

Keppel REIT (KREIT SP)

Holding ground

BUY

Share Price SGD 0.92
 12m Price Target SGD 1.05 (+21%)
 Previous Price Target SGD 1.05

Improving operating metrics, elevated gearing

KREIT reported 3Q distributable income of SGD53.7m, +3.9% QoQ, -1.6% YoY. Organic and inorganic top-line growth was offset by higher financing expense. Positive reversion continued at a low double-digit pace while occupancy improved sequentially for Australia and was steady elsewhere. Gearing and debt cost inched up. With rates poised to trend down, mgmt. noted potential for a stabilisation of asset values and consequential support for gearing. We tweak down our estimates but maintain our DDM-based TP of SGD1.05 and BUY rating.

Improving operating metrics

3Q revenue grew 18.9% and NPI rose 17.2% YoY. On a QoQ basis, revenue grew 7.5% and NPI rose 6.4%. Growth was driven by higher rental income and contribution from new assets (2 Blue Street and 255 George Street). Contribution from associates and JVs rose 3.3% QoQ/7.6% YoY led by higher rentals for ORQ and MBFC, which more than offset higher borrowing expenses. Financing expense rose 4.9% QoQ/39.4% YoY in 3Q influencing the QoQ/YoY comparable for 3Q distributable income. Portfolio occupancy rose to 97.6% from 97.0% in 2Q, led by 140bps improvement in occupancy in Australia. Occupancy in Singapore was stable overall. Slippage at ORQ and OFC was offset by improvement at Keppel Bay Tower. YTD rent reversion was +10.2% (+9.3% for 1H) while signing rent in Singapore was SGD12.93psf (12.63 in 2Q).

Elevated gearing, focus on capital recycling

Gearing inched up to 41.9% (2Q 41.3%) and debt cost 3.38% (2Q 3.31%). Coverage ratio was 2.7x (2Q 2.8x). Debt cost guide remains at mid-3% with potential to come in lower based on rate trajectory and bank margins. Mgmt. also expected potential stabilisation/uplift of asset values with recent transactional cap rates in Australia coming in lower than 6.5% for 255 George St and rent growth in Singapore. This is likely to lower gearing. However, focus remains on recycling for a resilient balance sheet.

Maintain BUY

We lower our FY24-25 DPU estimates by 2.5% and 1.4%, respectively. We leave our rating and TP unchanged. While there are some large renewals due for next year (15% of NLA), expiring rents of SGD11.14psf are well below market, and lower rates may further spur economic activity. Valuation is supportive at a 6.2% yield and 0.7x P/BV.

FYE Dec (SGD m)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	219	233	259	289	306
Net property income	176	182	202	221	235
Core net profit	206	191	202	210	229
Core EPU (cts)	5.5	5.1	5.3	5.4	5.8
Core EPU growth (%)	2.4	(8.5)	4.4	2.6	7.4
DPU (cts)	5.9	5.8	5.8	5.9	6.5
DPU growth (%)	1.7	(2.1)	(0.5)	2.2	9.2
P/NTA (x)	0.7	0.7	0.7	0.7	0.7
DPU yield (%)	6.5	6.2	6.3	6.4	7.0
ROAA (%)	2.4	2.2	2.4	2.4	2.6
Debt/Assets (x)	0.32	0.28	0.32	0.32	0.32
Consensus DPU	-	-	6.0	6.0	6.0
MIBG vs. Consensus (%)	-	-	(2.8)	(1.5)	7.6

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Company Description

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

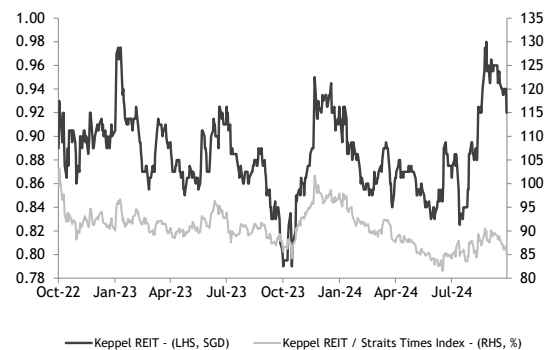
Statistics

52w high/low (SGD)	0.98/0.79
3m avg turnover (USDm)	5.6
Free float (%)	56.3
Issued shares (m)	3,770
Market capitalisation	SGD3.5B
	USD2.6B

