

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

6 Nov 2023

BUY (Upgrade from FULLY VALUED)

Last Traded Price (3 Nov 2023): US\$0.058 (STI : 3,143.66)

Price Target 12-mth: US\$0.10 (72% upside)

Analysts

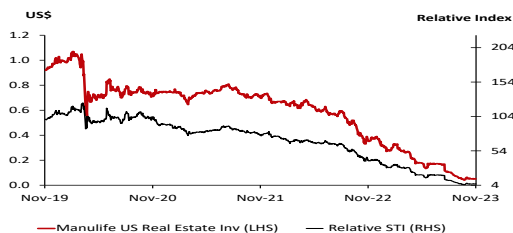
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What's New

- Capitalise on trading opportunity with upgrade; BUY with TP at US\$0.10
- MUST's 4th largest tenant renewed and extended lease, but portfolio occupancy continues to trend down (-0.4ppt q-o-q)
- Key positives: i) Major tenants considering renewals/expansion; ii) Marc Feliciano (from sponsor) appointed board chairman
- Data to watch: i) Potential resolution with lenders, ii) lower occupancy, iii) decline in hedging ratio

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2022A	2023F	2024F	2025F
Gross Revenue	203	193	190	195
Net Property Inc	113	109	108	112
Total Return	(130)	(225)	45.9	48.2
Distribution Inc	87.9	74.6	65.0	68.3
EPU (US cts.)	(7.3)	(12.6)	2.55	2.67
EPU Gth (%)	nm	(73)	nm	5
DPU (US cts.)	4.75	3.80	3.29	3.44
DPU Gth (%)	(11)	(20)	(13)	4
NAV per shr (US cts.)	57.4	41.8	41.9	42.0
PE (X)	nm	0.0	2.3	2.2
Distribution Yield (%)	81.9	65.5	56.8	59.3
P/NAV (x)	0.1	0.1	0.1	0.1
Aggregate Leverage (%)	48.6	56.2	56.4	56.6
ROAE (%)	(11.7)	(25.5)	6.1	6.4

Distn. Inc Chng (%)		0	0	-
Consensus DPU (US)		0.0	3.5	3.5
Other Broker Recs:		B: 3	S: 1	H: 0

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

Worth a shot?

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" trend 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 forecast 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 effects of a capital injection, which, we believe, is needed, given its strained financials (gearing of c.56%, ICR ratio of 2.4x) alongside a breach of a covenant that the manager is seeking a waiver on.

Upgrade to BUY, maintain TP at US\$0.10. We sense that the tripartite discussions to resolve the debt covenant breach is likely approaching a resolution, which we believe should re-rate the stock from current <0.2x P/B. Albeit more of a trading opportunity, we believe the announcement/disclosure of their debt restructuring plan will be a relief for unit holders, averting a worse-case scenario of a liquidation. That said, the devil is still in the details of how MUST and its sponsor plan to resolve the debt issue; and, we envision that the REIT will most likely still need an equity raise in the medium term to bring forth a longer-term sustainable recovery. Given that share price has overshot on the downside, it is currently trading at highly discounted valuation that could be worth a shot, though this is against a backdrop of high share price volatility which in turn will be driven by news, reactions to it and market sentiments.

Key Risks

Key potential risks include i) further asset valuation decline by year-end; ii) further decline in portfolio occupancy; iii) further increase in interest costs; and iv) potential highly dilutive equity fund raising.

At A Glance

Issued Capital (m shrs)	1,777
Mkt. Cap (US\$m/US\$m)	103 / 103
Major Shareholders (%)	
Manulife Financial Corp	5.5
Free Float (%)	94.5
3m Avg. Daily Val (US\$m)	0.70
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	

WHAT'S NEW

Worth a shot?

Fourth largest tenant renewed and extended lease for another five years with strong positive reversions; portfolio occupancy continues to trend down while gearing remains relatively stable.

- Kilpatrick Townsend, MUST's fourth largest tenant, has renewed their lease early and extend it by another five years to expire in 2030, following MUST's commitment to a US\$18m AEI, as previously announced. As such, we noted that MUST recorded strong rental reversions of +24% this quarter (9M23: +10%).
- However, portfolio occupancy continued to trend down, by 0.4ppt q-o-q to 84.7%.
- Gearing and unencumbered ratios remain relatively stable q-o-q, at 56% and 59.9%, respectively.
- Interest costs continued to inch up, by 0.3ppt q-o-q to 4.38%, and the interest coverage ratio declined to 2.4x vs. 2.6x in 2Q23.
- Hedging ratio has declined to 69% vs. 80% in 2Q23.

