

16 July 2019

Property | REITS

Keppel REIT (KREIT SP)

Neutral (Maintained)

A Mixed Bag; Stay NEUTRAL

Target Price (Return) SGD1.20 (-5%)
 Price: SGD1.26
 Market Cap: USD3,135m
 Avg Daily Turnover (SGD/USD) 7.0m/5.2m

- Maintain NEUTRAL, TP revised to SGD1.20** from SGD1.12, 5% downside. Keppel REIT's (KREIT) 2Q19 results are in line. Key positives ahead are strong rental growth potential and acquisition contributions, offset by downtime from tenant movements and absence of rental support. Valuations are fair, with FY19F yield of 4.4% (P/BV of 0.9x). We cut COE by 20bps to 7% to better reflect the prolonged low interest rate environment – which resulted in our higher TP.
- Room for organic rental rate growth to offset lack of income support.** About 272,900 sqf (attributable ~112,600 sqf) of leases were signed in 1H19, with rental reversions coming in strongly at +15%. With average expiring rents for 2H19/2H20/2H21 expiring leases being at SGD10.70/9.70/9.60 psf (10-20% below current signing rates), we see good room for rental growth ahead. This, in our view, should help offset the absence of rental income support (~SGD8.6m for 2018) which were fully utilised by 1Q19.
- Downtime expected from tenant movements.** UBS, which currently occupies ~230,000sqf at One Raffles Quay (ORQ), will be vacating the space post its lease expiry in end-2020. Management expects to see strong demand for the space, considering the current market momentum – but there is likely to be an earnings void of ~3-6 months during the transition period. Similarly, HSBC is expected to move into Marina Bay Financial Centre (MBFC) in May 2020, with the fit-out period commencing in 4Q19. Separately, Deutsche Bank, which has announced major restructuring plans for its Asia-Pacific operations, occupies ~200,000sqf at ORQ. Under the current lease term (which extends until 2025), management noted that the tenant will not be able to return the office space, but can potentially sub-lease some of its existing space.
- Maiden contribution from T Tower, 311SS to contribute from 2H20 onwards.** During 2Q, KREIT completed the acquisition of T Tower in Seoul which contributed SGD1.3m for the quarter. The asset was acquired at an initial NPI yield of 4.7%. Construction of 311 Spencer Street (311 SS, 50% stake) is on track for completion by 1H20, with earnings contributions expected to kick in from 2H20 onwards.
- Share buybacks limit downside.** The REIT plans to continue its unit buy-back programme, as management feels the unit price is still undervalued. During 2Q, it purchased and cancelled ~9.7m units, at an average of SGD1.26 per unit.
- DPU and TP adjustments.** We revise FY19-21F DPU by 1%/-1%/2%, after factoring in acquisition and occupancy changes.

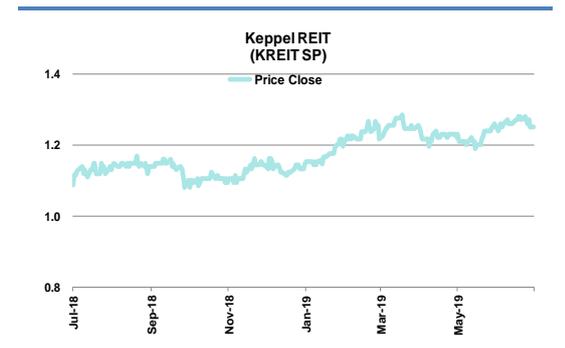
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	10.5	0.0	(0.8)	7.7	9.6
Relative	1.4	(3.9)	(1.5)	3.4	6.8
52-wk Price low/high (SGD)	0.70 - 0.90				



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (SGDm)	164.5	165.9	156.9	166.8	169.6
Net property income (SGDm)	131.2	133.2	126.2	134.0	136.2
Reported net profit (SGDm)	197.3	164.8	239.8	196.5	210.9
Distributable income (SGDm)	190.7	189.0	189.5	203.0	220.8
DPS (SGD - cents)	5.7	5.6	5.5	5.8	6.2
DPS growth (%)	(10.5)	(2.5)	(1.3)	5.8	7.5
P/BV (x)	0.9	0.9	0.9	0.9	0.8
Dividend Yield (%)	4.5	4.4	4.4	4.6	5.0
Return on average equity (%)	4.0	3.1	4.6	3.7	3.9
Return on average assets (%)	2.6	2.1	3.0	2.4	2.6
Interest coverage (x)	3.2	2.9	3.0	2.9	3.0

