

2 April 2024

Property | REITS

Keppel REIT (KREIT SP)

Buy (Maintained)

Acquisition Of 255 GS; BUY

- **Unchanged BUY and SGD1.08 TP, 24% upside and 7% yield.** Keppel REIT's acquisition 255 George Street (255 GS) is a pre-emptive strategy, in our view, to capitalise on recent office asset value corrections in Australia and a potential recovery ahead from rate cuts. While gearing will raise above 40%, we see divestments ahead to bring KREIT's gearing back to below 40%. It trades at >30% discount to book value, which we believe is unjustified, considering the REIT's high quality office assets in prime locations.
- **Acquisition of 50% stake in 255 GS, Sydney, Australia,** from Mirvac Wholesale Office Fund I for a purchase consideration of AUD363.8m (SGD321m). The freehold Grade-A office asset built in 1985 had major refurbishments done in 2022 and comes with strong environment credentials (5.5 Star National Australian Built Environment Rating System or NABERS energy rating). Committed occupancy stands at 93% with a relatively long weighted average lease expiry or WALE of 6.8 years and diversified tenant base. Management guided on first year net property income (NPI) yields based on acquisition costs be at mid-6% levels. However, this does include a rent guarantee (AUD5.2m) for 12 months on existing vacancies and potential expiries, and a 19-month period from 1 Dec 2024 for one specific tenancy, excluding which we believe the NPI yield is closer to 6% levels. Post this acquisition, Australia will account for c.19% of total assets (up from 17% currently), with Singapore assets still making up the bulk of KREIT's portfolio at 77%.
- **Flight to quality** remains a key trend driving the Australian post-COVID-19 central business district (CBD) office demand, with vacancy rates at Sydney's core CBD market remaining low at 11.5% vs other submarkets. JLL Research also expects prime office face rents to rise with a likely reduction in incentives.
- **T Tower divestment likely on the cards,** with KREIT currently marketing the asset for sale, according to [media reports](#). Management said it continuously evaluates its portfolio for asset recycling opportunities. T Tower was valued at KRW205.8bn (SGD320m) based on a 4.2% cap rate. Hence, a sale at slight premium to valuation or c.4% cap rate could provide a healthy yield spread of c.200bps if proceeds are recycled to above acquisition. The acquisition, in the meantime, would be fully funded by debt (estimated debt cost of slightly >4%) and results in overall gearing to increase to 41%. Based on 100% debt funding, KREIT expects *pro-forma* (FY23) yield accretion at c.1.4%.
- **We revise our FY24F-26F DPU by 1%,** factoring in acquisition and associated debt funding. KREIT's 3.2 ESG score is a notch above the country median. Hence, a 2% ESG premium is applied to our DDM-derived TP.

Target Price (Return): SGD1.08 (23.6%)
 Price (Market Cap): SGD0.88 (USD2,474m)
 ESG score: 3.2 (out of 4)
 Avg Daily Turnover (SGD/USD) 7.48m/6.27m

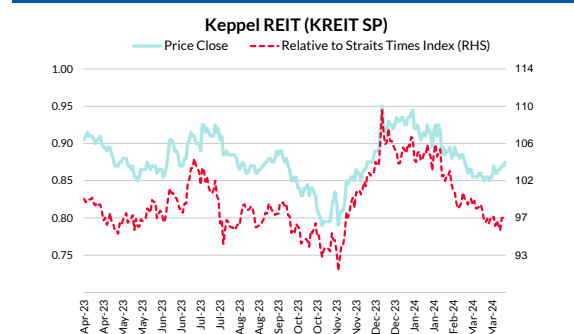
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(5.9)	1.2	(5.9)	2.3	(1.1)
Relative	(5.7)	(2.0)	(5.7)	1.8	(0.4)
52-wk Price low/high (SGD)				0.79	-0.95



