

# Singapore Company Guide

## Keppel DC REIT

Version 15 | Bloomberg: KDCREIT SP | Reuters: KEPE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

8 Oct 2019

### BUY

Last Traded Price ( 7 Oct 2019): S\$1.90 (STI : 3,099.48)  
Price Target 12-mth: S\$2.20 (16% upside) (Prev S\$1.87)

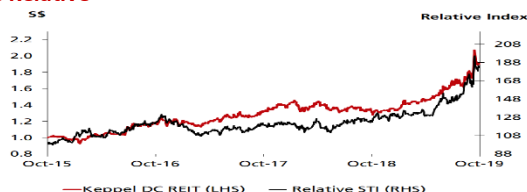
#### Analyst

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#### What's New

- Acquisition of two data centers in Singapore a significant driver to DPU
- Remains in a virtuous cycle of accretive acquisitions; pricing in a further S\$75m in debt-funded deals by 2H20
- Recent index inclusion to boost liquidity, resulting in a lower cost of capital for the REIT
- TP raised to S\$2.20 backed by DCF, maintain BUY

#### Price Relative



#### Forecasts and Valuation

FY Dec (\$m)	2018A	2019F	2020F	2021F
Gross Revenue	176	202	270	297
Net Property Inc	158	161	212	222
Total Return	142	110	142	155
Distribution Inc	96.1	111	147	156
EPU (S cts)	8.83	8.17	9.51	9.52
EPU Gth (%)	35	(7)	16	0
DPU (S cts)	7.32	7.80	8.60	9.07
DPU Gth (%)	3	7	10	6
NAV per shr (S cts)	107	107	118	119
PE (X)	21.5	23.2	20.0	19.9
Distribution Yield (%)	3.9	4.1	4.5	4.8
P/NAV (x)	1.8	1.8	1.6	1.6
Aggregate Leverage (%)	31.4	32.4	31.8	32.7
ROAE (%)	8.6	7.6	8.4	8.0

Distn. Inc Chng (%)		2	13	18
Consensus DPU (S cts)		7.70	8.10	8.50
Other Broker Recs:		B: 5	S: 1	H: 4

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

### Hitting the stratosphere

**BUY, TP raised to S\$2.20.** Given robust accretion from recent acquisitions, we believe Keppel DC REIT (KDC REIT) can maintain its meteoric rise on the back of a virtuous acquisition cycle strategy where its cost of capital remains well below its investment return. After an active year of acquisitions coupled with inclusion into the EPRA Nareit Developed Asia Index, we believe the REIT will continue to outperform market expectations to keep valuations at a premium. KDC REIT is projected to deliver a robust 2-year DPU CAGR of 8.0% in FY19-21. Maintain BUY!

**Where we differ: Our TP is higher than consensus.** Our TP of S\$2.20 is the highest on the street. Our numbers were raised further to incorporate recent acquisitions of two data centers in Singapore. Fueled by a still visible acquisition pipeline from the Sponsor and the manager scouting the globe for opportunities, we have assumed debt-funded acquisitions of S\$75m in our estimates to be completed by 2H20.

**Potential catalyst: Better than projected strong operational results.** With the recent acquisitions and news of its inclusion into the EPRA Nareit Developed Asia Index, we believe the higher visibility and trading liquidity will lower the cost of capital for the REIT. Catalysts to look out for include (i) stronger than anticipated results, (ii) tax transparency treatment for KDC 4 acquisition by 2H20, (iii) further acquisitions.

#### Valuation:

We maintain our BUY recommendation for KDC REIT and raised our TP to S\$2.20 based on DCF. Our discount rate reflects recent and assumed acquisitions.

#### Key Risks to Our View:

**Competition from larger third-party data centre players.** KDC REIT may face higher barriers to entry and stiffer competition from international operators/funds which are also looking to grow their footprint and attract tenants.

#### At A Glance

Issued Capital (m shrs)	1,487
Mkt. Cap (\$m/US\$m)	2,826 / 2,046
Major Shareholders (%)	
Keppel Corp Ltd	43.6
Cohen & Steers Inc	5.6
Daiwa Securities Group Inc	5.4
Free Float (%)	45.4
3m Avg. Daily Val (US\$m)	9.8
ICB Industry : Real Estate / Equity Real Estate Investment (REITs)	



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## WHAT'S NEW

### Hitting the Stratosphere

#### Recent acquisitions of 2 data centers in Singapore.

Keppel DC REIT (KDCREIT) recently completed the purchase of 2 data centers from its Sponsor and related entities. The properties are:

#### 1. 100% interest in 1-Net North Data Center– Held by Keppel Infrastructure Trust (KIT) previously

- The purchase of both Keppel Infrastructure Trust (KIT)'s 51% stake in the JV and the remaining 49% stake held by WDC Development.
- The total agreed value of S\$200.2m is slightly below Knight Frank's valuation of S\$200.5m and Edmund Tie's S\$201.5m.
- The property is let on a triple net basis to 1-Net, a wholly owned subsidiary of MediaCorp, for another 17 years, with an option to extend for a further 7.6 years.
- The initial yield is estimated to be c.9.0%.

