

CHINA
DEVELOPMENT
FINANCIAL

Manulife US REIT

(MUST SP/MANU.SI)

Rethinking office spaces after the pandemic

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- **Maintain NEUTRAL and TP of US\$0.86.** We maintain our NEUTRAL recommendation as we see limited upside in light of the weak rental market for US office space over the next 12 months.
- **MUST offers an attractive 8.2% forward dividend yield.** However, we remain concerned of downward pressure on US office property prices, and the potential impact on its gearing ratio, which last stood at 39.1% as at end-2Q20. In 1H20, MUST's property portfolio value dropped to US\$2,034.5mn (30 Jun 2020), a drop of 2.9% from US\$2,095.0mn (31 Dec 2019).

Financials & Key Operating Statistics					
YE Dec USD mn	2018	2019	2020F	2021F	2022F
Gross revenue	144.6	177.9	205.9	206.8	207.6
Net property income	90.7	110.8	131.8	132.3	132.9
Distributable income	71.0	83.3	97.3	97.7	98.3
DPU (US cents)	6.1	6.0	6.1	6.2	6.2
DPU growth (%)	70.4	(1.5)	2.8	0.5	0.6
Div Yield (%)	7.7	5.6	8.3	8.3	8.4
NAV (US cents)	80.0	80.0	80.7	80.9	81.1
Price / Book (x)	1.0	1.3	0.9	0.9	0.9
NPI Margin (%)	62.7	62.3	64.0	64.0	64.0
Net Margin (%)	44.6	26.7	35.8	35.8	35.9
Gearing (%)	38.4	38.8	38.8	38.8	38.8
ROE (%)	6.1	3.8	5.8	5.7	5.7

Source: Company Data, KGI Research

Impact of Covid-19 starting to become more evident. MUST reported a 96.2% high occupancy rate as at 30 June 2020, and enjoys 1.9% average rental escalation per annum. While we believe it is still too early to have a sense of where overall market occupancy rates will stabilise post-Covid, it is likely to be lower over the next 24 months given the reports from big companies (e.g., Dell Technologies, State Street Corp) that are looking to reduce office space. Another metric to watch is rental collection. MUST reported a healthy 96% rental collection in 2Q20, but this was on a declining trend, from 99% in April, to 97% in May and 93% in June. Furthermore, supplementary income from parking or other non-office uses may be most exposed to a prolonged downturn.

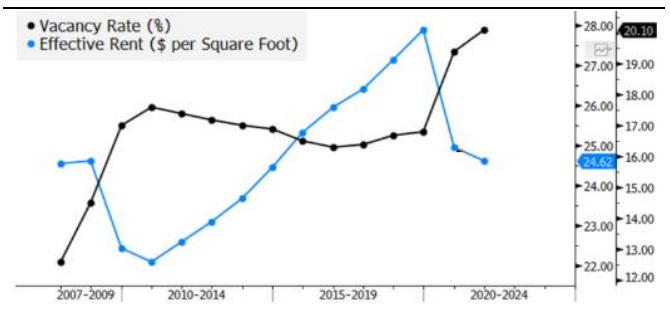
Muted outlook for US office space. The US office market enjoyed a robust 2019 as rents grew at around 2.7% for the year, according to Moody's Analytics REIS, after eight straight years of rental growth following the global financial crisis. However, the outlook looks muted going forward. REIS estimates that the value of office buildings across the US will decline by 17.2% in 2020, compared to a drop of 19.2% for retail properties and 20.5% drop in hospitality assets.

US national vacancy rates on the uptrend until 2021. According to REIS, US national office vacancy rates rose 10 bp to 17.1% as at the end of 2Q20, and forecasts it to rise to 19.3% by the end of the year, peaking at 20% in 2021. This is expected to exceed the previous historical high vacancy rate of 19.7% at the peak of the Savings and Loan crisis in 1991.

