



Manulife US REIT

(MUST SP/MANU.SI)

California next on the menu; Benchmark inclusion insight

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- **First foray into California.** Manulife US REIT (MUST) announced the acquisition of 400 Capitol building in Sacramento (California) for US\$198.8mn, at an implied cap rate of 7.2%.
- **Benchmark inclusion threshold met.** MUST could see inclusion within the FTSE EPRA Nareit Developed Asia Index by Dec 19.
- **Maintain OUTPERFORM.** DPU will likely remain flattish alongside an enlarged units base at 6.3/6.3 US cts for FY20/FY21 (previously 6.5/6.5 US cts); catalyst remains the near-term benchmark inclusion.

First foray into California. MUST announced the proposed acquisition of 400 Capitol (Sacramento, California) at an agreed valuation of US\$198.8mn, a marginal discount to the asset's latest market value of US\$200.5mn. The 27 year old building sits as the tallest commercial asset in the prime CBD area of Sacramento, and consist of 29-storeys. The top 10 tenants leased c.65.5% of total leasable area (500,662 sqft), and constitute firms within the legal, finance and co-working subsectors. Since 2016, 400 Capitol had undergone more than US\$12mn worth of asset enhancements involving the lobby area, restrooms and corridors. The property would also come with a tenant-funded, 5-star amenity base which includes a fitness centre, heated swimming pool, conference rooms amongst other facilities.

A tight market in Sacramento. Within the Sacramento submarket, supply remains tight with just two government-owned office buildings known to be within the near-term pipeline. Historical asking rent grew at a CAGR of 4.8% since 2014 to US\$40/sqft this year, with an average vacancy of 6.3% as opposed to 11.3% within other markets. This is consistent with higher construction costs driven by rising labour wages and price volatility in building materials such as steel and cement. Replacement cost for a comparable asset would be in the range of US\$700-US\$800/sqft, a significant premium to MUST's purchase price of US\$397/sqft.

Funding structure. The acquisition would be partly funded by debt (c.31%) and equity (c.69%). MUST will draw down from the loan facilities of US\$64mn and raise US\$142.1mn through an equity fund raising (EFR) exercise comprised of two tranches – private placement of US\$65mn and preferential offering to raise another US\$77.1mn. We anticipate the private placement tranche to be raised at the higher range of their indicated issue price of 84.9 US cts - 87.6 US cts and a similarly strong response for the preferential offering to be issued between 83.3 US cts - 86 US cts which is scheduled to open on 2 Oct.

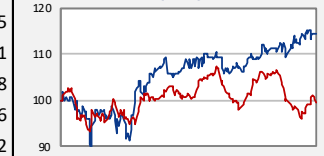
Outperform (Maintain)

Price as of 18 Sep 19 (USD)	0.91	Performance (Absolute)	
12M TP (USD)	1.01	1 Month (%)	1.6
Previous TP (USD)	0.98	3 Month (%)	5.0
Upside, incl div (%)	17.9%	12 Month (%)	22.8

Trading data

Mkt Cap (USD mn)	1,275
Issued Shares (mn)	1,401
Vol - 3M Daily avg (mn)	1.8
Val - 3M Daily avg (USD mn)	1.6
Free Float (%)	16.2

Perf. vs STI Index (Red)



Major Shareholders

Manulife Financial Corp	6.2%
Prudential PLC	5.5%
DBS Group Holdings	3.0%

Previous Recommendations

15-Aug-19	OP US\$0.98
29-Apr-19	OP US\$0.97
15-Feb-19	OP US\$0.95

Financials & Key Operating Statistics

YE Dec USD mn	2017	2018	2019F	2020F	2021F
Gross revenue	92.0	144.6	175.6	204.1	204.5
Net property income	58.4	90.7	112.4	130.6	130.9
Distributable income	46.7	71.0	88.7	100.6	100.9
DPU (US cents)	5.8	6.1	5.7	6.3	6.3
DPU growth (%)	64.5	3.6	(6.3)	11.1	0.3
Div Yield (%)	6.5	7.7	6.2	6.9	6.9
NAV (US cents)	82.0	83.4	0.8	0.8	85.4
Price / Book (x)	1.1	0.9	1.1	1.1	1.1
NPI Margin (%)	63.4	64.0	64.0	64.0	64.0
Net Margin (%)	63.0	44.7	28.1	37.3	37.3
Gearing (%)	34.9	38.4	37.7	37.7	37.7
ROE (%)	6.8	6.1	3.8	5.7	5.7

