

27 July 2023

Property | REITS

## Keppel Pacific Oak US REIT (KORE SP)

**Buy** (Maintained)

### Rising Against The Tide

Target Price (Return): USD0.56 (+85%)  
 Price (Market Cap): USD0.30 (USD313m)  
 ESG score: 3.1 (out of 4)  
 Avg Daily Turnover (USD/USD) 0.42m/0.42m

- **Stay BUY, new USD0.56 TP from USD0.64, 5% upside with c.16% FY23F yield.** Keppel Pacific Oak US REIT's 1H23 results are broadly in line with expectations. Its operational performance still holds up well against the broad market challenges faced by the US commercial sector, thereby emphasising the REIT's differentiated portfolio merits. Its gearing remains well below official limits – while there are downside risks to valuations, we do not expect a >10% decline by year-end at this juncture. No loan refinancing is due until 4Q24, and all assets remain unsecured
- **Adjusted DPU for 1H23 declined 12.6% YoY** mainly from higher interest costs, while overall DPU fell by 17.2% YoY on the effect of management fees being fully paid in cash (1Q22: 100% in units). No revaluations were conducted for 1H23, but based on its assessment and discussions with valuers in its markets, KORE does not see a material decline at this juncture. Also, its loan covenants are tied to official gearing limits, ie gearing threshold of 50% and interest cover of 2.5x. As such, valuations need to fall by 24% to breach this limit. In terms of debt profile, 78% of its debt is hedged using interest rate swaps with maturities mostly tied closer to loan expiries.
- **Portfolio occupancy dipped by 1.1ppt QoQ to 90.8%**, mainly on lower occupancy across all three Seattle assets. While there have been some tenant movements in Seattle, KORE is in active discussions to backfill some of these vacancies. Its largest asset, The Plaza, should see some near-term occupancy rate pressure. However, overall, KORE guided that it targets to maintain a portfolio occupancy rate of c.90% by end-2023. Leasing activity was muted in 2Q at c.70k sqf(1Q: 219k sqf), but is expected to improve in tandem with the slightly better economic outlook and improvement in the rate of workers returning to the office. Physical occupancy rates (ie return to office) across its portfolio improved slightly to 65%, from 64% in the previous quarter. 1H23 rental reversion was at -4.6%, skewed by one large renewal/expansion lease at Maitland Promenade I & II – excluding this detail, it would have been +4%. The REIT's management guided for rental reversions to stay positive, and in the low single digits in 2H23.
- **KORE's modest gearing of 38.4%** provides it with some buffer against a decline in valuation in these uncertain market conditions. As such, a 10-15% decline in its valuation would still keep its gearing at 42-45%. The lack of tenant concentration risks – since its top 10 tenants account for only 23.7% of income, and no tenant accounts for over 3.5% of income – limits vacancy and cash flow risks.
- **We trim FY23-24F DPU by 6% and 7% post tightening occupancy rate assumptions and assuming higher financing costs.** KORE's ESG score of 3.1 (out of 4) is a notch above the country median score, so we applied a 2% ESG premium to its intrinsic value to derive our TP.

#### Analyst

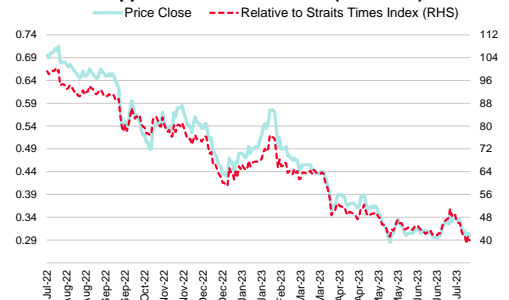
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(34.8)	1.7	(23.1)	(41.2)	(56.8)
Relative	(35.9)	(1.3)	(22.8)	(39.2)	(60.1)
52-wk Price low/high (USD)	0.29 – 0.72				

Keppel Pacific Oak US REIT (KORE SP)



Source: Bloomberg

#### Overall ESG Score: 3.1 (out of 4)

##### E: GOOD

For FY22, KORE's scope 1 and scope 2 greenhouse gas (GHG) emissions were 15.2% lower than levels recorded in 2019, while there was an 8.5% YoY decrease in waste. The REIT targets to reduce GHG emissions by 30% by 2030 vs 2019 levels, and has developed a 2-year roadmap to progressively implement Taskforce on Climate-related Disclosures (TCFD) recommendations.

