

28 July 2022

Property | REITS

Keppel Pacific Oak US REIT (KORE SP)

Buy (Maintained)

Remains Operationally Resilient; Keep BUY

Target Price (Return): USD0.87 (26.1%)
 Price (Market Cap): USD0.69 (USD721m)
 ESG score: 3.00 (out of 4)
 Avg Daily Turnover (USD/USD) 0.57m/0.57m

- **Stay BUY with a revised TP of USD0.87 from USD0.92, 26% upside and c.9% yield.** Keppel Pacific Oak US REIT's operational numbers in 2Q were in line with our expectations. Headline DPU declined mainly due to switching off entire management fees in cash, from all units previously. Portfolio occupancy improved slightly during the quarter with positive rent reversions, despite volatile market conditions in the US, underlining strength of its assets. Minimal impact is expected from rising interest rates and inflationary pressures. Valuation remains cheap at 0.84x 2022 P/BV.
- **2Q operational DPU up 1% YoY** while final DPU declined 10% YoY on the back of management receiving entire fees in cash instead of units. KORE noted the move is to prevent dilution with its units trading well below NAV as well as to avoid share price pressures from it selling in the market. Management expects fees to be fully paid in cash moving forward. In July, KORE also entered into a new USD180m loan facility to refinance early its loans maturing in Nov 2023 and Jan 2024 which should remove any financing requirements until Nov 2024. The loan pricing is competitive in the current environment in our view, with overall financing costs (excluding upfront amortisation costs) expected to increase only by 10bps to 2.8% and will lengthen its debt maturity to 4.1 years (from 2.8 years currently). 84% of its debt is fixed with every 50bps increase impacting DPU by c.-1%.
- **Divesting Powers Ferry and Northridge Center I & II** at a price above their latest valuations (estimated 5-10% premium, exit cap rates mid 6%). These two were the smallest assets in its portfolio with a combined value of USD34.6m, and were underperforming assets thus, we see the transaction as a positive move. The deal is expected to close during this quarter. Gearing post divestment is expected to be c.36%, providing USD100-150m debt headroom for acquisitions. Management remains on active lookout for acquisitions in key growth markets.
- **Operating metrics remain positive.** Rent reversion (1H) stood at +1.6% (1Q: +2.4%). Management noted that 2Q rent reversions were mainly dragged down by signing off a temporary lease for one of its existing tenants. Excluding this one off, rent reversion for 2Q/1H would be +4.5%/3.9%. Reversions are expected to remain positive in 2H in low single digits. It only has 6.3%/16% of leases due for renewal in 2H/FY23. Portfolio occupancy rose 0.3ppt QoQ to 92% despite a slower than expected return to office and market volatility.
- **We lower our FY22-24F DPU 8-10% by changing fees to be fully paid in cash.** Based on our proprietary ESG model, KORE has a score 3.0 (out of 4.0). As this score is in line with country median we apply a 0% premium to our DDM-derived TP.

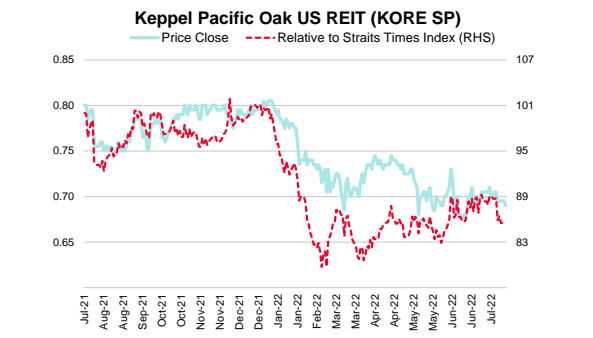
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(13.8)	(1.4)	(5.5)	(9.2)	(13.8)
Relative	(16.0)	(3.1)	(1.6)	(7.1)	(15.5)
52-wk Price low/high (USD)	0.68 – 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.

