COMPANY UPDATE

Manulife US REIT (MUST SP)

Attempting To Address Slight Breach Of Financial Covenant

MUST has announced a drop in valuation of 14.6% or US$280m after conducting a mid-year review, which caused aggregate leverage to spike to 57% as of Jun 23. The erosion of capital values was more severe than anticipated. The breach of the financial covenant could trigger a cross default of its interest rate swaps and lower regulatory limit for aggregate leverage from 50% to 45%. Management is seeking a waiver but panicky holders are likely to rush to sell. Downgrade to SELL. Target price: US$0.165.

WHAT'S NEW

- **Hammered by revaluation losses again.** Manulife US REIT (MUST) has announced that the valuation of its investment properties dropped 14.6% or US$280m due to a higher discount rate, higher cap rate and weakening occupancies. The discount rate used in its valuation increased by 50-125bp, while terminal cap rate increased by 25-100bp. Overall, cap rate for its portfolio expanded 75bp from 6.25% to 7.00%. Around 60% of the decline came from five properties, namely Figueroa (-US$37m or -17.5%), Michelson (-US$36m or -12.3%), Exchange (-US$32m or -11%), Penn (-US$32m or -20.5%) and Phipps (-US$31.9m or -15.2%). Its aggregate leverage has hit 57% based on the updated valuations. According to management, this is not considered a breach of regulatory limit on aggregate leverage because it is caused by circumstances beyond its control. Management cautioned that office valuations remain under pressure and could continue to decline in 2023.

- **Breached financial covenants.** Some of MUST's existing loans have financial covenants, which require total unencumbered debts over total unencumbered assets to be no more than 60:100 at all times. MUST's ratio is 60.2:100 based on the updated valuations. It has commenced discussion with banks to seek waiver for the above-mentioned breach. The breach would result in a cross default of MUST's interest rate swaps if bankers do not agree to a waiver. MUST would incur higher interest expenses if hedging by its interest rate swaps is rendered ineffective. It is in discussion with banks on whether it can make a distribution as it has breached financial covenants.

- **Risk of further pressure to deleverage.** MUST's adjusted interest coverage ratio (ICR) was 2.6x as of Jun 23. Its adjusted ICR could fall below 2.5x over time if the banks do not agree to the above-mentioned waiver on the breach of the financial covenant, causing the regulatory limit on aggregate leverage to fall from 50% to 45%.

KEY FINANCIALS

Year to 31 Dec (US$m)	2021	2022	2023F	2024F	2025F
Net turnover	185	203	195	169	170
EBITDA	98	102	97	84	85
Operating profit	98	102	97	84	85
Net profit (rep./act.)	39	(130)	(331)	78	85
Net profit (adj.)	68	86	78	52	55
EPU (US$ cent)	4.2	4.9	4.3	1.6^	1.2^
DPU (US$ cent)	5.3	4.8	4.1	1.6^	1.6^
PE (x)	4.0	3.5	3.9	7.5*	6.9*
P/B (x)	0.3	0.3	0.5	0.7*	0.7*
DPU Yld (%)	31.5	28.1	24.0	12.1*	12.8*
Net margin (%)	21.3	(64.0)	(169.7)	46.0	49.7
Net debt/(cash) to equity (%)	75.2	89.8	124.0	62.0	65.8
Interest cover (x)	3.4	3.0	2.6	2.9	3.4
ROE (%)	3.4	n.a.	n.a.	10.4	9.5
Consensus DPU (US$ cent)	n.a.	n.a.	4.1	3.4	3.5
UOBKH/Consensus (x)	-	-	0.99	0.46	0.47

** Based on theoretical ex-rights unit price of US$0.1288.*
^ Fully diluted for 1,400:1,000 rights issue @ US$0.10.
Source: Manulife US REIT, Bloomberg, UOB Kay Hian

SELL

(Downgraded)

Share Price	US$0.169
Target Price	US$0.165
Upside	-2.4%
(Previous TP	*US$0.47)*

COMPANY DESCRIPTION

MUST is the first pure play US office REIT listed in Asia. It invests in a portfolio of income-producing office real estate in key markets in the US. Its portfolio comprises 12 freehold office properties in Arizona, California, Georgia, New Jersey, Oregon, Virginia and Washington DC with NLA of 5.5m sf and valued at US$1.9b as of Dec 22.

