

Keppel REIT (KREIT SP)

Better Value in Developer Landlords

Maintain HOLD; Positives priced-in

FY17 DPU was slightly below ours and consensus estimates. While KREIT continues to report negative rental reversions, the magnitude of the contraction has lessened. Also, asset valuations were largely unchanged. While the narrow trading yield of KREIT is justified by a turn in the office cycle, we believe valuations are rich (4.3% yield, 0.94x P/BV) relative to historical values and could cap share price upside in the near-term. Maintain HOLD and TP of SGD1.19 based on a target yield of 5.25%. For exposure to Singapore's recovering office market, we see better value in developer landlords with large prime office exposure (UOL and GUOL).

No surprise; Smaller negative reversion a positive

FY17 DPU of 5.7cts was 95% of our estimate. In 4Q17, Net Property Income for Ocean Financial Centre was lifted by one-off pre-termination income of SGD4.2m. However, no surprises in its underlying property metrics. Portfolio occupancy was healthy at 99.7% with average signing rents at SGD9.80 psf for the year. Rent reversion for FY17 improved to -4% (2016: -9%) reflecting the marginal uptick in spot rents over the past year. KREIT has 8.3% of leases up for renewal and another 14.2% due for rent review in FY18. With expiring rents at SGD8.50-SGD12 psf, we expect negative reversion to persist for another year.

Property values largely unchanged

Contrary to our call for higher asset values, KREIT's valuers have kept the valuation of its Singapore assets largely unchanged. This reflects an unchanged cap rate of 3.75% used for its offices despite narrow yields at various office transactions and more aggressive valuations used by its peers. We view this as a positive for unitholders as DPUs will not be weighed down by a large increase in asset management fees (based on 0.5% of asset value +3.0% of NPI).

Positive data points in Singapore's office market

Preliminary data from CBRE showed that Grade A rents trended higher in 4Q17 to SGD9.40 psf (+3.3% QoQ). While market sentiment has improved significantly over the past year, we caution that rents may only rise moderately as 300k+ sf of secondary office space will be available annually in 2018/9E (CBRE estimates) as tenants move into new offices.

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)	0.9	0.9	1.0	1.0	1.0
DPU yield (%)	4.8	4.3	4.7	4.8	5.0
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	-	-	6.0	6.0	na
MKE vs. Consensus (%)	-	-	4.1	6.5	na

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HOLD

Share Price	SGD 1.32
12m Price Target	SGD 1.19 (-10%)
Previous Price Target	SGD 1.19

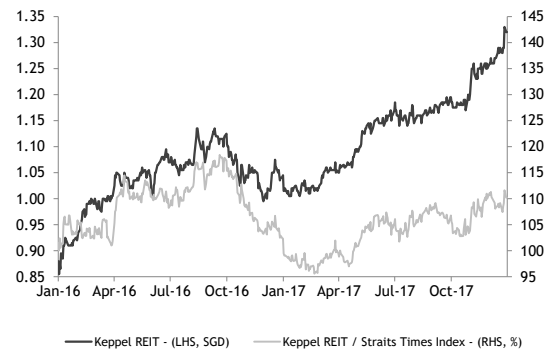
Statistics

52w high/low (SGD)	1.33/1.01
3m avg turnover (USDm)	4.3
Free float (%)	51.8
Issued shares (m)	3,262
Market capitalisation	SGD4.3B
	USD3.3B

Major shareholders:

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

Price Performance



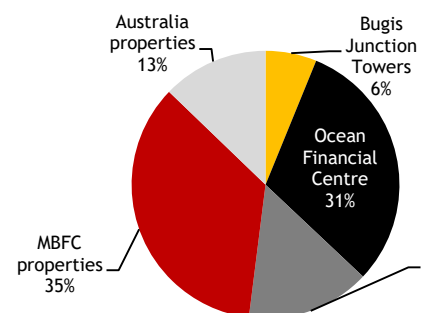
	-1M	-3M	-12M
Absolute (%)	6	10	27
Relative to index (%)	0	4	8

Source: FactSet

Companies mentioned

UOL (UOL SP, CP SGD9.29, BUY, TP SGD9.85)
GUOL (GUOL SP, CP SGD2.33, BUY, TP SGD2.95)

