

Singapore Company Guide

Keppel DC REIT

Version 12 | Bloomberg: KDCREIT SP | Reuters: KEPE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

6 Dec 2018

BUY

Last Traded Price (5 Dec 2018): S\$1.34 (STI : 3,155.92)
Price Target 12-mth: S\$1.52 (13% upside)

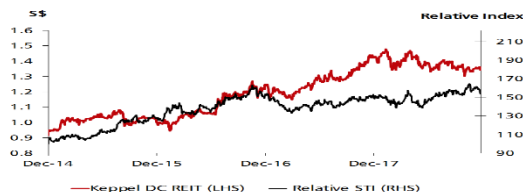
Analyst

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What's New

- High income visibility given limited expiries in FY19/20
- Organic growth driven by the operational ramp-up of KDC SGP 5
- Manager continues to seek acquisition opportunities in existing and new markets
- BUY call and TP maintained, reflective of conservative discount rates

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2017A	2018F	2019F	2020F
Gross Revenue	139	161	188	194
Net Property Inc	125	139	156	160
Total Return	65.2	94.4	105	107
Distribution Inc	82.3	94.7	105	107
EPU (S cts)	6.56	7.63	7.76	7.90
EPU Gth (%)	1	16	2	2
DPU (S cts)	7.12	7.42	7.55	7.69
DPU Gth (%)	7	4	2	2
NAV per shr (S cts)	96.9	103	104	104
PE (X)	20.4	17.6	17.3	17.0
Distribution Yield (%)	5.3	5.5	5.6	5.7
P/NAV (x)	1.4	1.3	1.3	1.3
Aggregate Leverage (%)	32.9	32.7	33.3	33.3
ROAE (%)	6.8	7.6	7.5	7.6

Distn. Inc Chng (%):	-	-	-
Consensus DPU (S cts):	7.60	7.90	8.40
Other Broker Recs:	B: 9	S: 0	H: 2

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

On cloud nine

BUY, TP S\$1.52. Trading at a yield of c.5.6-5.7%, Keppel DC REIT (KDC REIT) remains one of the few REITs in Singapore that are capable of making accretive acquisitions, supported by low cost of capital. The REIT is projected to deliver a solid 2% CAGR in distributions, with upside from acquisitions.

Where we differ: Our TP is higher than consensus. Our TP of S\$1.52 is the highest in the street, after pricing in the acquisition of a 99% interest in Kingsland Data-Center (KDC SGP 5) and fund raising. Our numbers could be raised by a further c.3% if the manager achieves tax transparency status for its stake in KDC SGP 5, which we have not priced in. In addition, the stock's conservative gearing of c.32% provides the REIT with ample gearing capacity to fund opportunistic acquisitions, if they arise.

Potential catalyst: Continued robust operational performance. 3Q18 results were in line with expectations, coupled with a sustained portfolio occupancy of c.92.0% while KDC SGP 5 ramps up operationally, contributing to higher revenues in the medium term. With limited expiries over the coming two financial years, there is high income visibility, a valued trait in the current volatile climate.

Valuation:

We maintain our BUY recommendation with a DCF-based TP of S\$1.52. Our discount rates reflect a refreshed 3.0% 10-year risk-free rate and a 50-bp increase in funding costs.

Key Risks to Our View:

Competition from larger third-party data centre players. The data centre market is dominated by several large international operators which have been aggressively expanding into markets where KDC REIT has a presence. KDC REIT may face higher barriers to entry and stiffer competition to attract and retain tenants.