Source: Bloomberg

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (SGDm)	219	233	243	270	274
Net property income (SGDm)	176	182	191	212	216
Reported net profit (SGDm)	450	208	246	260	263
Total distributable income (SGDm)	221	219	224	235	241
DPS (SGD)	0.06	0.06	0.06	0.06	0.06
DPS growth (%)	2.9	(2.2)	1.1	3.9	1.3
P/B (x)	0.64	0.66	0.66	0.66	0.66
Dividend Yield (%)	6.7	6.6	6.7	6.9	7.0
Return on average equity (%)	9.0	4.1	4.9	5.1	5.1
Return on average assets (%)	5.2	2.4	2.9	3.0	3.0

Source: Company data, RHB

Overall ESG Score: 3.2 (out of 4)

E: EXCELLENT

All of KREIT's Singapore buildings are Green Mark Platinum certified, with Keppel Bay Tower being the country's first zero-energy commercial building that is fully powered by renewable energy. It has set targets to reduce energy consumption by 10%, water usage by 5%, and increase use of renewal to 40% of portfolio by 2030 (from 2019's levels), and is progressing towards these aims.

S: GOOD

Diverse employee workforce with 75% of KREIT's full-time employees and c.30% of directors being female. The manager, together with the staff of Keppel Capital, contributed >c.630 hours for various community initiatives.

G: GOOD

Majority independent board. There is improving transparency levels in earnings and information disclosures, as well as well-established corporate governance frameworks related to board matters.

Financial Exhibits

Asia	Financial summary	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Singapore	Recurring EPS (SGD)	0.12	0.06	0.06	0.07	0.07
Property	EPS (SGD)	0.12	0.06	0.06	0.07	0.07
Keppel REIT	DPS (SGD)	0.06	0.06	0.06	0.06	0.06
KREIT SP	BVPS (SGD)	1.37	1.32	1.32	1.33	1.33
Buy	Return on average equity (%)	9.0	4.1	4.9	5.1	5.1
	Weighted avg adjusted shares (m)	3,724.39	3,770.60	3,816.90	3,864.35	3,912.87
Valuation basis	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
DDM methodology	Recurring P/E (x)	7.23	15.86	13.58	13.00	13.00
	P/E (x)	7.23	15.86	13.58	13.00	13.00
	P/B (x)	0.6	0.7	0.7	0.7	0.7
Key drivers	FCF Yield (%)	3.1	22.3	(4.3)	4.2	3.9
i. Positive outlook for Singapore office sector with firm demand and limited supply;	Dividend Yield (%)	6.7	6.6	6.7	6.9	7.0
ii. Strong quality Grade-A assets and sponsor;	EV/EBITDA (x)	na	2.83	3.73	3.35	3.38
iii. Inorganic and merger opportunities.	EV/EBIT (x)	10.13	4.64	5.43	4.82	4.89
Key risks	Income statement (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
i. Singapore economy tipping into recession ;	Total turnover	219	233	243	270	274
ii. Sharp deceleration in tech demand and increase in shadow spaces; and	EBITDA	(61)	210	185	209	215
iii. Downsizing and right-sizing of office spaces by key tenants.	Depreciation and amortisation	180	(82)	(58)	(64)	(66)
	Operating profit	119	128	127	146	148
	Net interest	(32)	(60)	(60)	(65)	(67)
	Income from associates & JVs	101	104	111	111	108
	Pre-tax profit	450	208	246	260	263
	Recurring net profit	450	208	246	260	263
Company Profile	Cash flow (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
KREIT is a real estate investment trust listed on the SGX. Sponsored by Keppel Land, the REIT owns and invests in a portfolio of income-producing commercial real estate and real estate related-assets in Singapore, Australia, South Korea, and Japan	Change in working capital	(53)	574	(308)	(48)	(64)
	Cash flow from operations	115	749	(129)	156	148
	Capex	(14)	(14)	(15)	(15)	(15)
	Cash flow from investing activities	32	16	140	144	145
	Dividends paid	(217)	(220)	(221)	(230)	(238)
	Cash flow from financing activities	(149)	(810)	(7)	(292)	(302)
	Cash at beginning of period	189	186	142	146	153
	Net change in cash	(3)	(45)	4	8	(10)
	Ending balance cash	186	142	146	153	143
	Balance sheet (SGDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total cash and equivalents	186	142	146	153	143
	Total investments	8,086	8,090	8,506	8,649	8,794
	Total assets	8,881	8,259	8,680	8,832	8,968
	Short-term debt	644	265	500	380	370
	Total long-term debt	2,208	2,074	2,138	2,288	2,328
	Total liabilities	3,016	2,508	2,834	2,883	2,918
	Shareholders' equity	5,119	5,005	5,079	5,159	5,236
	Minority interests	444	444	465	488	511
	Total equity	5,865	5,751	5,846	5,950	6,050
	Net debt	2,665	2,197	2,493	2,515	2,555
	Total liabilities & equity	8,881	8,259	8,680	8,832	8,968
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	1.2	6.3	4.4	10.7	1.8
	Recurrent EPS growth (%)	57.7	(54.4)	16.8	4.4	(0.0)
	Operating EBITDA margin (%)	(27.8)	90.2	76.0	77.7	78.2
	Net profit margin (%)	205.4	89.3	101.0	96.5	96.0
	Dividend payout ratio (%)	49.0	105.1	91.0	90.5	91.7
	Capex/sales (%)	6.2	6.1	6.0	5.5	5.5
	Interest cover (x)	2.06	1.92	1.67	1.76	1.76

