

Company update

Manulife US REIT

Singapore | Real Estate

Rating BUY (as at 5 August 2022)

Last Close USD 0.60

Fair Value USD 0.69

Changing office trend

- **1H22 DPU declined 3.3% YoY to 2.61 US cents**
- **Downsizing of tenants**
- **Expecting low to mid single digit positive rental reversion in 2022**

Investment thesis

Manulife US REIT's (MUST) 1H22 distribution per unit (DPU) dropped 3.3% year-on-year (YoY) to 2.61 US cents due to higher vacancies at existing properties and an enlarged unit base from private placement, in-line with our expectations. Physical occupancy rate at MUST's properties remained subdued at 28% as at 11 Jul 2022, as compared to 25.3% in 1Q22. As at 30 Jun 2022, portfolio occupancy was at 90.0% (-1.7 percentage points (ppt) quarter-on-quarter (QoQ)) due to non-renewals of three large tenants. Rental reversion for 1H22 came in at +1%. While management continues to expect positive low to mid single digit of rental reversion for 2022, they noted that leasing activity and office demand have slowed down in the US. MUST benefitted from a flight to quality which remains the dominant trend of the office market. However, tenant space needs remained unclear, and most tenants are still downsizing which is likely to continue. We trim our DPU estimates by 3-7% for FY22-26 on lower occupancy estimates. After adjustments, our fair value estimate decreases from USD0.77 to USD0.69.

Investment summary

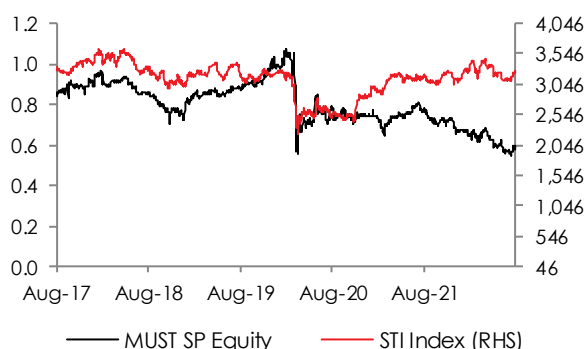
- **1H22 DPU met expectations** – MUST's 1H22 gross revenue and NPI grew 10.6% and 2.8% YoY to USD100.4m and USD57.6m, respectively, driven by additional contributions from acquisitions, lower rental abatements of USD200k (vs USD2m in 1H21), and higher carpark income. However, the growth was partially offset by lower rental income from existing properties due to lower occupancy rates and the absence of credit loss reversal. 1H22 DPU dropped 3.3% YoY to 2.61 US cents due to an enlarged unit base from private placement, representing 48% of our initial expectations, in-line.
- **Portfolio occupancy fell 1.7 ppt QoQ to 90%** – Physical occupancy rate at MUST's properties remained

Chu Peng
 Equity Research

Security information

Ticker	MUST SP
Market Cap (USD b)	1.0
Daily turnover (USD m)	1.5
Free Float	91%
Shares Outstanding (m)	1,764
Top Shareholder	MANULIFE FINANCIAL C 5.6%

Price performance chart



Financial summary

USD m	FY21	FY22E	FY23E
Gross revenue	185.1	208.8	216.0
Net property income	109.5	125.3	133.8
Total amt. avail for distribtn.	85.6	90.1	95.8
Distrib. per unit (US cents)	5.3	5.1	5.3

Key ratios

	FY21	FY22E	FY23E
DPU yield (%)	9.0	8.5	8.9
P/NAV (x)	0.9	0.8	0.8
NPI margin (%)	59.2	60.0	61.9
Gross gearing (%)	42.7	41.6	40.0

Source: Bloomberg, REIT manager, Internal estimates

subdued at 28% as at 11 Jul 2022, as compared to 25.3% in 1Q22. As at 30 Jun 2022, portfolio occupancy was at 90.0% (-1.7 ppt QoQ) due to non-renewals of three large tenants. MUST is in active discussions with the prospects to backfill the space. TCW Group and Quinn Emanuel, two of MUST's top 10 tenants had informed MUST of their non-renewal/downsizing decisions. TCW accounts for 3.8% of MUST's gross rental income (GRI) indicated that they will vacate the space when their lease expires in Dec 2023 to avoid major renovation. Quinn Emanuel (2.9% of GRI) will downsize by 71k square feet (sq ft) effective 31 Aug 2022 but will renew the remaining 64k sq ft for 5.4 years from Sep 2023 with +2.5% rental reversion.

