

Keppel REIT (KREIT SP)

Acquiring 'down under'

Buying 50% of freehold Grade-A Sydney CBD office

KREIT proposed acquisition of a 50% stake in 255 George Street for AUD363.8m from Mirvac Funds. The office building has 93% committed occupancy with an average lease to maturity of 6.8 years mostly tenanted to government agencies and a financial institution. The initial NPI yield exceeds 6%. Funded with a mix of AUD and SGD debt, pro-forma DPU accretion will be 1.4% with a higher gearing of 41%. Maintain BUY with unchanged estimates and DDM-based TP of SGD1.00 on an attractive 6.7% dividend yield and 40% discount to book.

Tapping flight-to-core trend

255 George Street is an iconic prime building located in Sydney CBD's highly sought after Core Precinct. The 1985-vintage freehold building underwent a AUD50m refurbishment and obtained an excellent green credential (NABERS 5.5 star energy rating). It counts the Australian Taxation Office and the Bank of Queensland as top two tenants accounting for c.87% of the NLA and has a long WALE of 6.8 years. The building has committed occupancy of 93%. The vendor is providing a rent guarantee for existing vacancies and potential expiries. About c.13% of the purchase amount consists of such guarantees, capitalized rent incentives or abatements and committed capex.

Strategic and financial merits of the deal

The asset will benefit from flight-to-quality and flight-to-prime locations for office demand. While 150K sqm of supply is expected this year in Sydney CBD, JLL research forecasts the supply to be absorbed within 1-2 years of completion. The long WALE, quality tenants and well-spread lease expiries will give stable cash flows. Proportion of freehold assets in KREIT's AUM mix will increase to 36.4% from 33.2%. A mix of AUD and SGD debt priced at c.4% will fund the deal. With pro-forma gearing is above 40%, the group will seek opportunities for capital recycling. In Feb, Mingtiandi reported that KREIT was marketing T Tower in Seoul (valued SGD316.8m, 4.9% NPI yield) and the potential purchase of 255 George Street.

Maintain Buy

Notwithstanding the challenging macro and emerging trend of hybrid working, KREIT is focussed on Grade A CBD assets and is taking the long view of its portfolio. That said, the rental support, capitalized rent incentives, tenant concentration and elevated gearing bears watching unless capital recycling lowers the gearing. We maintain Buy on its attractive valuation and our forecasts and TP are unchanged pending deal completion.

FYE Dec (SGD m)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	219	233	241	245	261
Net property income	176	182	192	196	211
Core net profit	206	191	184	193	203
Core EPU (cts)	5.5	5.1	4.8	5.0	5.2
Core EPU growth (%)	2.4	(8.5)	(4.3)	3.3	3.8
DPU (cts)	5.9	5.8	5.8	5.9	6.1
DPU growth (%)	1.7	(2.1)	(0.2)	2.5	3.4
P/NTA (x)	0.7	0.7	0.6	0.7	0.6
DPU yield (%)	6.5	6.2	6.6	6.8	7.0
ROAA (%)	2.4	2.2	2.2	2.3	2.3
Debt/Assets (x)	0.32	0.28	0.29	0.29	0.29
Consensus DPU	-	-	5.9	6.0	6.1
MIBG vs. Consensus (%)	-	-	(1.4)	(0.9)	1.6

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BUY

Share Price	SGD 0.88
12m Price Target	SGD 1.00 (+20%)
Previous Price Target	SGD 1.00

Company Description

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

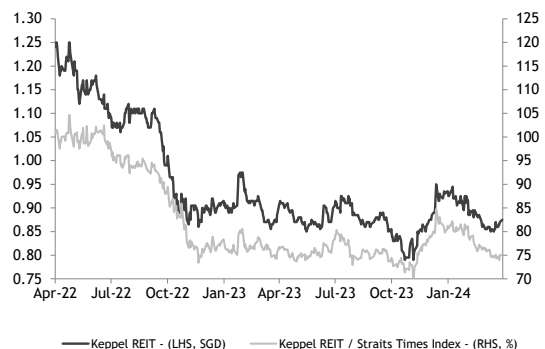
Statistics

52w high/low (SGD)	0.95/0.79
3m avg turnover (USDm)	5.7
Free float (%)	56.3
Issued shares (m)	3,770
Market capitalisation	SGD3.3B
	USD2.4B

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 (%)	1	(6)	(1)
Relative to index (%)	(2)	(5)	(0)

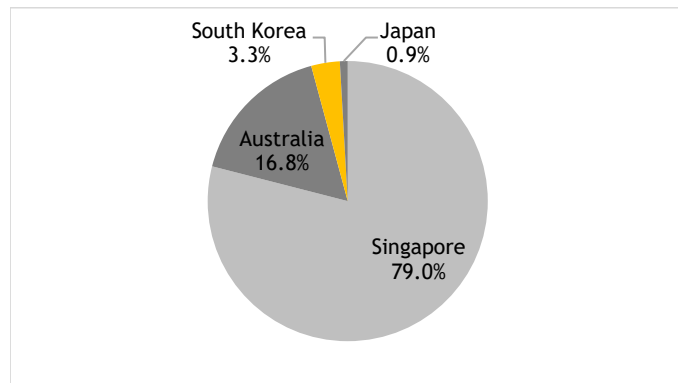
Source: FactSet

ESG@MAYBANK IBG
Tear Sheet Insert

Value Proposition

- One of the largest S-REITs at SGD9.0b 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)

