

# Keppel REIT (KREIT SP)

## Impacted by financing costs

### Robust operations, elevated gearing unchanged

KREIT reported 2H DPU of SGD2.8c, flat HoH/-3.4% YoY. Acquisition-led top-line growth was offset by higher borrowing cost. Portfolio achieved high and stable committed occupancy and mid-teens positive reversion. Gearing was stable; cost of debt rose and coverage fell. Portfolio value inched down due to expanding cap rates in Australia and adverse forex. We cut our estimates for FY26 and lower our DDM-based TP to SGD1.00 from SGD1.05. Maintain BUY.

### Occupancy improving; continued positive reversions

2H revenue of SGD136.5m, +9.1% HoH/+15.5% YoY. NPI of SGD105.1m, +8.6% HoH/+13.6% YoY. The growth was enabled by completion of 2 Blue Street, acquisition of 255 George Street and higher revenue from T Tower and KR Ginza II, which more than offset lower income from OFC and 8 Exhibition Street. Distributable income and DPU fell due to higher borrowing costs. The portfolio achieved strong rental reversion of 13.2% and maintained a high portfolio committed occupancy of 97.9% (3Q 97.6%) through proactive asset management, bolstered by the flight-to-quality trend. Increase in occupancy was mainly due to higher occupancy of 2 Blue Street. Keppel REIT's Singapore office leases had a weighted average signing rent of about SGD12.56 psf pm in FY24 (SGD12.93 psf pm in 3Q, SGD12.63 psf pm in 2Q). Notwithstanding the slowdown in signing rent, commentary suggests healthy leasing demand and positive reversion in FY25 as average expiring rent (SGD11.31) is below spot.

### Capital management

Gearing was 41.2% (3Q 41.9%). Cost of debt 3.4% (3Q 3.38%). Coverage fell from 2.7x to 2.5x. Debt cost guide remains at mid-3%. Portfolio valuation decreased 0.2% from 30 June 2024 due mainly to expansion of capitalisation rates of the Australia assets and foreign exchange translation differences. Mgmt.'s focus is on proactive asset management and disciplined capital management.

### Maintain BUY

We leave our FY25 estimates largely unchanged but lower FY26 by 7%, factoring in absence of rental support and lower income from Australia. We lower our TP to SGD1.00. While renewal of large leases poses downside risk, below market expiring rents and reasonable valuation keeps us on BUY.

FYE Dec (SGD m)	FY23A	FY24A	FY25E	FY26E	FY27E
Revenue	233	262	289	295	301
Net property income	182	202	221	226	232
Core net profit	191	214	207	216	225
Core EPU (cts)	5.1	5.6	5.3	5.5	5.7
Core EPU growth (%)	(8.5)	10.6	(4.5)	3.6	2.6
DPU (cts)	5.8	5.6	5.9	6.0	5.9
DPU growth (%)	(2.1)	(3.2)	5.3	1.0	(1.7)
P/NTA (x)	0.7	0.7	0.7	0.7	0.7
DPU yield (%)	6.2	6.5	6.9	7.0	6.8
ROAA (%)	2.2	2.6	2.4	2.5	2.6
Debt/Assets (x)	0.28	0.31	0.32	0.32	0.32
Consensus DPU	-	-	5.7	5.7	5.9
MIBG vs. Consensus (%)	-	-	3.8	5.0	(0.1)

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## BUY

Share Price	SGD 0.86
12m Price Target	SGD 1.00 (+23%)
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.

