

30 January 2023

Property | REITS

Keppel REIT (KREIT SP)

Buy (Maintained)

Laggard Proxy To Resilient Office Sector; BUY

- **Keep BUY, TP drops to SGD1.10 from SGD1.14, 13% upside.** Keppel REIT's results were slightly below estimates, with earnings meeting 96% of our full-year forecast. Despite the ongoing technology sector and economic slowdown, Singapore's office market is expected to stay resilient on low supply and flight-to-quality trends. We believe the REIT could also look at asset divestments to lower gearing and recycle capital. Valuations are reasonably attractive, at 0.7x book value with a FY23F yield of 6.2%.
- **2H22/FY22 DPU rose 2.4%/1.4% YoY**, aided by the first tranche of the anniversary dividend distribution of SGD10m. Operational DPU (2H) was lower by 4% YoY on higher interest expenses, lower JV & associates income, and a weaker AUD. KREIT remains committed to a SGD20m annual capital top-up for the next four years, which will offset interest cost hikes. Portfolio value rose 1.7% HoH, with Singapore assets (+2.3% HoH) more than offsetting the weakness from assets abroad. About 76% of debt is hedged, with every 50bps rise in interest rates affecting DPU by 2%.
- **Blue & William's first anchor tenant**, Equifax, will consolidate its office space to occupy one-third of the building (c.4,350sqm). Management noted signing rental rates were in line with development assumptions of c.900-1,100psm pa. The building is on track to be completed by mid-2023. The developer, Lendlease, has been providing 4.5% annual coupon payments during the current development phase, and has also committed to a 3-year rental guarantee on any unlet space after practical completion.
- **Slightly disappointing Japan entry.** In Oct 2022, KREIT announced its entry into the Japan market by acquiring Ginza 2-chome, a freehold office building in central Tokyo, for JPY8.8bn (SGD84m). While we welcome its move to diversify into Japan, we believe management overpaid for the asset. The building is only c.36% occupied currently, and has an estimated NPI yield of 1.2% (3.1% when fully occupied), which we regard as very low. Debt cost is expected to be around c.1.5%, which means the acquisition is not expected to be immediately yield-accretive. When the building is fully occupied, however, the deal will be mildly accretive with full debt funding.
- **Mid- to high-single digit reversions expected in FY23F.** KREIT posted strong portfolio rental reversions of +19.4% in 4Q22 (FY22: +10%) which we believe was mainly driven by mark-to-market of rent for space surrendered by Standard Chartered (c.80% of 184k sqf backfilled). Despite the economic and technology sector slowdown, it expects office leasing demand to remain firm in 1H, then cool down in 2H. The overall portfolio occupancy rate is expected to remain resilient, at c.96% for 2024.
- **We lower FY23-24F DPU by 4-5%** on higher interest costs, and after tweaking occupancy, rental and recent acquisition assumptions. As KREIT's ESG score of 3.2 is two notches above the country median, we applied a 4% premium to our intrinsic DDM value to derive our TP.

Target Price (Return): SGD1.10 (+13%)
 Price (Market Cap): SGD0.97 (USD2,763m)
 ESG score: 3.22 (out of 4)
 Avg Daily Turnover (SGD/USD) 9.88m/7.25m

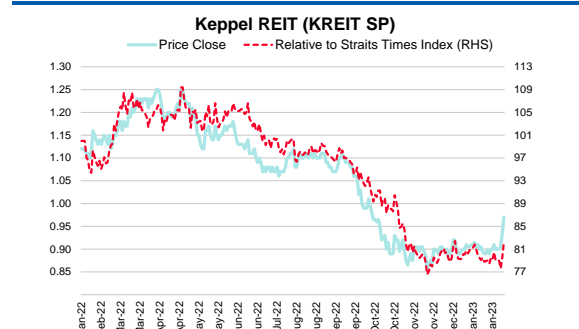
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	6.6	6.6	5.4	(11.8)	(15.7)
Relative	2.2	2.7	(7.2)	(17.7)	(19.8)
52-w k Price low /high (SGD)	0.86 – 1.25				



Source: Bloomberg

Overall ESG Score: 3.22 (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 target to reduce energy consumption by 10%, water usage by 5% and increase use of renewal to 40% of portfolio by 2030. lockdown ns.

S: GOOD

Diverse employee workforce with 75% of KREIT's full-time employees and c.30% 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.

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (SGDm)	217	219	229	233	236
Net property income (SGDm)	173	176	178	181	183
Reported net profit (SGDm)	279	450	259	257	193
Total distributable income (SGDm)	212	221	229	234	239
DPS (SGD)	0.06	0.06	0.06	0.06	0.06
DPS growth (%)	0.5	2.9	2.3	0.9	1.0
P/B (x)	0.74	0.71	0.71	0.71	0.73
Dividend Yield (%)	5.9	6.1	6.2	6.3	6.3
Return on average equity (%)	6.0	9.0	5.0	4.9	3.7
Return on average assets (%)	3.4	5.2	2.9	2.9	2.1

