

MREIT Inc (MREIT PM)

Higher for longer

1H23 results in-line; Maintain BUY

Better-than-expected 1H revenue was attributable to higher GLA leased and rental income, offsetting the COS and opex overruns arising from full expense recognition of infused assets. MREIT's 2Q23/1H23 net income of PHP734m/PHP1b (+ 8%/7% YoY) is within expectation at 52% of our FY23 forecast. We expect 1H23 occupancy rates to be sustainable and raise our FY23/24 earnings forecasts by 4%/8%, which, in turn, raises our rolled-forward DDM-based TP by 10% to PHP20. MREIT has an implied FY23/24E dividend yield of 8%/9%, supporting our BUY recommendation.

Revenue forecasts raised

GLA leased reached 311ksqm in 1H23, 4% higher than our FY23E forecast of 299ksqm, while rental income per sqm was also 5% higher than our FY23E estimate due to incremental recognition of the infused assets. Factoring in higher FY23/24 GLA leased of 310ksqm/311ksqm (+4%/+1%) and rental income per sqm of PHP840/PHP900 per sqm (+5%/11%), we raise our FY23/24E revenue assumptions by 9%/12% to PHP4.1b/4.4b.

Higher costs and opex

Cost of sales and opex were higher-than-expected in 1H23, due to the increase in repairs and maintenance (+929% YoY), other expenses (+190% YoY), and taxes and fees (+31%) amid the full recognition of expenses from the four office buildings acquired (One West Campus and Five West Campus in McKinley West, and Festive Walk 1B and Two Global Center in Iloilo Business Park). Nevertheless, this was partially offset by the 295% YoY rise in interest income due to short-term placements in the period, such that net income still increased by 7% YoY to PHP1.5b.

Managed risks, sustained growth

MREIT's 1H23 occupancy rate of 96% is higher than its 94% in FY22 and the industry average rate of 82% in Metro Manila. MREIT's WALE of c.3 years and renewal rate of c.100% as of 1H23 mitigate the risks posed by the high industry vacancy rate of 18%. Meanwhile, its target to reach 500sqm GLA by YE25E translates to a 54% expansion in its current portfolio, strengthening our thesis of sustained growth for the company.

FYE Dec (PHP m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	1,358	3,649	4,138	4,447	4,647
Net property income	1,086	2,935	3,200	3,477	3,645
Core net profit	1,093	2,645	2,956	3,236	3,387
Core EPU (PHP)	0.58	0.97	1.06	1.16	1.21
Core EPU growth (%)	(12.5)	68.4	9.1	9.5	4.7
DPU (PHP)	0.32	0.90	1.04	1.14	1.21
DPU growth (%)	nm	182.3	15.5	9.6	6.0
P/NTA (x)	34.2	14.9	11.6	10.6	10.1
DPU yield (%)	1.6	6.2	8.5	9.3	9.9
ROAE (%)	6.7	(0.3)	6.0	6.5	6.8
ROAA (%)	3.1	4.4	5.1	5.5	5.7
Debt/Assets (x)	0.12	0.12	0.12	0.12	0.13
Consensus DPU	-	-	0.99	1.04	1.14
MIBG vs. Consensus (%)	-	-	5.4	9.9	6.3

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BUY

Share Price	PHP 12.24
12m Price Target	PHP 20.00 (+72%)
Previous Price Target	PHP 18.00

Company Description

MREIT invests in income-generating real estate properties in the Philippines.