##### S: GOOD

KORE has a high employee engagement score of >70%. Each employee has chalked an average of 21.2 training hours in FY22, exceeding its target. In 2022, the REIT manager, together with the staff of Keppel Capital, put in about 1,000 volunteer hours to community initiatives.

##### G: EXCELLENT

There is an increasing level of earnings disclosure and timely updates for investors. The Majority of the Board comprises independent directors, and its composition is diverse. KORE also has a well-established corporate governance framework relating to Board matters.

#### Note:

Small cap stocks are defined as companies with a market capitalization of less than USD0.5bn.

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (USDm)	141	148	145	149	152
Net property income (USDm)	82.7	84.3	87.0	89.4	91.4
Reported net profit (USDm)	77.4	48.5	12.6	55.9	58.1
Total distributable income (USDm)	62.4	60.6	50.6	50.1	51.9
DPS (USD)	0.06	0.06	0.05	0.05	0.05
DPS growth (%)	2.1	(8.6)	(16.5)	(0.9)	3.5
P/B (x)	0.35	0.37	0.39	0.38	0.38
Dividend Yield (%)	21.2	19.3	16.1	16.0	16.6
Return on average equity (%)	9.5	5.7	1.5	6.9	7.1
Return on average assets (%)	5.4	3.2	0.8	3.7	3.9

Source: Company data, RHB

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## Financial Exhibits

Asia	Financial summary	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Singapore	Recurring EPS (USD)	0.08	0.05	0.01	0.05	0.06
Property	EPS (USD)	0.08	0.05	0.01	0.05	0.06
<b>Keppel Pacific Oak US REIT</b>	DPS (USD)	0.06	0.06	0.05	0.05	0.05
KORE SP	BVPS (USD)	0.87	0.81	0.77	0.78	0.79
Buy	Return on average equity (%)	9.5	5.7	1.5	6.9	7.1
	Weighted avg adjusted shares (m)	983.53	1,044.45	1,044.45	1,044.45	1,044.45
Valuation basis	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
DDM	Recurring P/E (x)	3.81	6.46	24.96	5.60	5.39
	P/E (x)	3.81	6.46	24.96	5.60	5.39
	P/B (x)	0.3	0.4	0.4	0.4	0.4
	FCF Yield (%)	18.8	11.4	28.4	26.0	26.6
	Dividend Yield (%)	21.2	19.3	16.1	16.0	16.6
	EV/EBITDA (x)	-	8.54	7.68	7.10	6.98
	EV/EBIT (x)	-	8.54	7.68	7.10	6.98
Key drivers	Income statement (USDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
i. Portfolio is focussed on growth markets, with technology and healthcare tenants;	Total turnover	141	148	145	149	152
ii. Migration of tenants to suburban and low-cost areas will benefit the REIT;	EBITDA	76	78	80	83	85
iii. Limited concentration risks.	Operating profit	76	78	80	83	85
	Net interest	(15)	(19)	(22)	(24)	(24)
	Pre-tax profit	90	48	13	56	58
	Taxation	(13)	0	0	0	0
	Recurring net profit	77	48	13	56	58
Key risks	Cash flow (USDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
i. US economy slowing down accompanied by an increase in interest rates;	Change in working capital	2	2	10	0	0
ii. Structural changes impacting the demand for office space;	Cash flow from operations	83	79	94	86	88
iii. Collapse in the value of office space due to the lack of financing.	Capex	(27)	(44)	(5)	(5)	(5)
	Cash flow from investing activities	(131)	(8)	(5)	(5)	(5)
	Dividends paid	(66)	(58)	(51)	(50)	(52)
	Cash flow from financing activities	42	(59)	(84)	(77)	(73)
	Cash at beginning of period	57	51	63	69	74
	Net change in cash	(6)	12	5	5	10
	Ending balance cash	51	63	69	74	84
Company Profile	Balance sheet (USDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
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 should benefit from favourable economic and office fundamentals that are above the national average, so as to provide sustainable distributions and strong total returns for unitholders.	Total cash and equivalents	51	63	69	74	85
	Total investments	1,456	1,423	1,386	1,391	1,396
	Total other assets	3	27	27	27	27
	Total assets	1,514	1,520	1,488	1,499	1,514
	Short-term debt	123	10	5	0	0
	Total long-term debt	438	567	566	574	582
	Total liabilities	660	673	680	685	694
	Shareholders' equity	854	846	808	814	820
	Total equity	854	846	808	814	820
	Net debt	511	514	502	500	497
	Total liabilities & equity	1,514	1,520	1,488	1,499	1,514
Key metrics	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	1.2	4.8	(1.9)	2.7	2.3
	Recurrent EPS growth (%)	31.0	(41.0)	(74.1)	345.6	4.0
	Operating EBITDA margin (%)	53.9	52.4	55.4	55.5	55.6
	Net profit margin (%)	54.8	32.8	8.6	37.5	38.2
	Dividend payout ratio (%)	80.7	124.9	403.0	89.6	89.2
	Capex/sales (%)	19.5	29.5	3.4	3.4	3.3
	Interest cover (x)	5.19	4.16	3.52	3.43	3.55