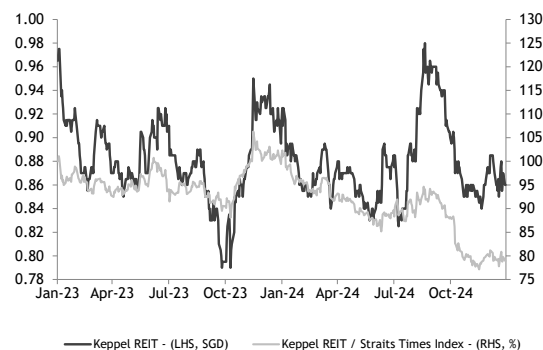
### Statistics

52w high/low (SGD)	0.98/0.83
3m avg turnover (USDm)	5.0
Free float (%)	56.3
Issued shares (m)	3,770
Market capitalisation	SGD3.2B
	USD2.4B

### Major shareholders:

Keppel Corp. Ltd.	43.3%
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### Price Performance



	-1M	-3M	-12M
Absolute (%)	(2)	(4)	(6)
Relative to index (%)	(2)	(11)	(22)

Source: FactSet

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# 1. Investment thesis

Fig 1: FY24 Result details

SGDm	4Q23	3Q24	4Q24	%QoQ	%YoY	2H23	1H24	2H24	%HoH	%YoY	FY23	FY24	% YoY
Gross revenue	60.5	68.6	67.9	-1.0	12.2	118.2	125.1	136.5	9.1	15.5	233.1	261.6	12.2
Property expenses	-12.1	-16.9	-14.5			-25.7	-28.3	-31.4			-50.7	-59.7	
Net property income	48.4	51.7	53.4	3.3	10.3	92.5	96.8	105.1	8.6	13.6	182.4	201.9	10.7
NPI attributable to unitholders	43.4	47.2	48.5	2.8	11.8	83.0	87.2	95.7			163.8	182.9	
Share of results of Asso. & JVs	25.3	28.2	26.8	-5.0	5.9	51.5	54.9	55.0	0.2	6.8	103.8	109.9	5.9
Borrowing costs	-18.2	-23.7	-23.6	-0.4	29.7	-35.2	-41.3	-47.3	14.5	34.4	-67.0	-88.6	32.2
Distributable inc. from ops.	50.1	48.7	48.9	0.4	-2.4	99.7	96.9	97.6	0.7	-2.1	198.7	194.5	-2.1
Anniversary distribution	5.0	5.0	5.0			10.0	10.0	10.0			20.0	20.0	
Total distributable inc.	55.1	53.7	53.9	0.4	-2.2	109.7	106.9	107.6	0.7	-1.9	218.7	214.5	-1.9
DPU (SGD cts)						2.90	2.80	2.80	0.0	-3.4	5.80	5.60	-3.4
NAV per unit (SGD)						1.29	1.27	1.24	-2.4	-3.9	1.29	1.24	-3.9
Aggregate leverage (%)	38.9	41.9	41.2	-70	230	38.9	41.3	41.2	-10	230	38.9	41.2	230
All-in financing cost (%)	2.89	3.38	3.4	2	51	2.89	3.31	3.40	42	51	2.89	3.40	51
ICR, x	3.0	2.7	2.5			3.0	2.8	2.5					
Fixed rate hedges, %	75	68	69			75	65	69					
Occupancy (%)	97.1	97.6	97.9	30	80	97.1	97.0	97.9	90	80	97.1	97.9	80
NPI margin (%)	80.0	75.4	77.0	163	-300	80.0	77.4	77.0	-38	-300	78.2	77.2	-1
<b>Performance by geography</b>													
<b>Net Property Income, SGDm.</b>	<b>4Q23</b>	<b>3Q24</b>	<b>4Q24</b>	<b>%QoQ</b>	<b>%YoY</b>	<b>2H23</b>	<b>1H24</b>	<b>2H24</b>	<b>%HoH</b>	<b>%YoY</b>	<b>FY23</b>	<b>FY24</b>	<b>% YoY</b>
Singapore	62.7	63.6	63.3	-0.5	1.0	124.3	127.7	126.9	-0.6	2.1	247.0	254.6	3.1
Australia	23.1	27.4	26.4	-3.6	14.3	44.6	45.4	53.8	18.5	12.1	85.1	99.2	16.6
North Asia	3.0	3.7	3.9	5.4	30.0	6.1	7.0	7.6	8.6	12.9	12.3	14.6	18.7
Total	88.8	94.7	93.6	-1.2	5.4	173.6	180.1	188.3	4.6	6.3	344.4	368.4	7.0
<b>Occupancy, %</b>													
Singapore	99.0	98.9	98.8	-10									
Australia	93.8	95.0	96.1	110									
North Asia	96.4	100	100.0	0									

