

Manulife US REIT

Leasing recovery overpowered by occupancy loss



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SINGAPORE | REAL ESTATE (REIT) | FY21 UPDATE

16 February 2022

- FY21 DPU of 5.33 US cts (-5.5 % YoY) was a miss, forming 93% of our forecast, due to lower-than-forecasted portfolio occupancy.
- Occupancy slid 1.1 ppts on non-renewals and downsizing, but US office market is showing signs of recovery. Leasing momentum doubled YoY, while net effective rents improved 3.4% YoY.
- Upgrade from ACCUMULATE to BUY; DDM-based TP (COE 9.1%) raised from US\$0.84 to US\$0.86. FY21 occupancy came in lower than we anticipated. As such, we lower FY22e-24e DPUs by 2.1-6.3% to factor in the gradual recovery in occupancy from the current, lower-than-forecasted portfolio occupancy. DDM-TP rises due to higher later-period DPU forecasts. The US office market appears to be at an inflection point, showing recovery in leasing momentum. Catalysts include stronger-than-expected leasing and portfolio reconstitution. Current share price implies FY22e/FY23e DPU yield of 8.6%/8.9%.

BUY (Upgraded)

LAST CLOSE PRICE	USD 0.655
FORECAST DIV	USD 0.057
TARGET PRICE	USD 0.860
TOTAL RETURN	39.9%

COMPANY DATA

BLOOMBERG CODE:	MUST SP
O/S SHARES (MN) :	1,600
MARKET CAP (USD mn / SGD mn) :	1149 / 1149
52 - WK HI/LO (SGD) :	0.82 / 0.63
3M Average Daily T/O (mn) :	2.20

MAJOR SHAREHOLDERS (%)

MANULIFE FINANCIAL CORP	5.3%
PRUDENTIAL PLC	4.5%
DRACHS INV 3 LTD	4.4%
VANGUARD GROUP INC	3.3%

Results at a glance

(USD mn)	2H21	2H20	YoY	FY21	FY20	YoY	Comments
Gross revenue	94.3	95.7	-1.4%	185.1	194.3	-4.7%	Due to lower occupancy of 92.3% (FY20: 93.4%), carpark income (-11.2% YoY)
Net property income	53.5	53.7	-0.3%	109.5	115.8	-5.4%	Due to higher rental abatement of 1.4% of GRI (FY20: 0.5% of FY20 GRI), partially offset by net reversal of expected credit loss of US\$1.7mn
Distributable income	42.6	41.0	+4.0%	85.6	89.0	-3.8%	
DPU (cents)	2.63	2.59	+1.5%	5.33	5.64	-5.5%	

Source: Company, PSR

The Positive

+ Leasing momentum doubled YoY with net effective rents improving 3.4%. MUST signed 654k sq ft, or 12% of NLA, in FY21, 2.3x the NLA executed in FY20. Traditional office tenants such as finance and insurance and government agencies accounted for 47% and 20% of leases signed. Reversions came in at -0.8% (FY20: +0.1%), weighed down by leases signed at Michelson. Michelson's expiring rents were above market rents due to the 2-3% annual escalation on long leases, leading to negative reversions when the leases were renewed at market rates. Excluding leases signed at Michelson, reversions would have been +3.3% (FY20: +4.7%). More importantly, net effective rents grew 3.4% YoY, as the rent-free period and tenant incentives eased. While improving, net effective rents are still 10-15% below pre-pandemic levels. Leases signed in FY21 were for an average term of 4.0 years, slightly shorter than the 6.4 years for leases signed in FY20.

The Negative

- Occupancy hurt by non-renewals and downsizing. Portfolio occupancy slid 1.1ppts YoY to 92.3%, 3.5ppts below FY19 levels. This compares with the average occupancy of 88.2% for Class A offices. Lower occupancy was due to non-renewals and downsizing with notable occupancy losses at Figueroa (-4.4 ppts), Penn (-5.4 ppts), Phipps (-5.5 ppts) and Capitol (-5.0 ppts).

