

EQUITY RESEARCH

24 May 2023

Manulife US Real Estate Investment Trust

Largest US Office SREIT.

Company Overview

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

Investment Overview

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. This implies a capital raise of US\$175m is needed, implying a rights issue, while dilutive 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.

Risks

Key Risks to our view.

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.

Key financial data based on the closing price

Bloomberg Ticker	MUST SP
Sector	Real Estate
Share Price (USD)	0.17
DBS Rating	BUY
12-mth Target Price (USD)	0.24
Market Cap (USD\$b)	0.31
Volume (m shares)	32.21
Free float (%)	91.00
Dividend yield (%)	na
Net Debt to Equity (%)	0
Fwd. P/E (x)	na
P/Book (x)	na
ROE (%)	na

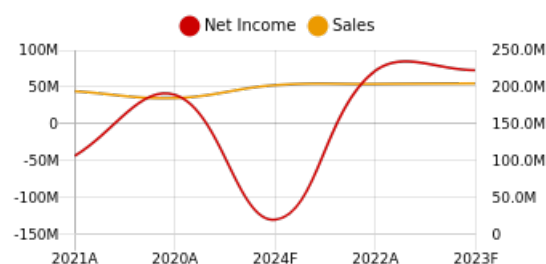
Source: Bloomberg Finance L.P.

Indexed Share Price vs Composite Index Performance



Source: Refinitiv

Revenue and Profit Trend (sample from CD SP)



Source: Company, DBS Bank

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FINANCIAL SUMMARY (USD, M)

FY Dec	FY2020A	FY2021A	FY2022A	FY2022F	FY2023F	FY2024F
Sales	194.3	185.1	202.6	0	204.1	204.9
% y-o-y	9.3	(4.7)	9.4	0	0.8	0.4
Gross Profit	115.8	109.5	113.2	0	128.2	129.4
% y-o-y	4.6	(5.4)	3.3	0	13.3	0.9
EBITDA	104.0	98.21	149.7	0	117.5	118.6
% y-o-y	5.7	(5.6)	52.4	0	(21.5)	0.9
Net Profit (Loss)	(43.28)	39.41	(129.7)	0	72.41	72.81
% y-o-y	0	0	0	98.4	nm	0.5
FCF	198.3	(140.3)	66.57	0	75.39	78.86
CAPEX	(24.17)	(230.9)	(25.41)	0	(2.04)	(3.07)
EBITDA Margin %	53.5	53.1	73.9	0	57.6	57.9
Net Margin %	(22.3)	21.3	(64.0)	0	35.5	35.5
ROA (%)	(2.0)	1.8	(5.9)	0	3.4	3.4
ROE (%)	(3.6)	3.4	(11.7)	0	7.1	7.1
Tax Rate %	0	2.8	0	1.0	1.0	1.0

Source: Company, DBS Bank

VALUATION METRICS (USD, M)

FY Dec	FY2020A	FY2021A	FY2022A	FY2022F	FY2023F	FY2024F
P/E	nm	9.6	nm	0	5.3	5.3
P/B	0	0	0	0	0	0
Dividend Yield	0	0	0	0	0	0
EV/EBITDA (x)	10.6	13.0	8.7	0	11.2	11.2
FCF Yield %	58.3	(37.0)	17.4	0	19.6	20.4

Source: Company, DBS Bank

CREDIT & CASHFLOW METRICS (USD, M)

FY Dec	FY2020A	FY2021A	FY2022A	FY2022F	FY2023F	FY2024F
Debt / Equity	0.7	0.8	1.0	0	1.0	1.0
Net Debt / Equity	0.7	0.8	0.9	0	0.9	0.9
Debt / Assets	0.4	0.4	0.5	0	0.5	0.5
Net Debt / Assets	0	0	0	0	0	0
EBITDA / Int Exp	3.5	3.4	4.4	0	2.6	2.6
ST Debt / Total Debt	0	0	0	0	0	0
Debt / EBITDA	8.2	9.9	6.9	0	8.9	9.0
[Cash + CFO] / ST Debt	0	0	0	0	0	0
Receivables Days	13.7	12.3	9.9	0	12.6	15.6
Days Payable	90.9	161.5	162.9	0	130.8	130.6
Inventory Days	0	0	0	0	0	0