NEUTRAL - Maintain			
Price as of 13 Aug 20 (USD)	0.74	Performance (Absolute)	
12M TP (USD)	0.86	1 Month (%)	2.7
Previous TP (USD)	1.11	3 Month (%)	5.5
Upside, incl div (%)	24.0%	12 Month (%)	-9.7
Trading data		Perf. vs STI Index (Red)	
Mkt Cap (USD mn)	1,156		
Issued Shares (mn)	1,573		
Vol - 3M Daily avg (mn)	3.6		
Val - 3M Daily avg (USD mn)	2.7		
Free Float (%)	16.2		
Major Shareholders		Previous Recommendations	
Manulife Financial Corp	6.2%	10-Feb-20	NEUTRAL US\$1.11
Prudential PLC	5.5%	6-Nov-19	OP US\$1.03
DBS Group Holdings	3.0%	19-Sep-19	OP US\$1.01

Some positive factors could lend support. A strong support for office assets is that long-term interest rates remain low, and there is still ample liquidity waiting to be deployed. In addition, office leases are typically locked in for many years, and in MUST's case, it has a long WALE of 5.7 years by NLA. MUST's tenants are mainly from sectors less affected by the Covid-19 pandemic: finance and insurance, legal and technology. These sectors are still performing well and continue to pay rent, even though they are not using their office spaces.

Figure 1: US office rent and vacancy forecasts by REIS



Source: REIS, Bloomberg Intelligence, KGI Research

Valuation & Action: Maintain NEUTRAL with a reduced TP of US\$0.86 (previously US\$1.11). We derive a lower TP as we factor in lower rental growth and incorporate a higher cost of equity of 8.5% (previously 8.0%). While dividend yield seems attractive, we remain concerned on risks to property values and pressure on rents going into 2021.

Risks: US tax changes would be the key risk, as it would have a negative impact on MUST's DPU. Forex risks for local investors as revenues, unit price and dividends are in USD. Another potential risk from the impact of Covid-19 is the increased acceptance of work from home and relocation, which may lead to soft office demand.

Valuations

Figure 2: DDM valuation (New forecasts)

USD cents, YE 31 December	FY17	FY18	FY19	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F
DPU	5.8	6.1	6.0	6.1	6.2	6.2	6.3	6.4	6.5
<i>YoY (%)</i>				2.8%	0.5%	0.6%	1.5%	1.5%	1.5%
Terminal value per unit									93.4
Cost of Equity		8.5%							
Target Price (US\$)		0.86							
<i>Capital Appreciation</i>		15.7%							
<i>Forward Dividend</i>		8.3%							

Source: KGI Research

Figure 2: DDM valuation (Old forecasts)

USD cents, YE 31 December	FY17	FY18	FY19	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F
DPU	5.8	6.1	6.0	6.1	6.3	6.4	6.5	6.7	6.9
<i>YoY (%)</i>				3.2%	1.8%	1.9%	2.5%	2.5%	2.5%
Terminal value per unit									127.5
Cost of Equity		8.0%							
Target Price (US\$)		1.10							