STOCK DATA

GICS sector	Real Estate
Bloomberg ticker:	MUST SP
Shares issued (m):	1,776.6
Market cap (US$m):	300.2
Market cap (US$m):	300.2
3-mth avg daily t'over (US$m):	1.0

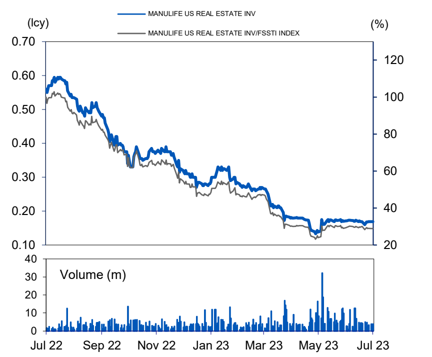
Price Performance (%)

52-week high/low US$0.595/US$0.133

1mth	3mth	6mth	1yr	YTD
(0.6)	(5.6)	(39.6)	(69.8)	(43.7)

Major Shareholders	**%**
Manulife Financial Corp	9.1
-	-
-	-
FY23 NAV/Share (USS$)	0.33
FY23 Net Debt/Share (USS$)	0.41

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- **Addressing the slight breach of financial covenants.** MUST breached the covenant for total unencumbered debts over total unencumbered assets marginally by less than 1ppt. Management intends to lower the ratio below 60% by repaying some borrowings. This will be funded by internal cash previously earmarked for other purposes. We do not expect MUST to pay distribution in 1H23. It could resume paying distribution in 2H23 assuming that it obtained the required waiver from its bankers.
- **Weathering downsizing and non-renewal by anchor tenants.** MUST has endured a series of downsizing and non-renewals by key tenants, such as Quinn Emanuel, William Carter and TCW Group. The latest setback is early termination by The Children's Place at Plaza in Secaucus. We estimated that MUST's portfolio occupancy could deteriorate by 9ppt to 79% by end-24 if vacant spaces are not backfilled.
- **Divestment of Phipps not a done deal.** Discussions on the proposed disposal of Phipps at Atlanta to the sponsor are still ongoing. According to management, the potential divestment would not bring aggregate leverage below 50% even if all the proceeds were used to repay bank borrowings. We estimate Phipps' valuation dropping US$60m (previous: US$48m) to US$150m (previous: US$162m) after factoring in the downsizing by William Carter (occupancy dropped 14.5ppt to 80.0% in 1Q23) and cap rate expansion of 75bp (previous: 25bp) to 6.6% (previous: 6.1%).
- **More flexibility to pursue divestments in a timely manner.** MUST is considering seeking a disposition mandate from unitholders to give it more flexibility to dispose of certain assets as long as the dispositions meet certain conditions.

EARNINGS REVISION/RISK

- **Erosion in capital values.** We estimated fair value of MUST's investment properties to drop 21% (previous: 15%), or US$362m (previous: US$250m), to US$1,367m (previous: US$1,478m) as at end-23 assuming cap rate for its portfolio expands 100bp (previous: 50bp) to 6.8% (previous: 6.3%). Thus, we expect aggregate leverage to increase and hit 55.2% at end-23 (previous: 51.5%).
- **Factoring in the cost to deleverage.** We have cut 2024 DPU forecast by 17% due to a 1,400:1,000 rights issue (previous: 969:1,000 rights issue) with issue price at US$0.10 (previous: US$0.12) to raise US$260m (previous: US$215m) and reduce aggregate leverage to 39.3% at end-24.
- **Rights issue does not dilute minorities.** MUST is likely to need an infusion of equity capital. We hypothetically assumed an equity fund-raising exercise to make our valuation for MUST more comparable to that of other US office REITs. There is execution risk associated with launching a rights issue. Nevertheless, a rights issue has the virtue of not diluting minority unitholders' interest.

