

Keppel REIT (KREIT SP)

High funding cost offsets steady operations

Lower distribution, reasonable valuation

KREIT's 9M23 distributable income (DI) of SGD163.6m fell 1.1% YoY and achieved 74% of our full-year forecast. 3Q23 DI fell 0.5% YoY but rose 1.5% QoQ. Occupancy rose across key assets sequentially on the back of healthy leasing momentum and continued positive rent reversions. However, higher borrowing cost led to the decline in distribution. Management remains focused on proactive portfolio and capital management. We lower DPU and our DDM-based TP by 5% to SGD1.00, but maintain BUY on the back of 7% yield and reasonable valuation of 0.7x FY23E PB.

Stable operations, but higher funding cost

9M gross revenue rose 5% YoY due to higher rentals, improved occupancy and contribution from KR Ginza II in Japan (acquired in Nov'22). However, lower margins due to higher utilities cost and property taxes, along with higher borrowing cost resulted in a 10.2% YoY drop in DI from operations. Anniversary top-ups helped to cushion the decline to 1.1% YoY for total DI. Financial trends for 3Q23 were similar on a YoY basis with DI from operations falling 23.7% YoY but overall DI declining 0.5% YoY.

Positive reversion continues

Committed occupancy rose by a full one percentage point QoQ to 95.9%. This was helped by higher occupancy in Australia (8 Chifley Square, Blue & William, 8 Exhibition Street) and KR Ginza II. Headline signing rents in Singapore grew to SGD12.43 psf pm for 9M23 compared to SGD12.35 psf pm for 1H23. Leasing momentum remains healthy with government agencies, financial institutions and existing TMT tenants accounting for incremental space take-up. Aggregate leverage rose 30bps QoQ to 39.5% while all-in funding cost increased by 1bps to 2.85%.

Lower DPU and TP, maintain Buy

We factor in a higher risk-free rate and lower margins resulting in c.1% lower DPU and c.5% cut in our target price. Its sponsor's proposed in-specie distribution of KREIT units, potentially lower asset values and the evolving hybrid work pattern are some of the near/medium-term headwinds. Notwithstanding these, maintain BUY due to stable distribution and reasonable valuation relative to own history and peer commercial REITs.

| FYE Dec (SGD m) | FY21A | FY22A | FY23E | FY24E | FY25E |
|------------------------|-------|-------|-------|-------|-------|
| Revenue | 217 | 219 | 229 | 241 | 245 |
| Net property income | 173 | 176 | 179 | 191 | 191 |
| Core net profit | 196 | 206 | 205 | 209 | 217 |
| Core EPU (cts) | 5.4 | 5.5 | 5.5 | 5.5 | 5.7 |
| Core EPU growth (%) | 12.0 | 2.4 | (1.3) | 0.9 | 2.9 |
| DPU (cts) | 5.8 | 5.9 | 5.9 | 5.9 | 6.1 |
| DPU growth (%) | 1.3 | 1.7 | (0.7) | (0.1) | 3.1 |
| P/NTA (x) | 0.9 | 0.7 | 0.7 | 0.7 | 0.7 |
| DPU yield (%) | 5.2 | 6.5 | 7.0 | 7.0 | 7.2 |
| ROAA (%) | 2.4 | 2.4 | 2.4 | 2.5 | 2.5 |
| Debt/Assets (x) | 0.32 | 0.32 | 0.33 | 0.32 | 0.32 |
| Consensus DPU | - | - | 5.8 | 5.9 | 6.0 |
| MIBG vs. Consensus (%) | - | - | 1.6 | (0.2) | 1.1 |

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BUY

| | |
|-----------------------|-----------------|
| Share Price | SGD 0.84 |
| 12m Price Target | SGD 1.00 (+26%) |
| Previous Price Target | SGD 1.05 |

Company Description

KREIT is a real estate investment trust that invests in income-producing properties used primarily for office purposes.