Exposure summary



Source: Company

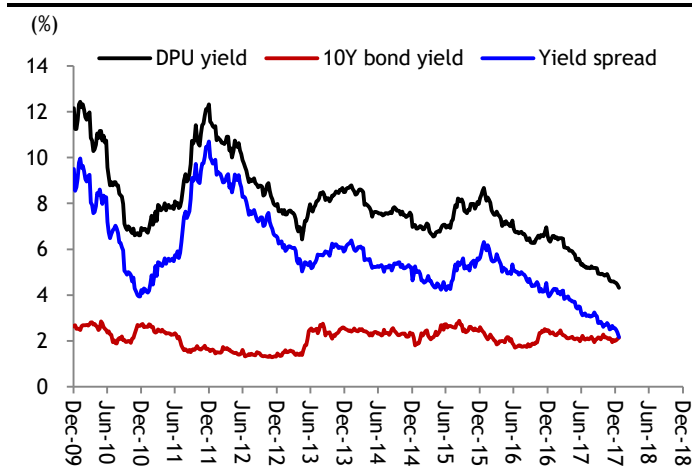
Figure 1: Quarterly profit and loss

FYE 31 Dec	4Q16 (SGD m)	3Q17 (SGD m)	4Q17 (SGD m)	Change		YTD17 (SGD m)	% of FY	FY17E (SGD m)
				QoQ %	YoY %			
Property income	40.0	40.4	44.4	9.7	10.9	164.5	101.5	162.1
Property expenses	(8.6)	(8.8)	(8.1)	(7.4)	(5.3)	(33.3)	99.3	(33.5)
Net property income	31.4	31.7	36.2	14.4	15.3	131.2	102.1	128.5
Share of results of associates & JVs	27.7	28.6	27.4	(4.1)	(0.9)	115.8	101.7	113.8
Distributable income to unitholders	48.7	47.0	48.2	2.6	(1.1)	190.7	95.8	199.1
Distribution per unit	1.48	1.40	1.43	2.1	(3.4)	5.70	94.9	6.01
NAV per unit (SGD)	1.44	1.42	1.41	(0.5)	(2.0)			
Aggregate leverage (%)^	38.5	38.8	38.7	(10)	20			
All-in financing cost (%)^	2.51	2.58	2.62	4	11			

^Change in basis points

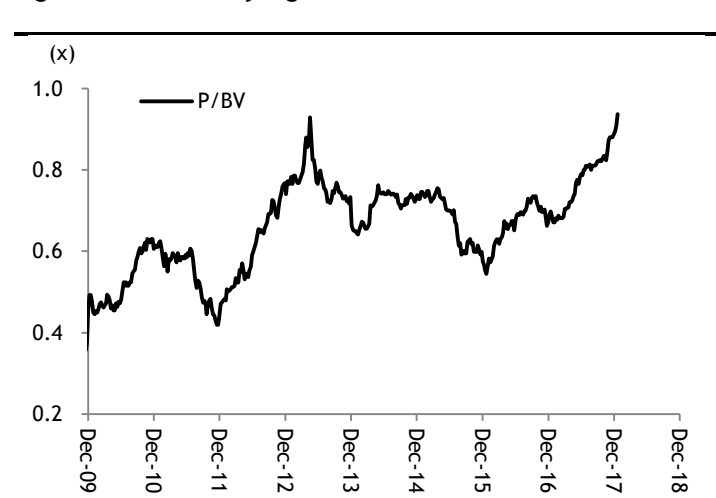
Source: Company, Maybank Kim Eng

Fig 2: Positives appear to be priced in with trading yield of 4.3% at historical low...



Source: Bloomberg, Maybank Kim Eng

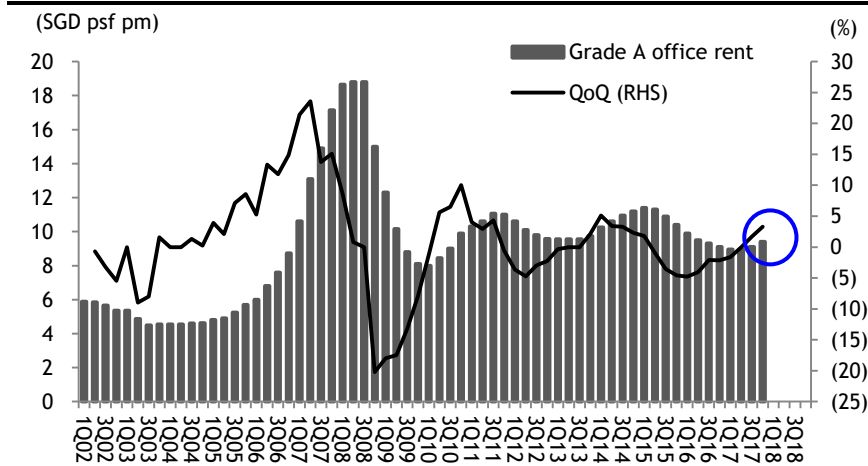
Fig 3: ...and relatively high P/BV of 0.94x



Source: Bloomberg, Maybank Kim Eng

Fig 4: Grade A office rents

Preliminary data from CBRE showed a marginal uptick in rents to SGD9.40 psf pm in 4Q17.