Source: Company, DBS Bank

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WHAT'S NEW

Proposed Sponsor's acquisition of Phipps to move the gearing needle down

24 May 2023

- Letter of intent for the potential sale of Phipps Tower in Atlanta to Sponsor, Manulife
- Last valued at US\$210m, a transaction will potentially bring gearing down to 42%-43%
- Overhang of a potential sizable dilutive fund raising lifted but a smaller EFR still needed to bring gearing towards comfortable <40%
- Lapse of exclusivity with Mirae provides MUST with flexibility to pursue other partnerships

What has happened

Manulife US REIT ("MUST") announced that they have entered into a letter of intent with its Sponsor, The Manufacturers Life Insurance company "Manulife" for the potential sale of "Phipps Tower" located at 3438 Peachtree Road, Atlanta. The proposed divestment is subject to execution of a definitive agreement with the Sponsor with the purchase consideration to be done at no more than the average of two average independent valuations commissioned by the Manager and the Trustee, a price that is internally approved by the purchaser and subject to an extraordinary general meeting ("EGM") to be convened.

At the same time, the Manager announced that the exclusivity period regarding the potential transaction with Mirae Asset Global Investments ("Mirae") has lapsed. While the manager is open to ongoing discussions with Mirae, it is also considering other proposals with other partners in relation to a strategic transaction involving MUST.

Our view.

A deal that matters and move the needle; NAV dilution to be minimal. The potential transaction involving Phipps, which as of Dec'22 is valued at c.US\$210m (-2.8% y-o-o-y). The property roughly accounts for c.10% of its asset value and in our view, is one of the gems in the portfolio which has historically shown resilient cashflows. While the potential sale of a property with strong property attributes could mean that the impact from occupancy challenges from its other existing properties is amplified, we see this as potential "bitter pill" to take in order to bring forth more stability for the portfolio.

Based on our estimates, assuming a sale at US\$200m (5% discount to last valuation) with proceeds used to repay debt, this will bring its gearing down towards the 42%-43% level, which will cure the perception of its stretched balance sheet (gearing of 49%) that the REIT per last report for 1st quarter 2023. Based on the reported US\$12.2m net property income for FY22, our assumed transaction price of US\$200m will imply an exit yield of c.6.0%.

Risk of sizable equity fund raising ("EFR") is reduced substantially. Post a deleveraging of its balance sheet to 42%-43%, the risk of a sizable dilutive fund raising (est at US\$175m) is reduced and a possible lift in the share price overhang of the stock. That said, we believe that a capital raise of US\$50m to US\$75m to bring gearing towards the 38%-39% level, a strategy that we believe, is still in consideration.

Our read on Mirae. The lapse of the exclusivity with Mirae provides MUST with the flexibility to pursue other strategic investments or mergers & acquisitions with other interested platforms. Over time, investors will want to see more commitment with the sponsor (Manulife or new investors) to support the REIT in its growth journey.

Stock price rebound. We anticipate a near term relief rally on the stock. While stock is up c.20% yesterday to US\$0.17/unit, it is still trading at 0.3x P/B and offering a forward yield of c.24%-25% (pre-disposal). We maintain our target of US\$0.25/unit and believe that a revision (higher) will be subject to the outcomes from its strategic review and EFR that is yet to be announced.

PRINCIPAL SHARE PRICE DRIVERS

Distribution per unit (DPU)

DPU growth led by organic growth from c.2% annual escalation and potential upside from under-rented rents in most of its office buildings.