Statistics

| | |
|------------------------|-----------|
| 52w high/low (SGD) | 0.98/0.83 |
| 3m avg turnover (USDm) | 4.4 |
| Free float (%) | 56.3 |
| Issued shares (m) | 3,770 |
| Market capitalisation | SGD3.2B |
| | USD2.3B |

Major shareholders:

| | |
|-----------------------------|-------|
| Keppel Corp. Ltd. | 43.3% |
| Keppel REIT Management Ltd. | 3.0% |
| The Vanguard Group, Inc. | 2.1% |

Price Performance



| | -1M | -3M | -12M |
|-----------------------|-----|-----|------|
| Absolute (%) | (6) | (8) | (9) |
| Relative to index (%) | (2) | (6) | (13) |

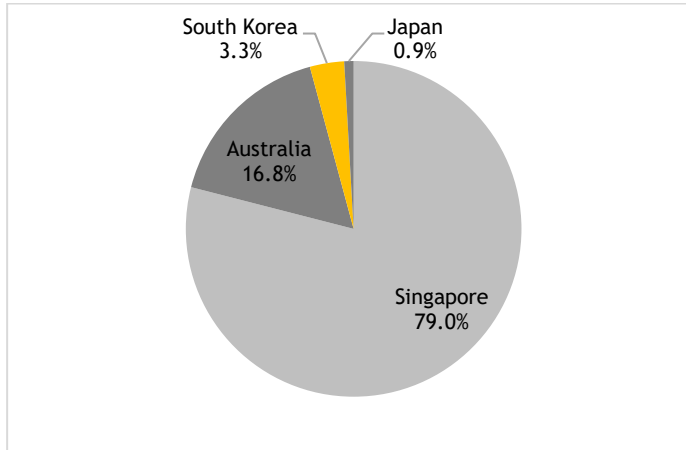
Source: FactSet

ESG@MAYBANK IBG
Tear Sheet Insert

Value Proposition

- One of the largest S-REITs with SGD9.0b in AUM, with significant exposure to Singapore’s Grade-A office market (at c.80% of NPI) and financial institution tenants (at c.28% of its NLA).
- Occupancy likely to remain stable against tight Grade A office supply in Singapore.
- Hybrid working likely to impact portfolio metrics over medium term but KREIT’s Grade-A assets in gateway cities likely to retain value.
- Manageable gearing, stable DPU profile supported by divestment gains, attractive valuation - 6.6% yield, 0.7x PB.

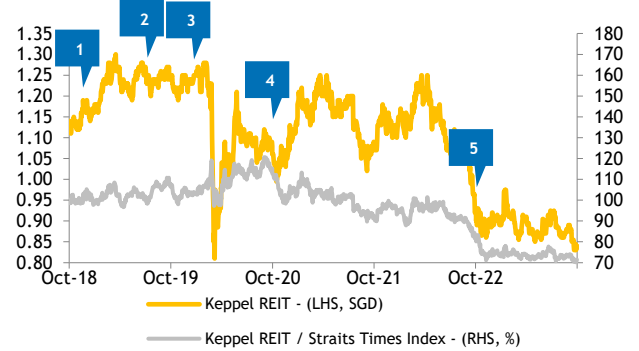
AUM by geography (as of end-Jun 2022)



Source: Company, Maybank IBG Research

Price Drivers

Historical share price trend



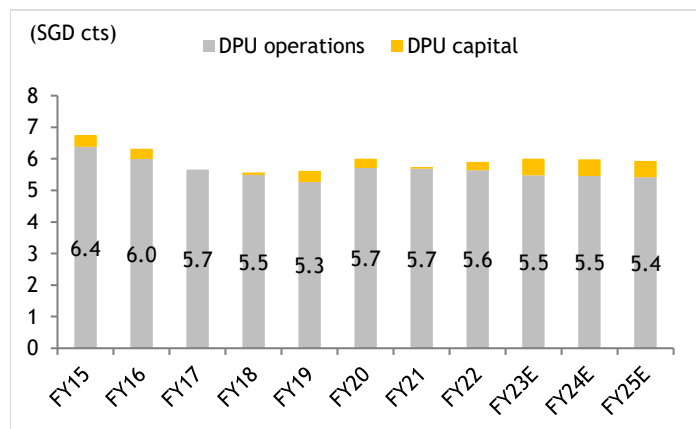
Source: Company, Maybank IBG Research

1. Nov-18: Divests 20% minority interest in Ocean Financial Centre to Allianz for SGD537.3m at 16.8% above 2011 purchase price.
2. Apr-19: Marks entry into South Korea with KRW252.6b (SGD301.4m) T Tower Seoul deal at 4.7% NPI yield, with majority of leases backed by +3.0% pa rental escalations.
3. Oct-19: Divests Bugis Junction Towers for SGD547.5m at 3.0% exit yield, 6.0% premium to valuation and c.243% above 2006 purchase price.
4. Sep-20: Acquires Pinnacle Office Park in Sydney, its first suburban office property, for AUD306.0m (SGD303.3m) at 5.25% NPI yield.
5. Oct-22: Enters Tokyo office market.