- **Exploring opportunities to reinvent office space** – MUST executed 192,000 sq ft of space in 1H22 with +1% rental reversion (1Q22: +3.9%; 2Q22: flat). While management continues to expect positive low to mid single digit of rental reversion for 2022, they noted that leasing activity and office demand have slowed down in the US. Tenant space needs remained unclear and most tenants are still downsizing. MUST expects the downsizing trend to continue as hybrid working models will stay and impact space needs. Management believes hotelisation of office could be the new normal ahead. MUST is partnering with best-in-class flex operators, e.g. Flex by JLL, to explore opportunities to provide flexible office solutions and reinvent office space.
- **Fair value estimate of USD0.69** – We believe MUST will benefit from a flight to quality which remains the dominant trend of the US office market, and the impact of vacancy risks will be buffered by its low lease expiry profile (4.8% GRI in 2H22 and 10.1% of GRI in 2023). We trim our DPU estimates by 3-7% for FY22-26 on lower occupancy estimates. After adjustments (risk-free rate: 3.5%; cost of equity: 8.5%), our fair value estimate decreases from USD0.77 to USD0.69.

ESG Updates

- Manulife US REIT's (MUST) ESG rating was upgraded in Dec 2021, mainly due to its robust efforts to further increase the proportion of green-certified buildings in its portfolio (89% vs the industry average of 37.8% in 2020). Additionally, MUST falls into the highest scoring range relative to global peers in terms of corporate governance. However, MUST shows lagging efforts to attract and retain talent relative to peers according to research.

Potential catalysts

- Stronger-than-expected portfolio rental reversions
- DPU accretive acquisitions

Results highlights

USD m	1H21	1H22	% chg
Gross revenue	90.8	100.4	10.6%
Property expenses	-34.7	-42.8	23.2%
Net property income	56.1	57.6	2.8%
Management fees	-4.3	-4.6	6.9%
Trust expenses	-0.1	-0.2	6.4%
Net finance costs	-14.7	-15.3	4.3%
Net income bef. rev. aluatn.	35.7	36.1	1.3%
Net income	6.7	62.8	nm
Net Income for distrb.	43.0	46.0	6.9%
DPU (US cents)	2.70	2.61	-3.3%

Source: REIT manager

Investment risks

- Slowdown in macroeconomic conditions may stifle business sentiment
- Weaker-than-expected leasing momentum

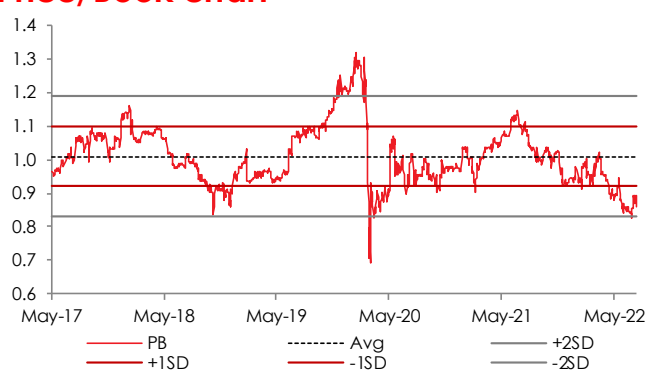
- Stronger-than-expected recovery in industry demand-supply dynamics
- Rental arrears and tenant defaults

Valuation analysis

	Price/Earnings		Price/Book		EV/EBITDA		Dividend Yield (%)		ROE (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
MANULIFE US REAL ESTATE INVEST (MUST SP)	12.0	12.2	0.9	0.9	16.4	16.3	9.2	9.6	7.1	7.2
PRIME US REIT (PRIME SP)	11.2	10.2	0.8	0.8	14.9	14.1	9.8	9.9	7.5	8.3
KEPPEL PACIFIC OAK US REIT (KORE SP)	12.9	13.7	0.8	0.8	13.2	13.0	8.9	8.8	7.6	7.7
KEPPEL REIT (KREIT SP)	21.2	20.8	0.8	0.8	46.0	44.5	5.5	5.5	3.5	3.8
CAPITALAND INTEGRATED COMMERCIAL (CICL SP)	19.0	16.6	1.0	1.0	25.1	22.8	5.3	5.6	5.5	6.5

