

8 June 2020

Property | REITS

Keppel Pacific Oak US REIT

Buy (Maintained)

Exceeding Expectations So Far; Keep BUY

Target Price (Return): USD0.80 (+11%)
 Price: USD0.72
 Market Cap: USD681m
 Avg Daily Turnover (USD/USD): 2m/2m

- **BUY, new TP of USD0.80 from USD0.76, 11% upside with c.8% FY20F yield.** We recently hosted a virtual non-deal roadshow for Keppel Pacific Oak US REIT, for Malaysian investors. Management is confident that, despite the sudden shift in office space outlook due to COVID-19, KORE can better weather the crisis due to its asset quality and choice submarkets, limited near-term lease expiries, and diversified tenant base. Key catalysts: better-than-expected economic recovery and recent index inclusions.
- **Superior yields vs Singapore peers.** KORE's FY21F yield of 8.3% is >300bps higher than the Office S-REIT average, and at a 20bps premium to the US office S-REIT average (Figure 2). With its recent inclusion into MSCI Singapore Small Cap Index and FTSE All World Small Cap Index, we expect trading liquidity to further improve and result in yield compression.
- **COVID-19 impact.** KORE has received requests for rent deferrals from 14% of its tenants so far, which are being evaluated on a case-by-case basis. Retail and F&B operators, which account for <2% of its portfolio, are among these. Management has granted most of them a 3-month rental deferral, which will be added to their end-of-lease tenures. For other tenants that have been directly impacted (eg tourism & hospitality, dentists, cosmetologists), management plans to offer deferrals of up to three months, which are to be repaid over the next 12-18 months. Rent collection has been healthy, with >90% of rent received for April and May exceeding management's expectations. Oil & gas tenants account for <1% of rental income. On concerns over the rising work-from-home trend in the tech sector, management does not foresee a drastic shift among such tenants, and expects people to slowly return to the office.
- **Only 6% of leases by rental income** are due for renewal in FY20 (and 14% in FY21). This mitigates concerns of a potential spike in vacancies. In 1Q20, KORE signed leases for 2.2% of its total portfolio with a rental reversion of 12%, indicating a healthy office market before COVID-19 struck. While the leasing momentum has nearly decelerated to a pause in 2Q20, KORE's average portfolio rental – which were 10-15% below market rates (pre-COVID-19) – offers some leeway to adjust rental rates.
- **Latest economic data shows positive green shoots.** In a surprising turnaround, May's job data showed that non-farm payrolls rose by 2.5m and the unemployment rate dropped to 13.3%, vs the market's expectation of 19.5%. The move comes as many US states gradually ease lockdown measures – which should boost sentiment on the office segment.
- **Gearing remains modest at 36.9%.** KORE has revolving credit facilities in place to refinance the small portion (4.4%) of debt maturing in FY20. It has refinanced 30% of FY21 loans early, with the rest due only in Nov 2021.
- **We raise FY20-22F DPU by 1-3%** by tweaking our occupancy outlook (+1-2ppt), vs our initially bearish ~5-7ppt decrease over the next two years.

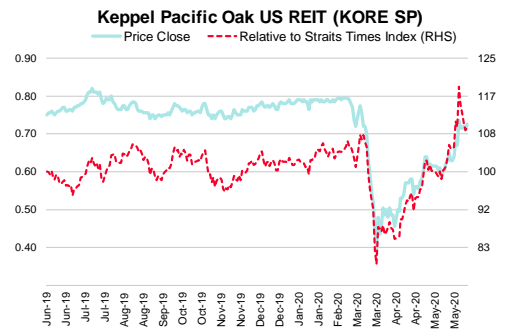
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(7.1)	16.9	(6.5)	(5.2)	(2.0)
Relative	7.5	9.9	2.3	8.1	10.4
52-wk Price low/high				0.39	0.82