Financial Metrics

- DPU to remain stable at c. SGD6cts. on the back of stable operations and distribution of divestment gains.

DPU profile



Source: Company, Maybank IBG Research

Swing Factors

Upside

- Earlier-than-expected pick-up in leasing demand for office space driving improvement in occupancy.
- Better-than-anticipated rental reversions.
- Accretive acquisitions or redevelopment projects

Downside

- Prolonged slowdown in economic activity could reduce demand for office space, resulting in lower occupancy and rental rates.
- Termination of long-term leases contributing to weaker portfolio tenant retention rate.
- Sharper-than-expected rise in interest rates could increase cost of debt and negatively impact earnings, with higher cost of capital lowering valuations.

| | |
|--|-------------|
| Risk Rating & Score ¹ | 11 (Low) |
| Score Momentum ² | -5.7 |
| Last Updated | 24 Nov 2022 |
| Controversy Score ³ (Updated: 24 Nov 2022) | 0 |

Business Model & Industry Issues

- KREIT draws on its available funds to invest in commercial real estate, undertake asset enhancements, and redevelop properties to optimise value for its unit holders. It is susceptible to sustainability-focused investors with strong preference for investing in companies that meet specific ESG criteria, given its incessant need for additional capital.
- Activities relating to permissible investments, leverage limits and annual reporting requirements are closely regulated by the MAS under Singapore's code on collective investment schemes. Independence, real estate and capital markets experience on its board is high, with representation by members with international experience, essential in our view, as its overseas portfolio is increasingly a growth platform.
- Made efforts to improve the scope of reporting and formalisation of targets with the formation of its sustainability committee in 2017. Is the only office S-REIT with SG assets certified with the highest Platinum status under the BCA's Green Mark Scheme.
- Was upgraded in MSCI ESG to A rating in 2021, and maintained its Green Star status and A rating for public disclosure in the Global Real Estate Sustainability Benchmark. Retained its Prime status in ISS-ekom's ESG corporate rating, and remains a constituent in the two key iEdge SG ESG Indices (the iEdge SG ESG Transparency Index and iEdge SG ESG Leaders Index).

Material E issues

- 9 of 11 properties are green-certified with all 4 in Singapore rated BCA Green Mark Platinum and majority in Australia having at least 5 Stars in the NABERS Energy rating.
- Targeting green certification for all buildings by FY23, with T Tower in FY22, and Blue & William upon its completion.
- Commenced Scope 3 emissions screening in FY21 to assess carbon footprint and reduction opportunities, while expanding reporting categories.
- Introduced new targets in FY21 to halve Scope 1 and 2 emissions by 2030 from 2019 levels, reduce water and energy usage by 5% and 10% respectively, while increasing renewable energy usage by 40%.
- Secured SGD520m of green loan facilities in FY21, bringing green loans to 39% of total borrowings, with target to achieve 50% sustainability-focused funding by FY25.

Material S issues

- Leverages sponsor's centralised human capital platform to support its talent management, leadership renewal and training and development initiatives eg. Keppel Leadership Institute (launched in 2015), Keppel Young Leaders and Advanced Leaders Programme (with INSEAD).
- Average training hours per full-time employee jumped to 28 hours in FY21, from 13.2 in FY20 and vs 33.5 in 2019, and compares to 22.1 in 2018 and 27.8 in 2017.
- Gender diversity is high, with female representation at 75% of all 24 employees (in FY21), 50% at the management level, and the Chairman's seat on the board. Target to maintain c.30% female board representation.

Key G metrics and issues

- Managed by Keppel Capital, the asset management arm of its sponsor Keppel Corp, which supports its growth via a pipeline of assets from its development activities, and access to capital markets.
- Board independence is high - it does not comprise any members with executive functions, and 4 of its 7 members are independent.
- Management fee structure, with the base fee at 0.5% of its deposited property, performance fee at 3.0% pa of NPI, as well as acquisition and disposal fee at 1.0% and 0.5% deal value, is comparable to peers.
- The cumulative remuneration of its key management team including the CEO has never represented >3.0% of the REIT's distributable income since its IPO.
- Payout ratio for taxable income has been consistently maintained at 100%, above the minimum 90% threshold for tax transparency.
- Has scaled up via DPU-accretive acquisitions from its sponsor's pipeline. The deal process is rigorous; involving a review by the board's audit committee, and if valued >5% of NAV, unit holders' approval at an EGM.
- Has generated significant value from its divestment of Bugis Junction Towers in 2019 - its lowest yielding asset with minimal rental upside potential given its long 6.2-year WALE - at 243.2% above its 2006 purchase price, with the property delivering 19.4% pa asset-level returns during a 13-year holding period.
- Gearing improved in 2008 after rights issuance but rose from acquisitions since 2011, with look-through leverage (including off-balance sheet debt) higher at c.40%. Ranked 15th out of 45 S-REITs and business trusts in the Governance Index for Trusts 2021, which assesses governance and business risks.

