.59	0.70	BUY
2:	03 Nov 22	0.36	0.48	BUY
3:	08 Feb 23	0.33	0.48	BUY
4:	10 Feb 23	0.29	0.45	BUY

Source: DBS Bank

Analyst: Rachel TAN

Derek TAN

DBS Bank recommendations are based on 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 share price catalysts within this time frame)

**Share price appreciation + dividends*

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

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