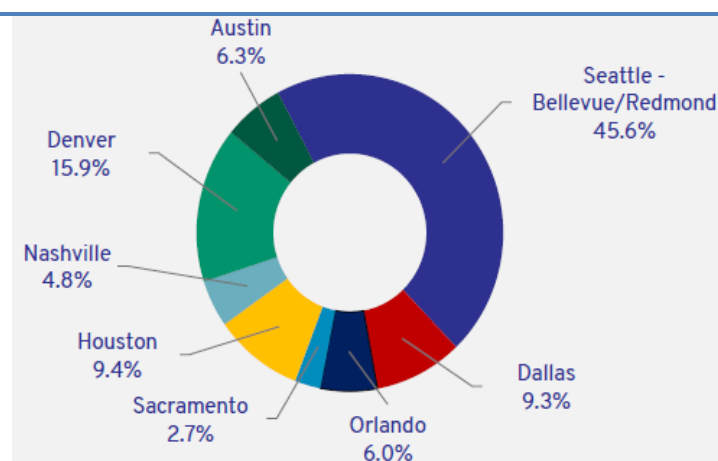
Source: Company data, RHB

Figure 1: DDM valuation

	FY23F	FY24F	FY25F	FY26F	FY27F	Terminal Value
DPU (US cents)	4.84	4.80	4.97	5.09	5.21	60.77
<b>Intrinsic value (USD)</b>	0.55					
ESG premium/(discount)	0.01					
<b>Target price (USD)</b>	0.56					
Current Price (USD)	0.30					
Price Upside	85.4%					
Distribution Yield FY23F	16.1%					
Total Returns	101.5%					
<b>Assumptions</b>						
Risk-free rate (%)	3.0					
Beta	1.0					
Cost of equity (%)	10.8					
Terminal growth (%)	2.0					

Source: RHB

Figure 2: NPI according to market (1H23)