Statistics

52w high/low (PHP)	15.90/11.28
3m avg turnover (USDm)	0.1
Free float (%)	37.5
Issued shares (m)	2,796
Market capitalisation	PHP34.2B
	USD603M

Major shareholders:

Megaworld Corp	65.6%
BlackRock Inc	0.5%
Andrew Tan	0.4%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(8)	(14)	(3)
Relative to index (%)	(9)	(11)	(9)

Source: FactSet

Acronyms used:

Gross leasable area (GLA)
Cost of sales (COS)
Weighted average lease expiry (WALE)
Business process outsourcing (BPO)

Details of other companies mentioned:

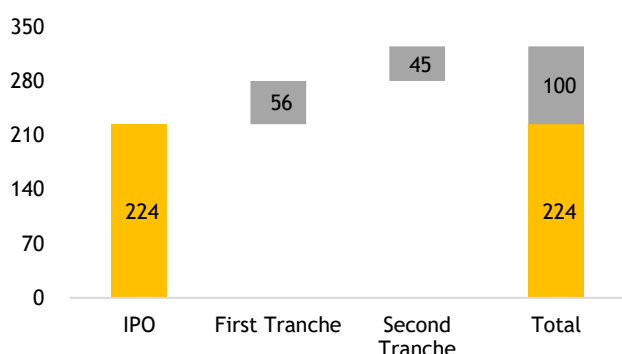
Megaworld Corp (MEG PM, CP: PHP2.03, Under review)

ESG@MAYBANK IBG
Tear Sheet Insert

Value Proposition

- MREIT is the commercial REIT vehicle of integrated property developer Megaworld Corp (MEG PM).
- MREIT's portfolio is primarily based in Bonifacio Global City, Eastwood Quezon City and Iloilo City, where vacancies are below-average and rental rates are above-average. All properties are accredited by the Philippine Economic Zone Authority (PEZA).
- MREIT's tenant base is diversified and consists mostly of large, quality names. BPOs occupy 79% of GLA.
- Dividend distribution should remain stable, given a healthy lease expiration profile (c.3 years).
- The sponsorship of MEG ensures long-term growth prospects for MREIT.

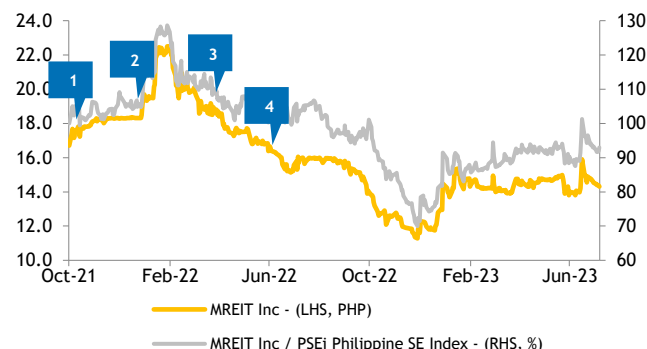
MREIT portfolio (000s sqm)



Source: Company

Price Drivers

Historical share price trend



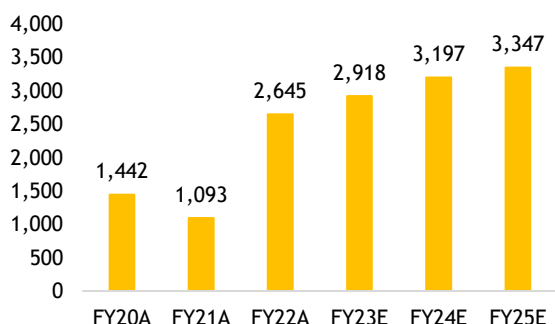
Source: Company, Maybank IBG Research

1. On 1 Oct 2021, MREIT successfully listed on the Philippine Stock Exchange at a price of PHP16.10/sh.
2. On 16 Dec 2021, MREIT announced the acquisition of three properties in Iloilo City and one property in BGC with a combined GLA of 56k sqm.
3. On 7 Mar 2022, MREIT declared a cash dividend of PHP0.24/sh.
4. On 4 Apr 2022, MREIT announced the acquisition of two properties in Iloilo City and two properties in BGC with a combined GLA of 45k sqm.

