

Manulife US REIT

Leasing headwinds despite rebound



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SINGAPORE | REAL ESTATE (REIT) | 1Q21 UPDATE

12 May 2021

- No financials provided in this operational update.
- 5.8% of NLA signed at +2.5% reversions, though with more tenant incentives and shortened leases. Leasing weakness to persist.
- Portfolio occupancy dipped QoQ from 93.4% to 92.0%. But rental collections remained high at 98.0%. Minimal rent abatement of 0.6%. WALE unchanged at 5.3 years.
- Maintain BUY and DDM TP (COE 9.1%) of US\$0.84. FY21e DPU yield of 8.1%. Catalysts expected from higher take-up in leasing and asset acquisitions.

The Positives

+ Pick-up in leasing. During the quarter, MUST signed 5.8% of NLA at +2.1% reversions. This compares with the 5.9% signed in FY20 at +0.1% reversions. The stronger leasing in 1Q21 further de-risked expiries in FY21 and FY22. FY21 lease expiries declined from 5.7% to 4.3% and for FY22, from 18.1% to 13.0%. Renewals formed 93.6% of the leases signed, with the remaining 5.3% and 1.1% coming from expansion and new leases. Leases signed were with traditional office-using sectors such as finance and insurance, administrative, advertising and legal. While rental reversions were positive with no downsizing, rent-free periods and tenant incentives increased by 20-30% for renewals and doubled for the new leases signed. WALE for new leases was also much lower at 2.7 years vs 6.4 years for those signed in FY20. Portfolio WALE was unchanged QoQ at 5.3 years. Fortunately, leases signed in 1Q21 still incorporated periodic rental escalations.

+ Rental collections remained high at 98.0%. About 2-3 out of the 16 F&B tenants in MUST's portfolio are not fully open. Rent abatement was given to them to help them tide over reduced foot traffic.

The Negatives

- Portfolio occupancy dipped from 93.4% to 92.0% QoQ (1Q20: 96.5%). This was caused by downsizing by a tenant in the lifestyle sector which returned one floor of space and non-renewal by a tenant who relocated to a suburban office. Still, MUST's occupancy outperformed the Grade A market's 82% (1Q20: 90.1%). Subleasing in its buildings remained low, inching down from 3.3% to 3.2%.

- Low physical occupancy of 5-25% to weigh on carpark income. No improvement in physical occupancy despite a 45.5% vaccination rate in the US. Carpark income contributed 7% to FY19 revenue. In FY20, carpark income took a 25% hit from remote working, which reduced physical occupancy in offices to about 15%. Remote working also lowered parking usage by the patrons of surrounding entertainment venues. Depressed physical occupancy is expected to keep FY21e carpark income in line with FY20 figures.

Outlook

Softer leasing expected, near term

Despite 1Q21's stronger leasing, tenants are taking a longer time to make leasing decisions. Filling vacancies remains challenging. Higher market vacancy rates have resulted in a tenants' market. Rent-free periods and tenant incentives have increased by 20-30% for renewals and doubled for the new leases signed. Lease terms have also shortened. According to rental forecasts by the CoStar Group, market rents could fall by up to 6% over the next 12 months. Minimal supply and lower subleasing in cities where MUST has assets should provide some leasing support.

Shifting focus to New Economy sectors and secondary markets

According to CBRE, tenants in the tech, healthcare and life science sectors accounted for 31% of the leasing demand in 2020. Research by JLL in April 2021 confirmed these sectors are

BUY (Maintained)

LAST CLOSE PRICE	USD 0.740
FORECAST DIV	USD 0.060
TARGET PRICE	USD 0.840
TOTAL RETURN	21.6%

COMPANY DATA

BLOOMBERG CODE:	MUST SP
O/S SHARES (MN) :	1,592
MARKET CAP (USD mn / SGD mn) :	1178 / 1178
52 - WK HI/LO (SGD) :	0.86 / 0.65
3M Average Daily T/O (mn) :	3.14

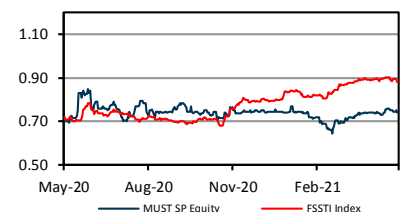
MAJOR SHAREHOLDERS (%)