VALUATION/RECOMMENDATION

- **Downgrade to SELL.** Our target price of US$0.165 is based on fully diluted 2024 P/NAV of 0.5x adjusted for rights entitlements.

SHARE PRICE CATALYST

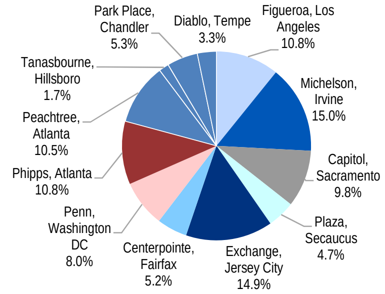
- Deleveraging to address the drop in portfolio valuation.
- Ongoing pressure on portfolio occupancy due to low physical occupancy.

KEY OPERATING METRICS

Key Metrics	1Q22	2Q22	3Q22	4Q22	1Q23	yoy % chg	qoq % chg*
DPU (US cents)	n.a.	2.61	n.a.	4.75	n.a.	n.a.	n.a.
Occupancy	91.7%	90.0%	88.1%	88.0%	86.1%	-5.6ppt	-1.9ppt
Aggregate Leverage	42.8%	42.4%	42.5%	48.8%	49.5%	6.7ppt	0.8ppt
Average Cost of Debt	2.86%	2.97%	3.34%	3.74%	3.98%	1.2ppt	0.3ppt
% Borrowing in Fixed Rates	86.5%	85.7%	81.1%	77.3%	80.2%	-6.3ppt	2.9ppt
WALE by NLA (years)	5.0	5.0	4.9	4.7	5.0	0yrs	0.3yrs
Weighted Average Debt Maturity (years)	2.6	2.3	3.1	2.4	2.7	0.1yrs	0.3yrs
Rental Reversions	3.9%	1.0%	4.3%	0.7%	5.0%	1.1ppt	4.3ppt

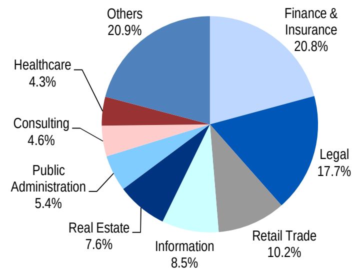
*Source: MUST * hoh % change for DPU*

PORTFOLIO VALUATION BY PROPERTY (MAR 23)



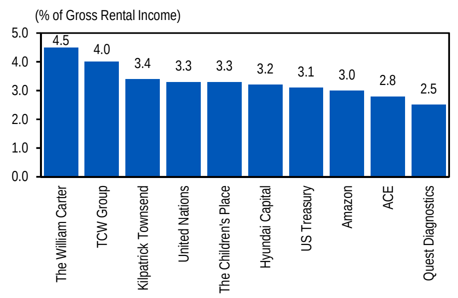
Source: MUST

TRADE SECTOR BY GRI (MAR 23)



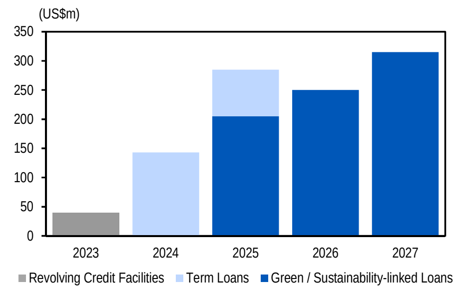
Source: MUST

TOP 10 TENANTS (MAR 23)



Source: MUST

DEBT MATURITY PROFILE (MAR 23)