Financial Metrics

- We forecast MREIT to post revenue growth of 13%/7% in FY23/24E, driven by (i) stable occupancy of 96%; (ii) rental escalation of 4% pa; and (iii) contributions from recent acquisitions (100k sqm added since IPO).
- MREIT should be able to distribute 100% of its AFFO through FY24E (120% dividend payout ratio).

Adjusted funds from operations (PHPm)



Source: Maybank IBG Research, Company

Swing Factors

Upside

- Occupancy ramp-up for properties driven by BPO expansion activities
- Greater-than-expected lease escalation rates
- Value-accretive acquisitions: We estimate MEG still has 1.5msqm of existing commercial assets that can be infused into MREIT.

Downside

- Higher-than-expected vacancies, especially from smaller tenants, due to macroeconomic weakness.
- Greater-than-expected degree of non-renewals and pre-terminations.
- Lower-than-expected lease escalation rates.

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Risk Rating & Score ¹	21.5
Score Momentum ²	NA
Last Updated	02 Sep 2022
Controversy Score ³	NA

Business Model & Industry Issues

- MREIT's ESG policy is still in its nascent stages. In FY21, MREIT conducted its first ESG materiality assessment to identify priority areas for its ESG policy.
- Currently, MREIT does not track Scope 2 and 3 emissions. It also does not have specific initiatives to manage waste generation, water usage or energy consumption. Currently, a roadmap is being developed to determine MREIT's contributions to Alliance Global Inc's (AGI PM) target of becoming carbon-neutral by FY25E.
- We believe MREIT's exposure to material 'S' issues is less than that of MEG as: MREIT (i) does not own the land on which its commercial properties stand; and (ii) does not participate in land acquisitions.
- 'G' issues are the most prominent as MREIT has engaged and will likely continue to engage in related-party transactions. Related party transactions require the unanimous vote of all independent directors and independent appraisal by a third party.

Material E issues

- MREIT's Scope 1 and 2 emissions stood at 585.64 tCO₂e and 45,321 tCO₂e respectively in FY22. MREIT currently does not track Scope 3 greenhouse gas emissions.
- MREIT monitors its energy consumption relative to its allocated budget.
- To address water conservation issues, the company aims to minimise leakages in its plumbing systems and promotes responsible use of water to tenants and visitors.
- Waste generated in MREIT's properties is sent to third-party haulers and recyclers accredited by the Department of the Environment and Natural Resources.
- 1800 Eastwood Avenue and 1880 Eastwood Avenue were awarded four-star IMMUNE Building Standard certification by the Design Building Institute, reflecting the buildings' measures to address Covid-19 and other bacteriological health threats.

Material S issues

- MREIT currently only has one female employee as other key personnel in MREIT's management team have been seconded from MEG.
- MREIT is aligned with MEG in terms of key policies on equal opportunity employment, employee training, occupational health and safety, promoting countryside development and data privacy.

