

6 September 2019

Property | REITS

Keppel Pacific Oak US REIT (KORE SP)

Buy (Maintained)

New Name, Yet Same Attractive 8% Yield; BUY

Target Price (Return)	USD0.88 (+19%)
Price:	USD0.74
Market Cap:	USD610m
Avg Daily Turnover (SGD/USD)	1.1m/0.8m

- Maintain BUY and USD0.88 TP, 19% upside plus c.8% yield.** Despite concerns over the rising US China trade tensions, we believe KORE's office portfolio, which mainly focuses on US technology hubs, will stay resilient and continue to outperform the broader market. The changes announced in name and trust structure are more cosmetic in nature, and should not have any operational impact. Valuations are attractive at 0.9x P/BV and 8.3% yield – healthy at >300bps spread compared to Singapore Office REITs.
- No operational changes expected from reorganisation.** Keppel-KBS US REIT announced a change of name to Keppel Pacific Oak US REIT (KORE), with plans underway to enter into a new outsourcing management agreement with a new US asset manager, Pacific Oak Capital Advisors LLC. The new outsourcing management agreement will be substantially on the same terms as the existing one. No operational impact is expected as the asset manager (the Core Plus team), and the REIT's management team are expected to remain the same, post changes. In our view, the impending reorganisation will help investors draw a clear distinction between KORE and its peer, Prime US REIT (PRIME SP, NR). KORE will also continue to have the “first-look opportunity” over assets in the Strategic Opportunity Series for acquisitions.
- Healthy positive rent reversions expected to continue.** Portfolio average rent of leases expiring in 2019-2021 are in the USD22-22.50 range, c.15% below the weighted average asking rents of USD26 psf. About 35% of portfolio leases by cash rental income (CRI) are due for renewal up until 2021, for which we expect mid- to high-single digit rental reversion. In addition, the leases have an in-built rent escalation of ~3% pa.
- Acquisition on the cards.** Management has guided for potential c.USD100m in acquisitions later this year, depending on market conditions. Potential target locations include sub markets of key growth cities like Austin, Denver, Salt Lake City, Charlotte, and North Carolina, where office capitalisation rates (6-7%) are still attractive. With a limited debt headroom, we expect funding to be via a combination of debt and equity (placement/preferential offerings).
- Potential upside from a rollback in tax structure changes not factored in.** There has been a slight delay in the finalisation of the proposed US tax regulations (announced in Dec 2018) that were expected to be completed by Jul 2019. The regulations, when finalised (under the current form), should be positive to the REIT as it should help in additional tax savings of ~2% (which is the tax paid in the Barbados entity). Management noted that such tax structure changes will incur a minimal one-off cost (<USD 1m), and can be completed within 1-2 months upon finalisation.

Analyst

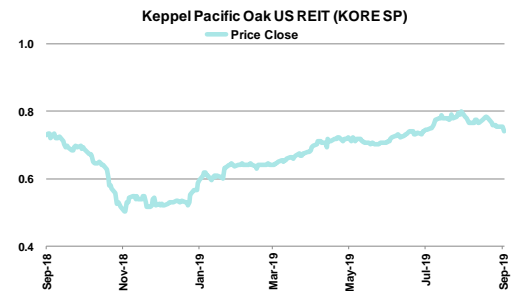
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	21.3	(5.7)	0.0	11.3	(6.2)
Relative	18.8	(4.2)	(0.1)	14.0	(5.9)

52-wk Price low/high (USD) 0.53 - 0.82



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (USDm)	106	120	125	128
Net property income (USDm)	64	74	76	78
Reported net profit (USDm)	53	54	57	59
Distributable income (USDm)	44	50	52	54
DPS (USD - cents)	6.2	6.1	6.3	6.5
DPS growth (%)	-	(1.7)	3.7	2.7
P/BV (x)	0.9	0.9	0.9	0.9
Dividend Yield (%)	8.4	8.3	8.6	8.8
Return on average equity (%)	9.6	9.9	10.3	10.4
Return on average assets (%)	5.9	5.8	6.0	6.0
Interest coverage (x)	4.3	3.4	3.5	3.5
Total Debt to assets (%)	34	38	38	38