Source: MUST

PROFIT & LOSS

Year to 31 Dec (US$m)	2022	2023F	2024F^	2025F^
Net turnover	202.6	195.3	169.4	170.2
EBITDA	101.7	96.6	84.5	84.8
Deprec. & amort.	0.0	0.0	0.0	0.0
EBIT	101.7	96.6	84.5	84.8
Net interest income/(expense)	(33.9)	(37.3)	(28.6)	(25.1)
Pre-tax profit	(147.8)	(350.6)	81.9	88.9
Tax	18.1	19.1	(3.9)	(4.4)
Net profit	(129.7)	(331.5)	78.0	84.5
Net profit (adj.)	85.9	78.4	51.9	55.3

BALANCE SHEET

Year to 31 Dec (US$m)	2022	2023F	2024F^	2025F^
Fixed assets	1,947.0	1,366.7	1,417.7	1,471.9
Other LT assets	47.7	47.7	47.7	47.7
Cash/ST investment	112.9	52.2	52.9	53.0
Other current assets	8.3	8.3	7.7	7.8
Total assets	2,115.9	1,474.8	1,526.0	1,580.3
ST debt	144.6	144.6	144.6	144.6
Other current liabilities	39.8	37.9	32.9	33.1
LT debt	884.4	670.0	455.0	495.0
Other LT liabilities	26.8	7.5	11.0	15.5
Shareholders' equity	1,020.3	614.8	882.4	892.2
Total liabilities & equity	2,115.9	1,474.8	1,526.0	1,580.3

CASH FLOW

Year to 31 Dec (US$m)	2022	2023F	2024F^	2025F^
Operating	92.0	102.8	51.1	59.9
Pre-tax profit	(147.8)	(350.6)	81.9	88.9
Tax	(0.1)	0.0	0.0	0.0
Working capital changes	1.2	(2.1)	(4.8)	0.2
Non-cash items	229.6	368.4	(19.9)	(22.6)
Other operating cashflows	9.0	87.1	(6.2)	(6.6)
Investing	(25.4)	124.9	(25.0)	(25.0)
Capex (growth)	0.0	0.0	0.0	0.0
Capex (maintenance)	(25.4)	(25.0)	(25.0)	(25.0)
Proceeds from sale of assets	0.0	149.9	0.0	0.0
Financing	(32.4)	(288.4)	(25.3)	(34.8)
Distribution to unitholders	(58.0)	(74.0)	(70.3)	(74.8)
Issue of shares	0.0	0.0	260.0	0.0
Proceeds from borrowings	16.8	(214.4)	(215.0)	40.0
Others/interest paid	8.8	0.0	0.0	0.0
Net cash inflow (outflow)	34.2	(60.7)	0.7	0.1
Beginning cash & cash equivalent	78.6	112.9	52.2	52.9
Changes due to forex impact	0.0	0.0	0.0	0.0
Ending cash & cash equivalent	112.8	52.2	52.9	53.0

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F^	2025F^
Profitability				
EBITDA margin	50.2	49.4	49.9	49.8
Pre-tax margin	(73.0)	(179.5)	48.3	52.2
Net margin	(64.0)	(169.7)	46.0	49.7
ROA	n.a.	n.a.	5.2	5.4
ROE	n.a.	n.a.	10.4	9.5
Growth				
Turnover	9.4	(3.6)	(13.3)	0.5
EBITDA	3.5	(5.0)	(12.6)	0.4
Pre-tax profit	(464.5)	n.a.	n.a.	8.6
Net profit	(429.1)	n.a.	n.a.	8.4
Net profit (adj.)	26.4	(8.8)	(33.8)	6.6
EPU	14.7	(11.8)	(62.0)	(25.2)
Leverage				
Debt to total capital	50.2	57.0	40.5	41.8
Debt to equity	100.8	132.5	68.0	71.7
Net debt/(cash) to equity	89.8	124.0	62.0	65.8
Interest cover (x)	3.0	2.6	2.9	3.4

^ Fully diluted for 1,400:1,000 rights issue @ US$0.10.

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