

Singapore Company Guide

Keppel DC REIT

Version 13 | Bloomberg: KDCREIT SP | Reuters: KEPE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

23 Jan 2019

BUY

Last Traded Price (22 Jan 2019): S\$1.44 (STI : 3,192.71)
Price Target 12-mth: S\$1.60 (11% upside) (Prev S\$1.52)

Analyst

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What's New

- FY18 operational results steady; NAV rose by 10% on the back of higher cashflows
- Low gearing empowers the REIT with headroom for acquisitions
- Estimates raised to reflect positive tax transparency ruling
- Buy, TP raised to S\$1.60

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2017A	2018A	2019F	2020F
Gross Revenue	139	176	192	198
Net Property Inc	125	158	160	163
Total Return	65.2	142	108	111
Distribution Inc	82.3	96.1	108	111
EPU (S cts)	6.56	8.83	7.98	8.21
EPU Gth (%)	1	35	(10)	3
DPU (S cts)	7.12	7.32	7.69	7.90
DPU Gth (%)	7	3	5	3
NAV per shr (S cts)	96.9	107	107	108
PE (X)	22.0	16.3	18.0	17.5
Distribution Yield (%)	4.9	5.1	5.3	5.5
P/NAV (x)	1.5	1.3	1.3	1.3
Aggregate Leverage (%)	32.9	31.4	32.4	32.4
ROAE (%)	6.8	8.6	7.4	7.6

Distn. Inc Chng (%): 3 4
Consensus DPU (S cts): 7.9 8.2
Other Broker Recs: B: 9 S: 0 H: 2

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

Up and away!

BUY, TP of S\$1.60. Trading at a yield of c.5.5% and low gearing of c.31%, Keppel DC REIT (KDC REIT) remains one of the few REITs in Singapore capable of making accretive acquisitions, supported by low cost of capital. The REIT is projected to deliver a solid 3%-5% growth in distributions, with upside from acquisitions.

Where we differ: Our TP is higher than consensus. Our TP of S\$1.60 is the highest on the street. Our numbers were raised to account for the recent positive tax transparency status for its stake in KDC SGP 5. In addition, the stock's conservative gearing of c.31% provides the REIT with ample gearing capacity to fund opportunistic acquisitions.

Potential catalyst: Continued robust operational performance. 4Q18 results were in line with expectations. With a sustained portfolio occupancy of c.93.0% and as KDC SGP 5 ramps up operationally, we are likely to see higher revenues in the medium term. With limited expiries in the coming two financial years, there is high income visibility, a valued trait in the current volatile climate.

Valuation:

We maintain our BUY recommendation. We raised our TP to S\$1.60 based on DCF. Our discount rate reflects 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)	1,946 / 1,431
Major Shareholders (%)	
Keppel Corp Ltd	25.2
Free Float (%)	74.8
3m Avg. Daily Val (US\$m)	2.1

ICB Industry : Financials / Real Estate Investment Trust



Live more, Bank less

WHAT'S NEW

Operational metrics looking up

(+) A strong end to the year; DPU of 7.32Scts in line with estimates. Keppel DC REIT reported FY18 gross rental income growth of 26.2% y-o-y to S\$175.5m, mainly from the contribution of recent additions to the portfolio (maincubes Data Centre and KDC Singapore 5 acquired in 2018, and full year contribution of KDC Dublin 2). This was also boosted by the appreciation of the EUR and GBP against the SGD, which partially offset the lower revenues from Basis Bay DC and Gore Hill DC, and the weak AUD vs SGD. Other income of S\$8.4m was S\$4.0m higher y-o-y, due to rental top-ups and higher ad hoc service revenues. As a result, net property income (NPI) rose by a higher 24.6% to S\$115.2m mainly on a proportionate increase in expenses (+28.0% y-o-y). On a quarterly basis, 4Q18 top line and net property income came in 30.5% and 30.1% higher.

Distributable income to unitholders (including capex reserves) rose 16.7% y-o-y to S\$96.1m in FY18. After stripping out these capex reserves and an enlarged equity base, DPU increased by a smaller 5.0% to 7.32 Scts (1.85 Scts in 4Q18, +5.7% y-o-y, flat q-o-q), coming within estimates.