Source: Company Data, KGI Research

* DPS for FY19 takes into account enlarged units base after equity fund raising

Operating statistics. With 400 Capitol's occupancy of 94.9% and WALE of 5.9 years, we expect a slight dip in occupancy next quarter to 96.9% (2Q19: 97.2%) and WALE to maintain at c.6.2 years. The enlarged portfolio will see concentration risk from the largest asset by % NPI (Michelson) reduced from 18.9% to 17.1%.

Benchmark inclusion in Dec 19. We anticipate c.164mn new units to be issued after this round of EFR, a c.12% increase from the total number of units in issue of 1.4bn (18 Sep). Management communicated that they expect free float market cap to increase from US\$1.15bn to US\$1.3bn after the completion of this acquisition. This should comfortably meet the free-float market cap requirement of US\$1.22bn to be included in the FTSE EPRA Nareit Developed Asia Index in the next round of review coming Dec 19.

Valuation & Action:

Maintain OUTPERFORM with TP of US\$1.01. We increased our TP from US\$0.98 to US\$1.01, in part due to a rental uplift from 400 Capitol beginning from 2020 and a reduction in our risk free rate by 25 bps to realign with the current dovish interest rate environment.

Risks:

Finalisation of US tax regulations (Section 267A) at year end; foreign exchange risk

Transactions Highlights

Overview of 400 Capitol, Sacramento, California

Top Class A Asset

Tallest in Sacramento, instantly recognisable office tower with best-in-class features

Iconic Location

Close to California State Capitol and government buildings, set in desirable Live, Work, Play Environment

94.9% High Occupancy¹

44 premier tenants in diversified sectors: legal, finance, state government, co-working, business and consulting services

Platinum LEED Status

Efficient building system maintained to highest institutional standards





Description	29-storey top Class A office building, located in Sacramento's CBD
Location	400 Capitol Mall, Sacramento, California
Land Tenure	Freehold
NLA	500,662 sq ft.
Parking Lots	1,094 parking spaces (6-storey garage)
Year of Completion	1992 (>US\$12 m capital expenditures and tenant improvements since 2016)
Purchase Price²	US\$198.8 m (US\$397.0 per sq ft.)
Valuation³	US\$200.5 m
Implied Cap Rate³	7.2%
Occupancy Rate¹	94.9%
WALE by NLA	5.9 years
Tenants	44

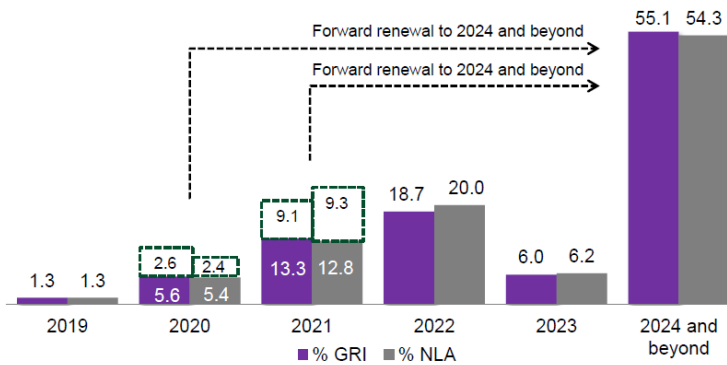
Data as at 11 Sep 2019

- (1) Committed occupancy has taken into account the renewal of certain tenant's lease effective 1 Oct 2019 and excludes a tenant who has vacated the Property
- (2) Subject to closing and post-closing adjustments in the ordinary course of business
- (3) Based on valuation as of 27 Aug 2019 by Cushman & Wakefield
- (4) Implied cap rate is calculated based on first year net operating income over appraised fair value in the valuation