At A Glance

Issued Capital (m shrs)	1,352
Mkt. Cap (\$m/US\$m)	1,811 / 1,325
Major Shareholders (%)	
Keppel Corp Ltd	29.4
Sumitomo Trust	4.8
DBS Bank	5.5
Free Float (%)	70.6
3m Avg. Daily Val (US\$m)	2.4
ICB Industry : Financials / Real Estate Investment Trust	



DBS
Live more, Bank less

WHAT'S NEW

Hitting ambitious growth targets

(+) Hitting its targets. 9M18 gross rental income grew by 24.7% y-o-y to S\$127.5m, mainly due to the contribution from an expanded portfolio (KDC Dublin 2 and KDC Singapore 5, maincubes DC) and higher power revenue from its Singapore properties. This was somewhat boosted by the appreciation of the EUR and GBP against the SGD. This partially offset the lower revenues from Basis Bay DC and Gore hill DC due to a bulk discount provided during renewal of the latter's lease a year ago and the weakness in the AUD vs the SGD. Other income of S\$5.0m (S\$2.5m higher y-o-y) due to rental top-ups partially offset lower ad hoc service and power revenues. Net property income (NPI) rose by a higher 24.6% to S\$115.2m mainly on a proportionate increase in expenses (+26.0% y-o-y). On a quarterly basis, top line and net property income came in at 34% and 33.4% respectively.

Distributable income to unitholders (including capex reserves) rose 24.6% y-o-y to S\$69.9m for 9M18. After stripping out these capex reserves and an enlarged equity base, DPU increased by a smaller 4.8% to 5.47 Scts (1.85 Scts, +6.3% y-o-y). This forms 74% of our full-year forecast.

(+) Steady operating metrics. Operational metrics generally improved as occupancy rate rose marginally to 93.1% (vs 92.0% in 2Q18) with a long weighted average lease expiry (WALE) of 8.5 years. We do note that for Singapore properties – Keppel DC Singapore 1 saw a slight dip due to a tenant returning space (86.6% vs 87.3% in 2Q18) but the overall impact is small. Keppel DC Singapore 5's occupancy rate improved to 84.2% (vs 73.9% in 2Q18) and has achieved its occupancy capacity for the data-centre space at the asset, with the remaining vacancy being office space which is likely to be taken up only in the medium term. We understand that the tenant has yet to run at full force and contribution will continue to improve q-o-q as its operations are ramped up. We project Keppel DC Singapore 5 to deliver

an initial yield of 7.8% when that happens from 2H19. The other data centres across its portfolio are substantially leased with a long WALE and offer strong income visibility.

(+) Financial metrics stable. The REIT's financial metrics remain strong, with average cost of debt still stable at 1.9% with 86% of the rates fixed. The REIT will be renewing 19% (or close to c.S\$130m) of loans expiring in 2019 which we believe should not be an issue to refinance. We believe that the opportunity will be to swap the debt into a foreign currency-denominated debt (EUR or AUD), given the REIT's diversified earnings base to achieve a better natural hedge position.

(+) Still looking for AUM growth. Overall gearing remained low at 32%, which empowers the REIT to acquire more assets going into 2019. While not committing to an AUM target, the manager is reviewing opportunities in both new and existing markets as the REIT looks to bulk up and grow its distributions and AUM.

Quarterly / Interim Income Statement (\$m)

FY Dec	3Q2017	2Q2018	3Q2018	% chg yoy	% chg qoq
Gross revenue	35.5	41.9	47.6	34.0	13.4
Property expenses	(3.2)	(3.9)	(4.5)	40.2	17.2
Net Property Income	32.3	38.1	43.0	33.4	13.0
Other Operating expenses	(5.5)	(5.9)	(6.9)	26.6	17.7
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	(3.3)	(4.0)	(4.1)	(26.7)	(2.4)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	23.5	28.2	32.0	35.9	13.6
Tax	(1.3)	(1.8)	(2.8)	111.7	54.0
Minority Interest	(0.7)	(0.8)	(0.8)	(7.0)	2.0
Net Income after Tax	21.5	25.6	28.4	32.2	11.1
Total Return	21.5	25.6	28.4	32.2	11.1
Non-tax deductible Items	(1.3)	(2.5)	(2.4)	87.6	(2.3)
Net Inc available for Dist.	20.2	23.1	26.0	28.7	12.5
Ratio (%)					
Net Prop Inc Margin	90.9	90.8	90.5		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

