

24 July 2020

Property | REITS

## Keppel Pacific Oak US REIT (KORE SP)

**Buy** (Maintained)

### Marching On Despite COVID-19; Keep BUY

Target Price (Return): USD0.80 (11.1%)  
Price: USD0.72  
Market Cap: USD671m  
Avg Daily Turnover (USD/USD): 1.20m/1.20m

- **Maintain BUY and TP of USD 0.80, 11% upside with c.8% yield.** Keppel Pacific Oak US REIT posted a strong set of 1H results with DPU coming in slightly ahead of our expectations. COVID-19's impact on KORE's portfolio remains muted so far. A lot of positives could be gleaned through in 1H operational data with fairly steady leasing momentum resulting in occupancy improvements and double-digit rent reversions. A risk remains the impact on the US economy from the bout of a second COVID-19 wave.
- **1H DPU up 3.3% YoY** aided by positive rental reversions seen in previous quarters, rental escalations and contribution from One Twenty Five in Dallas, which was acquired in Nov 2019. Management noted that it has chosen to maintain 100% payout ratio as rental collections remain fairly healthy at 94% for 1H20 and it doesn't see any major risk of tenant defaults.
- **KORE has received rent relief requests from c.15% of its tenants** by Cash Rental Income (CRI) and only 5.7% of them have been granted rent deferrals resulting in a c.2.8% economic impact. Co-working tenants in its portfolio remain small at c.2% of total CRI. Rent deferrals to office tenants were generally 0.5 months of rent, to be repaid over the next 12 to 18 months. For retail tenants (<2% of CRI) rent relief was generally one full month and up to four months for certain tenants with leases being extended for the length of the deferral in some cases. Management noted that despite a surge of a second wave of COVID-19 cases in its markets like Texas and Florida, it hasn't seen any spike in rent relief requests so far.
- **Fairly steady leasing momentum, with strong double-digit rental reversions.** In 2Q, KORE signed c.92,000 of leases (2% of total NLA, 1H20: 196,000 sqft) despite a COVID-19 fallout, with majority of them signed across Seattle, Atlanta and Houston. New leases (35%) and expansions (17%) accounted for more than half, with the tech sector still being the key demand driver. The strong leasing resulted in occupancy improving to 94.3% from 93.6% as of Dec 2019. Rental reversion for 1H came in strong at +14.7% (2Q: +18%) despite COVID-19, highlighting KORE's under-rented portfolio and strong-asset attributes. KORE guided that current in place average rents is still about 10.8% below asking rents and expects overall rental reversions to remain slightly positive in coming quarters barring a severe impact from a second COVID-19 wave.
- **KORE has refinanced USD115m of IPO loans** maturing in Nov 2021 at a much lower interest rate, resulting in a 15bps reduction in overall interest costs to 3.19% pa. Currently KORE has no long-term refinancing requirements until Nov 2022. All of its loans are unsecured with a healthy interest cover of 4.4x.
- **We make no changes to our earnings estimates.**

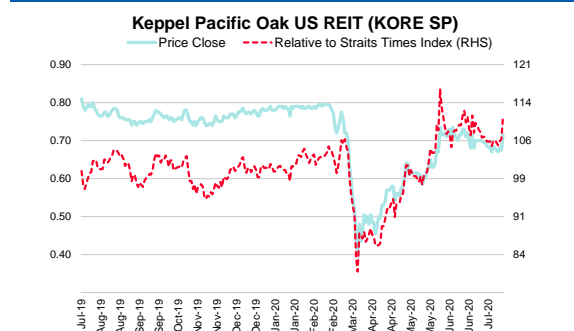
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(8.3)	(0.7)	27.7	(8.9)	(11.2)
Relative	10.7	0.2	24.9	10.3	11.4
52-wk Price low/high (USD)				0.40 – 0.80	



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (USDm)	106	123	131	134	136
Net property income (USDm)	64.4	74.8	80.0	81.5	83.2
Reported net profit (USDm)	53.0	69.7	54.8	55.9	56.7
Total distributable income (USDm)	43.8	50.8	55.6	56.4	57.4
DPS (USD)	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)	0.89	0.89	0.89	0.89	0.88
Dividend Yield (%)	8.7	8.4	8.3	8.4	8.5
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

#### Note:

Small cap stocks are defined as companies with a market capitalization of less than USD1bn.

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## Financial Exhibits

<b>Asia</b>	<b>Financial summary</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
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
<b>Keppel Pacific Oak US REIT</b>	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	7.3	7.4	7.5
	Weighted avg adjusted shares (m)	704.12	843.92	937.15	939.15	941.15
<b>Valuation basis</b>	<b>Valuation metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
DDM	Recurring P/E (x)	9.50	8.66	12.23	12.01	11.87
<b>Key drivers</b>	P/E (x)	9.50	8.66	12.23	12.01	11.87
i. Limited near-term lease expiry mitigating risks;	P/B (x)	0.9	0.9	0.9	0.9	0.9
ii. Stable balance sheet and low refinancing risks; and	FCF Yield (%)	6.3	6.3	12.0	10.9	11.6
iii. Benign interest rate environment and government stimulus.	Dividend Yield (%)	8.7	8.4	8.3	8.4	8.5
	EV/EBITDA (x)	- 1.41 -	1.93 -	1.85 -	1.87 -	1.89
	EV/EBIT (x)	- 1.41 -	1.93 -	1.85 -	1.87 -	1.89
<b>Key risks</b>	<b>Income statement (USDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
i. A deep protracted slowdown in the US economy on the back of a prolonged trade war and COVID-19 ;	Total turnover	106	123	131	134	136
ii. Structural changes in office demand, and	EBITDA	60	70	75	76	77
iii. Failure of co-working operator model	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
<b>Company Profile</b>	<b>Cash flow (USDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
Keppel Pacific Oak USS REITs 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	4	7	14	3	3
	Cash flow from operations	61	73	91	81	83
	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
	<b>Balance sheet (USDm)</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	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
	<b>Key metrics</b>	<b>Dec-18</b>	<b>Dec-19</b>	<b>Dec-20F</b>	<b>Dec-21F</b>	<b>Dec-22F</b>
	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