- Occupancy of 94.9%¹ with average 2.3% rental escalations p.a.
 - ✓ Retention rate of > 80.0% for expiring leases for last 3 years
- Average in-place rent is up to 11.5% below potential asking rental rate of the property

Long WALE by NLA of 5.9 Years²

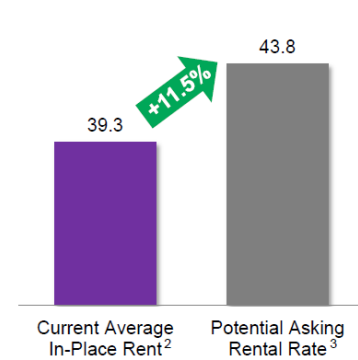
Lease Expiry Profile of the Property (%)²



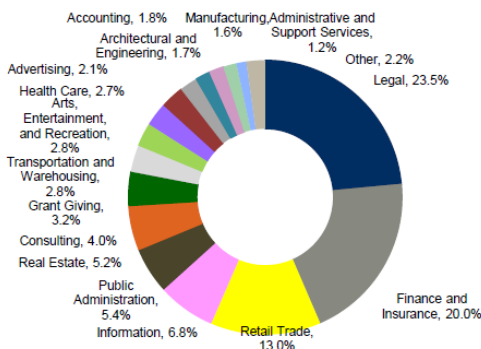
- (1) Committed occupancy has taken into account the renewal of certain tenant's lease effective 1 Oct 2019 and excludes a tenant who has vacated the Property
- (2) Data as at 11 Sep 2019
- (3) Potential asking rental rate of the Property is between US\$41.40 to US\$43.80 as per IMR as of 1 Sep 2019 by Cushman & Wakefield

Rent Upside of 11.5%

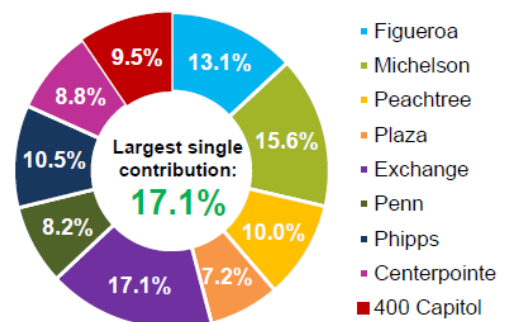
Current Average Rent (US\$ per sq ft.)