Source: Maybank IBG Research

# 2. Estimate changes

Fig 2: Estimate changes

	FY25E (old)	FY26E (old)	FY25E (New)	FY26E (New)	FY25E (% change)	FY26E (% change)
Revenue	289.2	305.9	289.2	295.0	0.0	-3.6
NPI	221.4	235.1	221.4	225.8	0.0	-4.0
Associates & JVs	100.6	104.0	100.6	104.0	0.0	0.0
Borrowing cost	-85.1	-82.5	-85.7	-83.2	0.7	0.9
DI	228.8	253.6	229.1	233.9	0.2	-7.8
DPU (SGD cents)	5.91	6.46	5.93	5.98	0.3	-7.3

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 lower contribution from 255 George Street and absence of rental support for 2026. We factor in 75% of fee in units from 100%. All in, we lower DPU by c.7% for FY26E. We lower our DDM-based target price to SGD1.00 and maintain our BUY rating.

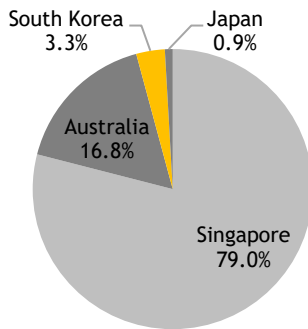
# 4. Risks

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

## 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)

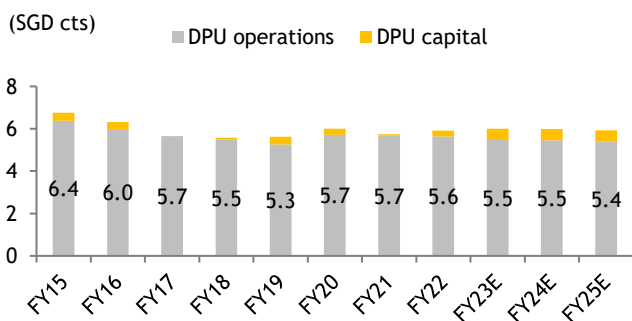


Source: Company, Maybank IBG Research

## Financial Metrics

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

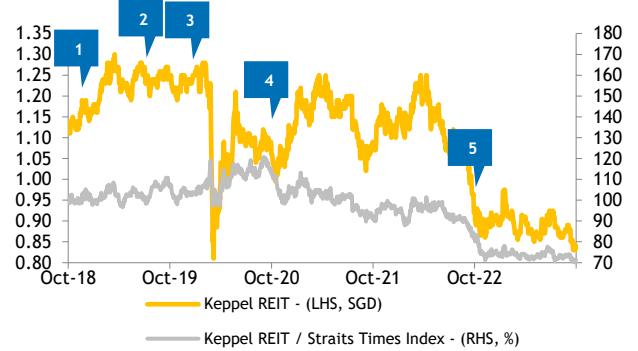
### DPU profile



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 <sup>1</sup>	11 (Low)
Score Momentum <sup>2</sup>	-5.7
Last Updated	24 Nov 2022
Controversy Score <sup>3</sup> (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 15<sup>th</sup> out of 45 S-REITs and business trusts in the Governance Index for Trusts 2021, which assesses governance and business risks.

<sup>1</sup>**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. <sup>2</sup>**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. <sup>3</sup>**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).