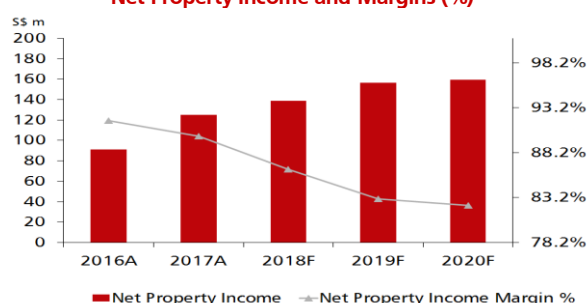
Acquisitions drive price. Over the relative young life of KDC REIT, its price has largely moved in tandem with the S-REIT Index with a strong correlation coefficient of 0.84. While its share price has diverged from the broader market performance, this can be largely explained by its acquisition announcements. KDC REIT remains one of the few REITs in Singapore that can acquire new assets at a lower cost of capital. Given that earnings of the existing portfolio are stable, growth in DPU is likely to be driven by acquisitions going forward which the manager is said to be considering. The targeted return for acquisitions of 6.5% implies that accretion is highly probable.

Negative newsflow has adverse impact. Being a data centre manager, KDC REIT is a niche player in the sector and does not have much flexibility in terms of asset type diversification. Any newsflow related to data centre outlook could directly impact the REIT's price performance. According to Cushman & Wakefield, there is a risk of an oversupply of data centres in Singapore, which is likely to result in limited organic potential for its Singapore data centres. In terms of demand, looking ahead, the REIT's major markets of Singapore, Europe and Australia continue to see strong demand for data centres on the back of global growth in data usage.

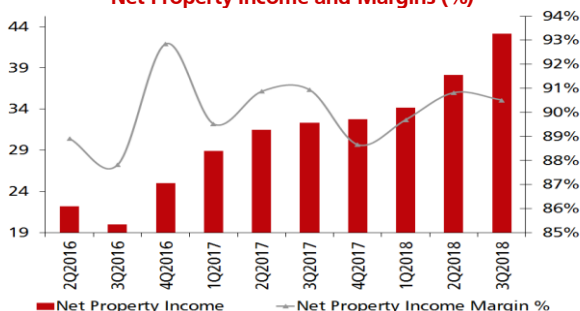
Acquisitions to drive distributions; S\$2bn AUM target by end-2018 achieved. Distributable income growth is a key driver of share price performance. Since its IPO, KDC REIT's AUM has grown by 50%, and distributable income and DPU by 43% and 9% respectively. The REIT has recently acquired a data centre in Singapore at an initial yield of 6.8% (stabilised yield of 7.8%) which is fully funded by equity. The strong take-up for the units attests to investors' favourable view on the REIT's outlook. Post acquisition, gearing is estimated to remain at a conservative 32%, which is within management's comfortable range.

Insignificant impact of interest rate on price. Interest rate movements, measured by the Singapore 10-year government bond yield, appear to have insignificant impact on KDC REIT's price. Interest-rate risks are likely to be mitigated by the proactive management of the REIT's debt profile. As such, we believe that KDC REIT's distributions are well hedged against interest rate movements.

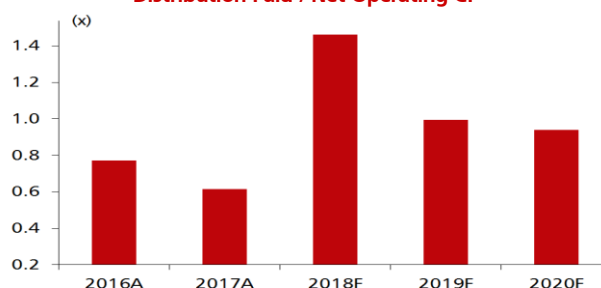
Net Property Income and Margins (%)