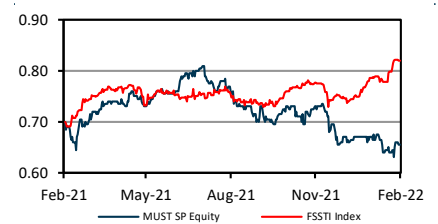
Outlook

FY21 physical occupancy at MUST's properties ranged from 25-30%. MUST provided rental abatement of US\$2.4mn, or 1.4% of GRI, for F&B and retail tenants in FY21 (FY20: 0.5% of GRI). More pronounced return-to-office is expected to lift carpark income and lower rental abatement burden.

PRICE PERFORMANCE (%)

	1MTH	3MTH	YTD
COMPANY	0.0	(4.8)	0.3
STI RETURN	4.4	6.0	9.7

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec, USD mn	FY20	FY21	FY22e	FY23e
Gross Rev. (USD mn)	194	185	214	224
NPI (USD mn)	116	110	127	132
Dist. Inc. (USD mn)	89	86	100	105
P/NAV (x)	0.90	0.97	0.98	1.00
DPU (US cents)	5.64	5.33	5.66	5.85
Distribution Yield (%)	8.61	8.14	8.64	8.93

Source: Company, PSR

VALUATION METHOD

DDM (COE: 9.1%; Terminal Growth: 2%)

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The US office market continues to show signs of recovery. This can be seen from (1) improving net effective rents; (2) lower TIs; (3) longer lease tenures signed; (4) decline in subleasing; and (5) improving rental growth outlook for MUST's cities. About 8.1% of GRI is up for renewal. FY22 renewals could yield positive reversions, given that passing rents are 2.1% below market rents.

Future acquisition is still focused on markets with high representation of tech, healthcare and life science tenants. MUST is eyeing assets with cap rates ranging 6.5% to 7.5% in sunbelt and magnet cities -- Seattle, Salt Lake City, Austin, Boston, and Raleigh. Following the acquisition of three properties in Phoenix and Portland in Dec21, MUST's exposure to tech and healthcare tenants increased from 9.5% to 12.8% of GRI. It hopes to increase its exposure to new economy tenants to 20% of GRI.

Upgrade from Accumulate to BUY, DDM TP raised from US\$0.84 to US\$0.86

FY21 occupancy came in lower than we anticipated. As such, we lower FY22e-24e DPUs by 2.1-6.3% to factor in the gradual recovery in occupancy from the current, lower-than-forecasted portfolio occupancy. DDM-TP rises due to higher later-period DPU forecasts. The US office market appears to be at an inflection point, showing recovery in leasing momentum. Catalysts include stronger-than-expected leasing and portfolio reconstitution. Current share price implies FY22e/FY23e DPU yield of 8.6%/8.9%.

Figure 1: Portfolio metrics at a glance

	NPI (US\$mn)			YoY	Occupancy			YoY ppts	Valuation (US\$mn)			YoY
	FY19	FY20	FY21		FY19	FY20	FY21		FY19	FY20	FY21	
Figuroa	16.0	14.5	13.9	-4.1%	93.8%	93.0%	88.6%	-4.4	337.6	320.0	315.2	-1.5%
Michelson	19.0	16.0	13.2	-17.5%	90.1%	84.4%	87.2%	2.8	345.0	319.0	317.0	-0.6%
Peachtree	13.0	11.2	10.9	-2.7%	95.0%	90.4%	90.8%	0.4	210.7	203.1	212.9	4.8%
Plaza	9.0	7.3	9.7	32.9%	98.9%	96.7%	96.7%	0.0	119.9	114.6	106.0	-7.5%
Exchange	21.0	18.9	17.9	-5.3%	95.8%	94.8%	97.7%	2.9	348.6	333.0	324.0	-2.7%
Penn	10.2	10.2	9.8	-3.9%	100.0%	99.2%	93.8%	-5.4	189.0	176.5	177.3	0.5%
Phipps	13.2	12.4	11.9	-4.0%	100.0%	100.0%	94.5%	-5.5	220.1	212.1	216.0	1.8%
Centerpointe	6.8	11.0	9.8	-10.9%	98.7%	91.7%	91.6%	-0.1	122.8	118.5	112.7	-4.9%
Capitol	2.6	14.3	11.9	-16.8%	94.2%	93.3%	88.3%	-5.0	201.3	196.0	197.0	0.5%
Total	110.8	115.8	109.0	-5.9%	95.8%	93.4%	92.3%	-1.1	2,095.0	1,992.8	1,978.1	-0.7%

