

13 April 2020

Property | REITS

Keppel Pacific Oak US REIT (KORE SP)

Buy (Maintained)

Navigating Rough Seas; Keep BUY

Target Price (Return): USD0.76 (+43%)
 Price: USD0.53
 Market Cap: USD496m
 Avg Daily Turnover (USD/USD): 2.32m/2.32m

- **Keep BUY with a new USD0.76 TP from USD0.88), 43% upside and c.11% yield.** COVID-19's impact on Keppel Pacific Oak US REIT's office portfolio is mitigated by a diversified asset/tenant base and reasonably long portfolio weighted average lease to expiry (>4 years). While overall office demand is expected to take a near-term hit, we expect demand in tech markets – to which KORE has most exposure – to hold up relatively well. The recent finalisation of tax regulations should provide some savings. Valuations are relatively cheap at 0.6x P/BV.

- **Operational updates.** Management updated during a recent call that, while it has not received any rent rebate requests so far, it expects such requests from some tenants in the near term. For such cases, KORE's strategy will be to evaluate the requests on a case-by-case basis. If needed, it may work with some tenant to provide rent relief to maintain long-term relationships and avoid bankruptcies. The retail segment (mainly cafes in office buildings) has been the worst hit, but accounts for <1% of overall income. While some rightsizing in the professional services sector and tenant movements are expected, the proportions of such are expected to be rather low.

- **Limited FY20 lease expiries and minimal tenant concentration risks.** Only c.7% of leases by rental income are due for renewal in FY20 – mostly in Seattle, Denver, and Austin – of which a portion were already renewed by February at positive (low double-digit) rent reversions. Office leasing has paused since then, and rent is expected to come under pressure. With KORE's expiring rent on average 10- 15% below market rates (before the COVID-19 crisis), it has some leeway in lowering rent. Tenant concentration risks remain minimal, with Top 10 tenants accounting for only 19.4% of the total, with no sector accounting for >30% of the portfolio.

- **Finalisation of tax regulations to result in tax savings.** The final regulations related to Section 267A of the US Internal Revenue Code were announced on 7 Apr. Based on these final regulations, KORE should be able to revert its tax structure to the one in place during its listing, ie without the need for the Barbados entity it currently has. The move should result in annual tax savings of c.1.5%.

- **No balance sheet concerns.** KORE has revolving credit facilities in place to refinance the small portion of debt (4.4%) maturing in FY20. It has also early refinanced 30% of its loans due in FY21, with the remaining only maturing in Nov 2021. 100% of debts are unsecured, with 81% in fixed terms. Gearing remains modest at 36.9%, ie well below the 45% threshold.

- **Earnings and TP changes.** We have lowered our FY20F-22F DPU 3-5% by factoring in some vacancies and lowering rent. Our COE is also raised 70bps to 9.7% to factor in increased market risks.

Analyst

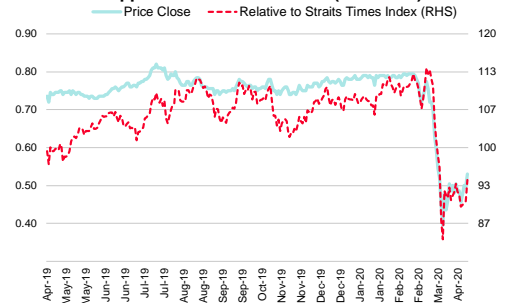
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(32.1)	(26.4)	(32.5)	(30.3)	(28.4)
Relative	(11.9)	(18.8)	(11.7)	(13.5)	(5.7)
52-wk Price low/high (USD)	0.40 – 0.82				

Keppel Pacific Oak US REIT (KORE SP)



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (USDm)	106	123	131	133	136
Net property income (USDm)	64.4	74.8	79.5	80.8	82.6
Reported net profit (USDm)	53.0	69.7	54.3	55.2	56.1
Total distributable income (USDm)	43.8	50.8	55.1	55.7	56.8
DPS (USD)	0.06	0.06	0.06	0.06	0.06
DPS growth (%)	0.0	(3.3)	(2.2)	0.9	1.7
P/B (x)	0.66	0.66	0.66	0.66	0.65
Dividend Yield (%)	11.7	11.4	11.1	11.2	11.4
Return on average equity (%)	0.0	9.9	7.2	7.3	7.4
Return on average assets (%)	0.0	5.9	4.1	4.2	4.2