Note: *Since listing in Nov 2017 to Dec 2018

Source: Company data, RHB

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Property | REITs

Financial Exhibits

Asia	Financial summary	Dec 18*	Dec 19F	Dec 20F	Dec 21F
Singapore	Recurring EPS (USD)	0.06	0.07	0.07	0.07
Property	EPS (USD)	0.06	0.07	0.07	0.07
Keppel Pacific Oak US REIT	DPS (USD)	0.06	0.06	0.06	0.07
Bloomberg KORE SP	BVPS (USD)	0.80	0.81	0.82	0.84
Buy	Weighted avg adjusted shares (m)	821	824	828	832
Valuation basis	Valuation metrics	Dec 18*	Dec 19F	Dec 20F	Dec 21F
We use DDM with the following assumptions:	Recurring P/E (x)	11.5	11.2	10.6	10.4
i. COE of 9.2%;	P/E (x)	11.5	11.2	10.6	10.4
ii. Risk-free rate of 3.0%;	P/B (x)	0.9	0.9	0.9	0.9
iii. 2% terminal growth.	FCF Yield (%)	5.2	9.1	12.6	13.0
Key drivers	Dividend Yield (%)	8.4	8.3	8.6	8.8
i. Continued strong momentum in office demand;	EV/EBITDA (x)	19.1	20.4	19.6	19.3
ii. Accretive acquisitions; and	EV/EBIT (x)	19.1	20.4	19.6	19.3
iii. Benign interest rate environment.					
Key risks	Income statement (USDm)	Dec 18*	Dec 19F	Dec 20F	Dec 21F
i. Unexpected slowdown in the US economy on the back of a prolonged trade war ;	Total turnover	106	120	125	128
ii. Negative changes to tax-efficient structure, and	Gross profit	64	74	76	78
iii. Failure of co-working operator model	EBITDA	51	52	54	56
	Depreciation and amortisation	0	0	0	0
	Operating profit	51	52	54	56
	Net interest	(12)	(15)	(15)	(16)
	Income from associates & JVs	0	0	0	0
	Exceptional income - net	0	0	0	0
	Pre-tax profit	63	66	70	71
	Taxation	(10)	(12)	(13)	(13)
	Minority interests	0	0	0	0
	Recurring net profit (adj)	53	54	57	59
Company Profile	Cash flow (USDm)	Dec 18*	Dec 19F	Dec 20F	Dec 21F
Keppel Pacific Oak US REIT's investment strategy is to principally invest in a diversified portfolio of income-producing commercial assets and real estate-related assets in key growth markets of the US, with favourable economic and office fundamentals that are above the national average, so as to provide sustainable distributions and strong total returns for unit holders.	Change in working capital	2	5	6	6
	Cash flow from operations	63	66	70	71
	Capex	(29)	(25)	(5)	(5)
	Cash flow from investing activities	(980)	(70)	(5)	(5)
	Dividends paid	(24)	(50)	(52)	(54)
	Cash flow from financing activities	960	(15)	(81)	(78)
	Cash at beginning of period	0	41	36	32
	Net change in cash	41	(5)	(3)	1
	Ending balance cash	41	36	32	33
	Balance sheet (USDm)	Dec 18*	Dec 19F	Dec 20F	Dec 21F
	Total cash and equivalents	41	36	32	33
	Tangible fixed assets	1017	1102	1124	1146
	Intangible assets	0	0	0	0
	Total investments	1017	1102	1124	1146
	Total other assets	10	9	9	9
	Total assets	1067	1147	1165	1188
	Short-term debt	5	0	0	0
	Total long-term debt	367	433	440	451
	Other liabilities	38	47	48	49
	Total liabilities	409	480	488	500
	Shareholders' equity	658	667	677	688
	Minority interests	0	0	0	0
	Total equity	658	667	677	688
	Net debt	331	397	407	418
	Total liabilities & equity	1067	1147	1165	1188
	Key metrics	Dec 18*	Dec 19F	Dec 20F	Dec 21F
	Revenue growth (%)	0.0	32.7	3.6	2.8
	Recurrent EPS growth (%)	2.6	5.0	2.5	1.6
	Gross margin (%)	60.8	61.1	61.2	61.2
	Operating EBITDA margin (%)	48.3	42.8	43.6	43.5
	Net profit margin (%)	50.1	45.2	45.8	45.7
	Dividend payout ratio (%)	100.0	100.0	100.0	100.0
	Capex/sales (%)	27.7	20.8	4.0	3.9
	Interest cover (x)	4.3	3.4	3.5	3.5