(+) NAV rose by close to 10%. The portfolio reported a revaluation gain of c. S\$32m, which was mainly from its Singapore datacenters largely due to higher revenues while cap rates remained stable. This more than offset some flux in asset values for its overseas datacentres. NAV rose to S\$1.07, which was close to 10% higher compared to a year ago.

(+) Steady operating metrics. Operational metrics generally remained stable in 4Q18 compared to a quarter ago with occupancy rates steady at 93.1% with a long weighted average lease expiry (WALE) of 8.3 years. Keppel DC Singapore 5's occupancy rate reached c.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 maintain our projection that Keppel DC Singapore 5 would 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.

(+) Development and asset upgrades to drive demand. KDC REIT has contracted to purchase IC3 East DV in Sydney, Australia, which is expected to be built on vacant land within the existing Intellicentre 2 Data Centre site with completion expected between 2019-2020. Upon completion, a 20-year lease will commence with Macquarie Telecom, which further enhances its income visibility and earnings upside. We have not priced in this acquisition.

In addition, ongoing upgrading works (power upgrading and fit-out works) at Keppel DC Dublin 1, where occupancy rate still hovers at around 55%, is expected to complete in 2020 and will also underpin more upside to earnings when completed.

(+) Financial metrics stable. The REIT's financial metrics remain strong, with average cost of debt stable at 1.9% with 86% of rates fixed. The REIT will be renewing 19% (or close to c.S\$130m) of loans expiring in 2019. We believe there is opportunity 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.

(+) Early "ang-bao" from tax authorities in Singapore The REIT recently announced that Keppel DC Singapore 5 has been awarded tax transparency status, similar to its other Singapore properties, which will add to distributions from 1Q19 onwards. Our estimates are revised higher to account for this tax transparency, resulting in a higher TP of S\$1.60.

(+) Still looking for AUM growth. Overall gearing remained low at 31%, after accounting for the revaluations for its portfolio, which empowers the REIT to acquire more assets. 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. The target in the longer term is to have 50% of its assets derived from assets from the Asia Pacific region (currently 67%).

Quarterly / Interim Income Statement (S\$m)

FY Dec	4Q2017	3Q2018	4Q2018	% chg yoy	% chg qoq
Gross revenue	36.8	47.6	48.0	30.5	1.0
Property expenses	(4.2)	(4.5)	(5.6)	33.4	23.5
Net Property Income	32.6	43.0	42.5	30.1	(1.3)
Other Operating expenses	(12.0)	(6.9)	(7.3)	(39.7)	4.9
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Net Interest (Exp)/Inc	(3.7)	(4.1)	(4.1)	(11.0)	1.0
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	16.9	32.0	31.1	83.8	(2.7)
Tax	(3.1)	(2.8)	1.00	nm	nm
Minority Interest	(3.0)	(0.8)	(1.8)	38.3	136.4
Net Income after Tax	10.8	28.4	30.3	180.1	6.6
Total Return	2.29	28.4	62.9	2,651.5	121.5
Non-tax deductible Items	18.0	(2.4)	(36.8)	nm	1,411.5
Net Inc available for Dist.	20.2	26.0	26.1	29.0	0.6
Ratio (%)					
Net Prop Inc Margin	88.6	90.5	88.4		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

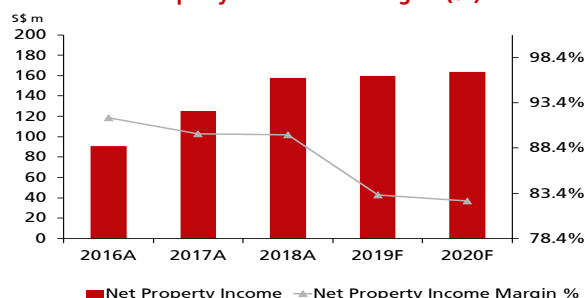
Acquisitions drive price. Over the relative young life of KDC REIT, its price has largely moved in tandem with the S-REIT Index with a strong correlation coefficient of 0.84. While its share price has diverged from the broader market performance, this can be largely explained by its acquisition announcements. 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.