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Singapore	Recurring EPS (USD)	0.08	0.08	0.06	0.06	0.06
Property	EPS (USD)	0.08	0.08	0.06	0.06	0.06
Keppel Pacific Oak US REIT	DPS (USD)	0.06	0.06	0.06	0.06	0.06
KORE SP	BVPS (USD)	0.80	0.80	0.80	0.81	0.81
Buy	Return on average equity (%)	-	9.9	7.2	7.3	7.4
	Weighted avg adjusted shares (m)	704.12	843.92	937.15	939.15	941.15
Valuation basis						
DDM						
Key drivers	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. Limited near-term lease expiry mitigating risks;	Recurring P/E (x)	7.04	6.42	9.15	9.01	8.90
ii. Stable balance sheet and low refinancing risks;	P/E (x)	7.04	6.42	9.15	9.01	8.90
iii. Benign interest rate environment and government stimulus.	P/B (x)	0.7	0.7	0.7	0.7	0.7
	FCF Yield (%)	8.4	8.6	16.1	14.6	15.5
	Dividend Yield (%)	11.7	11.4	11.1	11.2	11.4
	EV/EBITDA (x)	- 3.58	- 4.18	- 4.20	- 4.19	- 4.17
	EV/EBIT (x)	- 3.58	- 4.18	- 4.20	- 4.19	- 4.17
Key risks	Income statement (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. A deep protracted slowdown in the US economy on a prolonged trade war and COVID-19;	Total turnover	106	123	131	133	136
ii. Structural changes in office demand;	EBITDA	60	70	74	75	77
iii. Failure of co-working operator model.	Operating profit	60	70	74	75	77
	Net interest	(12)	(16)	(16)	(17)	(18)
	Pre-tax profit	63	90	55	55	56
	Taxation	(10)	(20)	(0)	0	0
	Recurring net profit	53	70	54	55	56
Company Profile	Cash flow (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
KORE's investment strategy is to principally invest in a diversified portfolio of income-producing commercial and real estate-related assets. These assets are in key growth markets in the US, with favourable economic and office fundamentals that are above the national average. This is so as to provide sustainable distribution and strong total returns for unit holders.	Change in working capital	4	7	14	3	3
	Cash flow from operations	61	73	90	81	83
	Capex	(29)	(35)	(10)	(8)	(5)
	Cash flow from investing activities	(980)	(180)	(10)	(8)	(5)
	Dividends paid	(24)	(61)	(55)	(56)	(57)
	Cash flow from financing activities	960	104	(75)	(60)	(68)
	Cash at beginning of period	0	41	38	43	56
	Net change in cash	41	(2)	5	12	10
	Ending balance cash	41	38	43	56	66
	Balance sheet (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	41	38	43	56	66
	Total investments	1,017	1,257	1,267	1,275	1,280
	Total other assets	4	0	0	0	0
	Total assets	1,067	1,301	1,316	1,337	1,352
	Short-term debt	5	21	25	25	25
	Total long-term debt	367	457	476	492	501
	Total liabilities	409	552	563	579	590
	Shareholders' equity	658	749	753	758	763
	Total equity	658	749	753	758	763
	Net debt	331	440	458	461	460
	Total liabilities & equity	1,067	1,301	1,316	1,337	1,352
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	0.0	16.0	6.2	1.7	2.1
	Recurrent EPS growth (%)	0.0	9.6	(29.8)	1.5	1.3
	Operating EBITDA margin (%)	56.5	56.6	56.8	56.7	56.7
	Net profit margin (%)	50.1	56.7	41.6	41.6	41.4
	Dividend payout ratio (%)	82.6	72.9	101.6	100.9	101.3
	Capex/sales (%)	27.7	28.6	7.7	6.0	3.7
	Interest cover (x)	4.97	4.33	4.44	4.31	4.20