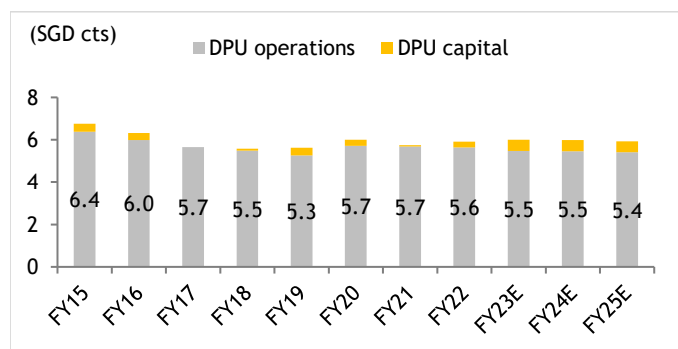


Source: Company, Maybank IBG Research

Financial Metrics

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

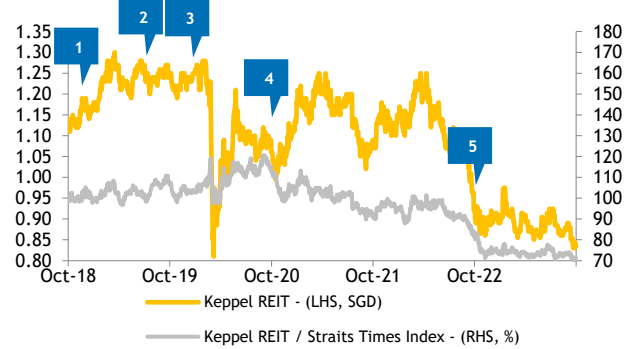
DPU profile



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.

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.

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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-oekom'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. Valuation

We value KREIT using dividend discount model with cost of equity assumption of 7.4%. We leave our estimates unchanged pending the deal completion. We maintain our target price of SGD1.00 and our BUY rating. KREIT trades at attractive valuation of 6.7% yield and 40% discount to book. This compares against mean yield of 6% and 20% mean discount to book.

2. Risks

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

FYE 31 Dec	FY22A	FY23A	FY24E	FY25E	FY26E
Key Metrics					
Price/DPU(x)	15.3	16.0	15.1	14.7	14.2
P/BV (x)	0.6	0.7	0.6	0.6	0.6
P/NTA (x)	0.7	0.7	0.6	0.7	0.6
DPU yield (%)	6.5	6.2	6.6	6.8	7.0
FCF yield (%)	4.5	4.9	4.7	4.8	5.2
INCOME STATEMENT (SGD m)					
Revenue	219.3	233.1	241.0	244.6	261.3
Net property income	175.9	182.4	191.7	195.7	210.8
Management and trustee fees	(63.5)	(62.4)	(64.5)	(65.5)	(67.3)
Net financing costs	(57.7)	(67.0)	(83.1)	(85.8)	(87.5)
Associates & JV	100.7	103.8	109.4	116.7	114.2
Exceptionals	261.5	24.7	198.8	48.0	104.2
Other pretax income/expenses	9.0	0.0	0.0	0.0	0.0
Pretax profit	423.5	181.5	352.3	209.2	274.5
Income tax	(2.0)	(11.6)	(11.6)	(11.6)	(11.6)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	(215.5)	20.6	(156.4)	(4.9)	(60.3)
Total return avail to unitholders	421.5	169.9	340.7	197.6	262.9
Core net profit	206.0	190.5	184.4	192.8	202.6
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	186.4	141.6	110.6	91.6	123.6
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	4,917.0	4,927.5	4,860.8	4,923.8	4,992.7
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	3,667.6	3,134.4	3,500.0	3,535.0	3,570.4
Other assets	110.3	55.8	55.8	55.8	55.8
Total assets	8,881.4	8,259.3	8,527.2	8,606.2	8,742.5
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	57.8	59.6	59.6	59.6	59.6
LT interest bearing debt	2,851.9	2,338.4	2,438.4	2,488.4	2,538.4
Other liabilities	106.4	110.2	110.2	110.2	110.2
Total Liabilities	3,016.1	2,508.3	2,608.3	2,658.3	2,708.3
Shareholders Equity	5,420.9	5,306.7	5,474.6	5,503.6	5,589.8
Minority Interest	444.4	444.4	444.4	444.4	444.4
Total shareholder equity	5,865.3	5,751.1	5,918.9	5,948.0	6,034.2
Total liabilities and equity	8,881.4	8,259.3	8,527.2	8,606.2	8,742.5
CASH FLOW (SGD m)					
Cash flow from operations	162.2	169.9	158.1	161.8	175.9
Capex	(10.6)	0.0	0.0	0.0	0.0
Acquisitions & investments	(161.9)	(87.3)	(100.0)	0.0	0.0
Disposal of FA & investments	0.0	0.0	0.0	0.0	0.0
Dividend income from associates	99.5	673.2	109.4	116.7	114.2
Other investing cash flow	26.7	17.4	25.9	25.9	26.8
CF from investing activities	(46.4)	603.3	35.3	142.5	141.0
Dividends paid	(217.0)	(219.4)	(220.8)	(229.2)	(239.9)
Interest expense	(53.9)	(61.1)	(83.1)	(85.8)	(87.5)
Change in debt	184.0	(491.3)	100.0	50.0	50.0
Equity raised / (purchased)	0.0	(17.2)	0.0	0.0	0.0
Other financial activities	(24.5)	(25.6)	(9.5)	(9.5)	(9.5)
CF from financing activities	(111.4)	(814.6)	(213.4)	(274.4)	(286.9)
Effect of exchange rate changes	(5.7)	(3.0)	0.0	0.0	0.0
Net cash flow	(1.3)	(44.4)	(20.0)	30.0	30.0

