27 October 2022

Property | REITS

Keppel Pacific Oak US REIT (KORE SP)

Buy (Maintained)

Defying Market Expectations; Keep BUY

Target Price (Return):	USD0.74 (37.2%)
Price (Market Cap):	USD0.54 (USD564m)
ESG score:	3.00 (out of 4)
Avg Daily Turnover (USD/USD)	0.51m/0.51m

- **Stay BUY, revised USD0.74 TP from USD0.87, 37% upside and c.11% yield.** Keppel Pacific Oak US REIT posted another strong quarter of operational numbers – defying broader market expectations of a sharp negative impact to the US office sector demand from an evolving hybrid working model. Its portfolio continues to benefit from its choice submarkets (Sun Belt cities) and well-diversified tenant base with limited concentration risks. Rising interest rates impact on financing costs is also well mitigated with no debt maturing until end 2024 and 77% of its debt hedged.
- **Adjustable distributable income in 3Q was up 2.1% YoY** while actual distributable income fell 8.1% YoY, mainly on management fees fully paid in cash vs 100% in units in 3Q21. In September, KORE refinanced USD180m of loans maturing in Nov 2023 and early 2024 at competitive rates, leaving no further refinancing needs until 4Q24. Overall average interest cost post refinancing (including amortisation of upfront costs) increased marginally by 22bps this quarter to 3.1% while 77% of its debt is hedged, with every 50bps increase in rates resulting in a c.1% DPU impact.
- **Portfolio occupancy** improved to 92.5% (+0.5ppts QoQ), driven by occupancy improvements at The Plaza buildings (TPB), Bellaire Park (BP), and One Twenty-Five. More importantly, more than half the demand for this quarter came from new and expansion demand, indicating a return of confidence. Physical occupancy at its assets increased to 60% vs c.50%, mirroring the overall market trend of a 49% return to office at the end of September from 30% levels since the start of the year. Rent reversions were also was stronger in 3Q at 5.3% (1H: 1.6%) – management attributed this to lease renewals coming out of its stronger assets, ie TBP and BP. Overall, KORE expects occupancy to be maintained above 90% with positive rent reversions in mid-single digits moving into 2023.
- **Cap rate expansions are likely (25-100bps)** on rising interest rates but we expect this to vary widely depending on assets and markets. Overall, we do not expect a >5% decline in asset value by end 2022. Gearing is comfortable at 37.5% – it is expected to see a slight reduction from divestment proceeds of Powers Ferry in Atlanta. Acquisitions are less likely in the near term, with focus more on asset enhancements and sustainability increases at its buildings.
- **No withholding tax impact.** Management again clarified on market speculation that non-US unitholders are not subjected to a 10% withholding tax impact under Section 1446(f), which comes into effect in Jan 2023.
- **We have lowered FY23-24F DPU by 3%,** factoring in higher interest costs and also raised COE assumptions by 100bps – factoring in higher-than-expected rate hikes. ESG score of 3.0 (out of 4.0) is in line with country median – hence, we apply a 0% premium/discount to our DDM-derived TP.

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (USDm)	140	141	151	154	157
Net property income (USDm)	83.0	82.7	91.8	93.8	95.6
Reported net profit (USDm)	56.4	77.4	67.1	67.0	67.9
Total distributable income (USDm)	58.6	62.4	62.5	60.7	61.4
DPS (USD)	0.06	0.06	0.06	0.06	0.06
DPS growth (%)	14.4	2.1	(5.4)	(3.2)	1.0
P/B (x)	0.66	0.62	0.65	0.65	0.65
Dividend Yield (%)	11.5	11.8	11.1	10.8	10.9
Return on average equity (%)	7.4	9.5	7.8	7.8	7.8
Return on average assets (%)	4.2	5.4	4.4	4.4	4.4

Source: Company data, RHB

Analyst

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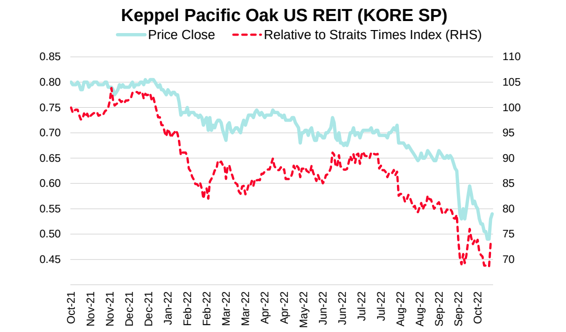
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(32.5)	(13.6)	(22.3)	(26.5)	(32.5)
Relative	(28.8)	(8.1)	(16.5)	(17.0)	(26.4)
52-wk Price low/high (USD)					0.49 – 0.81