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	68.4	69.5
Total distributable income (USDm)	58.6	62.4	62.5	62.0	63.0
DPS (USD)	0.06	0.06	0.06	0.06	0.06
DPS growth (%)	14.4	2.1	(5.4)	(1.0)	1.4
P/B (x)	0.84	0.79	0.84	0.83	0.83
Dividend Yield (%)	9.0	9.2	8.7	8.6	8.7
Return on average equity (%)	7.4	9.5	7.8	7.9	8.0
Return on average assets (%)	4.2	5.4	4.4	4.5	4.5

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Singapore	Recurring EPS (USD)	0.06	0.08	0.06	0.07	0.07
Property	EPS (USD)	0.06	0.08	0.06	0.07	0.07
Keppel Pacific Oak US REIT	DPS (USD)	0.06	0.06	0.06	0.06	0.06
KORE SP	BVPS (USD)	0.82	0.87	0.83	0.83	0.83
Buy	Return on average equity (%)	7.4	9.5	7.8	7.9	8.0
	Weighted avg adjusted shares (m)	939.02	983.53	1,042.05	1,044.05	1,046.05
Valuation basis						
DDM						
Key drivers	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. Portfolio focussed on tech and healthcare tenants and growth markets;	Recurring P/E (x)	11.49	8.77	10.71	10.53	10.38
ii. Migration of tenants to sub-urban and low cost states will benefit the REIT; and	P/E (x)	11.49	8.77	10.71	10.53	10.38
iii. Organic growth potential from rental growth and rent escalations	P/B (x)	0.8	0.8	0.8	0.8	0.8
	FCF Yield (%)	7.5	8.2	13.6	11.9	12.1
	Dividend Yield (%)	9.0	9.2	8.7	8.6	8.7
	EV/EBITDA (x)	- 2.71	- 3.50	- 3.00	- 3.00	- 3.02
	EV/EBIT (x)	- 2.71	- 3.50	- 3.00	- 3.00	- 3.02
Key risks	Income statement (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
i. US economy slowing down accompanied by increase in interest rates ;	Total turnover	140	141	151	154	157
ii. Structural changes impacting office demand, and	EBITDA	76	76	85	87	88
iii. Long protracted Covid resulting in delay in office reopening	Operating profit	76	76	85	87	88
	Net interest	(16)	(15)	(16)	(16)	(17)
	Pre-tax profit	69	90	67	68	70
	Taxation	(13)	(13)	0	0	0
	Recurring net profit	56	77	67	68	70
Company Profile	Cash flow (USDm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
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.	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)	(62.0)	(63.0)
	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)	1.7	1.4
	Operating EBITDA margin (%)	54.6	53.9	56.3	56.3	56.3
	Net profit margin (%)	40.4	54.8	44.4	44.3	44.2
	Dividend payout ratio (%)	104.0	80.7	93.2	90.7	90.7
	Capex/sales (%)	18.9	19.5	3.3	3.2	3.2
	Interest cover (x)	4.80	5.19	5.36	5.29	5.22

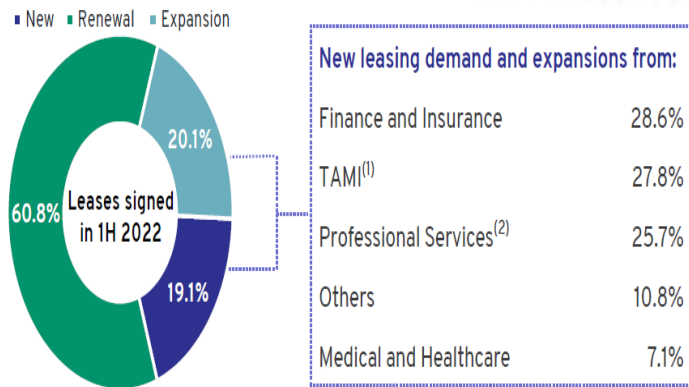
Source: Company data, RHB

Figure 1: DDM valuation

	FY22F	FY23F	FY24F	FY25F	FY26F	Terminal Value
DPU (US cents)	6.00	5.94	6.02	6.23	6.36	95.7
Intrinsic value (USD)	0.87					
ESG premium/(discount)	0.00					
Target price (USD)	0.87					
Current Price (USD)	0.79					
Price Upside	10.1%					
Distribution Yield FY22F	7.6%					
Total Returns	18%					
Assumptions						
Risk-free rate (%)	3.0					
Beta	0.8					
Cost of equity (%)	8.8					
Terminal growth (%)	2.0					

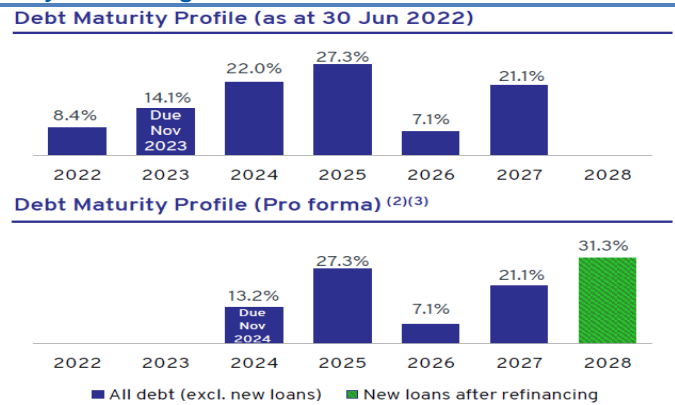
Source: RHB

Figure 2: Leasing demand (1H) – Leased space c.368k (7.3% of portfolio)