Key G metrics and issues

- MREIT's Board of Directors consists of seven members, of which three (43%) are independent. The REIT Law requires that at least three members of the Board are independent directors.
- MREIT has a one-tier Board of Directors.
- Two members (29%) of the board are women.
- Katherine Tan and Jesus Varela also serve on the board of the sponsor, MEG.
- The corporate governance committee is fully composed of independent directors.
- Two out of three (67%) members in the audit and related party transactions committees are independent. Both committees include one non-independent director.
- Related party transactions (RPT) are governed by a RPT policy. The policy requires RPTs to be (i) approved by the Board of Directors, including a unanimous vote by the independent directors; (ii) a third-party appraisal of the properties for acquisition; and (iii) undertaking of the transaction at arm's length and commercial terms.
- The RPT policy was enforced when MREIT acquired (i) four properties worth PHP9.1b via cash and debt in Dec 2021 and (ii) four properties worth PHP5.3b via property-for-share swap in Apr 2022.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Quantitative Parameters (Score: 35)						
	Particulars	Unit	2020	2021	2022	AREIT (2022)
E	Scope 1	tCO2e	NA	521	586	NA
	Scope 2	tCO2e	NA	36,992	45,321	NA
	Total	tCO2e	NA	37,512	45,907	0
	Scope 3	tCO2e	NA	NA	NA	NA
	Total	tCO2e	NA	NA	NA	0.0
	Scope 1+2 emission intensity	kgCO2e/sqm GFA	NA	NA	NA	17.1
	Energy intensity	kWh/sqm	NA	NA	NA	140.5
	Green energy share of capacity	%	NA	0.0%	0.0%	80%
	Water intensity	Cu.m/sqm	NA	NA	NA	1.2
	% of recycled material used	%	NA	NA	NA	15.5%
	% of debt from green instruments	%	NA	0.0%	0.0%	0.0%
	% of real estate certified by energy/green rating	% office GLA	NA	0%	21%	45.0%
S	% of women in workforce	%	NA	100%	100%	NA
	% of women in management roles	%	NA	100%	100%	NA
	Number of injuries resulting in lost time	number	NA	NA	NA	NA
G	MD/CEO salary as % of net profit	%	NA	NA	NA	0.0%
	Top 10 employees salary as % of profit	%	NA	0.6%	0.3%	0.0%
	Independent directors (tenure <10 years) as % of board of directors	%	NA	42.9%	42.9%	37.5%
	Women directors on board	%	NA	28.6%	28.6%	37.5%

Qualitative Parameters (Score: 0)	
a) is there an ESG policy in place and whether there is a standalone ESG committee or is it part of a risk committee?	<i>No. In FY21, the company conducted its first Environmental, Social, and Governance (ESG) materiality assessment. MREIT has a Board Risk Oversight Committee which evaluates material ESG risk exposures.</i>
b) is the senior management salary linked to fulfilling ESG targets?	<i>No.</i>
c) Does the company follow the task force of climate related disclosures (TCFD) framework for ESG reporting?	<i>No.</i>
e) Does the company have a mechanism to capture Scope 3 emissions - which parameters are captured?	<i>None yet.</i>
f) What are the 2-3 key carbon mitigation/water/waste management strategies adopted by the company?	<i>The company minimizes leakages to its plumbing system. The company sends generated waste to third-party haulers and recyclers accredited by the Department of the Environment and Natural Resources (DENR).</i>
g) Does carbon offset form part of the net zero/carbon neutrality target of the company?	

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ESG score	Weights	Scores	Final Score
Quantitative	50%	35	18
Qualitative	25%	0	0
Target	25%	0	0
Total			18

As per our ESG assessment, MREIT can improve with tracking relevant ESG metrics and setting clear medium-to-long term targets. MREIT's overall ESG score is 18, which makes its ESG rating below average in our view (average ESG rating = 50).

1. 2Q23/1H23 earnings

MREIT posted 2Q23/1H23 net income of PHP734m/PHP1b, up 8%/7% YoY and in-line with MIBGs' FY23E forecast at 52%.