Enlarged Portfolio: Trade Sector by GRI



Enlarged Portfolio: NPI by Property²



Source: Company Data, KGI Research

Financials

FYE 31 December					
INCOME STATEMENT (USD mn)	2017A	2018A	2019F	2020F	2021F
Gross revenue	92.0	144.6	175.6	204.1	204.5
Property expenses	(33.7)	(53.9)	(63.2)	(73.5)	(73.6)
Net property income	58.4	90.7	112.4	130.6	130.9
REIT Manager's fees	(4.7)	(7.1)	(8.5)	(8.5)	(8.5)
REIT Trustee's fees	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)
Net interest expense	(9.5)	(19.0)	(25.8)	(25.7)	(25.6)
Other expenses	(1.6)	(2.0)	(2.4)	(2.8)	(2.8)
Net profit/(loss)	42.4	62.3	75.4	93.3	93.7
Change in fair value - investment ppty	31.4	16.9	(14.9)	0.0	0.0
Total return before tax	73.8	79.2	60.5	93.3	93.7
Income tax	(15.8)	(14.7)	(11.2)	(17.3)	(17.3)
Total return after tax	58.0	64.5	49.3	76.1	76.3
Distributable income	46.7	71.0	88.7	100.6	100.9
BALANCE SHEET (USD mn)	2017A	2018A	2019F	2020F	2021F
Cash and cash equivalents	49.7	54.1	76.3	101.2	114.6
Trade and other receivables	5.9	9.1	7.1	8.3	8.3
Other current assets	0.8	1.0	0.6	0.6	0.6
Total current assets	56.4	64.2	84.0	110.1	123.5
Investment properties	1,312.8	1,738.7	2,076.0	2,076.0	2,076.0
Intangibles, others	0.0	0.0	4.5	4.5	4.5
Total assets	1,369.2	1,802.9	2,164.4	2,190.6	2,203.9
Trade and other payables	18.2	16.8	19.7	22.9	23.0
Other current liabilities	1.0	2.2	4.7	4.7	4.7
Total current liabilities	19.2	19.0	24.4	27.6	27.6
LT Borrowings	458.4	667.2	783.6	783.6	783.6
Other non-current liabilities	39.5	52.6	55.2	55.2	55.2
Total liabilities	517.1	738.8	863.2	866.4	866.5
Unitholders' funds and reserves	852.1	1,064.1	1,301.2	1,324.2	1,337.5
Total liabilities and equity	1,369.2	1,802.9	2,164.4	2,190.6	2,203.9
CASH FLOW STATEMENT (USD mn)	2017A	2018A	2019F	2020F	2021F
Total return before tax	73.8	79.2	60.5	93.3	93.7
Depreciation & Amortisation	(3.5)	(3.5)	(3.5)	(3.5)	(3.5)
Other non-cash adjustments	(23.6)	(4.5)	52.7	37.7	37.6
Changes in working capital	(1.9)	(8.3)	4.0	1.2	(0.8)
Taxes paid	(1.0)	(0.3)	0.0	0.0	0.0
Cash flows from operations	43.8	62.7	113.7	128.7	127.0
Capital expenditure	(9.3)	(10.8)	(33.7)	0.0	0.0
Acquisition of investment properties	(425.0)	(388.5)	(319.6)	(15.0)	(15.0)
Other investing cashflow	0.0	0.2	0.2	0.0	0.0
Cash flows from investing	(434.3)	(399.1)	(353.1)	(15.0)	(15.0)
Borrowings raised / (repaid)	165.9	208.9	116.3	0.0	0.0
Equity raised / (bought back)	288.7	196.5	236.1	0.0	0.0
Dividends paid	(42.5)	(58.7)	(88.7)	(88.7)	(98.6)
Other financing cashflow	(10.4)	(5.8)	(2.1)	0.0	0.0
Cash flows from financing	401.7	340.9	261.5	(88.7)	(98.6)
FX Effects, Others	0.1	(0.0)	0.0	0.0	0.0
Net increase in cash	11.2	4.5	22.1	25.0	13.4
Beginning Cash	38.4	49.7	54.1	76.3	101.2
Ending cash	49.7	54.1	76.3	101.2	114.6
KEY RATIOS	2017A	2018A	2019F	2020F	2021F
DPU (USD cents)	5.8	6.1	5.7	6.3	6.3
Dividend yield %	6.5	7.7	6.2	6.9	6.9
NAV per share (USD cents)	82.0	83.4	0.8	0.8	85.4
Price/NAV (x)	1.1	0.9	1.1	1.1	1.1
Profitability (%)					
NPI Margin	63.4	64.0	64.0	64.0	64.0
Net Margin	63.0	44.7	28.1	37.3	37.3
ROE	6.8	6.1	3.8	5.7	5.7
ROA	4.2	3.6	2.3	3.5	3.5
Financial Structure					
Interest Coverage (x)	5.5	4.2	3.9	4.6	4.6
Gearing (%)	34.9	38.4	37.7	37.7	37.7

Source: KGI Research

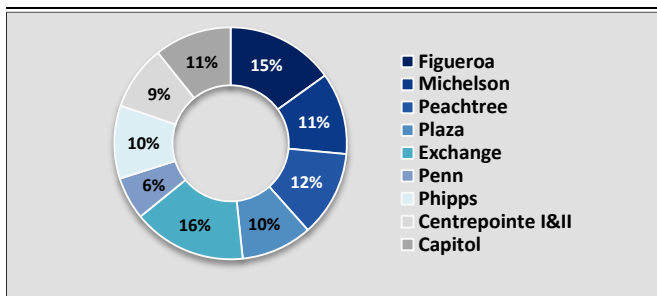
Company Snapshot

Figure 1: Company profile

Manulife US Real Estate Investment Trust (MUST) is a Singapore real estate investment trust (REIT) listed on Singapore Exchange Securities Trading Limited (the SGX-ST) since 20 May 2016. Its investment strategy is principally to invest in a portfolio of income-producing office real estate in the US, as well as real estate-related assets. The REIT is managed by Manulife US Real Estate Management Pte. Ltd. (the Manager) which is wholly owned by the Sponsor, The Manufacturers Life Insurance Company (Manulife), part of the Manulife Group.