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (m)	106	123	131	134	136
Net property income (m)	64.4	74.8	80.0	81.5	83.2
Reported net profit (m)	53.0	69.7	54.8	55.9	56.7
Total distributable income (m)	43.8	50.8	55.6	56.4	57.4
DPS	0.06	0.06	0.06	0.06	0.06
DPS growth (%)	0.0	(3.3)	(1.4)	1.2	1.6
P/B (x)	0.91	0.90	0.90	0.90	0.89
Dividend Yield (%)	8.6	8.3	8.2	8.3	8.4
Return on average equity (%)	0.0	9.9	7.3	7.4	7.5
Return on average assets (%)	0.0	5.9	4.2	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	0.08	0.08	0.06	0.06	0.06
Property	EPS	0.08	0.08	0.06	0.06	0.06
Keppel Pacific Oak US REIT	DPS	0.06	0.06	0.06	0.06	0.06
Buy	BVPS	0.80	0.80	0.80	0.81	0.81
	Return on average equity (%)	-	9.9	7.3	7.4	7.5
	Weighted avg adjusted shares (m)	704.12	843.92	937.15	939.15	941.15
Valuation basis	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
DDM	Recurring P/E (x)	9.63	8.78	12.40	12.18	12.04
	P/E (x)	9.63	8.78	12.40	12.18	12.04
	P/B (x)	0.9	0.9	0.9	0.9	0.9
	FCF Yield (%)	6.2	6.3	11.9	10.8	11.4
	Dividend Yield (%)	8.6	8.3	8.2	8.3	8.4
	EV/EBITDA (x)	- 1.29	- 1.81	- 1.73	- 1.74	- 1.76
	EV/EBIT (x)	- 1.29	- 1.81	- 1.73	- 1.74	- 1.76
Key drivers	Income statement (m)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. Limited near-term lease expiry mitigating risks;	Total turnover	106	123	131	134	136
ii. Stable balance sheet and low refinancing risks;	EBITDA	60	70	75	76	77
iii. Benign interest rate environment and government stimulus measures.	Operating profit	60	70	75	76	77
	Net interest	(12)	(16)	(16)	(17)	(18)
	Pre-tax profit	63	90	55	56	57
	Taxation	(10)	(20)	(0)	0	0
	Recurring net profit	53	70	55	56	57
Key risks	Cash flow (m)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
i. A deep, protracted slowdown in the US economy on the back of a prolonged trade war and COVID-19 pandemic;	Change in working capital	4	7	14	3	3
ii. Structural changes in office space demand;	Cash flow from operations	61	73	91	81	83
iii. Failure of the co-working operator model	Capex	(29)	(35)	(10)	(8)	(5)
	Cash flow from investing activities	(980)	(180)	(10)	(8)	(5)
	Dividends paid	(24)	(61)	(56)	(56)	(57)
	Cash flow from financing activities	960	104	(76)	(61)	(69)
	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	55	65
Company Profile	Balance sheet (m)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
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. These assets have favourable economic and office fundamentals that are above the national average, so as to provide sustainable distributions and strong total returns for unit holders.	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	6.9	1.8	2.0
	Recurrent EPS growth (%)	0.0	9.6	(29.2)	1.8	1.2
	Operating EBITDA margin (%)	56.5	56.6	56.8	56.8	56.9
	Net profit margin (%)	50.1	56.7	41.7	41.8	41.6
	Dividend payout ratio (%)	82.6	72.9	101.5	100.8	101.2
	Capex/sales (%)	27.7	28.6	7.6	6.0	3.7
	Interest cover (x)	4.97	4.33	4.47	4.35	4.23

Source: Company data, RHB

Figure 1: DDM valuation

	FY20F	FY21F	FY22F	FY23F	FY24F	Terminal Value
DPU (US cents)	5.93	6.00	6.10	6.38	6.64	88.6
Target price (USD)	0.80					
Current Price (USD)	0.73					
Price Upside	10.3%					
Distribution Yield FY20F	8.2%					
Total Returns	19%					
Assumptions						
Risk-free rate (%)	3.0					
Beta	0.9					
Cost of equity (%)	9.6					
Terminal growth (%)	2.0					