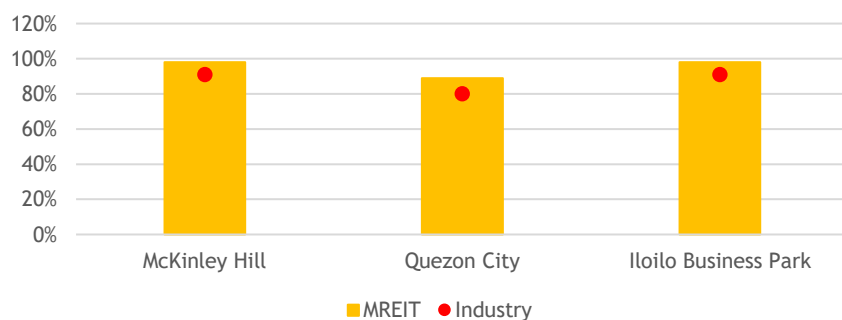
Fig 1: MREIT's 2Q23/1H23 earnings

PHP m	2Q23	2Q22	% YoY	1Q23	% QoQ	1H23	1H22	% YoY	MIBG FY23E	% of FY22E
Revenues	1,034	893	16	1,036	(0)	2,070	1,794	15	3,813	54
Cost of services	(213)	(132)	61	(217)	(2)	(431)	(265)	63	(700)	62
Gross profit	821	761	8	819	0	1,639	1,530	7	3,113	53
GPM	79%	85%		79%		79%	85%		82%	
Opex	(20)	(10)	106	(20)	0	(40)	(17)	132	(38)	105
Operating income	800	751	7	798	0	1,599	1,513	6	3,075	52
Op inc margin	77%	84%		77%		77%	84%		81%	
Others - net	(63)	(74)	(14)	(66)	(4)	(130)	(147)	(12)	(235)	55
Pre-tax profit	737	677	9	732	1	1,469	1,365	8	2,840	52
Tax expense	(3)	(1)	429	(2)	72	(5)	(1)	332	0	
Net inc	734	677	8	730	0	1,464	1,364	7	2,840	52
Net inc margin	71%	76%		71%		71%	76%		74%	

Sources: Company, Maybank IBG Research

- 2Q/1H23 revenues were at PHP1b/2b, 16%/15% higher YoY, mainly due to the 4 newly-acquired Grade-A office towers worth PHP5.3b, which began contributing to MREIT's earnings at the start of the year.
- MREIT's office occupancy as of end-Jun was at 96%, higher than the industry average occupancy rate of 82% in Metro Manila. BPO tenants took up 79% of the total occupied space, while traditional office tenants took up 15%. To recall, MREIT's portfolio currently comprises of 18 office properties located in 4 MEG premier townships.

Fig 2: MREIT's occupancy rates



Source: Company

- Cost and expenses were higher-than-expected, mainly due to the increase in repairs and maintenance (+929% YoY), other expenses (+190% YoY), and taxes and fees (+31%) amid the full recognition of expenses from the four office buildings acquired—namely One West Campus and Five West Campus in McKinley West, and Festive Walk 1B and Two Global Center in Iloilo Business Park.

2. Summary of changes to forecasts

We raise our FY23/24 earnings forecasts by 4%/8% on the basis of the following:

Fig 3: Changes to forecasts

PHP m	FY23E old	FY23E new	change	FY24E old	FY24E new	change	Notes
							Higher FY23/24 occupancy rate of 96%/96%, from 95%/95% previously.
Revenues	3,813	4,138	9%	3,985	4,447	12%	
Cost of serv	(700)	(857)	22%	(724)	(930)	29%	To reflect the incremental additions from the infused assets, FY23/24E GLA leased assumptions were also raised by 4%/1%, while rental rates were raised by 5%/11%.
Gross profit	3,113	3,281	5%	3,261	3,517	8%	Reflects full recognition of expenses from the infused assets
GPM	82%	79%		82%	79%		
Opex	(39)	(82)	112%	(40)	(40)	0%	FY23 opex increase due to one-time expense related to the valuation fees for the property-for-share swap transaction
Op inc	3,075	3,200	4%	3,221	3,477	8%	
Op inc margin	81%	77%		81%	78%		
Others - net	(235)	(235)	0%	(233)	(231)	-1%	
Pre-tax profit	2,840	2,965	4%	2,988	3,246	9%	
Tax expense	0	(9)		0	(10)		
Net inc	2,840	2,956	4%	2,988	3,236	8%	
Net inc margin	74%	71%		75%	73%		

Sources: Company

3. Valuation

After factoring in our higher earnings forecast and rolling forward our valuation base to mid-FY24E, our DDM-based TP is raised by 10% to PHP20.

