

Keppel REIT (KREIT SP)

Higher Signing Rents

Maintain HOLD; TP SGD1.19 post 1H18 results

1H18 core distributable income was in line with our and the street expectations. KREIT booked a large one-off pre-termination income for a tenant whose leases were scheduled to expire in 2020. Average rents signed at its Singapore offices improved along with the strengthening market. Management believes its stock price is undervalued and announced a share buyback programme effectively immediately. Maintain HOLD and SGD1.19 TP based on a target yield of 5.25%. We find the stock fairly valued with the trading yield of the REIT near historical lows. Prefer UOL (UOL SP, CP SGD6.79, BUY, TP SGD8.95) for office exposure.

Signing rents inched higher

1H18 distributable income of SGD96.6m was in line at 48% of our core estimate. Apart from a large pre-termination income received, income contributions from its buildings were broadly within our expectations. Signing rents for its Singapore offices rose to SGD10.74 psf pm in 1H18. This is an improvement from SGD10.05 for leases signed in 1Q18 and SGD9.80 for the entire 2017. This was corroborated by the 4.1% QoQ increase in Grade-A rents of SGD10.10, as reported by CBRE.

Booked large pre-termination income

KREIT booked yet another large one-off pre-termination income worth SGD12m in the quarter. Citing tenant confidentiality, management declined to provide specific details, except that its original leases were due to expire in 2020. However, with a significant increase in income from Ocean Financial Centre, we infer that the pre-termination was from this building. Banking and financial services firm ANZ now accounts for 3.8% of committed NLA, from 5.1% in 1Q18.

Commencing share buyback

Management believes its unit price is undervalued and intends to commence a share buyback programme using excess working capital. In order to comply with restrictions on the takeover code, it could purchase up to 1.5% of outstanding shares over a six months period. This translates into a potential cash utilisation of SGD58m at the current share price. Separately, management confirmed it still has SGD48m of capital gains that could be reinvested or distributed to shareholders.

FYE Dec (SGD m)	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	161	165	167	171	198
Net property income	128	131	134	138	159
Core net profit	131	121	138	154	172
Core EPU (cts)	4.0	3.6	4.1	4.5	5.0
Core EPU growth (%)	7.1	(9.7)	12.0	10.6	10.7
DPU (cts)	6.4	5.7	6.2	6.4	6.6
DPU growth (%)	(6.3)	(10.5)	9.6	2.3	2.9
P/NTA (x)	0.7	0.8	0.8	0.8	0.8
DPU yield (%)	6.2	5.1	5.5	5.6	5.8
ROAE (%)	5.3	3.7	3.0	3.3	3.7
ROAA (%)	1.7	1.6	1.8	2.0	2.2
Debt/Assets (x)	0.33	0.33	0.34	0.35	0.35
Consensus DPU	-	-	5.9	6.0	6.0
MKE vs. Consensus (%)	-	-	5.2	6.5	9.7

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HOLD

Share Price	SGD 1.14
12m Price Target	SGD 1.19 (+4%)
Previous Price Target	SGD 1.19

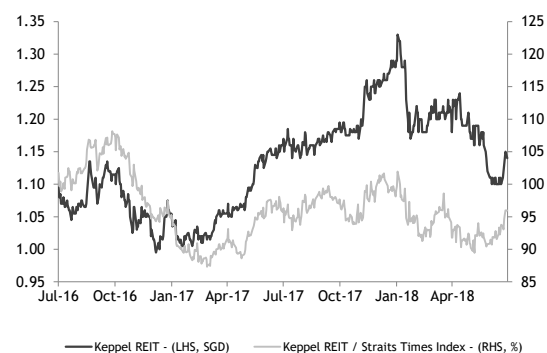
Statistics

52w high/low (SGD)	1.33/1.10
3m avg turnover (USDm)	4.4
Free float (%)	51.8
Issued shares (m)	3,403
Market capitalisation	SGD3.9B
	USD2.8B

Major shareholders:

Keppel Corp. Ltd.	46.3%
Newton Investment Management Ltd.	2.2%
PGIM, Inc.	1.3%

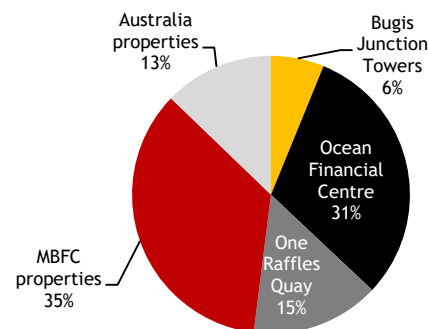
Price Performance



	-1M	-3M	-12M
Absolute (%)	2	(6)	(2)
Relative to index (%)	5	1	(1)