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).

1. Results Highlights

Fig 1: 9M23 results highlights (SGDm)

| | 3Q22 | 2Q23 | 3Q23 | % QoQ | % YoY | 9M22 | 9M23 | % YoY |
|--------------------------------------|------|-------|-------|-------|-------|-------|-------|-------|
| Gross revenue | 54.9 | 57.2 | 57.7 | 0.9 | 5.1 | 164.4 | 172.6 | 5.0 |
| Property expenses | -8.8 | -12.3 | -13.6 | | | -31.8 | -38.6 | |
| Net property income | 46.1 | 44.9 | 44.1 | -1.8 | -4.3 | 132.6 | 134.0 | 1.1 |
| Interest income | -0.1 | 1.7 | 1.9 | | | 16.1 | 5.6 | |
| Share of results of Associates & JVs | 36.1 | 26.5 | 26.2 | -1.1 | -27.4 | 80.5 | 78.4 | -2.6 |
| Borrowing costs | -8.0 | -16.4 | -17.0 | 3.7 | 112.9 | -40.5 | -48.8 | 20.5 |
| Distributable income from operations | 65.0 | 48.8 | 49.6 | 1.6 | -23.7 | 165.4 | 148.6 | -10.2 |
| Anniversary distribution | 0.0 | 5.0 | 5.0 | | | 0.0 | 15.0 | |
| Total distributable income (SGDm) | 54.9 | 53.8 | 54.6 | 1.5 | -0.5 | 165.4 | 163.6 | -1.1 |
| DPU (SGD cts) | | | | | | | | |
| Aggregate leverage (%) | 38.4 | 39.2 | 39.5 | 30 | 110 | 38.4 | 39.5 | 110 |
| All-in financing cost (%) | 2.13 | 2.84 | 2.85 | 1 | 72 | 2.13 | 2.85 | 72 |
| Occupancy (%) | 96.8 | 94.9 | 95.9 | 100 | -90 | 96.8 | 95.9 | -90 |
| NPI margin (%) | 84.0 | 78.5 | 76.4 | -2.1 | -8 | 80.7 | 77.6 | -3 |

Source: Company Data, Maybank IBG Research

2. Forecast changes

Fig 2: Forecast changes

| | FY23E (old) | FY24E (old) | FY23E (New) | FY24E (New) | FY23E (% change) | FY24E (% change) |
|-----------------|----------------|----------------|----------------|----------------|---------------------|---------------------|
| Revenue (SGDm) | 228.9 | 241.0 | 228.9 | 241.0 | 0.0 | 0.0 |
| NPI (SGDm) | 184.1 | 196.0 | 179.1 | 191.0 | -2.7 | -2.6 |
| DPU (SGD cents) | 5.95 | 5.95 | 5.90 | 5.89 | -0.9 | -1.0 |

Source: Maybank IBG Research

3. Valuation

We value KREIT using a dividend discount model with cost of equity assumption of 7.4%. This is higher versus our prior target of 7.2% due to a higher risk-free rate. Further, with c.1% lowering of DPU resulting from factoring in higher operating expenses, we lower our target price by 5% to SGD1.00 but maintain BUY.