Note: Centrepointe and Capitol were acquired on 10 May 19 and 29 Oct 19 respectively. Excludes Tanasbourne, Park Place and Diablo which were acquired in Dec21

Source: Manulife US REIT, PSR

Financials

Statement of Total Return and Distribution Statement

Y/E Dec, USD mn	FY19	FY20	FY21	FY22e	FY23e
Gross revenue	177.9	194.3	185.1	213.9	223.5
Property operating expenses	(67.1)	(78.5)	(75.6)	(87.3)	(91.2)
Net property income	110.8	115.8	109.5	126.6	132.3
Net Finance (Expense)/Inc.	(25.7)	(29.6)	(29.1)	(30.1)	(31.0)
Manager's base fee	(9.7)	(8.9)	(8.6)	(9.7)	(10.2)
Other items	(2.7)	(2.9)	(2.8)	(3.0)	(3.2)
Net income	72.6	74.4	69.1	83.8	88.0
FV change, derivatives & pptides	(13.5)	(128.5)	(42.4)	-	-
Total Return Before Tax	58.0	(66.0)	40.6	83.8	88.0
Taxation	(10.5)	22.7	(1.1)	(2.4)	(2.5)
Total Return After Tax	47.6	(43.3)	39.4	81.4	85.5
Distribution adjustments	35.8	132.3	46.2	18.6	19.2
Income available for distribution	83.3	89.0	85.6	100.0	104.7

Per unit data

Y/E Dec	FY19	FY20	FY21	FY22e	FY23e
NAV (US\$)	0.80	0.73	0.68	0.67	0.66
DPU (US cents)	5.96	5.64	5.33	5.66	5.85

Cash Flow

Y/E Dec, USD mn	FY19	FY20	FY21	FY22e	FY23e
CFO					
Total Return Before Tax	58.0	(66.0)	40.6	83.8	88.0
Adjustments	50.6	186.6	71.0	43.8	45.3
WC changes	2.6	(8.8)	6.1	(35.2)	1.3
Cash generated from ops	111.2	111.8	117.7	92.4	134.6
Others	(1.2)	(1.9)	(0.1)	(0.2)	(0.2)
Cashflow from ops	110.1	109.9	117.6	92.3	134.5
CFI					
Purchase of Inv. propty., net	(311.0)	-	(201.0)	-	-
Capex, net	(45.0)	(24.2)	(30.0)	(9.5)	(9.5)
Others	(1.2)	(1.9)	(0.1)	(0.2)	(0.2)
Cashflow from investments	(355.5)	(24.0)	(230.9)	(9.5)	(9.5)
CFF					
Share issuance, net	236.7	-	100.0	-	-
Loans, net of repayments	146.1	39.6	118.5	-	-
Interest paid	(23.9)	(27.9)	(26.9)	(27.6)	(28.6)
Distributions	(99.4)	(70.7)	(84.0)	(99.9)	(104.5)
Others	(1.2)	(1.9)	(0.1)	(0.2)	(0.2)
Cashflow from financing	252.1	(60.0)	105.3	(130.0)	(135.6)
Net change in cash	6.6	25.9	(8.1)	(47.2)	(10.6)
Effects of exchange rate	0.0	0.1	(0.0)	-	-
Ending cash	60.7	86.7	78.6	31.3	20.8