PRUDENTIAL PLC	5.9%
MANULIFE FINANCIAL CORP	5.5%
DRACHS INV 3 LTD	4.9%
VANGUARD GROUP INC	3.5%

PRICE PERFORMANCE (%)

	1MTH	3MTH	YTD
COMPANY	1.4	8.8	4.4
STI RETURN	0.6	9.9	13.3

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec, USD mn	FY19	FY20	FY21e	FY22e
Gross Rev. (SGD mn)	178	194	197	204
NPI (SGD mn)	111	116	121	125
Dist. Inc. (SGD mn)	83	89	95	98
P/NAV (x)	0.93	1.01	1.04	1.06
DPU (cents)	5.96	5.64	5.98	6.06
Distribution Yield (%)	8.05	7.62	8.08	8.19

Source: Company, PSR

VALUATION METHOD

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

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among the top-paying tenant industries. However, these New Economy industries only account for 10% of MUST's tenants, which has limited MUST's ability to increase rents. Going forward, MUST's acquisitions are expected to focus on secondary markets where these industries are frequently located. These include Seattle, Salt Lake City, Austin, Boston and Raleigh where cap rates range from 6.5% to 7.5%. MUST aims to increase its exposure to New Economy tenants to 20%. It is open to divesting, M&As and JVs to reposition its portfolio.

Maintain BUY, unchanged DDM TP of US\$0.84

No change in estimates. We are forecasting a FY21e DPU yield of 8.1%. Catalysts are expected from higher take-up in leasing and asset acquisitions.

Financials

Statement of Total Return and Distribution Statement

Y/E Dec, USD mn	FY18	FY19	FY20	FY21e	FY22e
Gross revenue	144.6	177.9	194.3	196.6	203.7
Property operating expenses	(53.9)	(67.1)	(78.5)	(75.6)	(79.1)
Net property income	90.7	110.8	115.8	121.0	124.5
Net Finance (Expense)/Inc.	(19.0)	(25.7)	(29.6)	(28.8)	(28.0)
Manager's base fee	(7.1)	(9.7)	(8.9)	(9.3)	(9.6)
Other items	(2.2)	(2.7)	(2.9)	(1.2)	(3.1)
Net income	62.3	72.6	74.4	81.7	84.0
FV change, derivatives & pptides	16.9	(13.5)	(128.5)	-	-
Total Return Before Tax	79.2	58.0	(66.0)	81.7	84.0
Taxation	(14.7)	(10.5)	22.7	(14.9)	(15.3)
Total Return After Tax	64.5	47.6	(43.3)	66.8	68.6
Distribution adjustments	6.5	35.8	132.3	28.6	29.2
Income available for distribution	71.0	83.3	89.0	95.4	97.9

Per unit data

Y/E Dec	FY18	FY19	FY20	FY21e	FY22e
NAV (US\$)	0.83	0.80	0.73	0.71	0.70
DPU (US cents)	5.57	5.96	5.64	5.98	6.06

Cash Flow

Y/E Dec, USD mn	FY18	FY19	FY20	FY21e	FY22e
CFO					
Total Return Before Tax	79.2	58.0	(66.0)	81.7	84.0
Adjustments	9.3	50.6	186.6	42.3	41.8
WC changes	(8.3)	2.6	(8.8)	5.5	1.3
Cash generated from ops	80.2	111.2	111.8	129.6	127.0
Others	(0.3)	(1.2)	(1.9)	(2.1)	(2.2)
Cashflow from ops	79.9	110.1	109.9	127.5	124.8
CFI					
Purchase of Inv. propty., net	(388.5)	(311.0)	-	-	-
Capex, net	(10.8)	(45.0)	(24.2)	(0.7)	(0.7)
Others	(0.3)	(1.2)	(1.9)	(2.1)	(2.2)
Cashflow from investments	(399.1)	(355.5)	(24.0)	(0.5)	(0.5)
CFF					
Share issuance, net	197.2	236.7	-	-	-
Loans, net of repayments	208.9	146.1	39.6	-	-
Interest paid	(17.3)	(23.9)	(27.9)	(26.9)	(26.1)
Distributions	(58.7)	(99.4)	(70.7)	(95.3)	(97.7)
Others	(0.3)	(1.2)	(1.9)	(2.1)	(2.2)
Cashflow from financing	323.6	252.1	(60.0)	(124.3)	(125.9)
Net change in cash	4.4	6.6	25.9	2.7	(1.6)
Effects of exchange rate	(0.0)	0.0	0.1	-	-
Ending cash	60.7	60.7	86.7	89.4	87.8