FYE 31 Dec	FY23A	FY24A	FY25E	FY26E	FY27E
<b>Key Metrics</b>					
Price/DPU(x)	16.0	15.5	14.5	14.4	14.6
P/BV (x)	0.7	0.6	0.7	0.6	0.6
P/NTA (x)	0.7	0.7	0.7	0.7	0.7
DPU yield (%)	6.2	6.5	6.9	7.0	6.8
FCF yield (%)	4.9	5.7	5.8	5.8	5.9
<b>INCOME STATEMENT (SGD m)</b>					
Revenue	233.1	261.6	289.2	295.0	300.7
<b>Net property income</b>	<b>182.4</b>	<b>201.9</b>	<b>221.4</b>	<b>225.8</b>	<b>232.3</b>
Management and trustee fees	(62.4)	(65.0)	(67.3)	(68.3)	(69.1)
Net financing costs	(67.0)	(88.5)	(85.7)	(83.2)	(84.7)
Associates & JV	103.8	110.0	100.6	104.0	107.5
Exceptionals	24.7	(43.5)	(22.7)	98.2	97.8
Other pretax income/expenses	0.0	0.0	0.0	0.0	0.0
<b>Pretax profit</b>	<b>181.5</b>	<b>114.8</b>	<b>146.3</b>	<b>276.4</b>	<b>283.7</b>
Income tax	(11.6)	(1.2)	(1.2)	(1.2)	(1.2)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	20.6	99.9	61.6	(58.7)	(58.0)
<b>Total return avail to unitholders</b>	<b>169.9</b>	<b>113.6</b>	<b>145.1</b>	<b>275.2</b>	<b>282.5</b>
Core net profit	190.5	213.5	206.7	216.5	224.6
<b>BALANCE SHEET (SGD m)</b>					
Cash & Short Term Investments	141.6	80.9	49.3	84.3	119.3
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	4,927.5	5,167.5	5,194.7	5,261.1	5,326.9
Intangible assets	0.0	0.0	0.0	0.0	0.0
Investment in Associates & JVs	3,134.4	3,176.2	3,176.2	3,207.9	3,240.0
Other assets	55.8	33.1	33.1	33.1	33.1
<b>Total assets</b>	<b>8,259.3</b>	<b>8,457.6</b>	<b>8,453.3</b>	<b>8,586.5</b>	<b>8,719.3</b>
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	59.6	51.9	51.9	51.9	51.9
LT interest bearing debt	2,338.4	2,657.8	2,707.8	2,757.8	2,807.8
Other liabilities	110.2	106.7	106.7	106.7	106.7
<b>Total Liabilities</b>	<b>2,508.3</b>	<b>2,816.4</b>	<b>2,866.4</b>	<b>2,916.4</b>	<b>2,966.4</b>
Shareholders Equity	5,306.7	5,193.1	5,138.8	5,221.9	5,304.7
Minority Interest	444.4	448.1	448.1	448.1	448.1
<b>Total shareholder equity</b>	<b>5,751.1</b>	<b>5,641.2</b>	<b>5,586.9</b>	<b>5,670.0</b>	<b>5,752.9</b>
<b>Total liabilities and equity</b>	<b>8,259.3</b>	<b>8,457.6</b>	<b>8,453.3</b>	<b>8,586.5</b>	<b>8,719.3</b>
<b>CASH FLOW (SGD m)</b>					
<b>Cash flow from operations</b>	<b>169.9</b>	<b>189.0</b>	<b>191.8</b>	<b>195.7</b>	<b>201.8</b>
Capex	0.0	0.0	0.0	0.0	0.0
Acquisitions & investments	(87.3)	(376.5)	0.0	0.0	0.0
Disposal of FA & investments	0.0	0.0	0.0	0.0	0.0
Dividend income from associates	673.2	108.7	100.6	104.0	107.5
Other investing cash flow	17.4	16.9	11.9	11.9	2.5
<b>CF from investing activities</b>	<b>603.3</b>	<b>(250.9)</b>	<b>112.5</b>	<b>115.9</b>	<b>110.0</b>
Dividends paid	(219.4)	(216.6)	(229.1)	(233.9)	(232.6)
Interest expense	(61.1)	(86.7)	(85.7)	(83.2)	(84.7)
Change in debt	(491.3)	331.5	50.0	50.0	50.0
Equity raised / (purchased)	(17.2)	0.0	0.0	0.0	0.0
Other financial activities	(25.6)	(26.0)	(9.5)	(9.5)	(9.5)
<b>CF from financing activities</b>	<b>(814.6)</b>	<b>2.2</b>	<b>(274.3)</b>	<b>(276.6)</b>	<b>(276.8)</b>
<b>Effect of exchange rate changes</b>	<b>(3.0)</b>	<b>(1.6)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net cash flow</b>	<b>(44.4)</b>	<b>(61.3)</b>	<b>30.0</b>	<b>35.0</b>	<b>35.0</b>