4. Risks

Dilutive capital raising, non-renewal of anchor leases, hybrid work pattern and higher interest costs.

| FYE 31 Dec | FY21A | FY22A | FY23E | FY24E | FY25E |
|--|----------------|----------------|----------------|----------------|----------------|
| Key Metrics | | | | | |
| Price/DPU(x) | 19.4 | 15.3 | 14.2 | 14.3 | 13.8 |
| P/BV (x) | 0.8 | 0.6 | 0.6 | 0.6 | 0.6 |
| P/NTA (x) | 0.9 | 0.7 | 0.7 | 0.7 | 0.7 |
| DPU yield (%) | 5.2 | 6.5 | 7.0 | 7.0 | 7.2 |
| FCF yield (%) | 2.6 | 4.5 | 4.9 | 5.2 | 5.2 |
| INCOME STATEMENT (SGD m) | | | | | |
| Revenue | 216.6 | 219.3 | 228.9 | 241.0 | 244.6 |
| Net property income | 172.5 | 175.9 | 179.1 | 191.0 | 191.0 |
| Management and trustee fees | (62.2) | (63.5) | (62.4) | (64.2) | (64.9) |
| Net financing costs | (51.5) | (57.7) | (65.1) | (88.8) | (88.8) |
| Associates & JV | 118.6 | 100.7 | 105.5 | 122.1 | 130.5 |
| Exceptionals | 84.6 | 261.5 | (294.4) | 70.6 | 65.0 |
| Other pretax income/expenses | 0.0 | 9.0 | 9.0 | 9.0 | 9.0 |
| Pretax profit | 259.5 | 423.5 | (128.3) | 239.7 | 241.8 |
| Income tax | (23.0) | (2.0) | (2.0) | (2.0) | (2.0) |
| Minorities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Discontinued operations | (40.0) | (215.5) | 335.7 | (28.3) | (22.3) |
| Total return avail to unitholders | 236.5 | 421.5 | (130.3) | 237.6 | 239.8 |
| Core net profit | 196.5 | 206.0 | 205.4 | 209.3 | 217.5 |
| BALANCE SHEET (SGD m) | | | | | |
| Cash & Short Term Investments | 189.2 | 186.4 | 55.1 | 35.1 | 18.1 |
| Accounts receivable | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Property, Plant & Equip (net) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Investment properties | 4,707.4 | 4,917.0 | 4,790.2 | 4,860.8 | 4,923.8 |
| Intangible assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Investment in Associates & JVs | 3,533.8 | 3,667.6 | 3,500.0 | 3,500.0 | 3,500.0 |
| Other assets | 57.3 | 110.3 | 110.3 | 110.3 | 110.3 |
| Total assets | 8,487.7 | 8,881.4 | 8,455.7 | 8,506.2 | 8,552.3 |
| ST interest bearing debt | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Accounts payable | 59.5 | 57.8 | 57.8 | 57.8 | 57.8 |
| LT interest bearing debt | 2,726.8 | 2,851.9 | 2,752.0 | 2,752.0 | 2,752.0 |
| Other liabilities | 111.4 | 106.4 | 106.4 | 106.4 | 106.4 |
| Total Liabilities | 2,897.7 | 3,016.1 | 2,916.2 | 2,916.2 | 2,916.2 |
| Shareholders Equity | 5,168.2 | 5,420.9 | 5,095.1 | 5,145.6 | 5,191.7 |
| Minority Interest | 421.8 | 444.4 | 444.4 | 444.4 | 444.4 |
| Total shareholder equity | 5,590.0 | 5,865.3 | 5,539.5 | 5,589.9 | 5,636.1 |
| Total liabilities and equity | 8,487.7 | 8,881.4 | 8,455.7 | 8,506.2 | 8,552.3 |
| CASH FLOW (SGD m) | | | | | |
| Cash flow from operations | 113.7 | 162.2 | 156.0 | 167.1 | 167.7 |
| Capex | (5.1) | (10.6) | 0.0 | 0.0 | 0.0 |
| Acquisitions & investments | (512.4) | (161.9) | 0.0 | 0.0 | 0.0 |
| Disposal of FA & investments | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividend income from associates | 116.1 | 99.5 | 105.5 | 122.1 | 130.5 |
| Other investing cash flow | 18.3 | 26.7 | 14.8 | 12.8 | 12.8 |
| CF from investing activities | (383.1) | (46.4) | 120.2 | 134.8 | 143.3 |
| Dividends paid | (205.6) | (217.0) | (221.7) | (223.6) | (232.7) |
| Interest expense | (46.8) | (53.9) | (65.1) | (88.8) | (88.8) |
| Change in debt | 314.7 | 184.0 | (99.8) | 0.0 | 0.0 |
| Equity raised / (purchased) | 265.2 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other financial activities | (24.2) | (24.5) | (9.5) | (9.5) | (9.5) |
| CF from financing activities | 303.4 | (111.4) | (396.1) | (321.9) | (331.0) |
| Effect of exchange rate changes | (1.6) | (5.7) | 0.0 | 0.0 | 0.0 |
| Net cash flow | 32.3 | (1.3) | (119.8) | (20.0) | (20.0) |