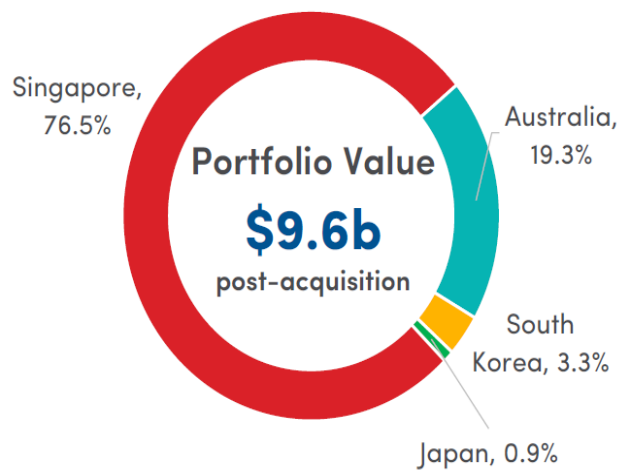
Source: Company data, RHB

Figure 1: KREIT's DDM valuation

DDM	FY24F	FY25F	FY26F	FY27F	Terminal value
DPU (SG cents)	5.86	6.06	6.14	6.27	112.04
Fair value (SGD)	1.04				
ESG premium/(discount)	0.04				
TP (SGD)	1.08				
Current price (SGD)	0.84				
Price upside (%)	28.8%				
Distribution yield (%)	7.0%				
Total returns (%)	35.8%				
Assumptions					
Risk-free rate (%)	2.8				
Beta	0.9				
Cost of equity (%)	7.6				
Terminal growth (%)	2.0				

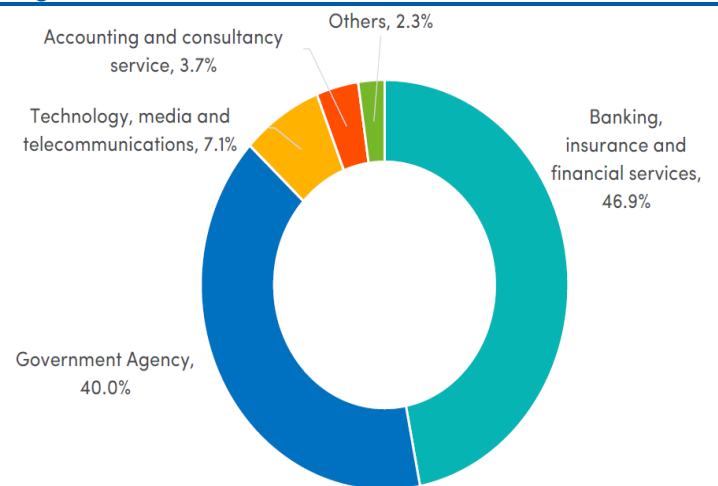
Source: RHB

Figure 2: Portfolio market composition post acquisition



Source: Company data

Figure 3: Tenant sectors at 255 GS



Source: Company data

Emissions And ESG

Trend analysis

Scope 1 and 2 emissions increased 11%YoY mainly due to more tenants returning to office. But compared to the base year (2019), this is 17% lower – reflecting commendable and tangible results from management's consistent efforts to reduce emissions. KREIT also engages with its tenants to adopt green practices and identify opportunities to improve the environmental performance of Keppel REIT's properties, including the signing of green lease agreements, where possible.