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
Singapore	Recurring EPS (SGD)	0.06	0.05	0.07	0.06	0.06
Property	EPS (SGD)	0.06	0.05	0.07	0.06	0.06
Keppel REIT	DPS (SGD)	0.06	0.06	0.05	0.06	0.06
Bloomberg KREIT SP	BVPS (SGD)	1.41	1.40	1.47	1.48	1.49
	Weighted avg adjusted shares (m)	3370.73	3393.40	3452.29	3494.06	3536.26
Valuation basis	Valuation metrics	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
We use DDM:	Recurring P/E (x)	20.7	24.9	17.4	21.5	20.3
i. COE of 7.0%;	P/E (x)	20.7	24.9	17.4	21.5	20.3
ii. Risk-free rate of 2.75%;	P/B (x)	0.9	0.9	0.8	0.8	0.8
iii. 2% terminal growth.	FCF Yield (%)	2.9	3.1	(6.0)	2.7	2.7
Key drivers	Dividend Yield (%)	4.7	4.6	4.5	4.8	5.2
i. Continued momentum in office demand;	EV/EBITDA (x)	31.2	31.2	32.3	30.7	28.6
ii. Yield-accretive acquisitions.	EV/EBIT (x)	31.2	31.2	32.3	30.7	28.6
Key risks	Income statement (SGDm)	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
i. Increasing competition among Grade-A office assets,	Total turnover	165	166	157	167	170
ii. Volatile macro-economic environment	Gross profit	131	133	126	134	136
	EBITDA	211	201	208	219	236
	Depreciation and amortisation	0	0	0	0	0
	Operating profit	211	201	208	219	236
	Net interest	(42)	(44)	(43)	(51)	(54)
	Income from associates & JVs	116	104	120	130	144
	Exceptional income - net	0	0	0	0	0
	Pre-tax profit	197	165	240	197	211
	Taxation	(17)	(10)	(18)	(9)	(9)
	Minority interests	0	1	0	0	0
	Recurring net profit (adj)	180	155	222	188	202
Company Profile	Cash flow (SGDm)	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
Keppel REIT is a REIT listed on the Singapore Exchange. Sponsored by Keppel Land, the trust owns and invests in a portfolio of income-producing commercial real estate and real estate related-assets in Singapore and across Asia	Change in working capital	1	2	(345)	9	7
	Cash flow from operations	120	130	(239)	127	127
	Capex	(14)	(11)	(12)	(12)	(13)
	Cash flow from investing activities	(3)	30	56	137	161
	Dividends paid	(157)	(190)	(189)	(196)	(212)
	Cash flow from financing activities	(181)	(410)	79	(260)	(289)
	Cash at beginning of period	253	189	259	154	159
	Net change in cash	(64)	70	(105)	4	(2)
	Ending balance cash	189	259	154	159	157
	Balance sheet (SGDm)	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
	Total cash and equivalents	198	259	154	159	157
	Tangible fixed assets	3775	3880	4150	4235	4311
	Intangible assets	0	0	0	0	0
	Total investments	3775	3880	4150	4235	4311
	Total other assets	3631	3646	3708	3743	3778
	Total assets	7604	7784	8012	8137	8245
	Short-term debt	425	60	666	670	874
	Total long-term debt	2097	2226	1965	1981	1787
	Other liabilities	167	163	168	176	179
	Total liabilities	2689	2449	2799	2828	2840
	Shareholders' equity	4763	4757	5061	5157	5253
	Minority interests	2	2	2	2	2
	Total equity	4915	5336	5213	5309	5405
	Net debt	2522	2286	2631	2651	2661
	Total liabilities & equity	7604	7784	8012	8137	8245
	Key metrics	Dec-17	Dec 18	Dec 19F	Dec 20F	Dec 21F
	Revenue growth (%)	2.0	0.8	(5.4)	6.3	1.7
	Recurrent EPS growth (%)	(25.3)	(17.0)	43.0	(19.0)	6.0
	Gross margin (%)	79.7	80.3	80.5	80.4	80.3
	Operating EBITDA margin (%)	128.2	121.0	132.8	131.6	139.4
	Net profit margin (%)	109.5	93.2	141.4	112.5	119.0
	Dividend payout ratio (%)	100.0	100.0	100.0	100.0	100.0
	Capex/sales (%)	8.8	6.7	7.6	7.5	7.5
	Interest cover (x)	3.2	2.9	3.0	2.9	3.0

Source: Company data, RHB

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Results And Operations Review

Portfolio occupancy improved 0.4ppt QoQ to 99.1%. The occupancy rate improvement mainly came from Singapore assets: MBFC and Bugis Junction Towers (BJT). Leasing demand (2Q) was driven by the technology, media and telecommunications, banking and financial sectors. Weighted average lease expiry (WALE) by NLA for its portfolio currently stands at 5.3 years.