Source: FactSet

Exposure summary



Source: Company

Fig 1: Quarterly profit and loss

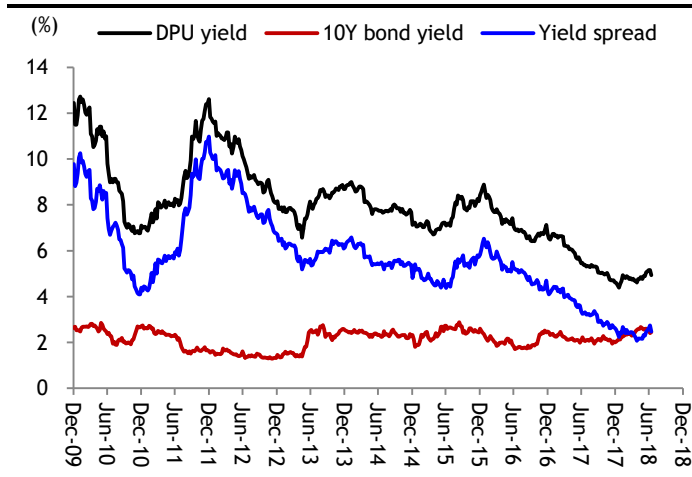
One-off pre-termination fee boosted 2Q18 revenue by SGD12m.

FYE 31 Dec	2Q17	1Q18	2Q18	Change		YTD18	% of FY	FY18E
	(SGD m)	(SGD m)	(SGD m)	QoQ %	YoY %			
Property income	39.8	38.1	51.7	35.5	29.6	89.8	53.6	167.4
Property expenses	(8.0)	(8.5)	(8.4)	(0.8)	6.2	(17.0)	50.7	(33.4)
Net property income	31.9	31.2	43.2	38.4	35.5	74.4	55.5	134.0
Share of results of associates & JVs	28.3	28.5	26.5	(7.0)	(6.5)	54.9	48.7	112.8
Distributable income to unitholders	47.4	48.2	48.3	0.2	1.9	96.6	47.8	201.8
Capital/other distributions	0.0	0.0	0.0	n.m.	n.m.	0.0	0.0	10.0
Total distributions to unitholders	47.4	48.2	48.3	0.2	1.9	96.6	45.6	211.8
Distribution per unit	1.42	1.42	1.42	0.0	0.0	2.84	45.4	6.25
NAV per unit (SGD)	1.41	1.42	1.41	(0.3)	(0.2)			
Aggregate leverage (%)^	38.5	38.6	38.6	0	10			
All-in financing cost (%)^	2.59	2.75	2.77	1	18			

^Change in basis points

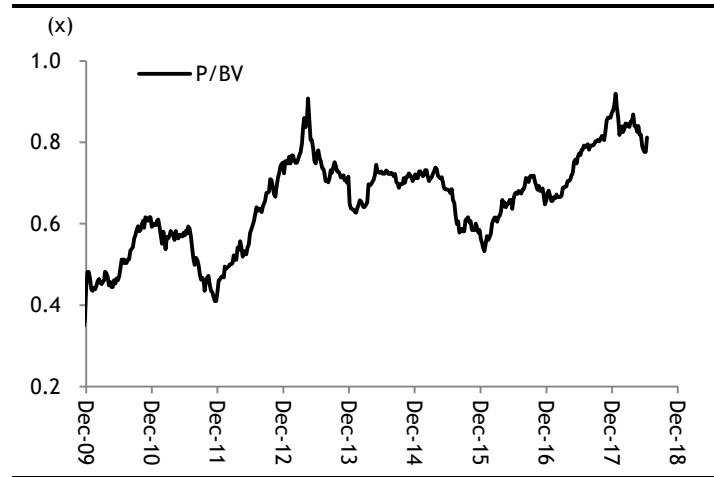
Source: Company, Maybank Kim Eng

Fig 2: Positives appear to be priced in with trading yield of 4.9% near historical low...