Source: Bloomberg

Overall ESG Score: 3.00 (out of 4)

E: GOOD
Target to reduce Greenhouse Gas Emissions by 30% by 2030 from 2019. Manager also plans to embark on various energy saving initiatives, water saving efforts, and waste conservation efforts.

S: GOOD
In 2020, an Employee Assistance Programme (EAP) was introduced to provide mental health support for employees and their families, to help them cope with the challenges of working from home, family responsibilities and living in an acutely changed world due to the pandemic. Each employee received an average of 19.1 training hours in FY20. In 2020, the Manager, together with staff of Keppel Capital, committed about 790 volunteer hours to community initiatives.

G: GOOD
KORE Increased its outreach of investor education and interaction to both institutional and retail investors in FY20. Improving transparency levels in earnings and information disclosure. Well-established corporate governance frameworks relating to board matters.

Financial Exhibits

Asia
Singapore
Property
Keppel Pacific Oak US REIT
KORE SP
Buy

Valuation basis

DDM

Key drivers

i. Portfolio focused on tech and healthcare tenants and growth markets;
ii. Migration of tenants to sub-urban and low cost states will benefit the REIT;
iii. Organic growth potential from rental growth and rent escalations.

Key risks

i. US economy slowing down accompanied by increase in interest rates;
ii. Structural changes impacting office demand;
iii. Long protracted COVID-19 resulting in delays in office reopenings.

Company Profile

Keppel Pacific Oak US 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.

Financial summary	**Dec-20**	**Dec-21**	**Dec-22F**	**Dec-23F**	**Dec-24F**
Recurring EPS (USD)	0.06	0.08	0.06	0.06	0.06
EPS (USD)	0.06	0.08	0.06	0.06	0.06
DPS (USD)	0.06	0.06	0.06	0.06	0.06
BVPS (USD)	0.82	0.87	0.83	0.83	0.83
Return on average equity (%)	7.4	9.5	7.8	7.8	7.8
Weighted avg adjusted shares (m)	939.02	983.53	1,042.05	1,044.05	1,046.05

Valuation metrics	**Dec-20**	**Dec-21**	**Dec-22F**	**Dec-23F**	**Dec-24F**
Recurring P/E (x)	8.99	6.87	8.38	8.41	8.32
P/E (x)	8.99	6.87	8.38	8.41	8.32
P/B (x)	0.7	0.6	0.7	0.7	0.6
FCF Yield (%)	9.5	10.4	17.4	15.2	15.5
Dividend Yield (%)	11.5	11.8	11.1	10.8	10.9
EV/EBITDA (x)	- 4.56	- 5.44	- 4.83	- 4.80	- 4.79
EV/EBIT (x)	- 4.56	- 5.44	- 4.83	- 4.80	- 4.79

Income statement (USDm)	**Dec-20**	**Dec-21**	**Dec-22F**	**Dec-23F**	**Dec-24F**
Total turnover	140	141	151	154	157
EBITDA	76	76	85	87	88
Operating profit	76	76	85	87	88
Net interest	(16)	(15)	(16)	(18)	(18)
Pre-tax profit	69	90	67	67	68
Taxation	(13)	(13)	0	0	0
Recurring net profit	56	77	67	67	68

Cash flow (USDm)	**Dec-20**	**Dec-21**	**Dec-22F**	**Dec-23F**	**Dec-24F**
Change in working capital	(2.1)	1.8	13.6	(0.3)	(0.5)
Cash flow from operations	74.6	82.9	102.8	91.0	92.6
Capex	(26.3)	(27.5)	(5.0)	(5.0)	(5.0)
Cash flow from investing activities	(26.3)	(131.0)	(5.0)	(5.0)	(5.0)
Dividends paid	(39.0)	(65.5)	(62.5)	(60.7)	(61.4)
Cash flow from financing activities	(29.2)	41.6	(98.4)	(74.4)	(86.2)
Cash at beginning of period	38.2	57.3	51.0	50.7	62.5
Net change in cash	19.1	(6.4)	(0.5)	11.5	1.4
Ending balance cash	57.3	50.9	50.4	62.2	63.9