| FYE 31 Dec | FY21A | FY22A | FY23E | FY24E | FY25E |
|--|---------|---------|---------|---------|---------|
| Key Ratios | | | | | |
| Growth ratios (%) | | | | | |
| Revenue growth | 27.2 | 1.2 | 4.4 | 5.3 | 1.5 |
| Net property income growth | 27.3 | 2.0 | 1.8 | 6.6 | (0.0) |
| Core net profit growth | 20.5 | 4.8 | (0.3) | 1.9 | 3.9 |
| Distributable income growth | na | na | na | na | na |
| Profitability ratios (%) | | | | | |
| Net property income margin | 79.7 | 80.2 | 78.2 | 79.3 | 78.1 |
| Core net profit margin | 90.7 | 93.9 | 89.7 | 86.9 | 88.9 |
| Payout ratio | 108.0 | 107.3 | 107.9 | 106.8 | 107.0 |
| DuPont analysis | | | | | |
| Total return margin (%) | 109.2 | 192.2 | nm | 98.6 | 98.0 |
| Gross revenue/Assets (x) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Assets/Equity (x) | 1.6 | 1.6 | 1.7 | 1.7 | 1.6 |
| ROAE (%) | na | na | na | na | na |
| ROAA (%) | 2.4 | 2.4 | 2.4 | 2.5 | 2.5 |
| Leverage & Expense Analysis | | | | | |
| Asset/Liability (x) | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 |
| Net gearing (%) (excl. perps) | 45.4 | 45.4 | 48.7 | 48.6 | 48.5 |
| Net interest cover (x) | 2.1 | 1.9 | 1.8 | 1.4 | 1.4 |
| Debt/EBITDA (x) | nm | nm | nm | nm | nm |
| Capex/revenue (%) | 2.4 | 4.8 | 0.0 | 0.0 | 0.0 |
| Net debt/ (net cash) | 2,537.6 | 2,665.4 | 2,696.9 | 2,716.9 | 2,733.9 |
| Debt/Assets (x) | 0.32 | 0.32 | 0.33 | 0.32 | 0.32 |

Source: Company; Maybank IBG Research

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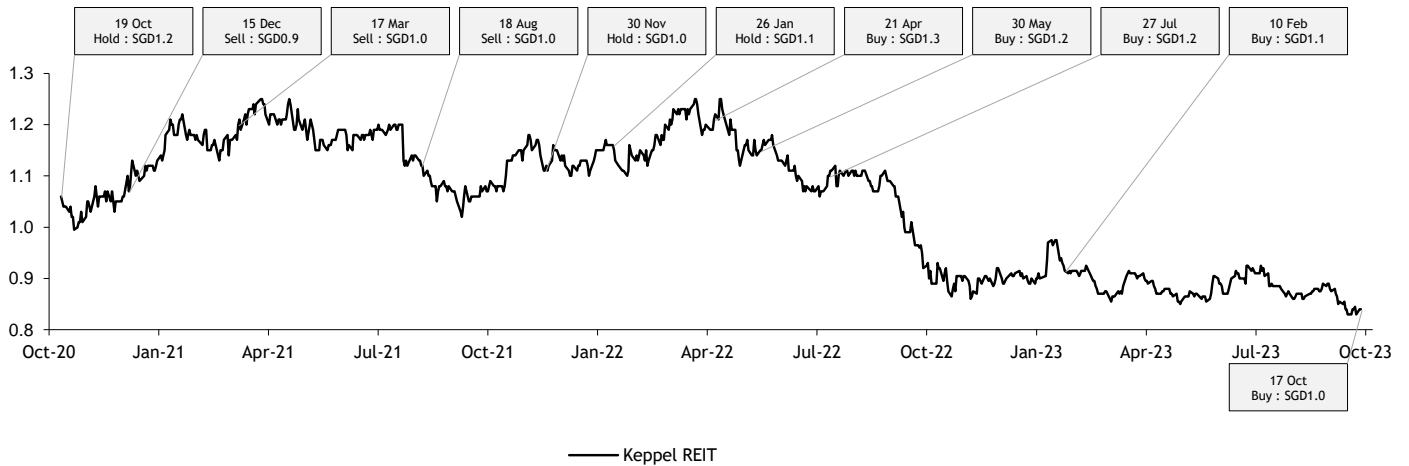
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