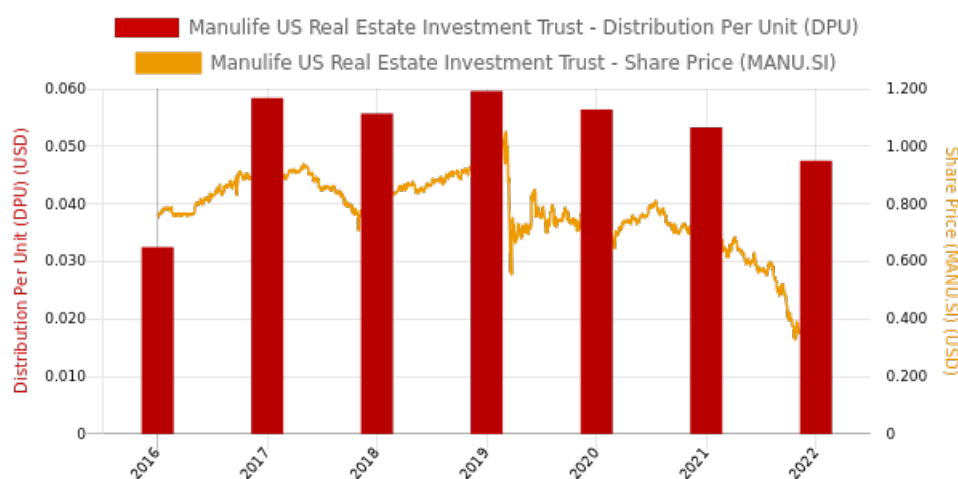
29 Nov 2020

Organic growth with inbuilt c.2% of annual escalation. MUST's properties are well positioned to experience strong organic growth delivered through inbuilt rental escalations embedded into their lease contracts. MUST's portfolio has inbuilt annual rental escalations of c.2% on average.

Under-rented rents in most of its office buildings. Most of its office buildings have passing rents that are still below or close to market rents except Michelson Centrepointe where they command premium rents due to the premium quality of the buildings in their respective sub-market. MUST can gain upside from positive reversions upon lease expiries, given majority of its office buildings passing rents are from close to market rents up to 20% below market rents.

Long WALE offers strong income visibility. With leases typically signed on a 3- to 10-year lease and some in excess of 10 years, MUST's portfolio enjoys a long WALE of c.6 years with only 7% leases expiring in FY21.

Manulife US Real Estate Investment Trust - Share Price (MANU.SI) vs. Distribution Per Unit (DPU)



Acquisitions

Acquisition-led growth a key strategy and another index inclusion to be a future catalyst.

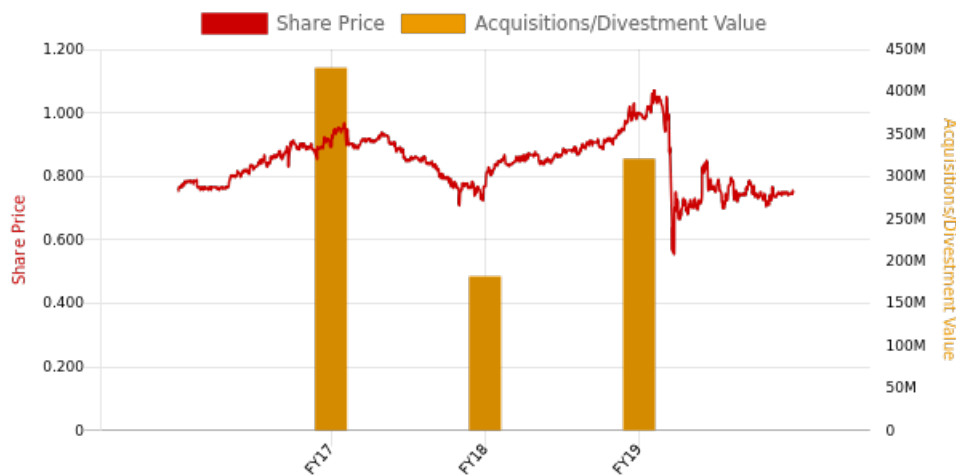
29 Nov 2020

Acquisition-led growth leading to index inclusion and greater investor visibility. Acquisitions and inorganic growth remain to be one of the core strategies for MUST and has been a key enabler of DPU growth. Since listing, MUST has grown from a portfolio of only 3 properties to the current 9 properties worth close to US\$2.0b. This has eventually led to inclusion into FTSE EPRA Nareit Global Developed Index in Dec19 which saw share price re-rate. We believe MUST will continue to grow in size via acquisitions with potential inclusion into another index would be a catalyst in the longer term.