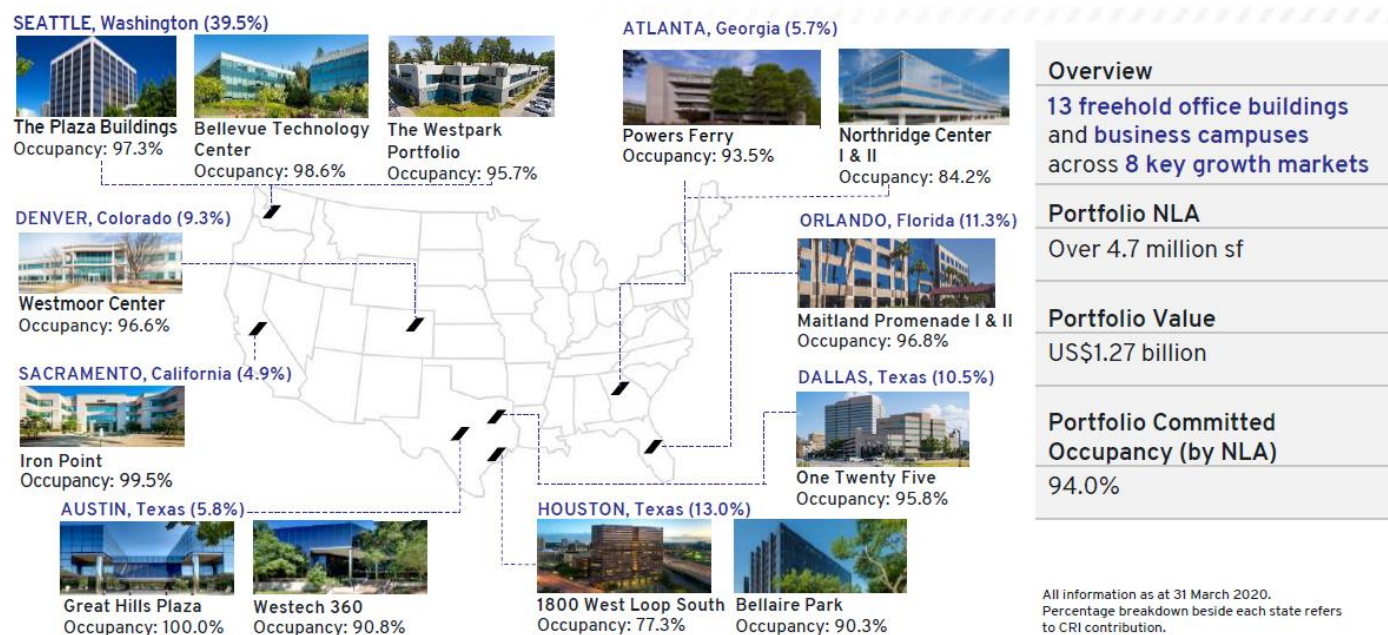
Source: Company data, RHB

Figure 2: Office REITs – a peer comparison

	Mkt cap (USDm)	3M-ADVT (USD '000)	Last price (LCY)	1D (%)	5D (%)	1M (%)	3M (%)	6M (%)	12M (%)	YTD (%)	vs 52W-low (%)	vs 52W-high (%)	P/B (x)	Div yield (FY-1)	Div yield (FY-2)	Yield Spread (%)	Gearing/s impl ave	WALE (years)	% FY-1	% FY-2
REITs (41)	72,777	309,713		1.5	4.3	11.7	(8.7)	(6.6)	0.6	(6.4)	52.9	(16.7)	1.0	5.3	5.9	4.3	35.8%	5.5		
Office (4)	12,655	52,301		1.1	6.2	13.2	(9.2)	(12.5)	(11.0)	(11.8)	45.4	(19.7)	0.86	5.1	5.5	4.1	37.3%			
CapitaLand Commercial Trust	5,045	23,461	1.82	1.7	4.0	15.2	(9.5)	(9.9)	(9.5)	(8.5)	40.0	(21.2)	0.99	4.4	4.9	3.4	35.5%	5.8	10%	26%
Suntec REIT	3,235	19,731	1.60	1.9	8.8	16.8	(9.6)	(13.5)	(14.0)	(13.0)	53.8	(20.4)	0.75	5.0	5.6	4.0	37.7%	2.8	13%	29%
Keppel REIT	2,823	8,096	1.16	0.9	8.4	12.6	(4.1)	(7.2)	(6.5)	(6.5)	46.8	(10.1)	0.86	5.2	5.2	4.1	35.8%	4.9	11%	23%
OUE Commercial Trust	1,552	1,012	0.40	(2.4)	3.9	0.0	(16.7)	(28.6)	(18.4)	(29.2)	42.9	(30.4)	0.65	7.5	8.0	6.5	40.3%	3.6	16%	22%
US Office REITs (3)	1,979	5,133		0.9	0.9	15.2	(15.0)	(14.8)	(3.2)	(14.6)	64.4	(20.8)	0.9	8.1	8.1	7.3	36.1%			
Manulife US REIT	1,298	3,182	0.83	0.6	(0.6)	17.9	(19.1)	(17.5)	(3.1)	(17.5)	51.4	(23.6)	1.03	7.3	7.3	6.4	37.7%	5.9	5%	7%
Prime US REIT	822	160	0.78	0.0	4.7	9.9	(22.0)	(20.4)	N.M	(19.2)	56.0	(27.1)	0.87	8.8	8.8	8.1	33.7%	5.1	7%	8%
Keppel Pacific Oak US REIT	681	1,951	0.73	2.1	(1.4)	17.9	(4.0)	(6.5)	(3.3)	(7.1)	85.9	(11.6)	0.91	8.3	8.3	7.4	36.9%	4.2	7%	14%