Fig 4: DDM-based valuation

PHP m	FY23E
Distributable income	2,956
Depreciation	0
Funds from operations	2,956
Capex on existing investment properties	(39)
Adjusted funds from operations	2,918
AFFO payout ratio	100%
Dividends	2,917.69
Total dividends as a % of distributable income	99%
Equity value	55,707
Target price (PHP/sh)	20
P/DPU (x)	12
Dividend yield (%)	8%

Sources: Company, Maybank IBG Research

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
Price/DPU(x)	61.6	16.0	11.7	10.7	10.1
P/BV (x)	0.7	0.8	0.7	0.7	0.7
P/NTA (x)	34.2	14.9	11.6	10.6	10.1
DPU yield (%)	1.6	6.2	8.5	9.3	9.9
FCF yield (%)	nm	7.0	9.7	10.4	10.8
INCOME STATEMENT (PHP m)					
Revenue	1,357.5	3,648.8	4,138.0	4,447.3	4,647.4
Net property income	1,085.7	2,935.2	3,199.9	3,477.4	3,644.7
Management and trustee fees	(63.8)	(200.7)	(227.6)	(244.6)	(255.6)
Net financing costs	9.0	(286.0)	(234.5)	(231.3)	(247.5)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income/expenses	0.0	0.0	0.0	0.0	0.0
Pretax profit	2,037.3	(172.2)	2,965.3	3,246.0	3,397.2
Income tax	(1.7)	(4.3)	(8.9)	(9.7)	(10.2)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Total return avail to unitholders	2,035.6	(176.5)	2,956.4	3,236.3	3,387.0
Core net profit	1,093.0	2,645.5	2,956.4	3,236.3	3,387.0
Distributable inc to unitholders	1,093.0	2,645.5	2,956.4	3,236.3	3,387.0
BALANCE SHEET (PHP m)					
Cash & Short Term Investments	1,333.8	1,380.5	1,540.4	1,641.5	2,166.6
Accounts receivable	88.1	264.0	299.3	321.7	336.2
Property, Plant & Equip (net)	0.0	0.0	0.0	0.0	0.0
Investment properties	59,261.0	56,349.0	56,387.8	56,427.3	56,467.6
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	182.3	406.8	449.0	475.6	492.8
Total assets	60,865.2	58,400.3	58,676.5	58,866.1	59,463.2
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	172.2	494.0	560.2	602.1	629.2
LT interest bearing debt	7,195.8	7,201.2	7,201.2	7,201.2	7,701.2
Other liabilities	1,335.9	1,276.9	1,448.1	1,556.3	1,626.3
Total Liabilities	8,703.9	8,972.1	9,209.5	9,359.6	9,956.8
Shareholders Equity	52,161.3	49,518.2	49,557.0	49,596.5	49,596.5
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	52,161.3	49,518.2	49,557.0	49,596.5	49,596.5
Total liabilities and equity	60,865.2	58,490.3	58,766.5	58,956.1	59,553.2
CASH FLOW (PHP m)					
Cash flow from operations	2,634.7	2,780.6	3,116.4	3,337.4	3,452.5
Capex	0.0	0.0	0.0	0.0	0.0
Acquisitions & investments	(9,116.0)	0.0	(38.8)	(39.6)	(40.4)
Disposal of FA & investments	0.0	0.0	0.0	0.0	0.0
Dividend income from associates	0.0	0.0	0.0	0.0	0.0
Other investing cash flow	0.0	0.0	0.0	0.0	0.0
CF from investing activities	(9,116.0)	0.0	(38.8)	(39.6)	(40.4)
Dividends paid	(607.7)	(2,466.5)	(2,917.7)	(3,196.8)	(3,387.0)
Interest expense	0.0	0.0	0.0	0.0	0.0
Change in debt	7,195.6	0.0	0.0	0.0	500.0
Equity raised / (purchased)	1,227.2	0.0	0.0	0.0	0.0
Other financial activities	0.0	0.0	0.0	0.0	0.0
CF from financing activities	7,815.1	(2,466.5)	(2,917.7)	(3,196.8)	(2,887.0)
Effect of exchange rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	1,333.8	314.1	159.9	101.1	525.1