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Manulife US Real Estate Investment Trust - Acquisitions/Divestment Value vs. Share Price



Yield Curve

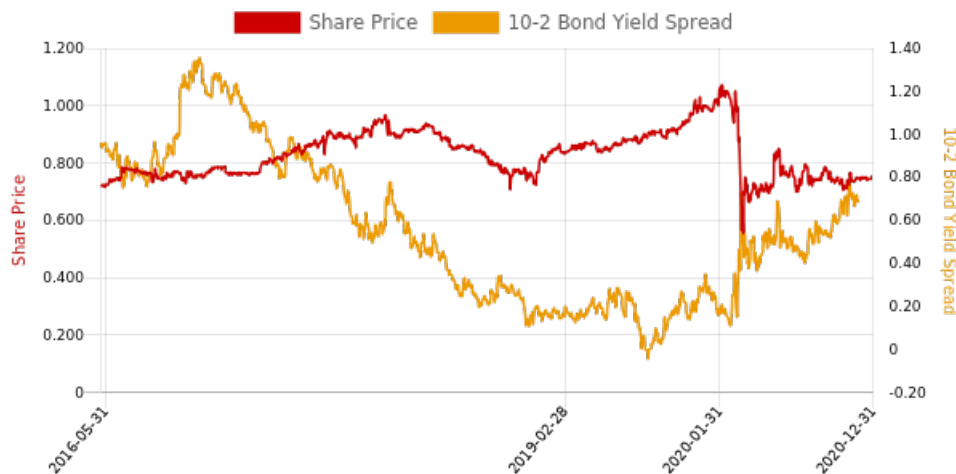
MUST offers attractive yield spread of more than 7% with US interest rates expected to remain low for a longer period.

29 Nov 2020

Attractive yield spread as interest rates are expected to remain low for longer. As interest rates are expected to remain low for a longer period especially in the US, MUST offers very attractive yield spread of more than 7% for investors despite challenges from COVID-19.

Interest savings from higher proportion of debt with floating rates and refinancing yet to be included in estimates. With lower base rates, debt with floating rates and refinancing of its expiring loans in the coming years will mean potential savings. Evidently, MUST's average cost of debt has been on a downward trend since 4Q19.

United States of America - 10-2 Bond Yield Spread vs. Manulife US Real Estate Investment Trust - Share Price



USD/SGD rate

Riding on the strengthening of USD with yield and tax-free.

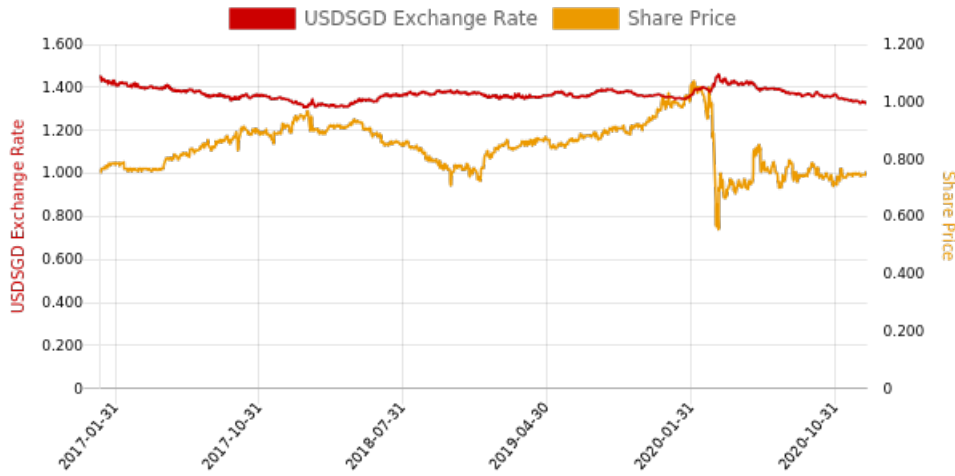
29 Nov 2020

A proxy to USD with yield and tax-free. Given its share price and DPU is in USD, MUST is seen as a proxy to USD with yield and tax-free. In cycles where USD is on an upward trend, we see MUST share price could remain resilient with the upside from the currency.