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Singapore	Recurring EPS (SGD)	0.08	0.12	0.07	0.07	0.05
Property	EPS (SGD)	0.08	0.12	0.07	0.07	0.05
Keppel REIT	DPS (SGD)	0.06	0.06	0.06	0.06	0.06
KREIT SP	BVPS (SGD)	1.32	1.37	1.37	1.37	1.34
Buy	Return on average equity (%)	6.0	9.0	5.0	4.9	3.7
	Weighted avg adjusted shares (m)	3,636.75	3,724.39	3,770.50	3,816.11	3,861.79
Valuation basis	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
DDM	Recurring P/E (x)	12.65	8.02	14.11	14.38	19.45
	P/E (x)	12.65	8.02	14.11	14.38	19.45
Key drivers	P/B (x)	0.7	0.7	0.7	0.7	0.7
i. Positive outlook for the Singapore office segment, due to firm demand and limited supply;	FCF Yield (%)	8.1	2.8	9.6	3.2	1.8
ii. Strong-quality Grade-A assets and sponsor;	Dividend Yield (%)	5.9	6.1	6.2	6.3	6.3
iii. Inorganic and merger opportunities.	EV/EBITDA (x)	3.77	na	6.59	6.24	4.28
	EV/EBIT (x)	4.14	8.41	8.18	8.27	8.31
Key risks	Income statement (SGDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
i. Sharp slowdown in the economy and the re-imposition of COVID-19 restrictions;	Total turnover	217	219	229	233	236
ii. Sharp deceleration in tech demand and an increase in shadow spaces;	EBITDA	120	(61)	146	156	223
iii. Downsizing and right-sizing of office spaces by key tenants.	Depreciation and amortisation	(11)	180	(28)	(38)	(108)
	Operating profit	109	119	118	118	115
	Net interest	(36)	(32)	(35)	(43)	(48)
	Income from associates & JVs	119	101	118	123	126
	Pre-tax profit	279	450	259	257	193
	Recurring net profit	279	450	259	257	193
Company Profile	Cash flow (SGDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Keppel REIT is 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, Australia, South Korea and Japan	Change in working capital	150	(53)	205	(26)	(91)
	Cash flow from operations	298	115	364	135	82
	Capex	(12)	(14)	(14)	(15)	(15)
	Cash flow from investing activities	(352)	32	34	149	154
	Dividends paid	(203)	(217)	(225)	(231)	(236)
	Cash flow from financing activities	88	(149)	(395)	(285)	(242)
	Cash at beginning of period	155	189	186	189	188
	Net change in cash	34	(3)	3	(1)	(6)
	Ending balance cash	189	186	189	188	182
	Balance sheet (SGDm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total cash and equivalents	189	186	189	188	182
	Total investments	8,262	8,086	8,105	8,223	8,283
	Total assets	8,488	8,881	8,904	9,022	9,076
	Short-term debt	188	644	200	400	300
	Total long-term debt	2,539	2,208	2,552	2,377	2,557
	Total liabilities	2,898	3,016	2,942	2,971	3,055
	Shareholders' equity	4,866	5,119	5,183	5,241	5,180
	Minority interests	422	444	478	508	538
	Total equity	5,590	5,865	5,963	6,051	6,021
	Net debt	2,538	2,665	2,563	2,589	2,674
	Total liabilities & equity	8,488	8,881	8,904	9,022	9,076
	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	27.2	1.2	4.5	1.4	1.4
	Recurrent EPS growth (%)	5187.4	57.7	(43.1)	(1.9)	(26.1)
	Operating EBITDA margin (%)	55.3	(27.8)	63.9	67.3	94.7
	Net profit margin (%)	128.7	205.4	113.1	110.7	81.7
	Dividend payout ratio (%)	76.1	49.0	88.3	90.8	124.0
	Capex/sales (%)	5.5	6.2	6.2	6.3	6.3
	Interest cover (x)	2.11	2.06	1.94	1.70	1.50

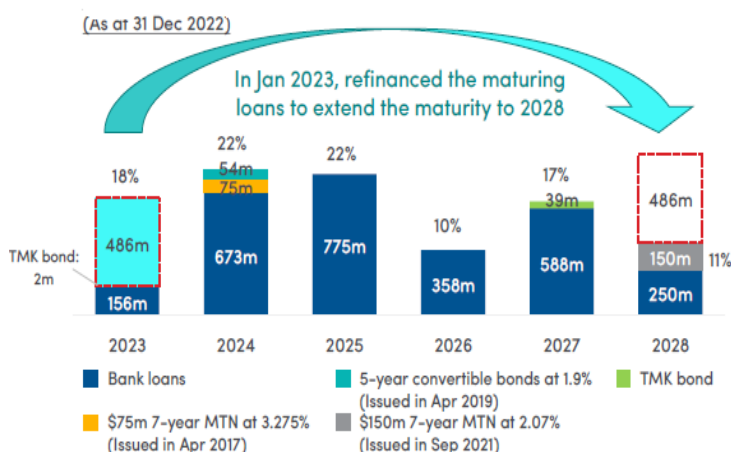
Source: Company data, RHB

Figure 1: KREIT's fair value based on a DDM calculation

DDM	FY23F	FY24F	FY25F	FY26F	Terminal Value
DPU (SG cents)	6.04	6.10	6.16	6.22	114.10
Fair value (SGD)	1.06				
ESG Premium/(discount)	0.04				
Target Price (SGD)	1.10				
Current price (SGD)	0.97				
Price upside (%)	13.6%				
Distribution yield (%)	6.2%				
Total returns (%)	19.9%				
Assumptions					
Risk-free rate (%)	2.8				
Beta	0.9				
Cost of equity (%)	7.6				
Terminal growth (%)	2.0				