Key operational highlights during the briefing

Some greenshoots seen – i) rents trend higher with Peachtree AEI announcement; ii) The Children's Place is re-engaging MUST; iii) some top 10 tenants may renew and/or expand leases

- Post the announcement of the Peachtree AEI, rents at Peachtree have been on a rising trend, from mid-US\$20psf close to US\$30psf
- The Children's Place, MUST's third largest tenant, is re-engaging MUST for discussions on its lease. This would be a positive development should it result in a potential renewal, after The Children's Place had chosen to terminate the lease early in Mar 23.
- Management highlighted that they are engaging with tenants, especially the top 10 tenants, and some have indicated their intention for some expansions and/or renewals. The realisation of potential renewals would bode well for MUST.
- Physical occupancy has inched up but remains in the mid-30% to 40% range.

Discussions between MUST, sponsor, and lenders are ongoing, working on holistic sponsor package; Marc (representative from sponsor) recently elected board chairman.

- MUST's management team continues to work alongside the sponsor in negotiating with lenders on a waiver of the debt covenant breach and payment of distributions. MUST and its sponsor are working on assembling a holistic sponsor package (which we believe could include a potential shareholders' loan that will help address MUST's long-term liquidity needs and provide financial flexibility, but the execution will require lenders' approval).

- Marc Lawrence Feliciano, global head of real estate – private markets for Manulife Investment Management (sponsor) was recently appointed board chairman, replacing Stephen James Blewitt. We hope that this bodes well for MUST and that the sponsor would take more actions with Marc onboard now.

Capitalise on trading opportunity with upgrade toBUY; TP at US\$0.10 maintained. We upgrade our rating to a BUY from FULLY VALUED previously but maintain our TP at US\$0.10. We sense that the tripartite discussions to resolve the debt covenant breach is likely approaching a resolution, which we believe should re-rate the stock from current <0.2x P/B. Albeit more of a trading opportunity, we believe the announcement/disclosure of their debt restructuring plan will be a relief for unit holders, averting a worse-case scenario of a liquidation. That said, the devil is still in the details of how MUST and its sponsor plan to resolve the debt issue; and, we envision that the REIT will most likely still need an equity raise in the medium term to bring forth a longer-term sustainable recovery.

Share price has collapsed in the last year and has further retreated by two-thirds since July on the back of its announcement of its breach in financial covenants and impact on distributions. Given that share price has overshot on the downside, it is currently trading at highly discounted valuation that could be worth a short-term punt. That said, this is against a backdrop of high share price volatility which in turn will be driven by news, reactions to it and market sentiments.

Key potential risks include i) further asset valuation decline by year-end; ii) further decline in portfolio occupancy; iii) further increase in interest costs; and iv) potential highly dilutive equity fund raising.

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.

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Key Operational Highlights

Key Operational Highlights	3Q2023	3Q2022	% y-o-y	2Q2023	% q-o-q
Portfolio occupancies	84.7%	88.1%	-3.4 ppt	85.1%	-0.4 ppt
Rental reversions (cumulative)	10.0%	1.7%	8.3 ppt	3.7%	6.3 ppt
WALE (years)	5.8	4.9	0.9	4.9	0.9
Gearing	56.0%	42.5%	13.5 ppt	56.7%	-0.7 ppt
Average cost of debt*	4.38%	3.34%	1 ppt	4.10%	0.3 ppt
DSCR	2.40	3.40	(1.0)	2.60	(0.2)
Hedging ratio	69.2%	81.1%	-11.9 ppt	80.2%	-11 ppt
Leases expiring in FY2023	5.6%	10.1%	-4.5 ppt	7.6%	-2 ppt
Leases expiring in FY2024	13.4%	11.9%	1.5 ppt	10.8%	2.6 ppt