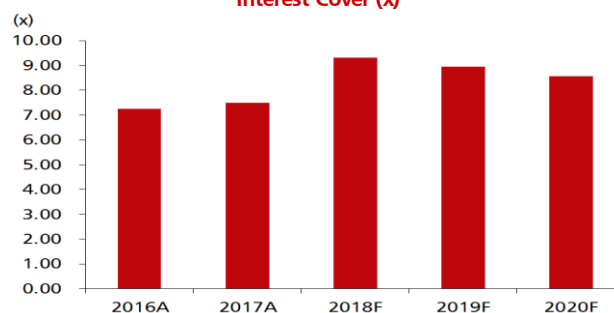
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Conservative hedging policies. Major currencies that will impact earnings – AUD and EUR – have been hedged for two years up to 1H20 through foreign currency forward contracts, thereby minimising currency fluctuation effects going forward.

Gearing is reset to 32%. KDC REIT's aggregate gearing has been lowered to c.32% after its recent share placement. All-in cost of debt is low at 1.9%. As at end-3Q18, more than 80% of the REIT's borrowings were hedged into fixed-rate debt, which will provide earnings visibility in a volatile interest rate environment.

Share Price Drivers:

Acquisitions to be a key share price driver. Given that the REIT's earnings profile is stable, growth in DPUs is likely to be driven by acquisitions, which the manager is considering. Given its current share price, targeted returns for acquisitions of c.7-8% imply that acquisitions are likely to be accretive.

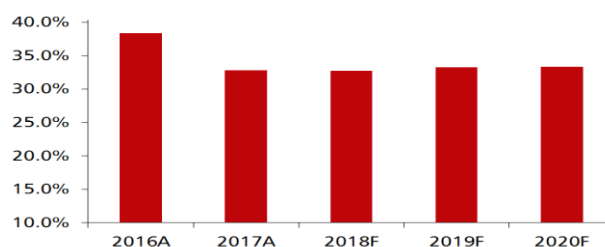
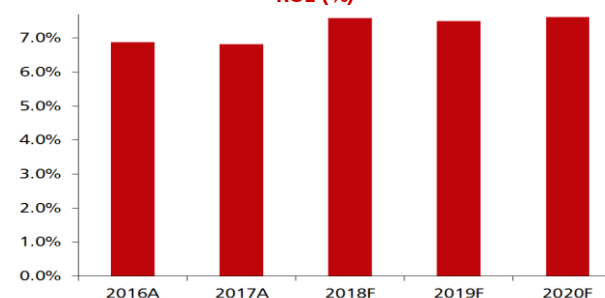
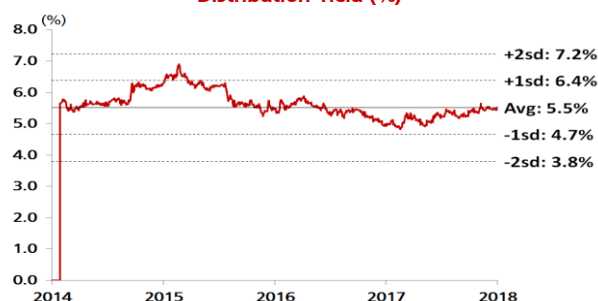
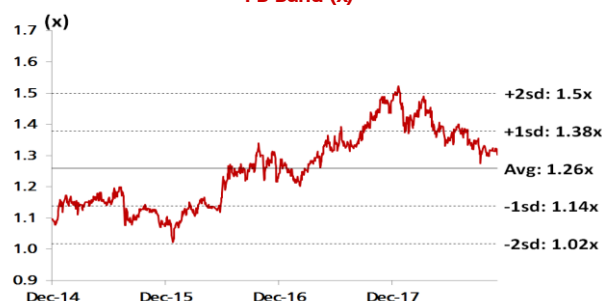
Key Risks:

Higher maintenance capex relative to other asset classes. Due to the shorter lifespan of a data centre's infrastructure, the REIT may have to rely on borrowings to fund maintenance capex at certain properties, which could impact gearing.