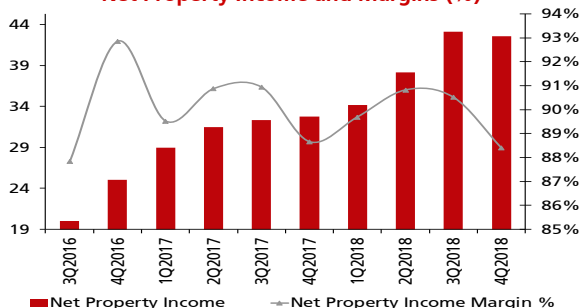
Acquisitions to drive distributions; S\$2bn AUM target by end- 2018 achieved. Distributable income growth is a key driver of share price performance. Since its IPO, KDC REIT's AUM has grown by 50%, and distributable income and DPU by 43% and 9% respectively. The REIT recently acquired a data centre in Singapore at an initial yield of 6.8% (stabilised yield of 7.8%) 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.

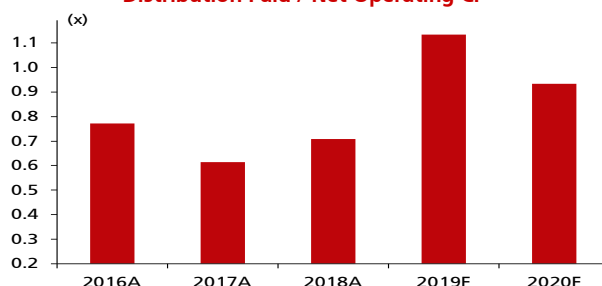
Net Property Income and Margins (%)



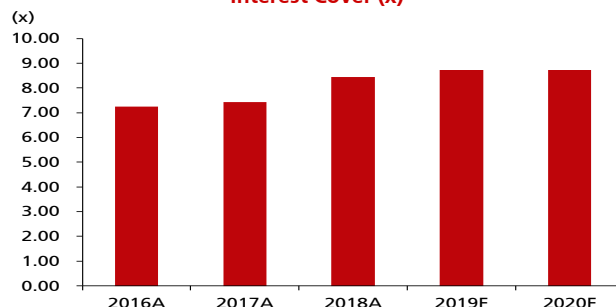
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



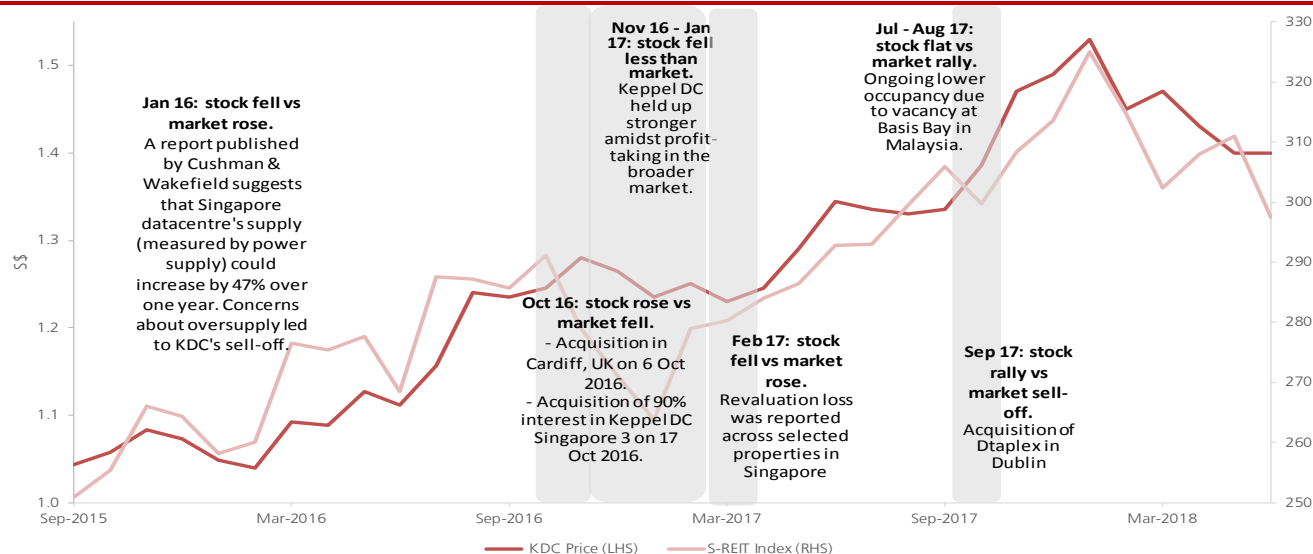
Interest Cover (x)



Source: Company, DBS Bank

Appendix 1: A look at Company's listed history – what drives its share price?