FYE 31 Dec	FY22A	FY23A	FY24E	FY25E	FY26E
Key Ratios					
Growth ratios (%)					
Revenue growth	1.2	6.3	3.4	1.5	6.8
Net property income growth	2.0	3.7	5.1	2.1	7.7
Core net profit growth	4.8	(7.5)	(3.2)	4.5	5.1
Distributable income growth	na	na	na	na	na
Profitability ratios (%)					
Net property income margin	80.2	78.3	79.5	80.0	80.7
Core net profit margin	93.9	81.7	76.5	78.8	77.5
Payout ratio	107.3	114.8	119.8	118.9	118.4
DuPont analysis					
Total return margin (%)	192.2	72.9	141.4	80.8	100.6
Gross revenue/Assets (x)	0.0	0.0	0.0	0.0	0.0
Assets/Equity (x)	1.6	1.6	1.6	1.6	1.6
ROAE (%)	na	na	na	na	na
ROAA (%)	2.4	2.2	2.2	2.3	2.3
Leverage & Expense Analysis					
Asset/Liability (x)	2.9	3.3	3.3	3.2	3.2
Net gearing (%) (excl. perps)	45.4	38.2	39.3	40.3	40.0
Net interest cover (x)	1.9	1.8	1.5	1.5	1.6
Debt/EBITDA (x)	nm	19.5	19.2	19.1	17.7
Capex/revenue (%)	4.8	0.0	0.0	0.0	0.0
Net debt/ (net cash)	2,665.4	2,196.8	2,327.8	2,396.8	2,414.8
Debt/Assets (x)	0.32	0.28	0.29	0.29	0.29

Source: Company; Maybank IBG Research

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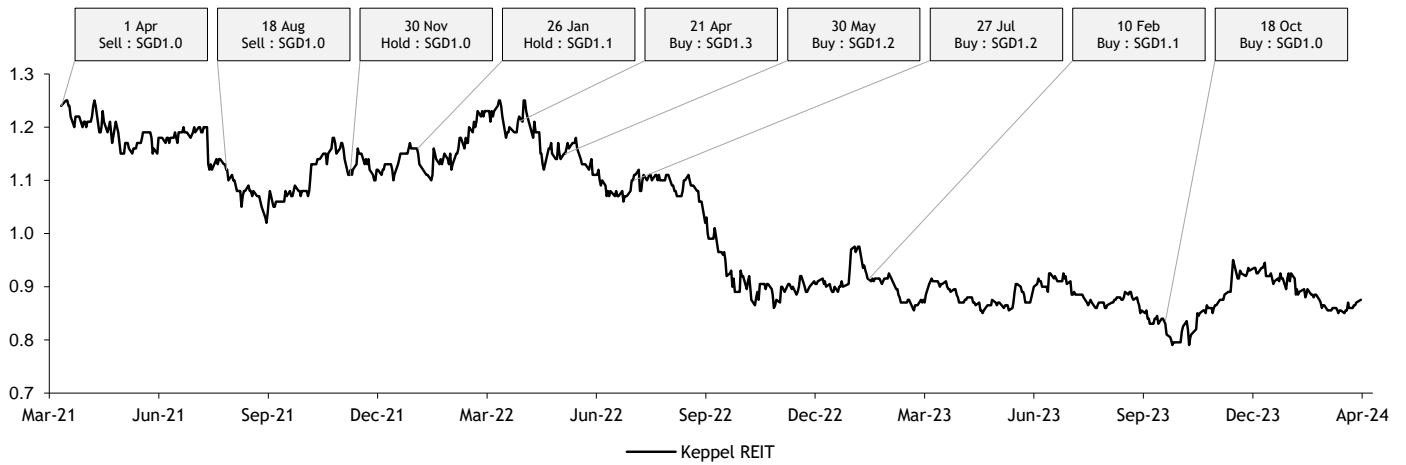
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