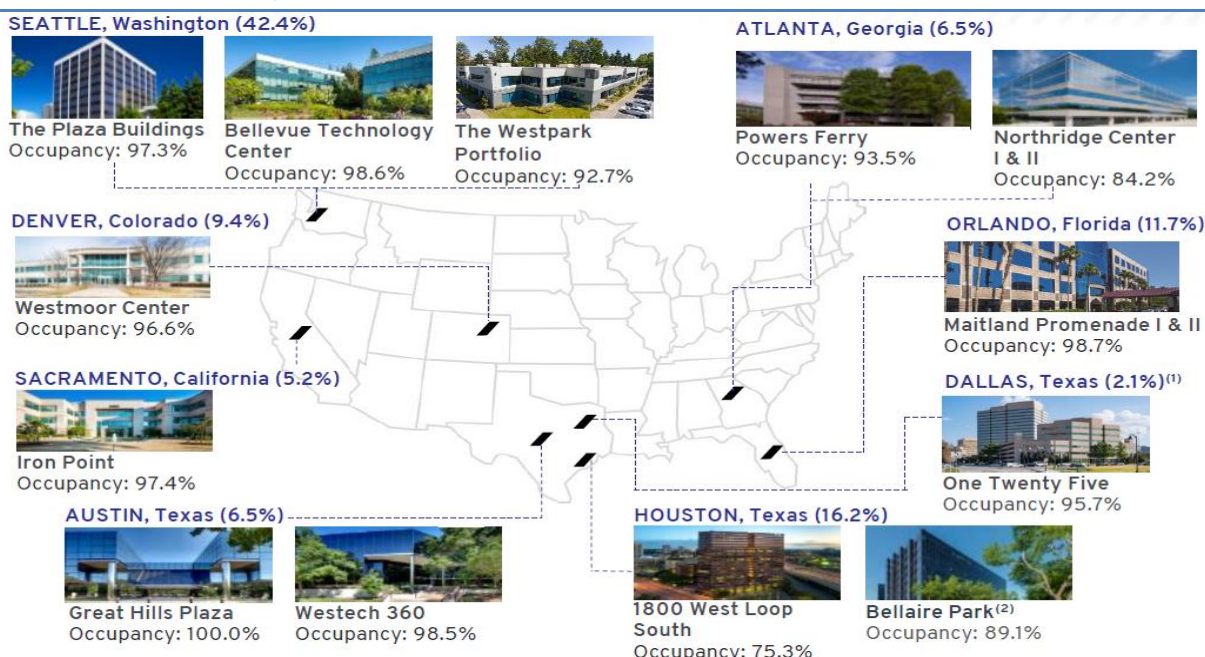
Source: Company data, RHB

Figure 1: DDM valuation

	FY20F	FY21F	FY22F	FY23F	FY24F	Terminal value
DPU (cents)	5.88	5.93	6.03	6.22	6.32	84.0
TP (USD)	0.76					
Current price (USD)	0.53					
Price upside	43%					
Distribution yield FY19F	11%					
Total returns	54%					
Assumptions						
Risk-free rate (%)	3.0					
Beta	0.9					
Cost of equity (%)	9.7					
Terminal growth (%)	2.0					