Source: KGI Research

Financials

FYE 31 December					
INCOME STATEMENT (USD mn)	2018A	2019A	2020F	2021F	2021F
Gross revenue	144.6	177.9	205.9	206.8	207.6
Property expenses	(53.9)	(67.1)	(74.1)	(74.4)	(74.7)
Net property income	90.7	110.8	131.8	132.3	132.9
REIT Manager's fees	(7.1)	(8.3)	(10.3)	(10.6)	(10.6)
REIT Trustee's fees	(0.2)	(0.3)	(0.3)	(0.3)	(0.3)
Net interest expense	(19.0)	(25.7)	(27.1)	(27.1)	(26.9)
Other expenses	(2.0)	(3.8)	(4.1)	(4.1)	(4.2)
Net profit/(loss)	62.3	72.6	90.0	90.3	91.0
Change in fair value - investment ppty	16.9	(13.5)	0.0	0.0	0.0
Total return before tax	79.2	59.1	90.0	90.3	91.0
Income tax	(14.7)	(10.5)	(16.2)	(16.3)	(16.4)
Total return after tax	64.5	48.7	73.7	74.0	74.5
Distributable income	71.0	83.3	97.3	97.7	98.3
BALANCE SHEET (USD mn)	2018A	2019A	2020F	2021F	2021F
Cash and cash equivalents	54.1	60.7	62.3	81.3	100.3
Trade and other receivables	9.1	7.6	8.8	8.9	8.9
Other current assets	1.0	1.2	1.2	1.2	1.2
Total current assets	64.2	69.6	72.3	91.4	110.4
Investment properties	1,738.7	2,095.0	2,095.0	2,095.0	2,095.0
Intangibles, others	0.0	0.5	0.5	0.5	0.5
Total assets	1,802.9	2,165.1	2,167.8	2,186.9	2,205.9
Trade and other payables	16.8	26.9	7.4	7.5	7.5
Other current liabilities	2.2	5.1	5.1	5.1	5.1
Total current liabilities	19.0	32.0	12.5	12.6	12.6
LT Borrowings	667.2	812.0	812.0	812.0	812.0
Other non-current liabilities	52.6	62.7	62.7	62.7	62.7
Total liabilities	738.8	906.7	887.3	887.3	887.3
Unitholders' funds and reserves	1,064.1	1,258.3	1,280.6	1,299.6	1,318.6
Total liabilities and equity	1,802.9	2,165.1	2,167.8	2,186.9	2,205.9
CASH FLOW STATEMENT (USD mn)	2018A	2019A	2020F	2021F	2021F
Total return before tax	79.2	58.0	90.0	90.3	91.0
Depreciation & Amortisation	(3.5)	(3.7)	(3.7)	(3.7)	(3.7)
Other non-cash adjustments	(4.5)	30.3	44.1	44.3	44.1
Changes in working capital	(8.3)	4.0	(20.3)	0.3	0.3
Taxes paid	(0.3)	(1.2)	0.0	0.0	0.0
Cash flows from operations	62.6	87.5	110.1	131.2	131.8
Capital expenditure	(10.8)	(45.0)	0.0	0.0	0.0
Acquisition of investment properties	(388.5)	(311.0)	(15.0)	(15.0)	(15.0)
Other investing cashflow	0.2	0.5	0.0	0.0	0.0
Cash flows from investing	(399.1)	(355.5)	(15.0)	(15.0)	(15.0)
Borrowings raised / (repaid)	208.9	146.1	0.0	0.0	0.0
Equity raised / (bought back)	196.5	236.7	0.0	0.0	0.0
Dividends paid	(58.7)	(99.4)	(93.5)	(97.3)	(97.7)
Other financing cashflow	(5.8)	(7.4)	0.0	0.0	0.0
Cash flows from financing	340.9	276.0	(93.5)	(97.3)	(97.7)
FX Effects, Others	(0.0)	0.1	0.0	0.0	0.0
Net increase in cash	4.4	8.1	1.6	19.0	19.0
Beginning Cash	49.7	54.1	60.7	62.3	81.3
Ending cash	54.1	62.2	62.3	81.3	100.3
KEY RATIOS	2018A	2019A	2020F	2021F	2021F
DPU (USD cents)	6.1	6.0	6.1	6.2	6.2
Dividend yield %	7.7	5.6	8.3	8.3	8.4
NAV per share (USD cents)	80.0	80.0	80.7	80.9	81.1
Price/NAV (x)	1.0	1.3	0.9	0.9	0.9
Profitability (%)					
NPI Margin	62.7	62.3	64.0	64.0	64.0
Net Margin	44.6	26.7	35.8	35.8	35.9
ROE	6.1	3.8	5.8	5.7	5.7
ROA	3.6	2.2	3.4	3.4	3.4
Financial Structure					
Interest Coverage (x)	4.2	3.8	4.3	4.3	4.3
Gearing (%)	38.4	38.8	38.8	38.8	38.8

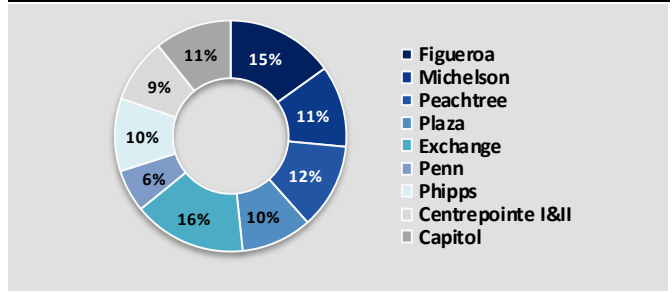
Source: Company Data, KGI Research

Figure 4: 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.