Source: Bloomberg

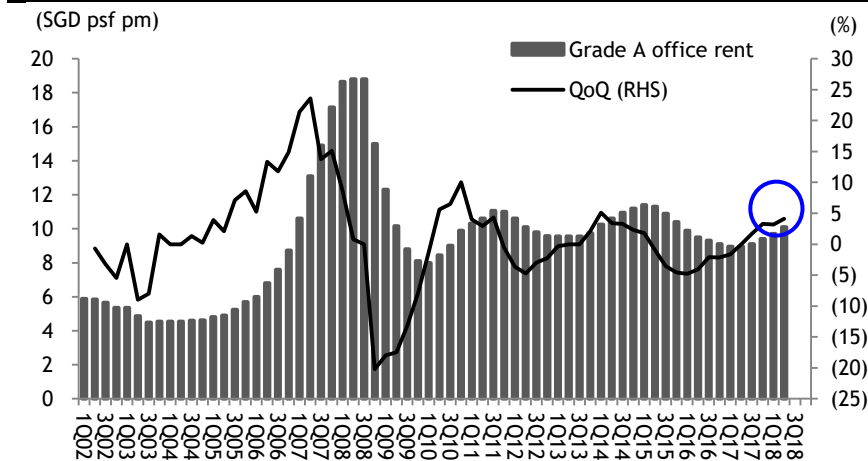
Fig 3: ...and relatively high trailing P/BV of 0.81x



Source: Bloomberg, Maybank Kim Eng

Fig 4: Grade A office rents

Preliminary data from CBRE showed a marginal uptick in rents to SGD10.10 psf pm in 2Q18

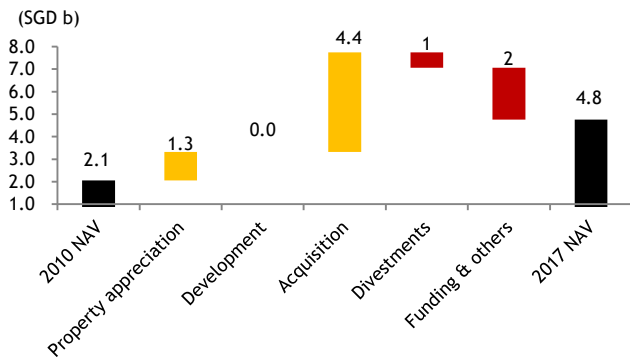


Source: CBRE

Value Proposition

- KREIT is a commercial REIT with 87% of its office portfolio in Singapore and 13% in Australia. Backed by Keppel Corporation, one of Singapore’s largest conglomerates.
- One of the largest office landlords with SGD8.5b worth of properties.
- NAV expansion driven by aggressive acquisition-led growth with nearly SGD4.4b of assets purchased since 2010.
- With limited redevelopment potential, this strategy may continue to be the avenue for growth.
- Singapore’s office market has turned around.

NAV changes

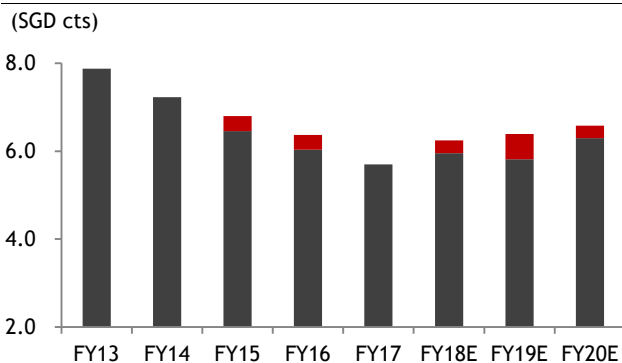


Source: Company, Maybank Kim Eng

Financial Metrics

- Lack of capital distributions led to a dip in FY17 DPU.
- Operating DPU could rise in FY20E on completion of 311 Spencer Street.
- Capital value of its properties in the Marina Bay area could benefit from aggressive land bids for Central Boulevard.
- Management could offset the negative impact of higher financing cost with capital distributions.

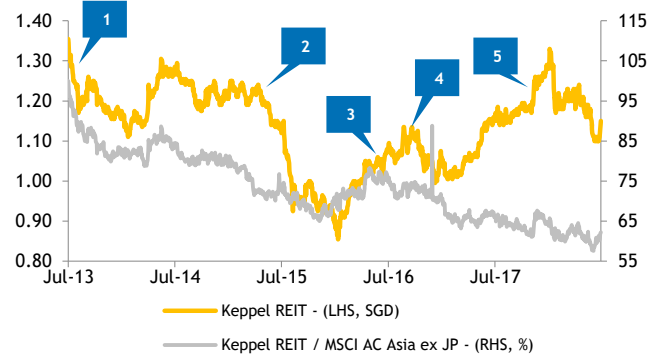
DPU trajectory



Source: Company, Maybank Kim Eng

Price Drivers

Historical share price trend



Source: FactSet, Company, Maybank Kim Eng

1. Fed raised interest rates. Global yield assets sold off.
2. Office rents peaked in Singapore. Concerns about oversupply. Fund-raising risks for KREIT due to its higher leverage than peers.
3. Sharp fall in bond yields on heightened risk aversion after Brexit. Rotation to stable income-producing properties.
4. Fed announces second rate hike. Yield sensitive assets under pressure.
5. Office rents started to pick up from 3Q17.