Major shareholders:

Keppel Corp. Ltd.	43.3%
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Price Performance



	-1M	-3M	-12M
Absolute (%)	(4)	5	14
Relative to index (%)	(3)	(0)	(3)

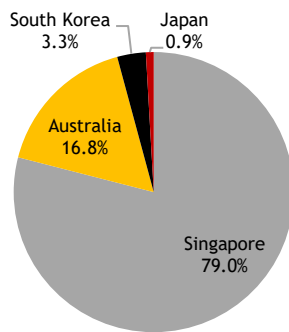
Source: FactSet

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 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.

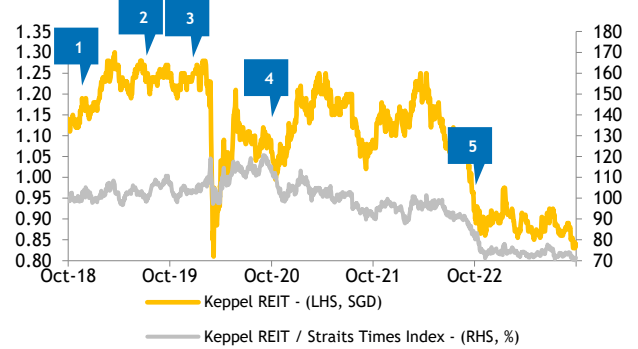
AUM by geography (as of end-Jun 2022)



Source: Company, Maybank IBG Research

Price Drivers

Historical share price trend



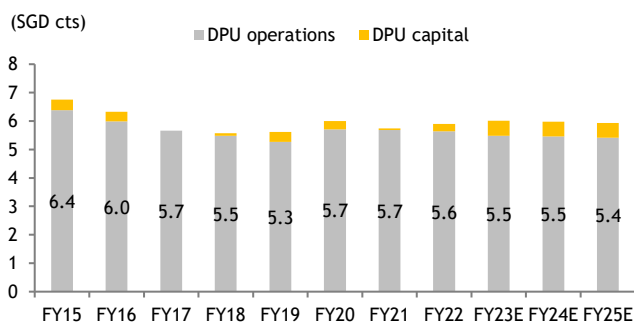
Source: Company, Maybank IBG Research

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 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.

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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-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. Result highlights

Fig 1: 9M result details

SGDm.	3Q23	2Q24	3Q24	%QoQ	%YoY	9M23	9M24	%YoY
Gross revenue	57.7	63.8	68.6	7.5	18.9	172.6	193.7	12.2
Property expenses	-13.6	-15.2	28.3					
Net property income	44.1	48.6	51.7	6.4	17.2	134.0	148.5	10.8
NPI attributable to unitholders	39.6	43.8	47.2	7.8	19.2	120.4	134.4	11.6
Share of results of Associates & JVs	26.2	27.3	28.2	3.3	7.6	78.4	83.1	6.0
Borrowing costs	-17.0	-22.6	-23.7	4.9	39.4	-48.8	-65.0	33.2
Distributable income from operations	49.6	46.7	48.7	4.3	-1.8	148.6	145.6	-2.0
Anniversary distribution	5.0	5.0	5.0			15.0	15.0	0.0
Total distributable income	54.6	51.7	53.7	3.9	-1.6	163.6	160.6	-1.8
Aggregate leverage (%)	39.5	41.3	41.9	60	240	39.5	41.9	240
All-in financing cost (%)	2.85	3.31	3.38	7	53	2.85	3.38	53
ICR, x	2.9	2.8	2.7			2.9	2.7	
Fixed rate hedges, %	76	65	68			76	68	
Occupancy (%)	95.9	97.0	97.6	60	170	95.9	97.6	170
NPI margin (%)	76.4	76.2	75.4	-0.8	-1.1	77.6	76.7	-1.0
Portfolio rent reversion YTD, %		9.3	10.2				10.2	
Singapore signing rent for the qtr, SGD psf pm	12.43	12.63	12.93				12.93	
Performance by geography								
Net Property Income, SGDm.	3Q23	2Q24	3Q24	%QoQ	%YoY	9M23	9M24	%YoY
Singapore	61.6	63.4	63.6	0.3	3.2	184.3	191.3	3.8
Australia	21.5	23.0	27.4	19.1	27.4	62.0	72.8	17.4
North Asia	3.1	3.8	3.7	-2.6	19.4	9.3	10.7	15.1
Total	86.2	90.2	94.7	5.0	9.9	255.6	274.8	7.5
Occupancy, %								
Singapore		98.9	98.9	0				
Australia		93.6	95.0	140				
North Asia		100	100	0				