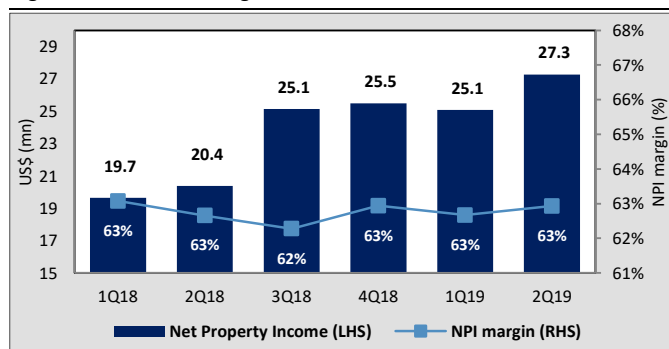
Source: Company

Figure 2: Portfolio breakdown by NLA



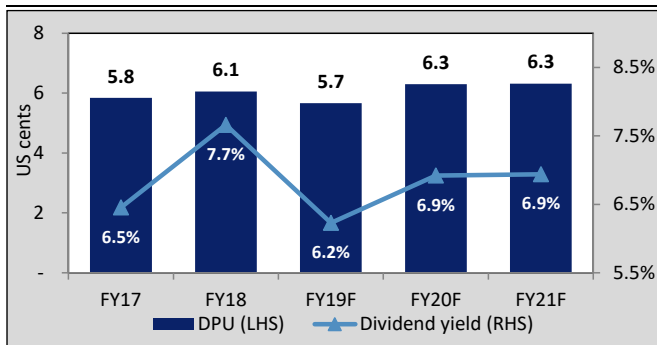
Source: Company Data, KGI Research

Figure 3: NPI and NPI margins



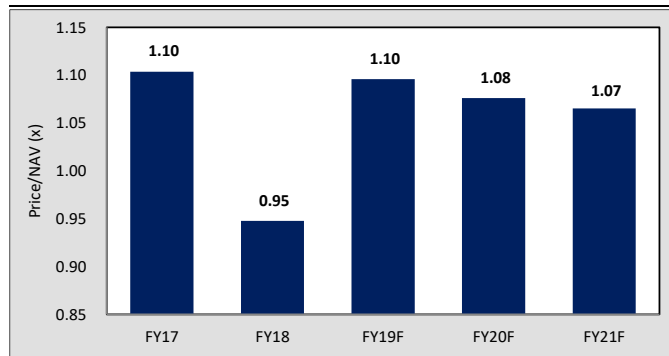
Source: Company Data, KGI Research

Figure 4: DPU and Dividend yield



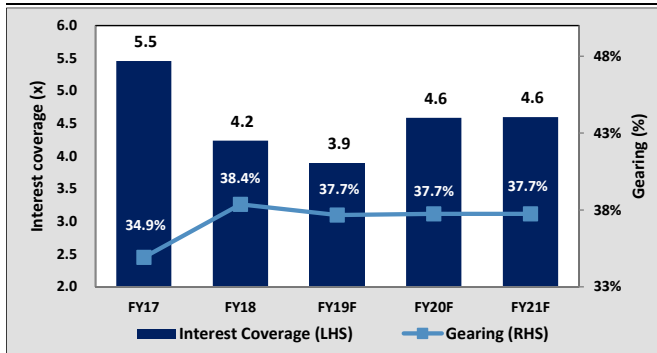
Source: Company Data, KGI Research

Figure 5: Price/NAV



Source: Company Data, KGI Research

Figure 6: Interest Coverage and Gearing Ratio



Source: Company Data, KGI Research

Figure 7: Historical 1 year share price performance against benchmarks



Source: Company Data, KGI Research

Figure 8: Historical P/B band since IPO



Source: Company Data, KGI Research

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Rating	Definition
Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
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