Swing Factors

Upside

- Appreciation in the capital value of its properties.
- Divestment of fringe assets to reduce leverage.
- Earlier-than-expected rebound in office rents.

Downside

- Sharper-than-expected decline in office rents or occupancies.
- Overpaying for acquisitions.
- Higher financial leverage implies bigger exposure to interest-rate spikes than peers.

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Metrics					
Price/DPU(x)	16.1	19.7	18.2	17.8	17.3
P/BV (x)	0.7	0.8	0.8	0.8	0.8
P/NTA (x)	0.7	0.8	0.8	0.8	0.8
DPU yield (%)	6.2	5.1	5.5	5.6	5.8
FCF yield (%)	5.0	6.2	7.4	5.4	5.8
INCOME STATEMENT (SGD m)					
Revenue	161.3	164.5	167.4	171.3	197.6
Net property income	128.4	131.2	134.0	137.7	158.8
Management and trustee fees	(56.9)	(56.5)	(56.9)	(57.4)	(58.0)
Net financing costs	(64.0)	(65.3)	(66.8)	(73.0)	(77.2)
Associates & JV	114.2	115.8	112.7	119.2	122.0
Exceptionals	28.3	0.0	0.0	0.0	0.0
Other pretax income/expenses	91.2	51.7	0.0	0.0	0.0
Pretax profit	279.1	197.3	142.3	157.8	176.2
Income tax	(21.3)	(17.2)	(4.6)	(3.7)	(3.7)
Minorities	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Total return avail to unitholders	250.2	172.6	137.6	154.0	172.4
Preferred Dividends	(7.5)	(7.5)	(7.5)	(7.5)	(7.5)
Distributable inc to unitholders	208.1	190.7	211.8	219.2	228.2
BALANCE SHEET (SGD m)					
Cash & Short Term Investments	278.7	198.2	150.1	111.5	145.2
Accounts receivable	10.7	8.6	8.6	8.6	8.6
Property, Plant & Equip (net)	0.2	0.1	0.2	0.3	0.4
Investment properties	3,618.1	3,774.9	3,924.9	3,987.3	3,987.3
Intangible assets	22.5	10.7	1.0	1.0	1.0
Investment in Associates & JVs	2,975.4	2,992.9	2,992.9	2,992.9	2,992.9
Other assets	629.8	618.8	625.0	631.3	637.6
Total assets	7,535.3	7,604.3	7,702.8	7,732.9	7,773.1
ST interest bearing debt	0.0	425.0	0.0	0.0	0.0
Accounts payable	51.8	56.5	56.5	56.5	56.5
LT interest bearing debt	2,481.8	2,097.1	2,650.0	2,700.0	2,750.0
Other liabilities	103.2	110.4	111.5	112.6	113.7
Total Liabilities	2,636.8	2,689.0	2,818.0	2,869.1	2,920.2
Shareholders Equity	4,746.7	4,763.4	4,733.0	4,712.0	4,701.0
Minority Interest	2.1	2.1	2.1	2.2	2.2
Total shareholder equity	4,748.9	4,765.6	4,735.2	4,714.2	4,703.2
Total liabilities and equity	7,535.3	7,604.3	7,702.8	7,732.9	7,773.1
CASH FLOW (SGD m)					
Cash flow from operations	108.2	120.0	118.7	123.2	144.2
Capex	(0.0)	(0.0)	(0.1)	(0.1)	(0.1)
Acquisitions & investments	0.0	0.0	0.0	0.0	0.0
Disposal of FA & investments	0.0	0.0	0.0	0.0	0.0
Dividend income from associates	109.6	120.1	112.7	119.2	122.0
Other investing cash flow	200.4	(122.7)	(121.0)	(31.1)	30.6
CF from investing activities	310.0	(2.6)	(8.3)	87.9	152.5
Dividends paid	(182.6)	(156.9)	(211.8)	(219.2)	(228.2)
Interest expense	(60.7)	(62.5)	(66.8)	(73.0)	(77.2)
Change in debt	(16.3)	46.9	127.8	50.0	50.0
Equity raised / (purchased)	0.0	0.0	0.0	0.0	0.0
Other financial activities	(2.2)	(1.4)	(0.1)	(0.1)	(0.1)
CF from financing activities	(269.3)	(181.4)	(158.4)	(249.8)	(263.0)
Effect of exchange rate changes	5.6	(2.7)	0.0	0.0	0.0
Net cash flow	148.9	(64.0)	(48.1)	(38.6)	33.7