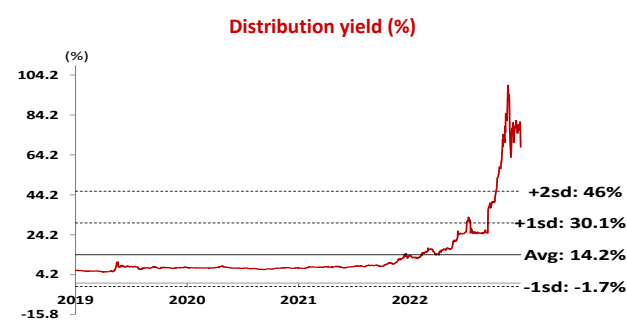
Source: Company, DBS Bank

Interim Income Statement (US\$m)

FY Dec	1H2022	2H2022	1H2023	% chg yoy	% chg hoh
Gross revenue	100	102	99.6	(0.8)	(2.5)
Property expenses	(42.8)	(46.6)	(44.2)	3.3	(5.1)
Net Property Income	57.6	55.5	55.4	(3.9)	(0.3)
Other Operating expenses	(6.2)	(5.3)	(5.3)	(13.9)	1.2
Other Non Opg (Exp)/Inc	32.8	15.2	(0.1)	nm	nm
Associates & JV Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	(15.3)	(18.6)	(21.6)	(41.2)	(16.1)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	68.9	46.9	28.3	(58.9)	(39.6)
Tax	(7.7)	25.8	16.5	nm	(36.3)
Minority Interest	0.0	0.0	0.0	-	-
Net Income after Tax	61.2	72.7	44.8	(26.8)	(38.4)
Total Return	62.8	(192)	(248)	nm	28.6
Non-tax deductible Items	(15.2)	(30.8)	(6.8)	(55.2)	(77.8)
Net Inc available for Dist.	46.0	41.9	37.9	(17.4)	(9.4)
Ratio (%)					
Net Prop Inc Margin	57.4	54.4	55.6		
Dist. Payout Ratio	100.0	91.0	100.0		

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

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Income Statement (US\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Gross revenue	185	203	193	190	195
Property expenses	(75.6)	(89.4)	(83.4)	(82.3)	(83.4)
Net Property Income	110	113	109	108	112
Other Operating expenses	(11.3)	(11.5)	(8.8)	(7.8)	(8.8)
Other Non Opg (Exp)/Inc	0.0	48.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(29.1)	(33.9)	(45.4)	(53.4)	(54.2)
Exceptional Gain/(Loss)	(28.5)	(264)	(280)	0.0	0.0
Net Income	40.6	(148)	(225)	46.3	48.7
Tax	(1.1)	18.1	(0.6)	(0.5)	(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	39.4	(130)	(225)	45.9	48.2
Total Return	39.4	(130)	(225)	45.9	48.2
Non-tax deductible Items	46.2	218	300	19.2	20.1
Net Inc available for Dist.	85.6	87.9	74.6	65.0	68.3
Growth & Ratio					
Revenue Gth (%)	(4.7)	9.4	(4.8)	(1.5)	2.8
N Property Inc Gth (%)	(5.4)	3.3	(3.4)	(1.7)	3.9
Net Inc Gth (%)	nm	nm	(73.7)	nm	5.2
Dist. Payout Ratio (%)	100.0	95.7	91.0	91.0	91.0
Net Prop Inc Margins (%)	59.2	55.9	56.7	56.7	57.3
Net Income Margins (%)	21.3	(64.0)	(116.9)	24.2	24.7
Dist to revenue (%)	46.2	43.4	38.7	34.3	35.0
Managers & Trustee's fees	6.1	5.7	4.5	4.1	4.5
ROAE (%)	3.4	(11.7)	(25.5)	6.1	6.4
ROA (%)	1.8	(5.9)	(11.3)	2.5	2.6
ROCE (%)	4.8	5.1	5.6	5.8	6.0
Int. Cover (x)	3.4	3.0	2.2	1.9	1.9

Source: Company, DBS Bank

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Interim Income Statement (US\$m)