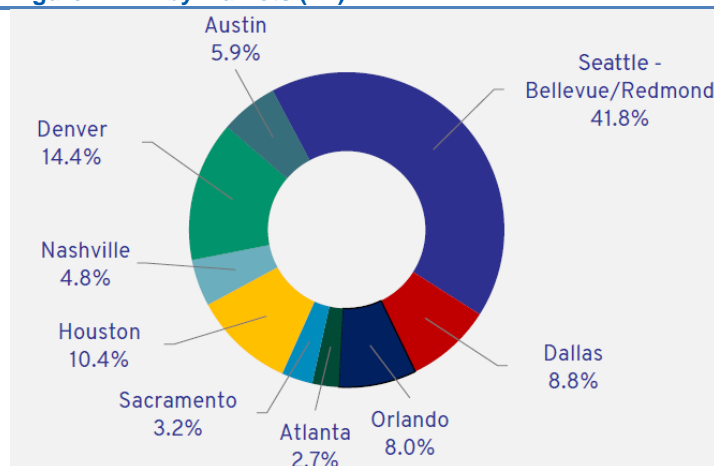
Source: Company data

Figure 3: Pro forma debt maturity profile post proposed early refinancing



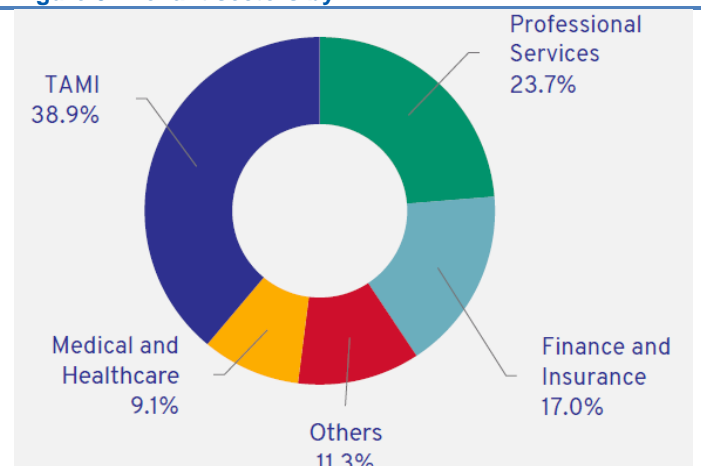
Source: Company data

Figure 4: NPI by markets (1H)



Source: Company data

Figure 5: Tenant sectors by NLA



Source: Company data

Recommendation Chart

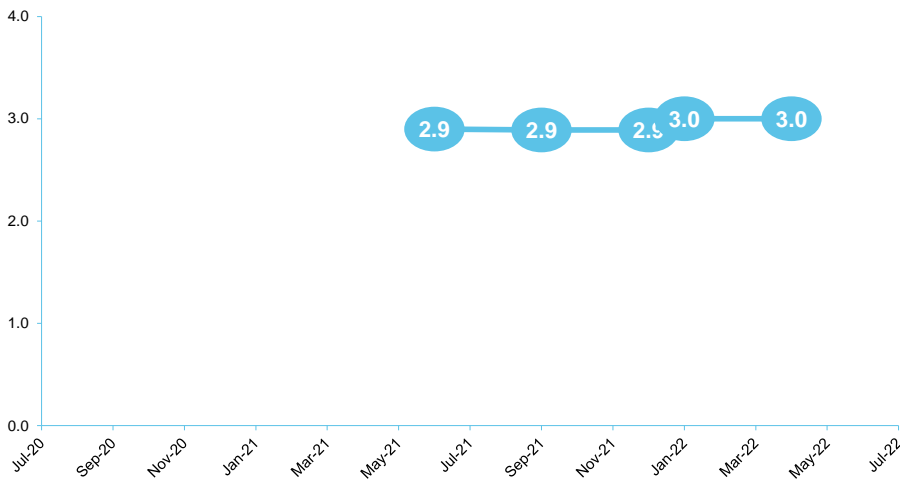


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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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