FYE 31 Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Key Ratios					
Growth ratios (%)					
Revenue growth	(5.3)	2.0	1.8	2.3	15.4
Net property income growth	(6.6)	2.2	2.1	2.8	15.3
Core net profit growth	9.4	(7.5)	13.8	11.9	11.9
Distributable income growth	(4.2)	(8.4)	11.0	3.5	4.1
Profitability ratios (%)					
Net property income margin	79.6	79.7	80.0	80.4	80.4
Core net profit margin	81.1	73.5	82.2	89.9	87.2
Payout ratio	83.1	74.3	153.9	142.4	132.4
DuPont analysis					
Total return margin (%)	nm	nm	82.2	89.9	87.2
Gross revenue/Assets (x)	0.0	0.0	0.0	0.0	0.0
Assets/Equity (x)	1.6	1.6	1.6	1.6	1.7
ROAE (%)	5.3	3.7	3.0	3.3	3.7
ROAA (%)	1.7	1.6	1.8	2.0	2.2
Leverage & Expense Analysis					
Asset/Liability (x)	2.9	2.8	2.7	2.7	2.7
Net gearing (%) (excl. perps)	46.4	48.8	52.8	54.9	55.4
Net interest cover (x)	1.7	1.5	1.4	1.5	1.7
Debt/EBITDA (x)	nm	nm	nm	nm	nm
Capex/revenue (%)	0.0	0.0	0.1	0.1	0.1
Net debt/ (net cash)	2,203.1	2,324.0	2,499.9	2,588.5	2,604.8
Debt/Assets (x)	0.33	0.33	0.34	0.35	0.35

Source: Company; Maybank

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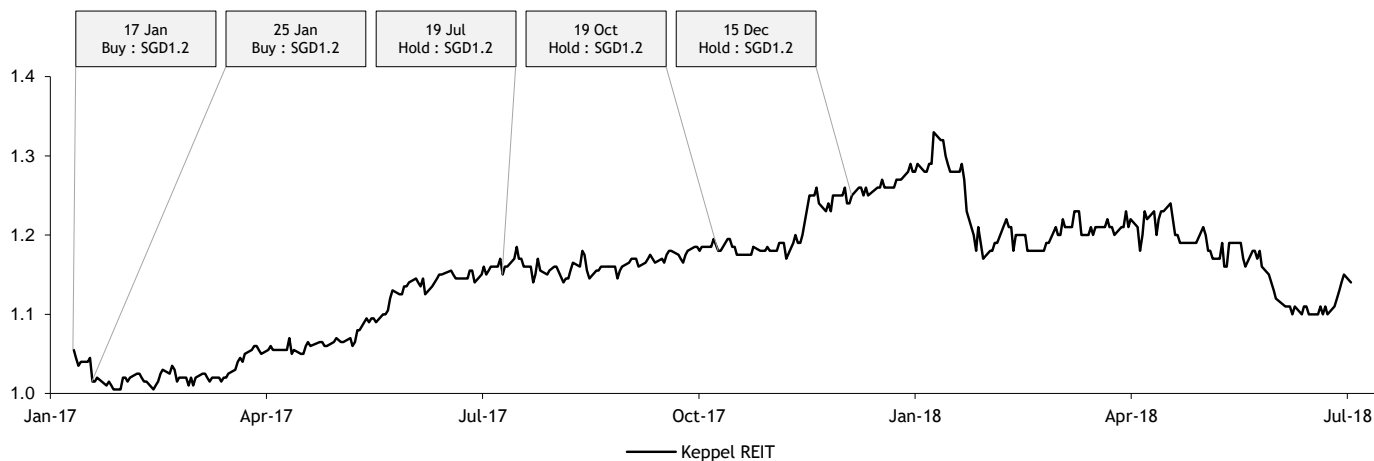
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