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

19 Jul 2023

FULLY VALUED (Downgrade from BUY)

Last Traded Price (17 Jul 2023): US$0.169 (STI : 3,254.26)
Price Target 12-mth: US$0.10 (41% downside) (Prev US$0.24)

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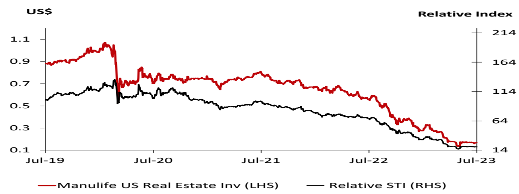
What's New

- Higher-than-expected valuation loss brings gearing to 57%; financial covenant breach limits dividend-paying ability
- Manager to set course with lenders to cure breach and boost liquidity needs to run the REIT's operations
- Downgrade to FULLY VALUED, TP US$0.10 as we raise discount rate assumptions

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)	(225)	45.9
Distribution Inc	85.6	87.9	74.6	65.0
EPU (US cts.)	2.23	(7.3)	(12.6)	2.55
EPU Gth (%)	nm	nm	(73)	nm
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	41.8	41.9
PE (X)	7.6	nm	nm	6.6
Distribution Yield (%)	31.5	28.1	22.5	19.5
P/NAV (x)	0.3	0.3	0.4	0.4
Aggregate Leverage (%)	42.7	48.6	56.2	56.4
ROAE (%)	3.4	(11.7)	(25.5)	6.1

Distn. Inc Chng (%):			0	0
Consensus DPU (US			4.50	4.60
Other Broker Recs:		B: 6	S: 0	H: 0

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

A case of too little, too late

Investment Thesis:

Diversified US office REIT. 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 amid the new flexible working trends emerging post COVID-19. That said, its portfolio has been impacted by tenant vacancies, which limits the ability for the REIT to raise cash flows to pay for incremental debt obligations as interest rates rise in the US.

DPU downtrend till FY24F. We have forecasted a DPU decline of a 15% CAGR from FY22-24F, mainly coming from higher refinancing costs. Our estimates have yet to factor in the potential impact of a capital injection, which, we believe, is needed, given its strained financials (gearing of c.57%, ICR ratio of 2.6x) with a breach of a covenant that the manager is seeking a waiver on. While the stock trades at a c.20% yield, the potential delay in paying 1H23 distributions will remain an overhang.

Downgrade to FULLY VALUED, TP US$0.10 (vs. US$0.24 previously). We have, in our past reports, envisioned a roadmap which highlights a more urgent response from the sponsor (through asset sales and/or equity injection) towards MUST, to prevent an incidence of any further breach of the financial covenants, but found the timing to be lacking. With a spiralling debt crisis and a near-term "dividend stopper", we believe that equity shareholders will not be compensated if they wait out a recovery. As such, we see weakness in the stock price in the interim. We have hiked our discount rate assumptions to a WACC of 8.6% (vs. 6.8% previously) with a revised TP of S$0.10. Based on a revised book of US$0.42/share, our target price implies a P/B of 0.2x.

Key Risks

Risk to earnings: Tenant vacates and higher interest costs.
Key risk to our investment thesis: Privatisation.

At A Glance

Issued Capital (m shrs)	1,777
Mkt. Cap (US$m/US$m)	300 / 300
Major Shareholders (%)	
Manulife Financial Corp	5.5
Free Float (%)	94.5
3m Avg. Daily Val (US$m)	1.1

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

WHAT'S NEW

Too little too late

Gearing spikes to 57% with another 15% decline in asset valuation, which has three major implications, in the worst-case scenario. In the latest updated asset valuation as of 1H23, Manulife US REIT (MUST)'s portfolio valuation declined by 14.6% to US$1.6bn vs. US$1.9bn as at Dec 22. Following the asset valuation decline, gearing is expected to be at 57% (exceeding the leverage limit of 50%), while the ICR is maintained above 2.5x, at 2.6x. While the gearing limit does not by itself constitute a breach, it has three other major implications: i) It results in the breach of another financial covenant, which constitutes that total unencumbered debt vs. unencumbered assets are within 60% (MUST's ratio is at 60.2% as at Jun 23); ii) cross default of interest rate swaps, which will subject MUST to higher interest rates for its loans, and subsequently impact the ICR ratio; and iii) potential implications on distributions to be declared, with MUST expecting to report a loss in its 1H23 financial results. MUST is currently in discussions with its lenders i) to waive the breach of the financial covenants, ii) exploring an option to lower the ratio of total unencumbered debt vs. unencumbered assets, and iii) seeking approval to declare distributions. In the announcement, MUST mentioned that the manager and sponsor are exploring a potential alternative method with its lenders, which may address MUST's mid and long-term liquidity needs.

Details on the asset valuation decline. The decline in valuation was mainly due to higher discount rates and terminal cap rates for certain properties reflecting risks posed by the volatile macroeconomic environment and idiosyncratic risks at the property level (higher vacancy and/or weak submarket fundamentals). 60% of the decline was led by five properties, namely, Figueroa, Michelson, Exchange, Penn, and Phipps. The decline in the valuation of each asset ranges from 11% to 21%.

Our View

Spiralling debt crisis gives rise to need for stronger support from sponsor to ensure MUST's sustainability in the interim while we wait for a positive turn in the market. Following the latest asset valuation, the sale of Phipps is no longer sufficient to bring gearing to below 50% as we previously expected. Based on our ballpark estimates, the divestment of Phipps at its new asset value of US$178m will lower gearing to 52%. As such, MUST is seeking a disposition mandate from unitholders that will give it more flexibility to dispose certain assets within certain conditions to allow more timely dispositions. Given the current 'debt crisis', 1H23 distributions will be withheld until the situation is resolved (post the divestment of Phipps).