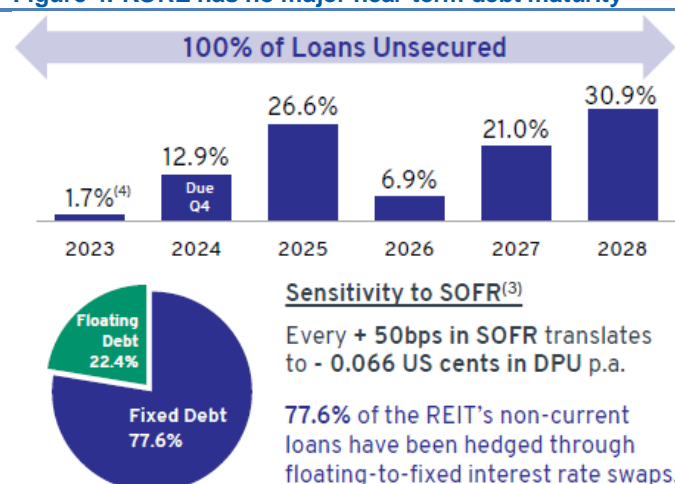
Source: Company data

Figure 2: Minimal concentration risks – these are KORE's top 10 tenants

Top 10 Tenants	Sector	Asset	Location	% of CRI
Comdata Inc	TAMI	Bridge Crossing	Nashville	3.5%
Ball Aerospace	TAMI	Westmoor Center	Denver	2.9%
Lear Cooperation	TAMI	The Plaza Buildings	Seattle - Bellevue/Redmond	2.8%
Gogo Business Aviation	TAMI	105 Edgeview	Denver	2.7%
Meta	TAMI	The Westpark Portfolio	Seattle - Bellevue/Redmond	2.6%
TerraPower	TAMI	Bellevue Technology Center	Seattle - Bellevue/Redmond	2.2%
Zimvie <sup>(1)</sup>	TAMI	Westmoor Center	Denver	2.0%
Goldman Sachs Personal Financial Management	Finance & Insurance	One Twenty Five	Dallas	1.7%
Auth0	TAMI	The Plaza Buildings	Seattle - Bellevue/Redmond	1.7%
Bio-Medical Applications	Medical & Healthcare	One Twenty Five	Dallas	1.6%
<b>Total</b>				<b>23.7</b>
WALE by NLA				4.7 years
WALE by CRI				4.8 years

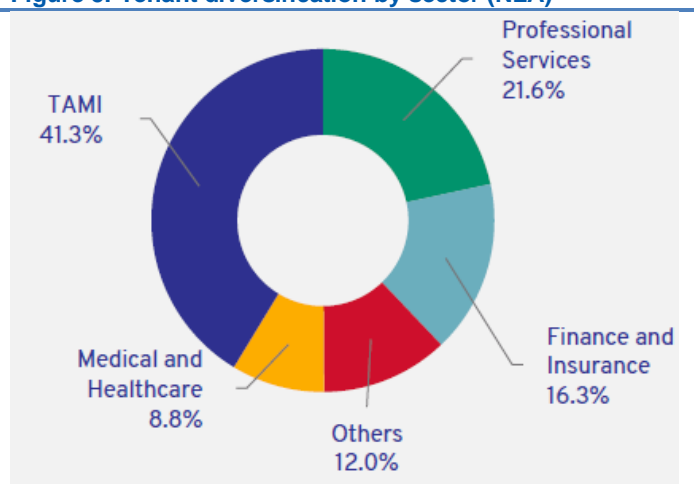
Source: Company data

Figure 4: KORE has no major near-term debt maturity



Source: Company data

Figure 5: Tenant diversification by sector (NLA)



Source: Company data

### Recommendation Chart

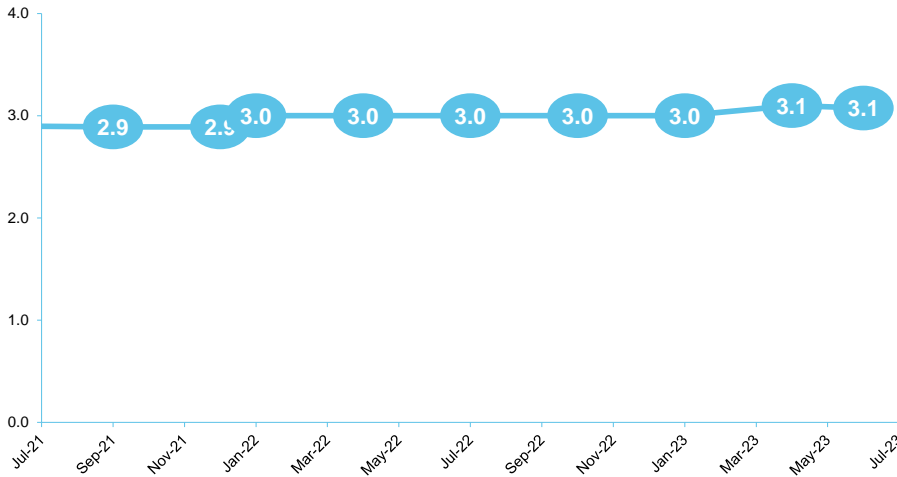


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-06-19	Buy	0.64	0.31
2023-04-19	Buy	0.64	0.36
2023-02-02	Buy	0.69	0.58
2022-10-27	Buy	0.74	0.55
2022-07-27	Buy	0.87	0.69
2022-01-27	Buy	0.92	0.76
2021-09-22	Buy	0.90	0.78
2021-07-27	Buy	0.90	0.80
2021-01-28	Buy	0.84	0.73
2020-10-22	Buy	0.80	0.71
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
2019-09-09	Buy	na	0.75

Source: RHB, Bloomberg

### ESG Rating History



Source: RHB

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