Source: Bloomberg

Price/Book chart



Source: Bloomberg

Dividend Yield chart



Source: Bloomberg

Company overview (as of 31 December 2021)

Company description

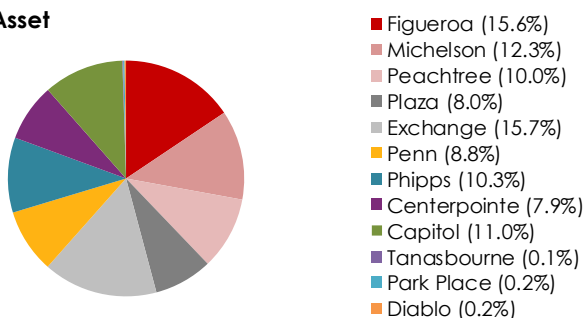
Manulife US Real Estate Investment Trust (MUST) is a Singapore-based real estate investment trust (REIT). The Trust is focused on investing in a portfolio of office real estate in markets in the United States, as well as real estate-related assets.

MUST's portfolio comprises 12 freehold office properties in Arizona, California, Georgia, New Jersey, Oregon, Virginia and Washington D.C. The current portfolio has an aggregate net lettable area of 5.4 million sq ft and is valued at US\$2.2 billion as at 31 December 2021.

The Trust's manager is Manulife US Real Estate Management Pte. Ltd.

FY21 Gross Revenue Breakdown

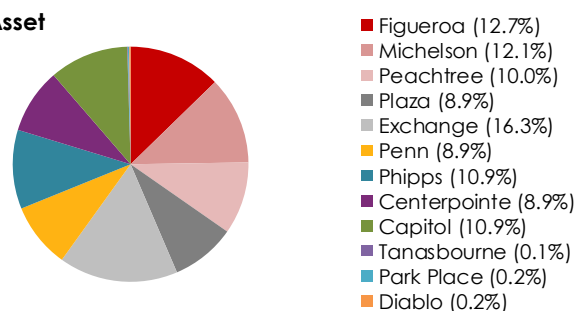
By Asset



Source: REIT manager

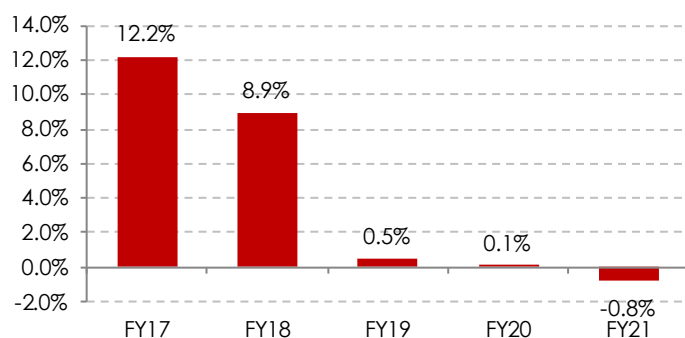
FY21 Net Property Income Breakdown

By Asset



Source: REIT manager

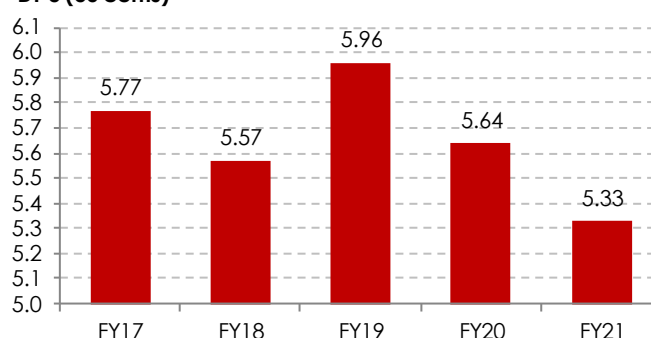
Portfolio Rental Reversions



Source: REIT manager

Distribution per unit

DPU (US cents)