Source: Company data, RHB

Figure 2: Portfolio composition by cities and assets



Source: Company

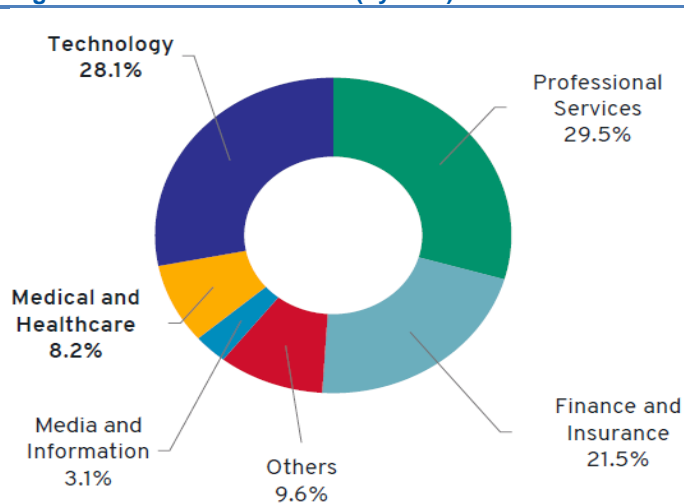
Figure 3: Top 10 tenants

Tenant	Sector	Asset	% CRI
Ball Aerospace	Technology	Westmoor Ctr	3.5
Oculus VR	Technology	Westpark Portfolio	2.3
Lear	Technology	The Plaza Buildings	2.1
Zimmer Biomet Spine	Technology	Westmoor Ctr	2.0
Spectrum	Media & Information	Maitland Promenade I	1.8
Unigard Insurance ⁽¹⁾	Finance & Insurance	Bellevue Technology Ctr	1.7
Bio-Medical Applications	Medical & Healthcare	One Twenty Five	1.7
US Bank	Finance & Insurance	The Plaza Buildings	1.6
Reed Group	Technology	Westmoor Ctr	1.4
Nintex USA	Technology	The Plaza Buildings	1.3
Total			19.4
WALE (by NLA)			5.5 years
WALE (by CRI)			5.6 years

(1) Subsidiary of QBE Insurance Group.

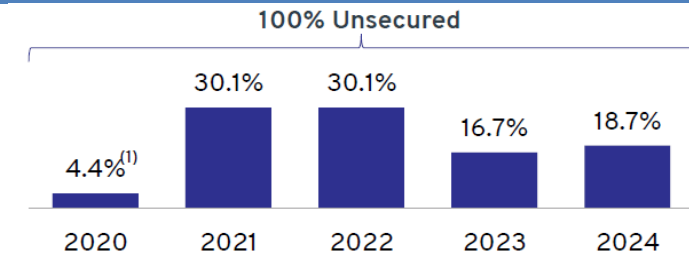
Source: Company data

Figure 4: Tenant trade sector (by NLA)

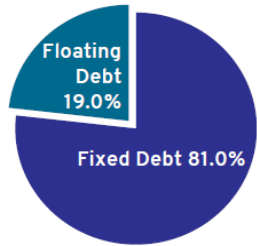


Source: Company data

Figure 5: Debt profile



Interest Rate Exposure

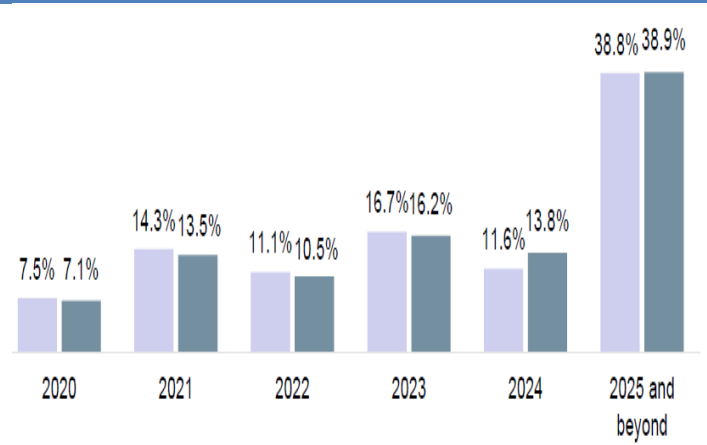


Sensitivity to LIBOR⁽⁵⁾

Every +/- 50bps in LIBOR translates to +/- 0.058 US cents in DPUs p.a.

Source: Company data

Figure 6: Lease expiry profile by NLA and CRI



(1) By NLA.
 (2) Based on NLA, portfolio WALE was 4.3 years.
 (3) As at 31 December 2019.

NLA
 CRI

Source: Company data

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-01-22	Buy	0.88	0.79
2019-10-16	Buy	na	0.76
2019-09-09	Buy	na	0.75
2019-09-06	Buy	na	0.75
2019-07-18	Buy	na	0.81
2019-07-17	Buy	na	0.82

Source: RHB, Bloomberg

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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