Balance sheet (USDm)	**Dec-20**	**Dec-21**	**Dec-22F**	**Dec-23F**	**Dec-24F**
Total cash and equivalents	57	51	51	62	64
Total investments	1,305	1,456	1,461	1,466	1,471
Total other assets	0	3	3	3	3
Total assets	1,367	1,514	1,521	1,538	1,545
Short-term debt	41	123	90	90	80
Total long-term debt	463	438	448	457	466
Total liabilities	595	660	661	671	672
Shareholders' equity	772	854	860	866	873
Total equity	772	854	860	866	873
Net debt	447	511	487	485	482
Total liabilities & equity	1,367	1,514	1,521	1,538	1,545

Key metrics	**Dec-20**	**Dec-21**	**Dec-22F**	**Dec-23F**	**Dec-24F**
Revenue growth (%)	13.6	1.2	7.0	2.2	1.8
Recurrent EPS growth (%)	(27.2)	31.0	(18.1)	(0.4)	1.0
Operating EBITDA margin (%)	54.6	53.9	56.3	56.3	56.3
Net profit margin (%)	40.4	54.8	44.4	43.4	43.2
Dividend payout ratio (%)	104.0	80.7	93.2	90.5	90.4
Capex/sales (%)	18.9	19.5	3.3	3.2	3.2
Interest cover (x)	4.80	5.19	5.36	4.89	4.76

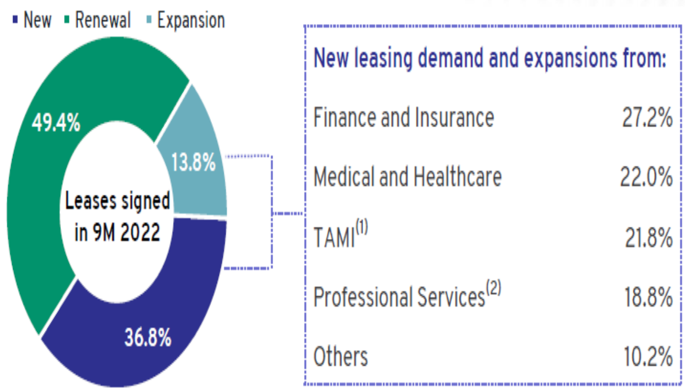
Source: Company data, RHB

Figure 1: DDM valuation

	FY22F	FY23F	FY24F	FY25F	FY26F	Terminal value
DPU (US cents)	6.00	5.81	5.87	6.08	6.20	81.6
Intrinsic value (USD)	**0.74**					
ESG premium/(discount)	0.00					
Target price (USD)	**0.74**					
Current price (USD)	0.54					
Price upside	37.2%					
Distribution yield FY22F	11.1%					
Total returns	48.3%					
Assumptions						
Risk-free rate (%)	3.0					
Beta	0.9					
Cost of equity (%)	9.8					
Terminal growth (%)	2.0					