Share price performance



Source of all data: Company, DBS Bank

KDC Share Price vs DPU Growth



Source of all data: Company, DBS Bank

Comments:

Share price has historically been correlated to DPU growth. With KDC REIT projected to continue delivering strong acquisition-driven DPU growth, we expect its share price to remain elevated.

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 Dec'18, 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.

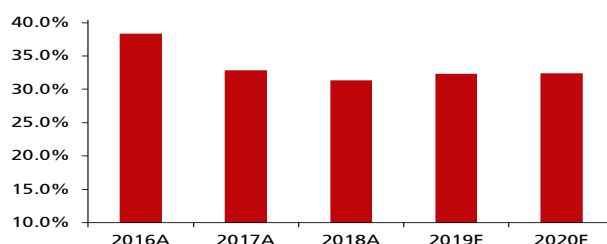
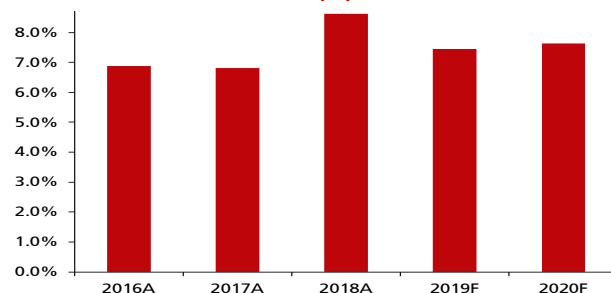
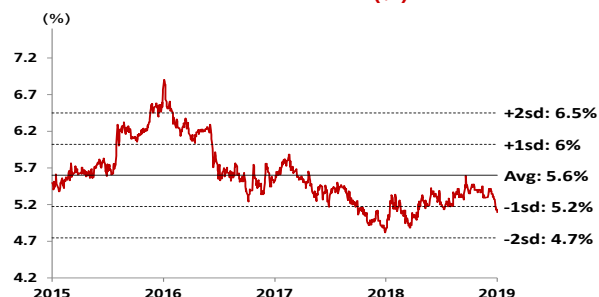
Key Risks:

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	2018A	2019F	2020F
Gross revenue	99.1	139	176	192	198
Property expenses	(8.2)	(13.9)	(17.9)	(32.3)	(34.6)
Net Property Income	90.9	125	158	160	163
Other Operating expenses	(7.8)	(26.7)	(24.0)	(21.2)	(21.3)
Other Non Opg (Exp)/Inc	0.0	0.93	0.56	0.0	0.0
Net Interest (Exp)/Inc	(11.5)	(13.3)	(15.8)	(15.9)	(16.3)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	71.7	86.1	118	123	126
Tax	(6.7)	(7.3)	(5.0)	(9.8)	(10.1)
Minority Interest	0.0	(5.0)	(4.1)	(5.0)	(5.0)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	64.9	73.7	109	108	111
Total Return	50.9	65.2	142	108	111
Non-tax deductible Items	10.1	17.1	(45.8)	0.30	0.30
Net Inc available for Dist.	61.0	82.3	96.1	108	111
Growth & Ratio					
Revenue Gth (%)	(3.3)	40.3	26.2	9.3	3.2
N Property Inc Gth (%)	4.7	37.6	26.0	1.2	2.4
Net Inc Gth (%)	2.5	13.6	48.1	(1.4)	2.8
Dist. Payout Ratio (%)	100.0	100.0	94.2	96.0	96.0
Net Prop Inc Margins (%)	91.7	90.0	89.8	83.2	82.5
Net Income Margins (%)	65.5	53.0	62.2	56.2	55.9
Dist to revenue (%)	61.6	59.2	54.7	56.3	56.1
Managers & Trustee's fees	7.8	19.2	13.7	11.0	10.8
ROAE (%)	6.9	6.8	8.6	7.4	7.6
ROA (%)	4.6	4.4	5.4	4.8	4.9
ROCE (%)	5.5	5.5	6.5	5.7	5.8
Int. Cover (x)	7.2	7.4	8.4	8.7	8.7

Source: Company, DBS Bank

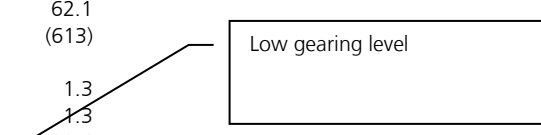
Driven by acquisitions

Quarterly / Interim Income Statement (\$m)