Source: Maybank IBG Research, Company Data

2. Estimate changes

Fig 2: Changes to our FY24-25 estimates

	FY24E (old)	FY25E (old)	FY24E (New)	FY25E (New)	FY24E (% change)	FY25E (% change)
Revenue	264.6	289.2	259.3	289.2	-2.0	0.0
NPI	208.9	228.7	201.7	221.4	-3.5	-3.2
Associates & JVs	107.4	95.6	112.4	100.6	4.7	5.2
Borrowing cost	-88.4	-89.3	-87.1	-85.1	-1.4	-4.6
Distributable Inc.	226.2	232.0	220.5	228.8	-2.5	-1.4
DPU (SGD cents)	5.93	5.99	5.78	5.91	-2.5	-1.4

Source: Maybank IBG Research

3. Valuation

We value KREIT using a dividend discount model with a cost of equity assumption of 7.0%. Our risk-free rate is unchanged at 2.75%. We factor in a slightly lower contribution from Australian assets, lower NPI margin and higher valuation gains. This results in NPI declines of 3.5% and 3.2% for FY24 and FY25, respectively. Coupled with lower financing expense and a smaller dividend payout ratio from JV for FY24, we lower DPU by 2.5% and 1.4% for FY24-25E. We leave our DDM-based target price of SGD1.05 and BUY rating unchanged.

4. 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	15.9	15.6	14.3
P/BV (x)	0.6	0.7	0.7	0.7	0.7
P/NTA (x)	0.7	0.7	0.7	0.7	0.7
DPU yield (%)	6.5	6.2	6.3	6.4	7.0
FCF yield (%)	4.5	4.9	5.0	5.5	5.7
INCOME STATEMENT (SGD m)					
Revenue	219.3	233.1	259.3	289.2	305.9
Net property income	175.9	182.4	201.7	221.4	235.1
Management and trustee fees	(63.5)	(62.4)	(65.8)	(68.0)	(69.9)
Net financing costs	(57.7)	(67.0)	(87.1)	(85.1)	(82.5)
Associates & JV	100.7	103.8	112.4	100.6	104.0
Exceptionals	261.5	24.7	(28.1)	10.9	99.4
Other pretax income/expenses	9.0	0.0	0.0	0.0	0.0
Pretax profit	423.5	181.5	133.0	179.8	286.1
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	80.1	41.7	(45.8)
Total return avail to unitholders	421.5	169.9	121.5	168.2	274.6
Core net profit	206.0	190.5	201.5	209.9	228.7
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	186.4	141.6	115.6	101.6	133.6
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	5,133.9	5,194.7	5,261.1
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	3,667.6	3,134.4	3,300.0	3,300.0	3,333.0
Other assets	110.3	55.8	55.8	55.8	55.8
Total assets	8,881.4	8,259.3	8,605.3	8,652.1	8,783.5
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	2,738.4	2,788.4	2,838.4
Other liabilities	106.4	110.2	110.2	110.2	110.2
Total Liabilities	3,016.1	2,508.3	2,908.3	2,958.3	3,008.3
Shareholders Equity	5,420.9	5,306.7	5,252.7	5,249.5	5,330.9
Minority Interest	444.4	444.4	444.4	444.4	444.4
Total shareholder equity	5,865.3	5,751.1	5,697.0	5,693.9	5,775.3
Total liabilities and equity	8,881.4	8,259.3	8,605.3	8,652.1	8,783.5
CASH FLOW (SGD m)					
Cash flow from operations	162.2	169.9	176.3	194.4	207.2
Capex	(10.6)	0.0	0.0	0.0	0.0
Acquisitions & investments	(161.9)	(87.3)	(400.0)	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	112.4	100.6	104.0
Other investing cash flow	26.7	17.4	13.4	13.4	14.3
CF from investing activities	(46.4)	603.3	(274.3)	114.0	118.3
Dividends paid	(217.0)	(219.4)	(220.5)	(228.8)	(253.6)
Interest expense	(53.9)	(61.1)	(87.1)	(85.1)	(82.5)
Change in debt	184.0	(491.3)	400.0	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)	83.0	(273.4)	(295.5)
Effect of exchange rate changes	(5.7)	(3.0)	0.0	0.0	0.0
Net cash flow	(1.3)	(44.4)	(15.0)	35.0	30.0