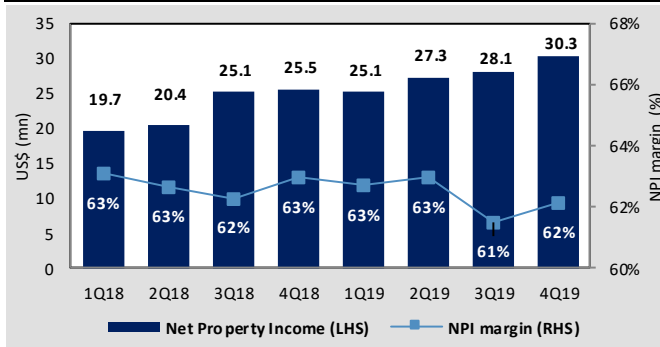
Source: Company

Figure 5: Portfolio breakdown by NLA



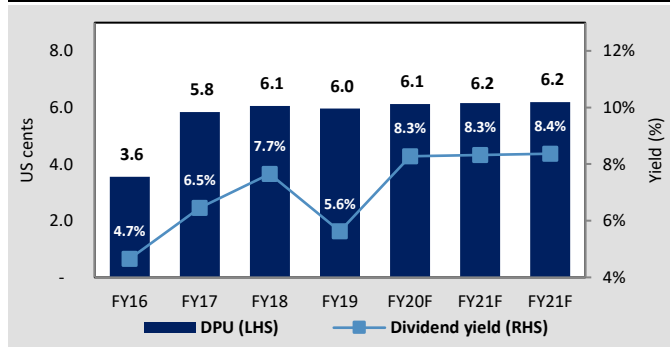
Source: Company Data, KGI Research

Figure 6: NPI vs NPI margins



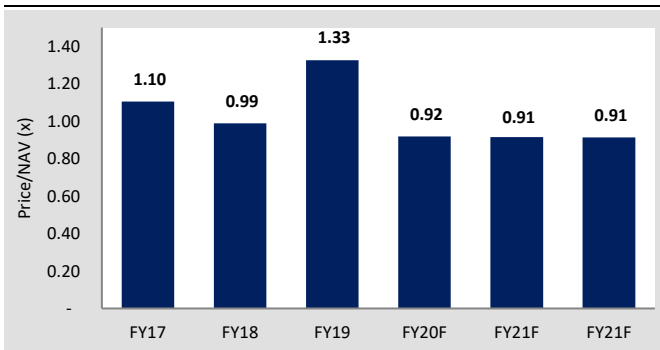
Source: Company Data, KGI Research

Figure 7: DPU and Dividend yield



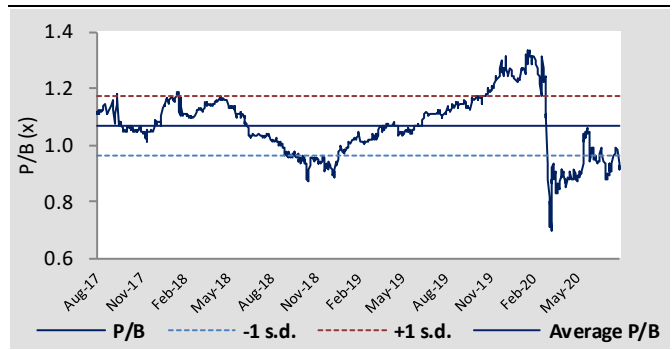
Source: Company Data, KGI Research

Figure 8: Price/NAV



Source: Company Data, KGI Research

Figure 9: Historical P/B band



Source: Company Data, KGI Research

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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.
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