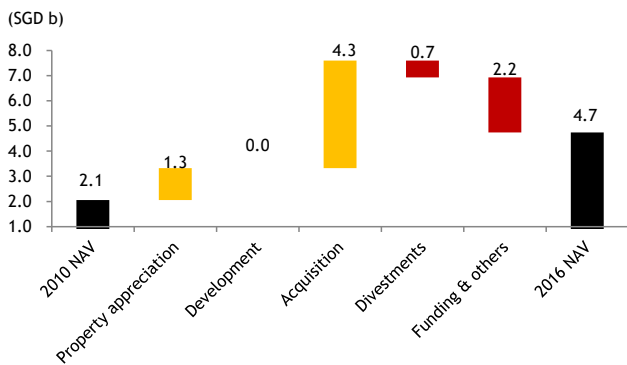


Source: CBRE, Maybank Kim Eng

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 SGD4.3b 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.

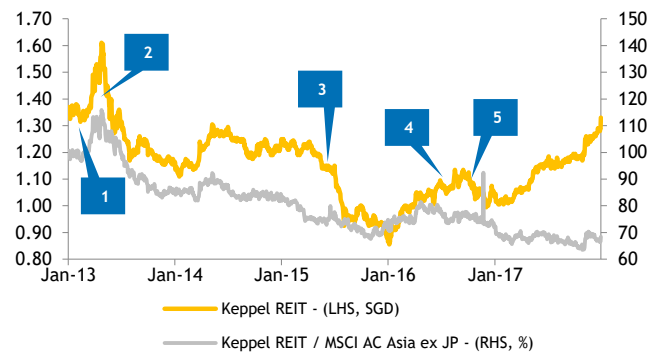
NAV changes



Source: Company, Maybank Kim Eng

Price Drivers

Historical share price trend



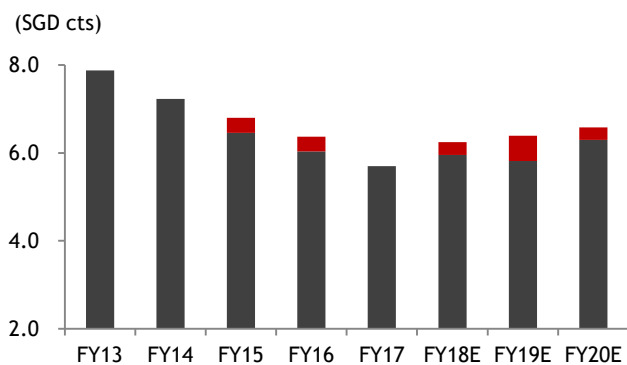
Source: FactSet, Company, Maybank Kim Eng

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

Financial Metrics

- Lack of capital distributions has led to a dip in FY17 DPU.
- Pared debt with issuance of SGD150m perpetual securities to a more comfortable aggregate leverage of 38.7%.
- 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

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)	20.7	23.2	21.1	20.7	20.1
P/BV (x)	0.9	0.9	1.0	1.0	1.0
P/NTA (x)	0.9	0.9	1.0	1.0	1.0
DPU yield (%)	4.8	4.3	4.7	4.8	5.0
FCF yield (%)	3.9	5.3	6.4	4.7	5.1
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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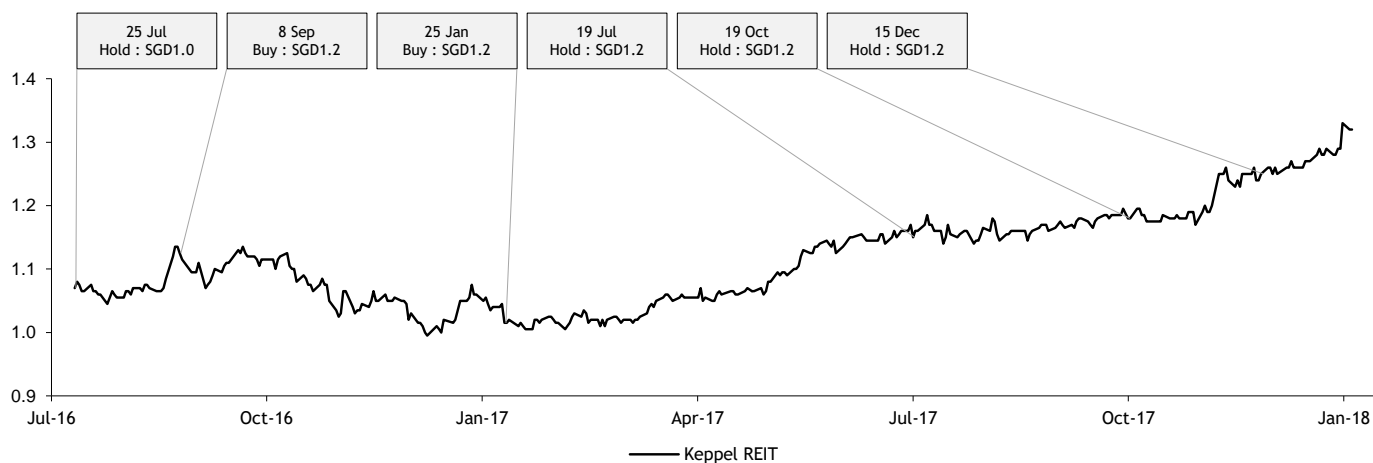
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