FYE 31 Dec	FY22A	FY23A	FY24E	FY25E	FY26E
Key Ratios					
Growth ratios (%)					
Revenue growth	1.2	6.3	11.3	11.5	5.8
Net property income growth	2.0	3.7	10.6	9.8	6.2
Core net profit growth	4.8	(7.5)	5.8	4.1	9.0
Distributable income growth	na	na	na	na	na
Profitability ratios (%)					
Net property income margin	80.2	78.3	77.8	76.5	76.8
Core net profit margin	93.9	81.7	77.7	72.6	74.8
Payout ratio	107.3	114.8	109.4	109.0	110.9
DuPont analysis					
Total return margin (%)	192.2	72.9	46.8	58.2	89.7
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	2.4	2.4	2.6
Leverage & Expense Analysis					
Asset/Liability (x)	2.9	3.3	3.0	2.9	2.9
Net gearing (%) (excl. perps)	45.4	38.2	46.0	47.2	46.8
Net interest cover (x)	1.9	1.8	1.6	1.8	2.0
Debt/EBITDA (x)	nm	19.5	nm	18.2	17.2
Capex/revenue (%)	4.8	0.0	0.0	0.0	0.0
Net debt/ (net cash)	2,665.4	2,196.8	2,622.8	2,686.8	2,704.8
Debt/Assets (x)	0.32	0.28	0.32	0.32	0.32

Source: Company; Maybank IBG Research

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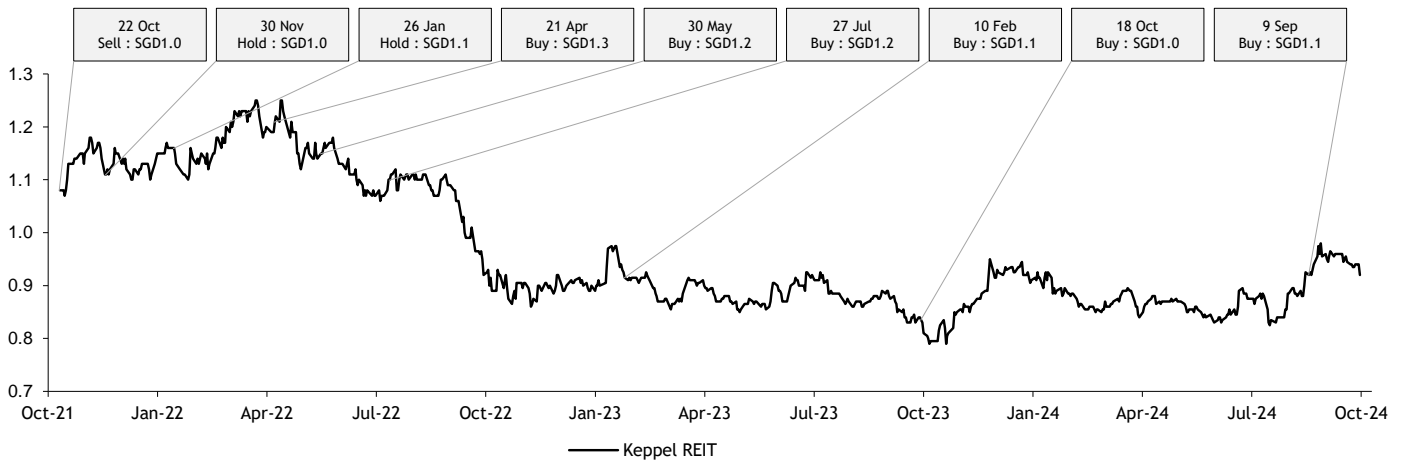
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