Note: *Data as of 5 Jun 2020
Source: Bloomberg, RHB

Figure 3: Portfolio composition by city and asset



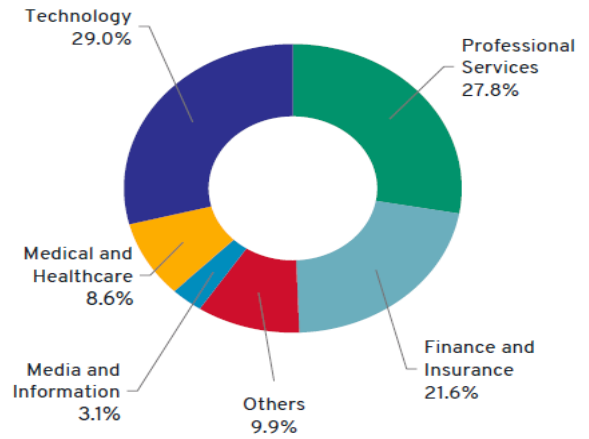
Source: Company

Figure 4: Top 10 tenants (1Q20)

Tenant	Sector	Asset	% CRI
Ball Aerospace	Technology	Westmoor Center	3.5
Oculus VR	Technology	Westpark Portfolio	2.4
Lear	Technology	The Plaza Buildings	2.1
Zimmer Biomet Spine	Technology	Westmoor Center	2.0
Spectrum	Media & Information	Maitland Promenade I	1.8
Unigard Insurance ⁽¹⁾	Finance & Insurance	Bellevue Technology Center	1.7
Bio-Medical Applications	Medical & Healthcare	One Twenty Five	1.7
US Bank	Finance & Insurance	The Plaza Buildings	1.6
Auth0	Technology	The Plaza Buildings	1.4
Reed Group	Technology	Westmoor Center	1.3
Total			19.5
WALE (by NLA)			5.3 years
WALE (by CRI)			5.4 years

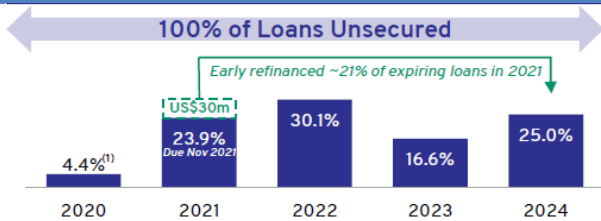
Source: Company data

Figure 5: Tenant trade sector (by NLA) – 1Q20

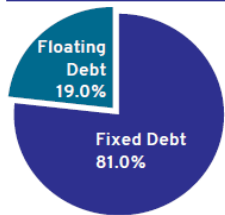


Source: Company data

Figure 6: Debt profile



Interest Rate Exposure

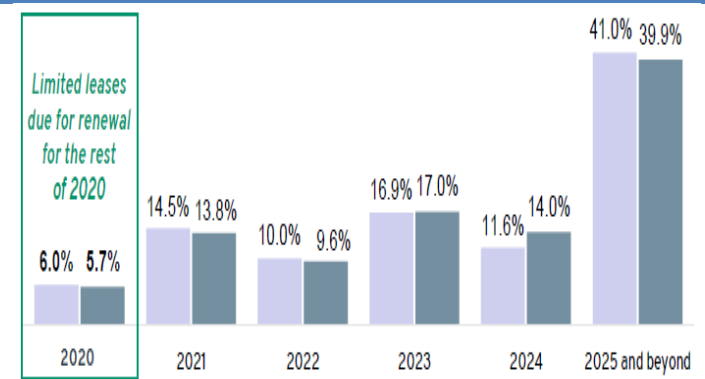


Sensitivity to LIBOR⁽⁵⁾

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

Source: Company data

Figure 7: Lease expiry profile by NLA and CRI



- 1) By NLA.
- 2) By CRI. Based on NLA, portfolio WALE was 4.2 years.

Source: Company data

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-04-13	Buy	0.76	0.54
2020-01-22	Buy	0.88	0.79
2019-10-16	Buy	na	0.76

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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