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Figure 1: DDM valuation

	FY20F	FY21F	FY22F	FY23F	FY24F	Terminal Value
DPU (USD cents)	5.93	6.00	6.10	6.38	6.64	88.6
<b>Target price (USD)</b>	<b>0.80</b>					
Current Price (USD)	0.68					
Price Upside	11.9%					
Distribution Yield FY20F	8.3%					
Total Returns	20.2%					
<b>Assumptions</b>						
Risk-free rate (%)	3.0					
Beta	0.9					
Cost of equity (%)	9.6					
Terminal growth (%)	2.0					

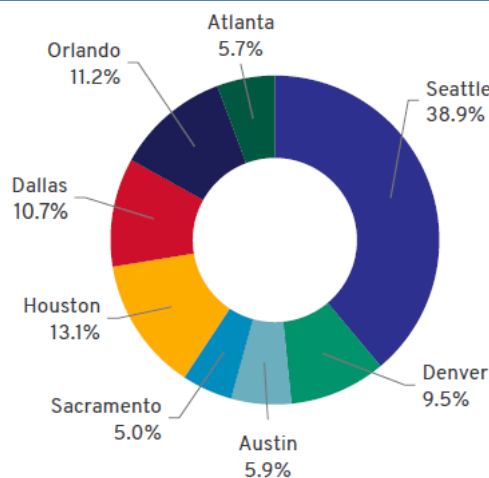
Source: Company data, RHB

Figure 2: Portfolio composition by cities and assets



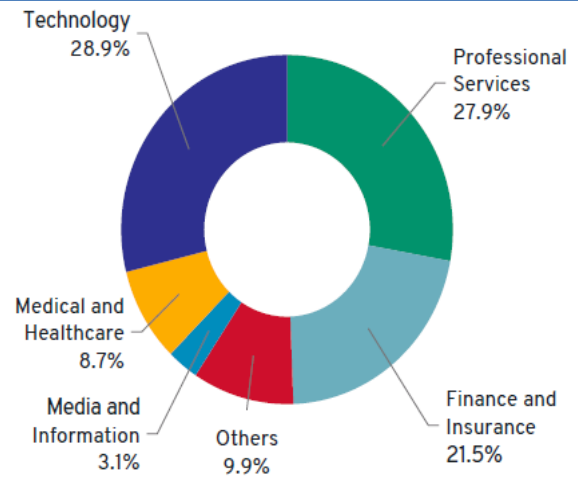
Source: Company

Figure 3: CRI by market – 1H20



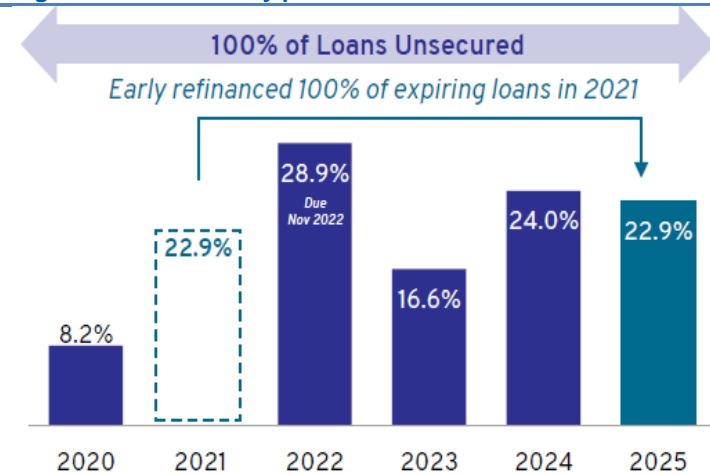
Source: Company Data

Figure 4: Tenant trade sector (by NLA) – 1H20



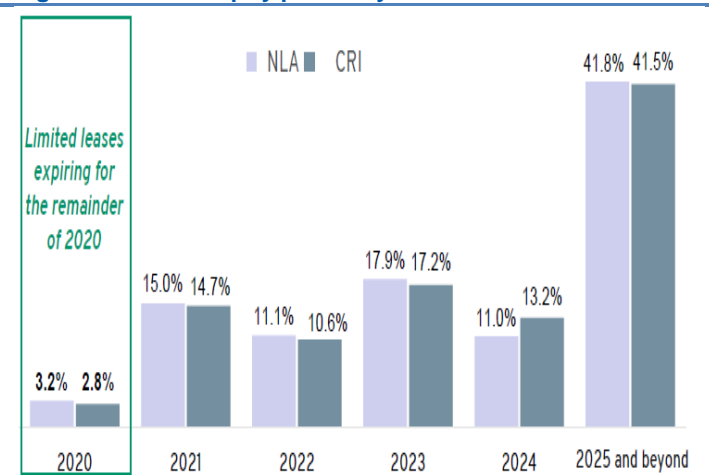
Source: Company Data

Figure 5: Debt maturity profile



Source: Company Data

Figure 6: Lease expiry profile by NLA and CRI



Source: Company Data

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-06-07	Buy	0.80	0.73
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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<b>Buy:</b>	Share price may exceed 10% over the next 12 months
<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
<b>Take Profit:</b>	Target price has been attained. Look to accumulate at lower levels
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<b>Not Rated:</b>	Stock is not within regular research coverage

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