FY Dec	1H2021	2H2021	1H2022	2H2022	1H2023
Gross revenue	90.8	94.3	100	102	99.6
Property expenses	(34.7)	(40.8)	(42.8)	(46.6)	(44.2)
Net Property Income	56.1	53.5	57.6	55.5	55.4
Other Operating	(5.7)	(5.6)	(6.2)	(5.3)	(5.3)
Other Non Opg (Exp)/Inc	4.21	9.69	32.8	15.2	(0.1)
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(14.7)	(14.5)	(15.3)	(18.6)	(21.6)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	39.9	43.1	68.9	46.9	28.3
Tax	4.13	(5.3)	(7.7)	25.8	16.5
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	44.0	37.8	61.2	72.7	44.8
Total Return	6.70	32.7	62.8	(192)	(248)
Non-tax deductible Items	(1.0)	9.90	(15.2)	(30.8)	(6.8)
Net Inc available for Dist.	43.0	42.6	46.0	41.9	37.9
Growth & Ratio					
Revenue Gth (%)	(5)	4	6	2	(3)
N Property Inc Gth (%)	4	(5)	8	(4)	0
Net Inc Gth (%)	1	(14)	62	19	(38)
Net Prop Inc Margin (%)	61.8	56.7	57.4	54.4	55.6
Dist. Payout Ratio (%)	100.0	100.0	100.0	91.0	100.0

Balance Sheet (US\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Investment Properties	2,184	1,947	1,685	1,704	1,723
Other LT Assets	5.65	47.7	47.7	47.7	47.7
Cash & ST Invt	78.6	113	113	115	119
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	5.55	5.40	8.25	8.13	8.36
Other Current Assets	1.44	2.93	2.93	2.93	2.93
Total Assets	2,276	2,116	1,856	1,878	1,901
ST Debt	297	145	145	145	145
Creditor	58.8	31.3	29.1	28.7	29.5
Other Current Liab	8.25	8.50	8.50	8.50	8.50
LT Debt	675	884	900	916	933
Other LT Liabilities	49.6	26.8	26.8	26.8	26.8
Unit holders' funds	1,188	1,020	747	753	759
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	2,276	2,116	1,856	1,878	1,901
Non-Cash Wkg. Capital	(60.0)	(31.4)	(26.4)	(26.1)	(26.7)
Net Cash/(Debt)	(893)	(916)	(932)	(946)	(958)
Ratio					
Current Ratio (x)	0.2	0.7	0.7	0.7	0.7
Quick Ratio (x)	0.2	0.7	0.7	0.7	0.7
Aggregate Leverage (%)	42.7	48.6	56.2	56.4	56.6

Source: Company, DBS Bank

Manulife US Real Estate Inv

Cash Flow Statement (US\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Income	40.6	(148)	55.2	46.3	48.7
Dep. & Amort.	1.93	4.35	0.0	0.0	0.0
Tax Paid	(0.1)	(0.1)	(0.6)	(0.5)	(0.5)
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(20.8)	1.25	(5.0)	(0.3)	0.58
Other Operating CF	69.1	234	19.9	19.2	20.1
Net Operating CF	90.6	92.0	69.6	64.7	68.9
Net Invnt in Properties	(231)	(25.4)	(1.9)	(2.8)	(2.9)
Other Invnts (net)	0.0	0.0	0.0	0.0	0.0
Invnts 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	0.02	0.05	(16.1)	(15.9)	(16.3)
Net Investing CF	(231)	(25.4)	(18.0)	(18.8)	(19.2)
Distribution Paid	(84.0)	(88.6)	(67.9)	(59.2)	(62.2)
Chg in Gross Debt	215	56.0	16.1	15.9	16.3
New units issued	0.70	0.25	0.0	0.0	0.0
Other Financing CF	0.0	0.0	0.0	0.0	0.0
Net Financing CF	132	(32.4)	(51.8)	(43.3)	(45.9)
Currency Adjustments	0.0	0.03	0.0	0.0	0.0
Chg in Cash	(8.1)	34.3	(0.2)	2.68	3.80
Operating CFPS (US cts.)	6.32	5.11	4.18	3.62	3.78
Free CFPS (US cts.)	(8.0)	3.75	3.79	3.44	3.65

Source: Company, DBS Bank

Target Price & Ratings 12-mth History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	08 Feb 23	0.33	0.48	BUY
2:	10 Feb 23	0.29	0.45	BUY
3:	18 May 23	0.14	0.24	BUY
4:	19 Jul 23	0.12	0.10	FULLY VALUED

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analysts: 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: 6 Nov 2023 06:25:47 (SGT)

Dissemination Date: 6 Nov 2023 06:35:37 (SGT)

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

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