Emissions (tCO₂e)

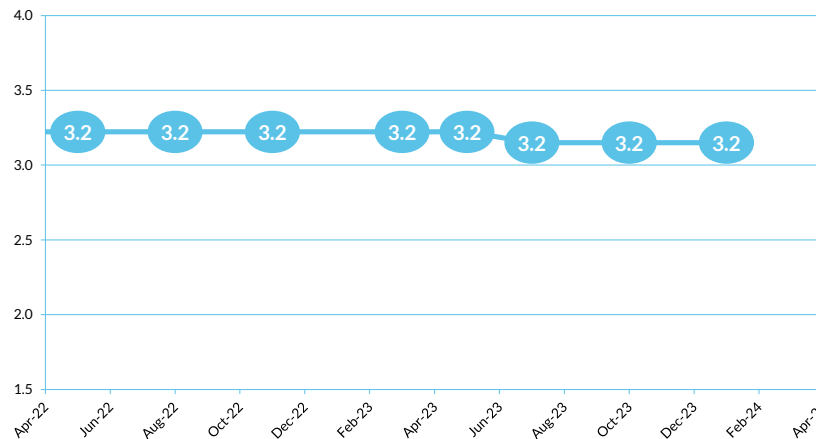
	Dec-21	Dec-22	Dec-23
Scope 1	1,572	1,551	1,453
Scope 2	17,293	16,124	18,189
Scope 3	-	27,241	27,602
Total emissions	18,865	44,916	47,244

Source: Company data, RHB

Latest ESG-Related Developments

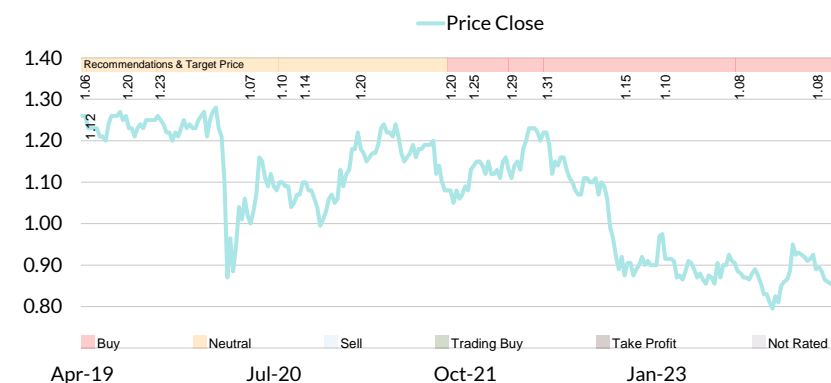
- 64% sustainability-focused funding higher than 50% as at end Dec 2022.
- KREIT has commenced reporting on Scope 3 emissions from 2021 onwards and is among a very few handful of S-REITs that currently do so.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-01-31	Buy	1.08	0.93
2023-10-18	Buy	1.08	0.84
2023-07-25	Buy	1.08	0.93
2023-01-29	Buy	1.10	0.97
2022-10-26	Buy	1.15	0.93
2022-04-20	Buy	1.31	1.19
2022-01-26	Buy	1.29	1.16
2021-10-26	Buy	1.25	1.07
2021-08-31	Buy	1.20	1.05
2021-01-26	Neutral	1.20	1.20
2020-09-14	Neutral	1.14	1.08
2020-07-20	Neutral	1.10	1.09
2020-05-04	Neutral	1.07	1.03
2019-10-17	Neutral	1.23	1.25
2019-10-02	Neutral	1.23	1.26

Source: RHB, Bloomberg

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