This will cause a short-term overhang on the share price. Despite painting a worst-case picture, we believe that MUST can possibly attain the relevant waivers from lenders with a more concrete medium-term plan to address the liquidity issue. Moving forward, its sponsor's support is even more crucial now (either via further asset dispositions to the sponsor or support to address liquidity concerns) to ensure the sustainability of MUST, given that the Mirae deal has fallen through. We still believe that MUST should bite the bullet with the rights issue option. However, we note that MUST faces limitations, given its sponsor's shareholding cap of below 10%. With such a deep decline in asset valuation (c.25% since Dec 22), coupled with the Fed rate hike cycle approaching the end, considering the latest inflation data, we believe that MUST could survive the crisis with some support from the sponsor in the interim. Though it is still early, we believe that the US office market is starting to see some green shoots and we are hopeful that we are approaching a stabilisation/inflection point in the US office market.

Downgrade to FULLY VALUED, TP S$0.10. We have previously, in our past reports, envisioned a roadmap which highlights a more urgent reaction from the sponsor (through asset sales and equity injection) towards MUST to prevent an incidence of a further breach of financial covenants, but found the timing to be lacking. With a spiralling debt crisis, the breach of its covenants, and a near-term "dividend stopper", we believe that equity shareholders will not be compensated if they wait out a recovery. As such, we see weakness in the stock price in the interim. We have hiked our discount rate assumptions to a WACC of 8.6% (vs. 6.8% previously) with a revised TP of S$0.10. Based on a revised book of US$0.42/share, our target price implies a P/B of 0.2x.

Company Background

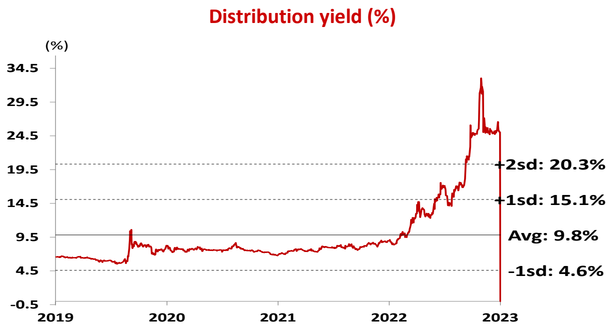
Manulife US REIT (MUST) is the first pure-play US office REIT listed in Asia. Its portfolio consists of eight freehold, class A, or trophy-quality office properties in Atlanta, Los Angeles, New Jersey, Washington DC, Virginia, and Orange County.

Book value changes

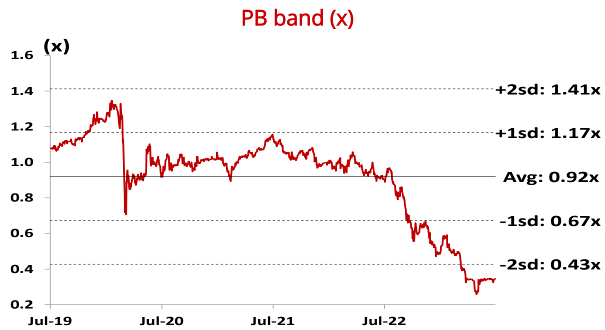
Valuation	2Q22	4Q22	% Chg (h-o-h)	2Q23	% chg (h-o-h)	% drop y-o-y
Figueroa	315.2	211.0	-33%	174.0	-18%	-45%
Michelson	317.0	292.0	-8%	256.0	-12%	-19%
Peachtree	212.9	205.0	-4%	175.0	-15%	-18%
Plaza	106.0	92.0	-13%	67.0	-27%	-37%
Exchange	324.0	290.0	-10%	258.0	-11%	-20%
Penn	177.3	156.0	-12%	124.0	-21%	-30%
Phipps	216.0	210.0	-3%	178.2	-15%	-18%
Centerpointe	112.7	101.0	-10%	79.0	-22%	-30%
Capitol	197.0	190.0	-4%	165.0	-13%	-16%
Diablo	65.0	63.5	-2%	58.6	-8%	-10%
Park Place	106.9	103.0	-4%	98.7	-4%	-8%
Tanasbourne	34.4	33.5	-3%			Sold
Portfolio	2,184.4	1,947.0	-11%	1,633.5	-16%	-25%

Source of all data: Company, DBS Bank

Historical distribution yield and PB band



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



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)	(280)	0.0
Net Income	(66.0)	40.6	(148)	(225)	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)	(225)	45.9
Total Return	(43.3)	39.4	(130)	(225)	45.9
Non-tax deductible Items	132	46.2	218	300	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	(73.7)	nm
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)	(116.9)	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)	(25.5)	6.1
ROA (%)	(2.0)	1.8	(5.9)	(11.3)	2.5
ROCE (%)	5.3	4.8	5.1	5.6	5.8
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	1,685	1,704
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	1,856	1,878
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	747	753
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	2,088	2,276	2,116	1,856	1,878
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	56.2	56.4
Z-Score (X)	1.0	1.0	1.0	1.0	1.0

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:	03 Nov 22	0.36	0.48	BUY
2:	08 Feb 23	0.33	0.48	BUY
3:	10 Feb 23	0.29	0.45	BUY
4:	18 May 23	0.14	0.24	BUY

Source: DBS Bank

Analyst: Rachel TAN
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 share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 19 Jul 2023 07:36:42 (SGT)
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