FY Dec	4Q2017	1Q2018	2Q2018	3Q2018	4Q2018
Gross revenue	36.8	38.0	41.9	47.6	48.0
Property expenses	(4.2)	(3.9)	(3.9)	(4.5)	(5.6)
Net Property Income	32.6	34.1	38.1	43.0	42.5
Other Operating expenses	(12.0)	(3.4)	(5.9)	(6.9)	(7.3)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(3.7)	(3.6)	(4.0)	(4.1)	(4.1)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	16.9	27.1	28.2	32.0	31.1
Tax	(3.1)	(1.4)	(1.8)	(2.8)	1.00
Minority Interest	(3.0)	(0.7)	(0.8)	(0.8)	(1.8)
Net Income after Tax	10.8	25.0	25.6	28.4	30.3
Total Return	2.29	25.0	25.6	28.4	62.9
Non-tax deductible Items	18.0	(4.1)	(2.5)	(2.4)	(36.8)
Net Inc available for Dist.	20.2	20.9	23.1	26.0	26.1
Growth & Ratio					
Revenue Gth (%)	4	3	10	13	1
N Property Inc Gth (%)	1	4	12	13	(1)
Net Inc Gth (%)	(50)	131	2	11	7
Net Prop Inc Margin (%)	88.6	89.7	90.8	90.5	88.4
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

Balance Sheet (\$m)

FY Dec	2016A	2017A	2018A	2019F	2020F
Investment Properties	1,226	1,570	2,029	2,052	2,059
Other LT Assets	18.7	15.1	4.02	4.02	4.02
Cash & ST Invt	298	118	128	116	124
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	38.7	56.2	85.7	76.7	79.2
Other Current Assets	1.66	3.74	6.11	6.11	6.11
Total Assets	1,583	1,763	2,253	2,255	2,272
ST Debt	6.66	3.66	134	134	134
Creditor	28.0	48.2	36.3	12.8	13.2
Other Current Liab	0.50	1.40	16.9	9.80	10.1
LT Debt	464	576	573	596	603
Other LT Liabilities	9.95	17.9	17.1	17.1	17.1
Unit holders' funds	1,074	1,090	1,445	1,449	1,454
Minority Interests	0.34	26.8	31.2	36.2	41.2
Total Funds & Liabilities	1,583	1,763	2,253	2,255	2,272
Non-Cash Wkg. Capital	11.9	10.3	38.6	60.3	62.1
Net Cash/(Debt)	(173)	(461)	(578)	(614)	(613)
Ratio					
Current Ratio (x)	9.6	3.3	1.2	1.3	1.3
Quick Ratio (x)	9.6	3.3	1.1	1.2	1.3
Aggregate Leverage (%)	38.4	32.9	31.4	32.4	32.4
Z-Score (X)	1.8	1.7	1.7	1.7	1.7



Low gearing level

Source: Company, DBS Bank

Cash Flow Statement (\$m)

FY Dec	2016A	2017A	2018A	2019F	2020F
Pre-Tax Income	71.7	86.1	118	123	126
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	0.0	(4.7)	0.0	(16.9)	(9.8)
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	24.3	1.53	(29.9)	(14.5)	(2.1)
Other Operating CF	(20.2)	34.9	23.4	0.30	0.30
Net Operating CF	75.7	118	112	91.4	114
Net Invt in Properties	(121)	(305)	(448)	(23.2)	(6.9)
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)	(448)	(23.2)	(6.9)
Distribution Paid	(58.5)	(72.4)	(79.3)	(104)	(107)
Chg in Gross Debt	96.1	98.9	145	23.2	6.93
New units issued	279	0.0	303	0.0	0.0
Other Financing CF	(15.1)	(16.8)	(21.8)	0.0	0.0
Net Financing CF	302	9.71	347	(80.5)	(99.7)
Currency Adjustments	3.78	0.0	(1.0)	0.0	0.0
Chg in Cash	261	(178)	10.2	(12.3)	7.64
Operating CFPS (S cts)	5.13	10.3	11.5	7.85	8.62
Free CFPS (S cts)	(4.5)	(16.7)	(27.2)	5.05	7.95

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
8:	06 Dec 18	1.36	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

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Dissemination Date: 23 Jan 2019 10:13:49 (SGT)

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