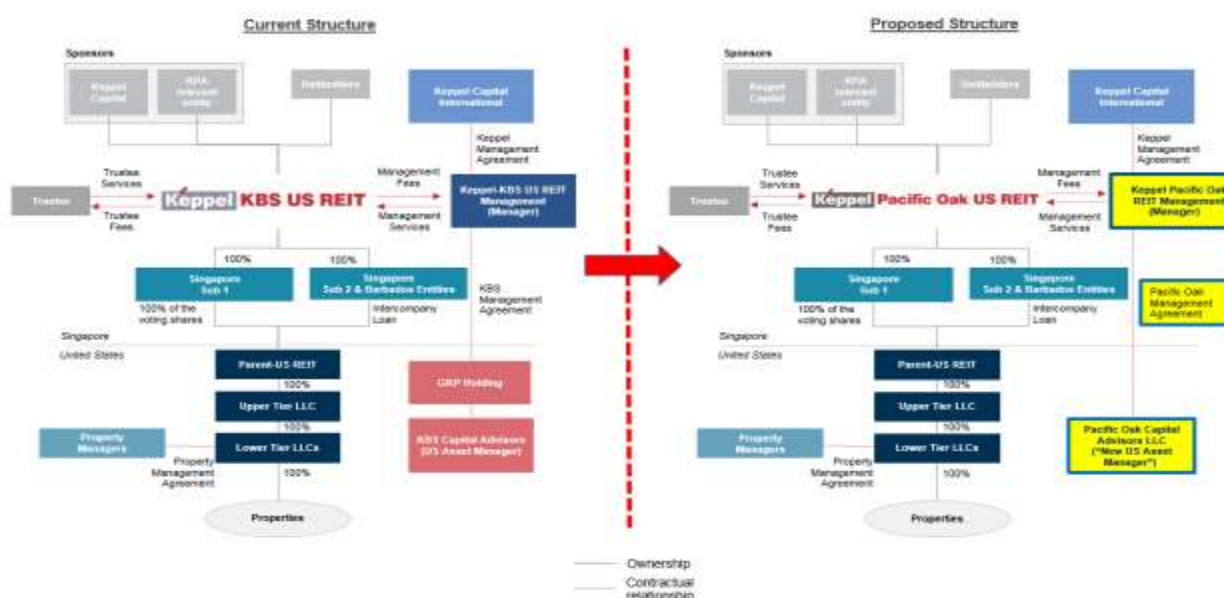
*Since listing in Nov 2017 to Dec 2018;
Source: Company data, RHB

Figure 1: DDM valuation

-	FY19F	FY20F	FY21F	FY22F	FY23F	Terminal Value
DPU (USD cents)	6.1	6.3	6.5	6.7	6.9	97.2
Target price (USD)	0.88					
Current Price (USD)	0.74					
Price Upside	18.9%					
Distribution Yield FY19F	8.3%					
Total Returns	27.2%					
Assumptions						
Risk-free rate (%)	3.0					
Beta	0.9					
Cost of equity (%)	9.2					
Terminal growth (%)	2.0					

Source: Company data, RHB

Figure 2: Trust structure



Source: Company

Figure 3: Asset summary

Portfolio Overview						
Property	City	Location	NLA (sf)	Committed occupancy (by NLA)	WALE (in years)	Carrying Value (US\$m)
The Plaza Buildings	Seattle	Bellevue CBD, one of the most active leasing submarket in Seattle	490,994	96.5%	3.5	258.8
Bellevue Technology Center	Seattle	Bellevue, one of the most active leasing submarket in Seattle	330,508	98.5%	3.4	137.7
The Westpark Portfolio	Seattle	Redmond submarket, one of the best performing office markets in the Seattle region	782,185	97.8%	3.7	180.3
Iron Point	Sacramento	Carmichael / Fair Oaks / Citrus Heights; Expected to outperform the overall Sacramento market	211,944	95.8%	2.8	37.4
Westmoor Center	Denver	Northwest Denver; Well-positioned to capture tenants that outgrow nearby Boulder, and has better quality real estate	612,890	91.2%	5.2	128.6
Great Hills Plaza	Austin	Northwest submarket, a popular office locale along the Capital of Texas Highway corridor	139,252	98.1%	5.3	37.9
Westech 360	Austin	Northwest submarket, a popular office locale along the Capital of Texas Highway corridor	177,615	96.4%	2.7	47.2
1800 West Loop South	Houston	West Loop, which is amenity-rich and highly sought after	400,101	81.9%	4.2	79.4
West Loop I & II	Houston	Bellaire, one of Houston's most desirable and affluent neighbourhoods	313,873	89.5%	4.4	43.6
Powers Ferry	Atlanta	Cumberland / I-75; Have been outperforming greater Atlanta market in terms of occupancy rate	149,324	98.0%	3.0	19.8
Northridge Center I & II	Atlanta	North Central / I-285 / GA 400; Home to numerous Fortune 500 companies, which solidifies the positive attributes of the location	188,944	85.1%	2.8	21.1
Maitland Promenade I	Orlando	Maitland Center, which is dominated by finance, insurance, tech and strong activity in the Class A market	230,366	97.9%	3.6	49.5
Maitland Promenade II	Orlando	Maitland Center, which is dominated by finance, insurance, tech and strong activity in the Class A market	230,371	99.7%	4.4	44.5
Portfolio Information as at 30 June 2019			4,258,367	94.0%	3.9 ⁽¹⁾	1,085.8

Source: Company data

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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