Competition from larger third-party data centre players. The data centre market is dominated by several large international operators which have been aggressively expanding into markets where KDC REIT has a presence. KDC REIT may face higher barriers to entry and stiffer competition to attract and retain tenants.

Company Background

Keppel DC REIT (KDC REIT) is a Singapore-based real estate investment trust (REIT). It was established with the principal investment strategy of investing, directly or indirectly, in a portfolio of income-producing real estate assets which are used primarily for data centre purposes, with an initial focus on Asia Pacific and Europe.

Aggregate Leverage (%)**ROE (%)****Distribution Yield (%)****PB Band (x)**

Source: Company, DBS Bank

Income Statement (\$m)

FY Dec	2016A	2017A	2018F	2019F	2020F
Gross revenue	99.1	139	161	188	194
Property expenses	(8.2)	(13.9)	(22.0)	(32.0)	(34.4)
Net Property Income	90.9	125	139	156	160
Other Operating expenses	(7.8)	(25.7)	(17.7)	(17.4)	(17.6)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(11.5)	(13.3)	(13.0)	(15.5)	(16.6)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	71.7	86.1	108	123	125
Tax	(6.7)	(7.3)	(11.9)	(13.6)	(13.8)
Minority Interest	0.0	(5.0)	(1.8)	(5.0)	(5.0)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	64.9	73.7	94.4	105	107
Total Return	50.9	65.2	94.4	105	107
Non-tax deductible Items	10.1	17.1	0.30	0.30	0.30
Net Inc available for Dist.	61.0	82.3	94.7	105	107
Growth & Ratio					
Revenue Gth (%)	(3.3)	40.3	15.6	17.1	3.0
N Property Inc Gth (%)	4.7	37.6	10.9	12.6	2.1
Net Inc Gth (%)	2.5	13.6	28.0	11.0	1.8
Dist. Payout Ratio (%)	100.0	100.0	97.0	97.0	97.0
Net Prop Inc Margins (%)	91.7	90.0	86.3	83.0	82.3
Net Income Margins (%)	65.5	53.0	58.7	55.7	55.0
Dist to revenue (%)	61.6	59.2	58.9	55.8	55.1
Managers & Trustee's fees	7.8	18.5	11.0	9.3	9.1
ROAE (%)	6.9	6.8	7.6	7.5	7.6
ROA (%)	4.6	4.4	4.8	4.8	4.8
ROCE (%)	5.5	5.6	5.6	5.7	5.8
Int. Cover (x)	7.2	7.5	9.3	9.0	8.6

Full-year contribution
from KDC SGP 5

Source: Company, DBS Bank

Quarterly / Interim Income Statement (\$m)

FY Dec	3Q2017	4Q2017	1Q2018	2Q2018	3Q2018
Gross revenue	35.5	36.8	38.0	41.9	47.6
Property expenses	(3.2)	(4.2)	(3.9)	(3.9)	(4.5)
Net Property Income	32.3	32.6	34.1	38.1	43.0
Other Operating expenses	(5.5)	(12.0)	(3.4)	(5.9)	(6.9)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(3.3)	(3.7)	(3.6)	(4.0)	(4.1)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	23.5	16.9	27.1	28.2	32.0
Tax	(1.3)	(3.1)	(1.4)	(1.8)	(2.8)
Minority Interest	(0.7)	(3.0)	(0.7)	(0.8)	(0.8)
Net Income after Tax	21.5	10.8	25.0	25.6	28.4
Total Return	21.5	2.29	25.0	25.6	28.4
Non-tax deductible Items	(1.3)	18.0	(4.1)	(2.5)	(2.4)
Net Inc available for Dist.	20.2	20.2	20.9	23.1	26.0
Growth & Ratio					
Revenue Gth (%)	3	4	3	10	13
N Property Inc Gth (%)	3	1	4	12	13
Net Inc Gth (%)	16	(50)	131	2	11
Net Prop Inc Margin (%)	90.9	88.6	89.7	90.8	90.5
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