FYE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth ratios (%)					
Revenue growth	(33.5)	168.8	13.4	7.5	4.5
Net property income growth	(44.2)	170.4	9.0	8.7	4.8
Core net profit growth	(1.6)	142.0	11.8	9.5	4.7
Distributable income growth	(1.6)	142.0	11.8	9.5	4.7
Profitability ratios (%)					
Net property income margin	80.0	80.4	77.3	78.2	78.4
Core net profit margin	80.5	72.5	71.4	72.8	72.9
Payout ratio	55.6	93.2	98.7	98.8	100.0
DuPont analysis					
Total return margin (%)	149.9	nm	71.4	72.8	72.9
Gross revenue/Assets (x)	0.0	0.1	0.1	0.1	0.1
Assets/Equity (x)	1.2	1.2	1.2	1.2	1.2
ROAE (%)	6.7	(0.3)	6.0	6.5	6.8
ROAA (%)	3.1	4.4	5.1	5.5	5.7
Leverage & Expense Analysis					
Asset/Liability (x)	7.0	6.5	6.4	6.3	6.0
Net gearing (%) (excl. perps)	11.2	11.8	11.4	11.2	11.2
Net interest cover (x)	na	10.3	13.6	15.0	14.7
Debt/EBITDA (x)	6.6	2.5	2.3	2.1	2.1
Capex/revenue (%)	0.0	0.0	0.0	0.0	0.0
Net debt/ (net cash)	5,862.0	5,820.7	5,660.8	5,559.7	5,534.6
Debt/Assets (x)	0.12	0.12	0.12	0.12	0.13

Source: Company; Maybank IBG Research

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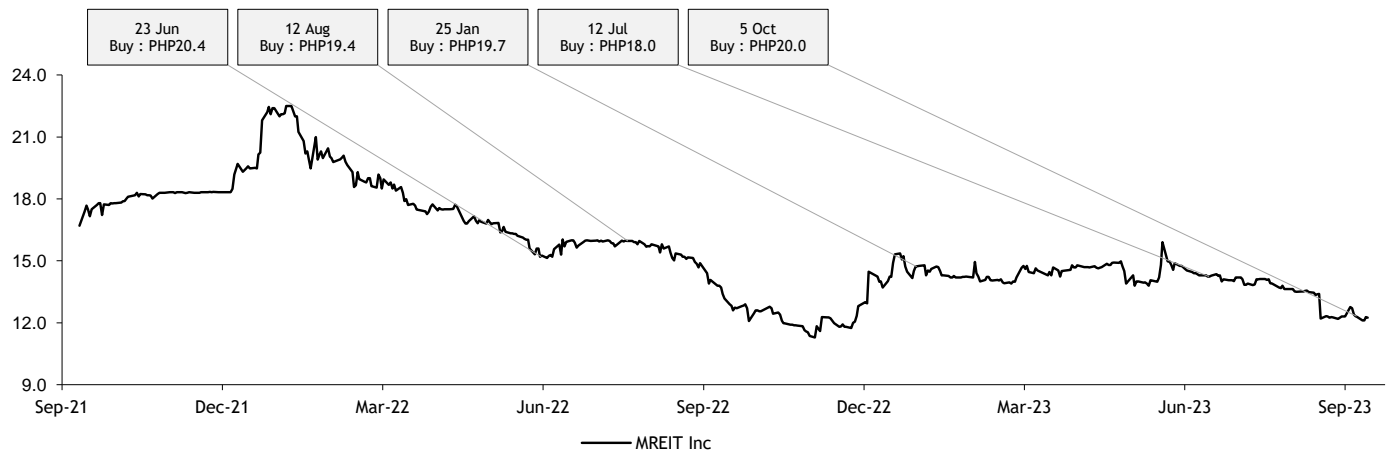
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