Source: RHB

Figure 2: Debt maturity profile



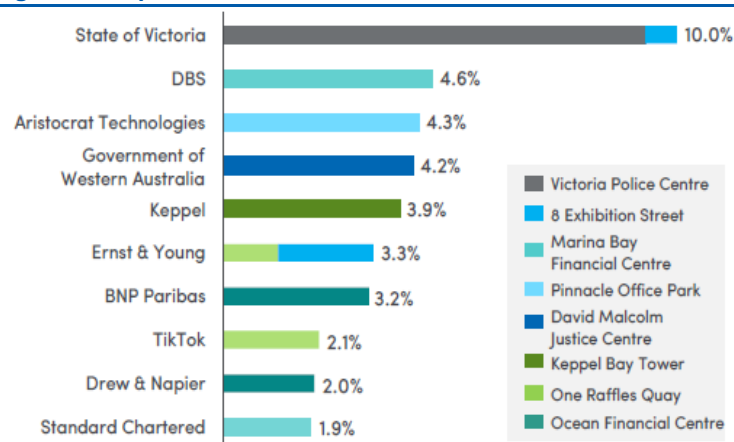
Source: Company data

Figure 3: Leasing demand by sector and type (FY22)



Source: Company data

Figure 4: Top 10 tenants



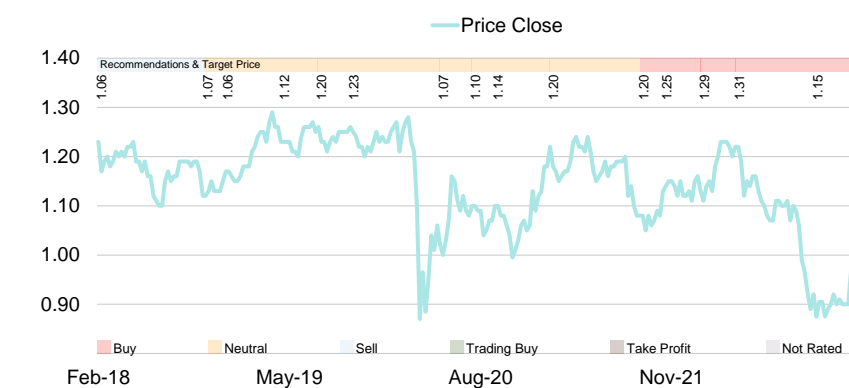
Source: Company data

Figure 5: Tenant mix by sector

Tenant Business Sector	%
Banking, insurance and financial services	27.9%
Government agency	14.8%
Technology, media and telecommunications	14.3%
Manufacturing and distribution	7.7%
Legal	7.3%
Energy, natural resources, shipping and marine	6.9%
Real estate and property services	6.6%
Accounting and consultancy services	5.1%
Services	3.2%
Retail and food & beverage	2.7%
Others	3.5%
Total	100%

Source: Company data

Recommendation Chart

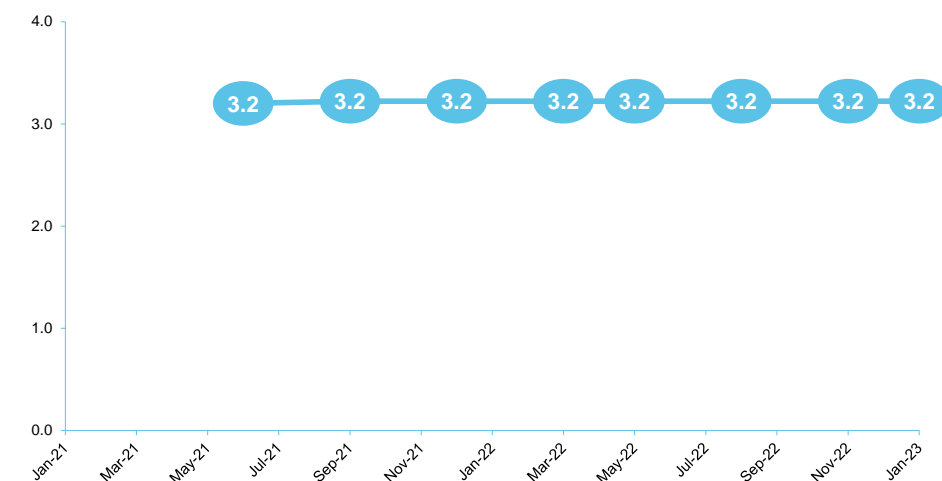


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-07-16	Neutral	1.20	1.27
2019-04-18	Neutral	1.12	1.23
2019-01-22	Neutral	1.06	1.17
2018-12-03	Neutral	1.06	1.17

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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