Source: Company, Phillip Securities Research (Singapore) Estimates

Balance Sheet

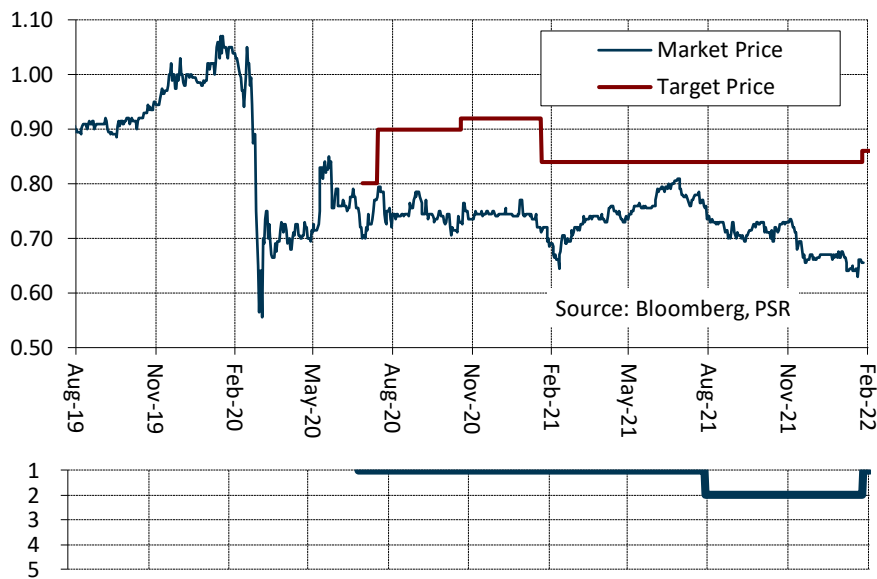
Y/E Dec, USD mn	FY19	FY20	FY21	FY22e	FY23e
ASSETS					
Investment properties	2,095.0	1,992.8	2,184.4	2,195.4	2,206.4
Others	0.5	-	5.7	5.7	5.7
Total non-current assets	2,095.5	1,992.8	2,190.1	2,201.1	2,212.1
Trade receivables	7.6	6.9	5.6	11.7	11.7
Cash	60.7	86.7	78.6	31.3	20.8
Others	0.5	-	5.7	5.7	5.7
Total current assets	71.0	95.3	85.6	44.5	33.9
Total Assets	2,166.5	2,088.1	2,275.6	2,245.5	2,245.9
LIABILITIES					
Current borrowings	78.9	233.6	296.6	206.9	244.9
Trade payables	26.9	18.1	58.8	30.1	31.3
Others	0.5	-	5.7	5.7	5.7
Total current liabilities	110.9	258.6	363.7	245.4	284.6
Non-current borrowings	733.1	618.7	674.7	764.4	726.4
Others	0.5	-	5.7	5.7	5.7
Total non-current liabilities	797.3	671.5	720.5	811.9	776.3
Total Liabilities	908.2	930.1	1,084.2	1,057.3	1,060.9
Net assets	1,258.3	1,158.0	1,191.4	1,188.2	1,185.0
Represented by:					
Unitholders' funds	1,258.2	1,157.9	1,187.7	1,184.5	1,181.3
Perp. securities holders	0.1	0.1	0.8	0.8	0.8

Valuation Ratios

Y/E Dec	FY19	FY20	FY21	FY22e	FY23e
P/NAV (x)	0.82	0.90	0.97	0.98	1.00
Distribution Yield	9.1%	8.6%	8.1%	8.6%	8.9%
NPI yield	5.8%	5.7%	5.2%	5.8%	6.0%

Growth & Margins (%)

	FY19	FY20	FY21	FY22e	FY23e
Growth					
Revenue	n.m.	9.3%	-4.7%	15.5%	4.5%
Net property income (NPI)	n.m.	4.6%	-5.4%	15.6%	4.5%
Distributable income	n.m.	6.8%	-3.8%	16.8%	4.7%
DPU	n.m.	-5.4%	-5.5%	6.2%	3.4%
Margins					
NPI margin	62.3%	59.6%	59.2%	59.2%	59.2%
Key Ratios					
Net Debt or (Net Cash)	751	766	893	940	951
Gearing (%)	37.5%	40.8%	42.7%	43.3%	43.2%

Ratings History

PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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