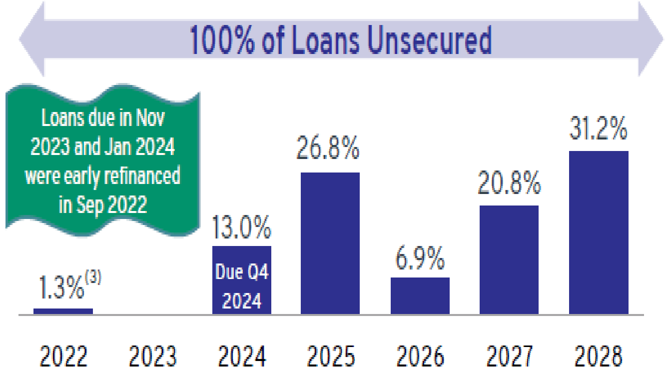
Source: RHB

Figure 2: Higher new and expansion demand in 9M22



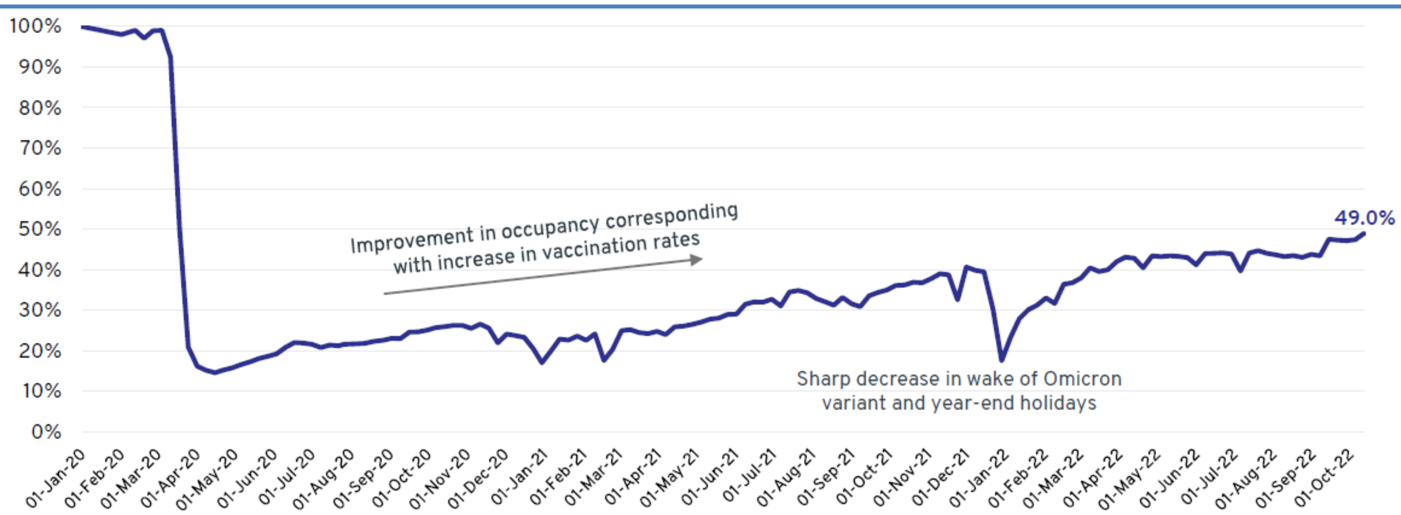
Source: Company

Figure 3: No debt refinancing until 4Q24



Source: Company

Figure 4: US key cities weekly occupancy since COVID-19



Source: Kastle.com, KORE

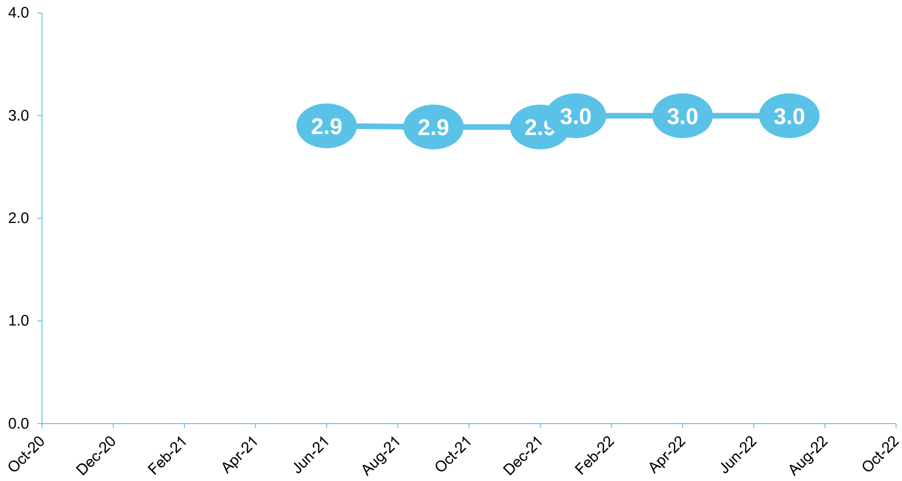
Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-09-06	Buy	na	0.75
2019-07-18	Buy	na	0.81
2019-07-17	Buy	na	0.82
2019-07-12	Buy	na	0.81

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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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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Not Rated:	Stock is not within regular research coverage

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