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- USDSGD Exchange Rate vs. Manulife US Real Estate Investment Trust
- Share Price



PROFILE

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FORECASTS AND VALUATION (USD, M)

FY Dec	FY2020A	FY2021A	FY2022A	FY2022F	FY2023F	FY2024F
Gross Revenue	194.3	185.1	202.6	0	204.1	204.9
Net Property Inc	115.8	109.5	113.2	0	128.2	129.4
Total Return	(43.28)	39.41	(129.7)	0	72.41	72.81
Distribution Inc	88.97	85.60	87.87	0	81.21	81.85
EPU (USD)	(0.027)	0.022	(0.073)	0	0.041	0.040
EPU Gth (%)	0	0	0	97.5	(6.5)	(0.3)
DPU (USD)	0.056	0.053	0.048	0	0.041	0.041
DPU Gth (%)	(5.4)	(5.5)	(10.9)	0	(13.0)	(0.0)
NAV per shr (USD)	0.731	0.673	0.574	0	0.575	0.574
PE (x)	nm	9.6	nm	0	5.3	5.3
Distribution Yield (%)	26.2	24.8	22.1	0	19.2	19.2
P/NAV (x)	0.3	0.3	0.4	0	0.4	0.4
Aggregate Leverage (%)	40.8	42.7	48.6	0	48.8	49.1
ROAE (%)	(3.6)	3.4	(11.7)	0	7.1	7.1

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INCOME STATEMENT (USD, M)

FY Dec	FY2020A	FY2021A	FY2022A	FY2022F	FY2023F	FY2024F
Gross revenue	194.3	185.1	202.6	0	204.1	204.9
Property expenses	(78.47)	(75.55)	(89.40)	0	(75.91)	(75.54)
Net Property Income	115.8	109.5	113.2	0	128.2	129.4
Other Operating expenses	(11.83)	(11.34)	(11.49)	0	(10.73)	(10.79)
Other Non Opg (Exp)/Inc	(0)	(0)	48.01	0	(0)	(0)
Associates & JV Inc	(0)	(0)	(0)	0	(0)	(0)
Net Interest (Exp)/Inc	(29.57)	(29.12)	(33.89)	0	(44.35)	(45.07)
Exceptional Gain/(Loss)	(140.4)	(28.53)	(263.6)	0	(0)	(0)
Net Income	(65.98)	40.56	(147.8)	0	73.14	73.54
Tax	22.70	(1.14)	18.12	0	(0.731)	(0.735)
Minority Interest	(0)	(0)	(0)	0	(0)	(0)
Preference Dividend	(0)	(0)	(0)	0	(0)	(0)
Net Income After Tax	(43.28)	39.41	(129.7)	0	72.41	72.81
Total Return	(43.28)	39.41	(129.7)	0	72.41	72.81
Non-tax deductible Items	132.3	46.19	217.6	0	8.79	9.04
Net Inc available for Dist.	88.97	85.60	87.87	0	81.21	81.85
Revenue Gth (%)	9.3	(4.7)	9.4	0	0.8	0.4
N Property Inc Gth (%)	4.6	(5.4)	3.3	0	13.3	0.9
Net Inc Gth (%)	0	0	0	98.4	(5.7)	0.5
Dist. Payout Ratio (%)	100.0	100.0	95.7	0	91.0	91.0
Net Prop Inc Margins (%)	59.6	59.2	55.9	0	62.8	63.1
Net Income Margins (%)	(22.3)	21.3	(64.0)	0	35.5	35.5
Dist to revenue (%)	45.8	46.2	43.4	0	39.8	39.9
Managers & Trustee's fees to sales (%)	6.1	6.1	5.7	0	5.3	5.3
ROAE (%)	(3.6)	3.4	(11.7)	0	7.1	7.1
ROA (%)	(2.0)	1.8	(5.9)	0	3.4	3.4
ROCE (%)	5.3	4.8	5.1	0	6.0	6.0
Int. Cover (x)	3.5	3.4	3.0	0	2.6	2.6