Source: Company, Phillip Securities Research (Singapore) Estimates

Balance Sheet

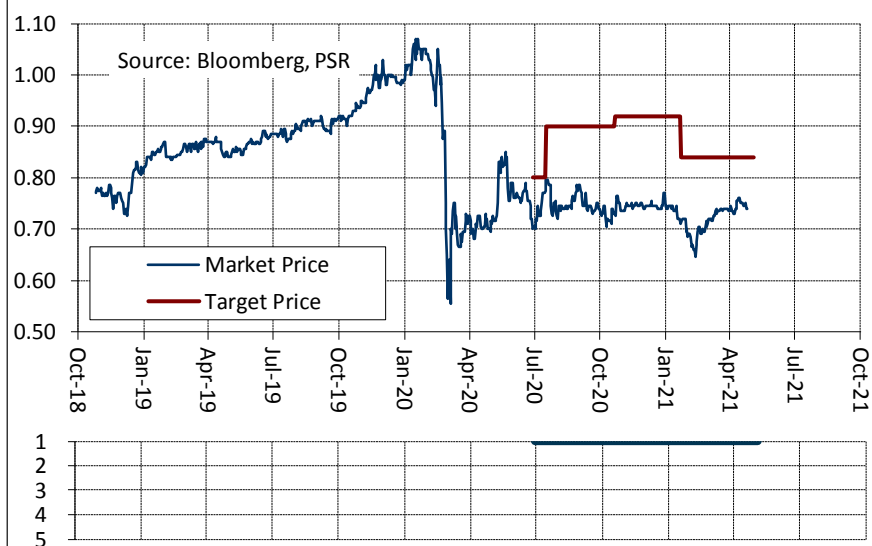
Y/E Dec, USD mn	FY18	FY19	FY20	FY21e	FY22e
ASSETS					
Investment properties	1,738.7	2,095.0	1,992.8	1,994.2	1,995.6
Others	-	0.5	-	-	-
Total non-current assets	1,738.7	2,095.5	1,992.8	1,994.2	1,995.6
Trade receivables	9.1	7.6	6.9	10.2	11.5
Cash	54.1	60.7	86.7	89.4	87.8
Others	-	0.5	-	-	-
Total current assets	64.2	71.0	95.3	101.2	100.9
Total Assets	1,802.9	2,166.5	2,088.1	2,095.4	2,096.5
LIABILITIES					
Current borrowings	109.9	78.9	233.6	204.6	114.9
Trade payables	16.8	26.9	18.1	27.2	29.7
Others	-	0.5	-	-	-
Total current liabilities	128.9	110.9	258.6	238.8	151.5
Non-current borrowings	557.3	733.1	618.7	647.7	737.4
Others	-	0.5	-	-	-
Total non-current liabilities	609.8	797.3	671.5	713.0	815.9
Total Liabilities	738.7	908.2	930.1	951.7	967.4
Net assets	1,064.2	1,258.3	1,158.0	1,143.7	1,129.1
Represented by:					
Unitholders' funds	1,064.1	1,258.2	1,157.9	1,143.6	1,129.0
Perp. securities holders	0.1	0.1	0.1	0.1	0.1

Valuation Ratios

Y/E Dec	FY18	FY19	FY20	FY21e	FY22e
P/NAV (x)	0.89	0.93	1.01	1.04	1.06
Distribution Yield	7.5%	8.1%	7.6%	8.1%	8.2%
NPI yield	5.9%	5.8%	5.7%	6.1%	6.2%

Growth & Margins (%)

Growth					
Revenue	n.m.	23.0%	9.3%	1.2%	3.6%
Net property income (NPI)	n.m.	22.2%	4.6%	4.5%	2.9%
Distributable income	n.m.	17.4%	6.8%	7.2%	2.6%
DPU	n.m.	7.0%	-5.4%	6.0%	1.3%
Margins					
NPI margin	62.7%	62.3%	59.6%	61.5%	61.1%
Key Ratios					
Net Debt or (Net Cash)	613	751	766	763	765
Gearing (%)	37.0%	37.5%	40.8%	40.7%	40.7%

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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