Source: REIT manager

Company financials

Income Statement

In Millions of USD except Per Share 12 Months Ending	FY 2017 31/12/2017	FY 2018 31/12/2018	FY 2019 31/12/2019	FY 2020 31/12/2020	FY 2021 31/12/2021
Revenue	92.0	144.6	177.9	194.3	185.1
- Cost of Revenue	—	—	—	—	—
Gross Profit	—	—	—	—	—
+ Other Operating Income	0.9	0.9	0.5	1.9	2.4
- Operating Expenses	5.8	8.3	9.8	15.0	11.3
Operating Income or Losses	51.9	81.3	98.4	104.0	98.2
- Interest Expense	9.5	19.0	26.0	29.4	28.7
- Foreign Exchange Losses (Gains)	—	—	—	—	—
- Net Non-Operating Losses (Gains)	-31.4	-16.8	14.3	140.6	28.9
Pretax Income	73.8	79.2	58.0	-66.0	40.6
- Income Tax Expense (Benefit)	15.8	14.7	10.5	-22.7	1.1
Income Before XO Items	58.0	64.5	47.6	-43.3	39.4
- Extraordinary Loss Net of Tax	0.0	0.0	0.0	0.0	0.0
- Minority/Non Controlling Interests (Credits)	0.0	0.0	0.0	0.0	0.0
Net Income/Net Profit (Losses)	58.0	64.5	47.6	-43.3	39.4
Net Inc Avail to Common Shareholders	58.0	64.5	47.6	-43.3	39.4
Abnormal Losses (Gains)	-31.4	-16.9	13.5	128.5	42.4
Tax Effect on Abnormal Items	5.3	2.9	0.0	0.0	0.0
Normalized Income	31.9	50.5	61.1	85.2	81.8
Basic Earnings per Share	0.1	0.1	0.0	0.0	0.0
Basic Weighted Avg Shares	746.8	1,177.5	1,399.5	1,575.7	1,603.0
Diluted EPS Before Abnormal Items	0.0	0.0	0.0	0.1	0.1
Diluted EPS Before XO Items	0.1	0.1	0.0	0.0	0.0
Diluted EPS	0.1	0.1	0.0	0.0	0.0
Diluted Weighted Avg Shares	746.8	1,177.5	1,399.5	1,575.7	1,603.0

Profitability Ratios

12 Months Ending	FY 2017 31/12/2017	FY 2018 31/12/2018	FY 2019 31/12/2019	FY 2020 31/12/2020	FY 2021 31/12/2021
Returns					
Return on Common Equity	8.29	6.73	4.10	-3.58	3.36
Return on Assets	5.17	4.07	2.40	-2.03	1.81
Return on Capital	5.39	4.24	2.50	-2.12	1.89
Return on Invested Capital	3.69	4.24	4.12	4.68	4.50
Margins					
Operating Margin	56.35	56.26	55.30	53.53	53.06
Incremental Operating Margin	56.19	56.09	51.14	34.35	-62.92
Pretax Margin	—	—	—	—	—
Income before XO Margin	62.98	44.63	26.74	-22.28	21.29
Net Income Margin	62.98	44.63	26.74	-22.28	21.29
Net Income to Common Margin	62.98	44.63	26.74	-22.28	21.29
Additional					
Effective Tax Rate	21.43	18.51	18.06	—	2.82
Dividend Payout Ratio	103.14	109.93	175.16	—	238.57
Sustainable Growth Rate	-0.26	-0.67	-3.08	—	-4.66

Credit Ratios

12 Months Ending	FY 2017 31/12/2017	FY 2018 31/12/2018	FY 2019 31/12/2019	FY 2020 31/12/2020	FY 2021 31/12/2021
Total Debt/EBIT	8.84	8.20	8.26	8.19	9.89
Net Debt/EBIT	7.88	7.54	7.64	7.36	9.09
EBIT to Interest Expense	5.49	4.28	3.78	3.53	3.42
Long-Term Debt/Total Assets	33.48	30.91	33.84	29.63	29.65
Net Debt/Equity	47.96	57.62	59.71	66.12	75.16

Source: Bloomberg

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