Refinanced loans due for 2019 with slight savings in interest costs. KREIT completed the refinancing of the entire SGD538m due this year, with overall interest cost currently at 2.86% pa (vs 2.88% as of 1Q19). 92% of debt is currently on fixed terms.

Gearing rose from 35.7% in 1Q19 to 38.4% post acquisition of T Tower, and is expected to inch closer to 40% levels, with the progressive payments for 311SS. Management is comfortable with gearing levels of 40-42%. However, with limited headroom, future acquisitions are likely to be funded by a combination of debt and equity.

2Q19 DPU down 2.1% YoY; results in line. Revenue and NPI (100% basis) were down 23% and 28YoY, due mainly to lower one-off income from Ocean Financial Centre (OFC) and lower income from (BJT). There was no rental support income during the quarter as the amount stands fully utilised as of 1Q19. Capital distribution of SGD3m was paid during the quarter (similar to 1Q19) to offset the impact of the loss in income from the divestment of its OFC stake. Overall, 2Q19 and 1H19 DPU are in line, at 25% and 50% of our estimates .

Figure 1: 2Q19 results summary

(SGDm)	2Q18	1Q19	2Q19	%QoQ	%YoY	Comments
Gross revenue	51.7	40.0	39.9	(0.3)	(22.7)	Decrease due to lower one-off income for income for early surrender of leases
Operating expenses	(8.4)	(8.7)	(8.9)	1.7	4.8	
NPI	43.2	31.3	31.1	(0.8)	(28.1)	Divestment of 20% stake in OFC partly offset by T Tower contributions
Income support	2.2	2.7	0.0	nm	nm	
Other income	0.0	0.0	0.0	nm	nm	
Manager's fees	(13.1)	(12.0)	(11.9)	(0.7)	(9.3)	
Trustee fees	(1.7)	(0.5)	(8.7)	1,746.2	418.0	
Other expenses	(2.0)	(2.5)	0.0	nm	nm	
Net income before financing cost & tax	28.5	19.0	10.5	(44.8)	(63.2)	
Interest income	6.2	7.3	7.0	(3.6)	12.7	
Borrowing costs	(17.1)	(15.1)	(17.2)	13.4	0.2	
EBT	17.7	11.2	0.4	(96.8)	(98.0)	
Share of profit of associate company & JV	26.5	26.4	27.0	1.9	1.9	Share of associate profit was higher due to one-off income, while JV share declined on the depreciation of the AUD
Extraordinary items	(1.8)	1.2	(5.5)	nm	213.2	
Revaluations of investment properties	0.0	0.0	0.0	nm	nm	
Total return before tax	42.4	36.1	21.7	(39.9)	(48.8)	
Tax	0.7	(1.5)	(1.3)	(11.6)	nm	
Minority Interest	0.0	3.4	3.4	(1.0)	11,236.7	
Total return - reported	43.0	34.6	20.4	(41.1)	(52.6)	
Total return (ex exceptional)	44.8	33.4	25.9	(22.5)	(42.2)	
Add-back: Non tax deductibles	7.9	16.5	30.9	87.3	292.3	
Income available for distribution	48.3	47.3	47.3	(0.1)	(2.1)	
Distribution to unitholders	48.3	47.3	47.3	(0.1)	(2.1)	Includes capital gains of SGD 3m for 2Q19 and SGD6m for 1H19
Number of units (end of period) ('m)	3,403	3,404	3,405	0.0	0.1	
DPU (SGD-cts)	1.42	1.39	1.39	0.0	(2.1)	
NAV (SGD)	1.41	1.38	1.37	(0.7)	(2.8)	
Payout ratio (%)	100.0	100.0	100.0	0.0ppt	0.0ppt	
NPI margins (%)	83.6	78.2	77.8	(0.4) ppt	(5.8) ppt	