Balance Sheet (\$m)

FY Dec	2016A	2017A	2018F	2019F	2020F
Investment Properties	1,226	1,570	2,007	2,030	2,037
Other LT Assets	18.7	15.1	15.1	15.1	15.1
Cash & ST Invt	298	118	89.1	89.8	96.3
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	38.7	56.2	64.3	75.3	77.6
Other Current Assets	1.66	3.74	3.74	3.74	3.74
Total Assets	1,583	1,763	2,179	2,214	2,230
ST Debt	6.66	3.66	3.66	3.66	3.66
Creditor	28.0	48.2	10.7	12.5	12.9
Other Current Liab	0.50	1.40	13.3	15.0	15.2
LT Debt	464	576	710	733	740
Other LT Liabilities	9.95	17.9	17.9	17.9	17.9
Unit holders' funds	1,074	1,090	1,396	1,399	1,402
Minority Interests	0.34	26.8	28.6	33.6	38.6
Total Funds & Liabilities	1,583	1,763	2,179	2,214	2,230
Non-Cash Wkg. Capital	11.9	10.3	44.0	51.5	53.2
Net Cash/(Debt)	(173)	(461)	(624)	(647)	(647)
Ratio					
Current Ratio (x)	9.6	3.3	5.7	5.4	5.6
Quick Ratio (x)	9.6	3.3	5.5	5.3	5.5
Aggregate Leverage (%)	38.4	32.9	32.7	33.3	33.3
Z-Score (X)	1.8	1.7	1.7	1.7	1.7

Gearing stable at c.33%,
inching up slightly to account
for capex for KDC Dublin 1

Source: Company, DBS Bank

Keppel DC REIT

Cash Flow Statement (\$m)

FY Dec	2016A	2017A	2018F	2019F	2020F
Pre-Tax Income	71.7	86.1	108	123	125
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	0.0	(4.7)	0.0	(11.9)	(13.6)
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	24.3	1.53	(45.6)	(9.2)	(1.9)
Other Operating CF	(20.2)	34.9	0.30	0.30	0.30
Net Operating CF	75.7	118	62.8	103	110
Net Invst in Properties	(121)	(305)	(437)	(23.1)	(6.8)
Other Invt (net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.0	0.0	0.0	0.0	0.0
Net Investing CF	(121)	(305)	(437)	(23.1)	(6.8)
Distribution Paid	(58.5)	(72.4)	(91.8)	(102)	(104)
Chg in Gross Debt	96.1	98.9	134	23.1	6.79
New units issued	279	0.0	303	0.0	0.0
Other Financing CF	(15.1)	(16.8)	0.0	0.0	0.0
Net Financing CF	302	9.71	345	(78.8)	(97.0)
Currency Adjustments	3.78	0.0	0.0	0.0	0.0
Chg in Cash	261	(178)	(29.1)	0.68	6.54
Operating CFPS (S cts)	5.13	10.3	8.76	8.28	8.31
Free CFPS (S cts)	(4.5)	(16.7)	(30.3)	5.89	7.67

Source: Company, DBS Bank

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	23 Jan 18	1.46	1.60	BUY
2:	19 Mar 18	1.40	1.60	BUY
3:	17 Apr 18	1.41	1.60	BUY
4:	26 Jun 18	1.34	1.52	BUY
5:	18 Jul 18	1.39	1.52	BUY
6:	08 Aug 18	1.38	1.52	BUY
7:	17 Oct 18	1.34	1.52	BUY

Source: DBS Bank

Analyst: Derek TAN

Mervin SONG, CFA

DBS Bank recommendations are based on Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 6 Dec 2018 07:39:30 (SGT)

Dissemination Date: 6 Dec 2018 08:17:04 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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