FYE 31 Dec	FY23A	FY24A	FY25E	FY26E	FY27E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	6.3	12.2	10.6	2.0	1.9
Net property income growth	3.7	10.7	9.6	2.0	2.9
Core net profit growth	(7.5)	12.1	(3.2)	4.7	3.7
Distributable income growth	na	na	na	na	na
<b>Profitability ratios (%)</b>					
Net property income margin	78.3	77.2	76.5	76.5	77.2
Core net profit margin	81.7	81.6	71.5	73.4	74.7
Payout ratio	114.8	100.5	110.9	108.1	103.6
<b>DuPont analysis</b>					
Total return margin (%)	72.9	43.4	50.2	93.3	94.0
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 (%)	2.2	2.6	2.4	2.5	2.6
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	3.3	3.0	2.9	2.9	2.9
Net gearing (%) (excl. perps)	38.2	45.7	47.6	47.2	46.7
Net interest cover (x)	1.8	1.5	1.8	1.9	1.9
Debt/EBITDA (x)	19.5	19.4	17.6	17.5	17.2
Capex/revenue (%)	0.0	0.0	0.0	0.0	0.0
Net debt/ (net cash)	2,196.8	2,576.9	2,658.6	2,673.6	2,688.6
Debt/Assets (x)	0.28	0.31	0.32	0.32	0.32

Source: Company; Maybank IBG Research

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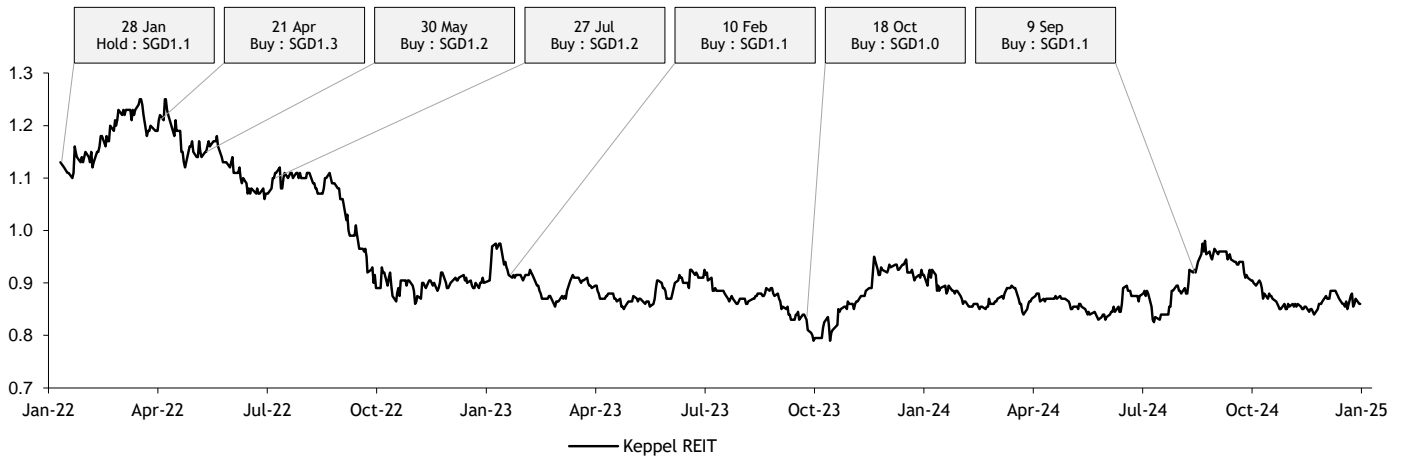
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