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BALANCE SHEET (USD, M)

FY Dec	FY2020A	FY2021A	FY2022A	FY2022F	FY2023F	FY2024F
Investment Properties	1,993	2,184	1,947	0	1,966	1,987
Other LT Assets	(0)	5.65	47.66	0	47.66	47.66
Cash & ST Invts	86.67	78.58	112.9	0	114.4	118.7
Inventory	(0)	(0)	(0)	0	(0)	(0)
Debtors	6.93	5.55	5.40	0	8.74	8.77
Other Current Assets	1.66	1.44	2.93	0	2.93	2.93
Total Assets	2,088	2,276	2,116	0	2,140	2,165
ST Debt	233.6	296.6	144.6	0	144.6	144.6
Creditor	18.10	58.77	31.27	0	30.84	30.96
Other Current Liab	6.88	8.25	8.50	0	8.50	8.50
LT Debt	618.7	674.6	884.4	0	901.5	918.9
Other LT Liabilities	52.91	49.60	26.78	0	26.78	26.78
Unit holders' funds	1,158	1,188	1,020	0	1,028	1,035
Minority Interests	(0)	(0)	(0)	0	(0)	(0)
Total Funds & Liabilities	2,088	2,276	2,116	0	2,140	2,165
Non-Cash Wkg. Capital	(16.39)	(60.02)	(31.43)	0	(27.66)	(27.75)
Net Cash/(Debt)	(765.6)	(892.7)	(916.1)	0	(931.7)	(944.8)
Current Ratio (x)	0.4	0.2	0.7	0	0.7	0.7
Quick Ratio (x)	0.4	0.2	0.7	0	0.7	0.7
Aggregate Leverage (%)	40.8	42.7	48.6	0	48.8	49.1

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CASH FLOW STATEMENT (USD, M)

FY Dec	FY2020A	FY2021A	FY2022A	FY2022F	FY2023F	FY2024F
Pre-Tax Income	74.43	40.56	(147.8)	0	73.14	73.54
Dep. & Amort.	(0.684)	1.93	4.35	0	()	()
Tax Paid	(1.92)	(0.134)	(0.065)	0	(0.731)	(0.735)
Associates & JV Inc/(Loss)	()	()	()	0	()	()
Chg in Wkg.Cap.	(36.61)	(20.84)	1.25	0	(3.77)	0.086
Other Operating CF	187.2	69.11	234.3	0	8.79	9.04
Net Operating CF	222.5	90.63	91.99	0	77.43	81.93
Net Invt in Properties	(24.17)	(230.9)	(25.41)	0	(2.04)	(3.07)
Other Invts (net)	()	()	()	0	()	()
Invts in Assoc. & JV	()	()	()	0	()	()
Div from Assoc. & JVs	()	()	()	0	()	()
Other Investing CF	0.166	0.021	0.046	0	(17.12)	(17.40)
Net Investing CF	(24.01)	(230.9)	(25.37)	0	(19.16)	(20.47)
Distribution Paid	(70.74)	(83.97)	(88.62)	0	(73.90)	(74.48)
Chg in Gross Debt	38.57	215.5	56.00	0	17.12	17.40
New units issued	()	0.700	0.253	0	()	()
Other Financing CF	()	()	()	0	()	()
Net Financing CF	(32.16)	132.2	(32.37)	0	(56.78)	(57.08)
Currency Adjustments	0.053	(0.010)	0.031	0	()	()
Chg in Cash	166.3	(8.09)	34.28	0	1.50	4.38
Operating CFPS (USD)	0.164	0.063	0.051	0	0.045	0.045
Free CFPS (USD)	0.125	(0.080)	0.037	0	0.042	0.044

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RECOMMENDATION DEFINITION

DBS Group Research 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

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

Target Price & Ratings History



#	Date of Report	Closing Price	12-m Target Price	Rating
1	26 May'22	0.59	0.70	Buy
2	03 Nov'22	0.36	0.48	Buy

Analysts: Rachel Tan

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