Source: RHB

Figure 2: KREIT's DDM valuation

DDM	FY19F	FY20F	FY21F	FY22F	Terminal Value
DPU (SGD cts)	5.49	5.81	6.24	6.40	130.93
Fair value (SGD)	1.20				
Current price (SGD)	1.26				
Price upside (%)	-5%				
Distribution yield (%)	4.4%				
Assumptions					
Risk-free rate (%)	2.8				
Beta	0.8				
Cost of equity (%)	7.0				
Terminal growth (%)	2.0				

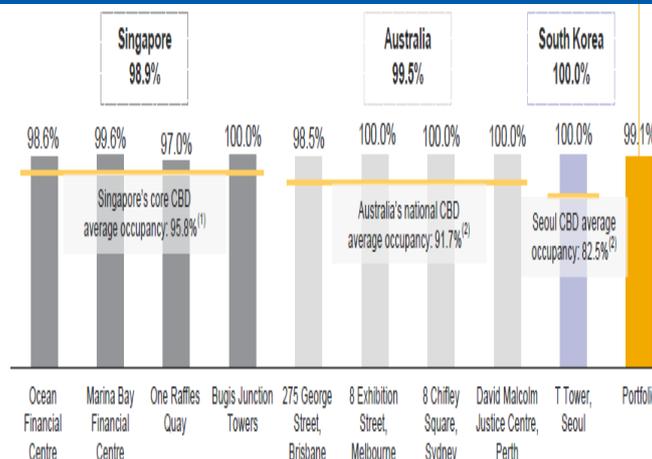
Source: RHB

Figure 3: Income contributions by property

	1H 2019	%	1H 2018	%
Ocean Financial Centre⁽¹⁾	32,796	27.0	54,719	38.4
Marina Bay Financial Centre	42,373	34.9	41,394	29.0
One Raffles Quay	12,313	10.1	13,506	9.5
Bugis Junction Towers	8,003	6.6	7,959	5.6
8 Chifley Square	6,214	5.1	6,507	4.6
8 Exhibition Street	6,355	5.2	5,888	4.1
275 George Street	5,651	4.7	5,805	4.1
David Malcolm Justice Centre	6,399	5.3	6,661	4.7
T Tower⁽²⁾	1,311	1.1	-	-
Total	121,415	100.0	142,439	100.0

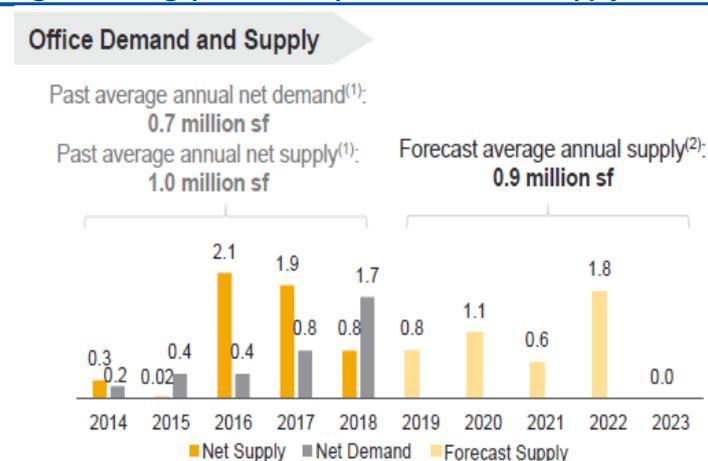
Source: Company data

Figure 4: Occupancy by property



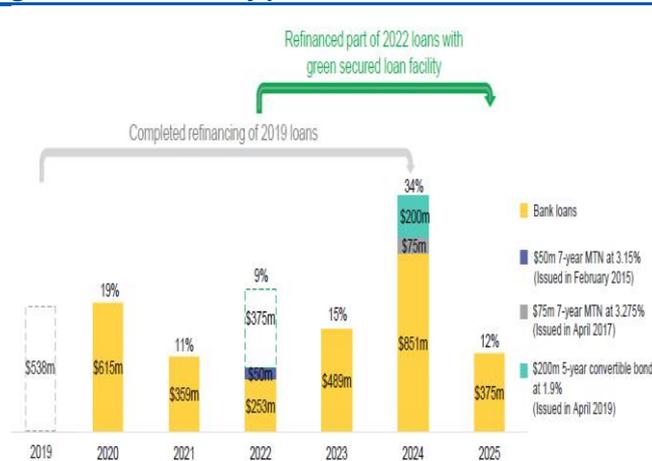
Source: Company data

Figure 3: Singapore office space demand and supply



Source: CBRE, Company data

Figure 4: Debt maturity profile



Source: Company data

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