#### 2. 99% interest in Keppel DC Singapore 4 (KDC SGP 4)

- The acquisition of Keppel DC Singapore 4 for S\$384.9m is below the independent valuation of S\$385.1m (including rental support of S\$8.7m).
- Occupancy rate is 92% with IT power fully-committed; implying that demand for the space is robust and likely to be sticky.
- Given that the tenants had just recently taken possession of the space and will need time to ramp up their operations, the vendor has provided a two-year rental support of S\$8.7m.
- KDC REIT will enter into a facility management agreement with Keppel T&T to provide facilities, management and maintenance services.
- KDC REIT will enter into a Keppel Lease arrangement where the sponsor will manage the property and in return pay KDC REIT a return that its pegged to 99% of the underlying EBITDA.
- The initial yield is estimated to be c.7.0%; and will rise to 7.5% over time as the tenants are fully committed to the datacentre's power output.

The total agreed valuation for the two properties is estimated to be c.S\$580.7m and after accounting for all-in acquisition costs, amounted to c.S\$599.5m.

#### Our thoughts:

#### 1. Diversity in earnings and asset base; improve income visibility.

- The acquisitions will strengthen the income resilience and diversity of KDC REIT's income base from 17 properties in its portfolio (18 properties if we include the ongoing development of IC3 East data-center in Sydney, which we estimate to complete and will be acquired by end of 2020).
- KDC 4 will be the 5<sup>th</sup> co-location asset in Singapore which enables the REIT to ride the uptrend in demand for data centers in Singapore. The launch of 5G networks in Singapore by 2020, powered by data centres will augment continued robust demand for data centre space in the medium term.
- 1-Net North Data Center, backed by a long master lease of close to 17 years coupled with annual escalations of c.4% will significantly boost KDC REIT's income visibility.
- With both acquisitions, the average WALE for the portfolio improves from 7.8 years to 8.9 years.
- Post completion, KDC REIT will have < 5% of the leases up for renewal in 2019-2020.

#### 2. Fund raising to part fund the purchases; larger headroom for debt-funded acquisition opportunities.

- KDC REIT has raised S\$479.3m from a private placement (S\$235.4m, 135 units @S\$1.744/unit) and a pro-rata non-renounceable offering (S\$243.8m, 141.9m units @ S\$1.71/unit) which were both well received among new and existing investors.
- Post fund raising, we estimate net gearing will fall from c.31% to 30%, providing KDCREIT with a slightly larger debt funded capacity to take on more opportunistic acquisitions in the future.
- Given the debt headroom available to the REIT and abundant acquisition opportunities, we have also factored S\$75m debt-funded acquisition by middle of FY20 into our estimates.
- Our estimates are adjusted upwards to account for the contribution from the above mentioned two data centers, starting from FY20F onwards. We raised our DPU estimates by 2.0%-5.0%; we have previously assumed S\$200m worth of acquisitions in our estimates, but management has exceeded our projections.
- Our target price is also raised to S\$2.20 as we roll forward our valuation, implying a total return of 15%.

## Summary of target acquisitions.


**99% Interest in  
Keppel DC Singapore 4  
(KDC SGP 4)**

Location	20 Tampines Street 92, Singapore 528875
Land tenure	30-year leasehold till 30 June 2020; option to renew for another 30 years
Building description	Five-storey carrier-neutral and purpose-built facility completed in 2017
Net Lettable area	Approx. 84,544 sq ft
Occupancy <sup>1</sup>	<ul style="list-style-type: none"> <li>Occupancy: 92.0%</li> <li>IT power fully-committed</li> </ul>
WALE <sup>1</sup>	3.0 years
Independent Valuations <sup>2</sup>	<ul style="list-style-type: none"> <li>Cushman &amp; Wakefield<sup>3</sup>: S\$385.1m</li> <li>Savills<sup>4</sup>: S\$385.1m</li> </ul>
Agreed Value	S\$384.9 million
Vendors	Thorium DC Pte. Ltd., a 70:30 joint venture between Alpha Data Centre Fund and Keppel Data Centres Holding


**100% Interest in  
1-Net North Data Centre  
(1-Net North DC)**

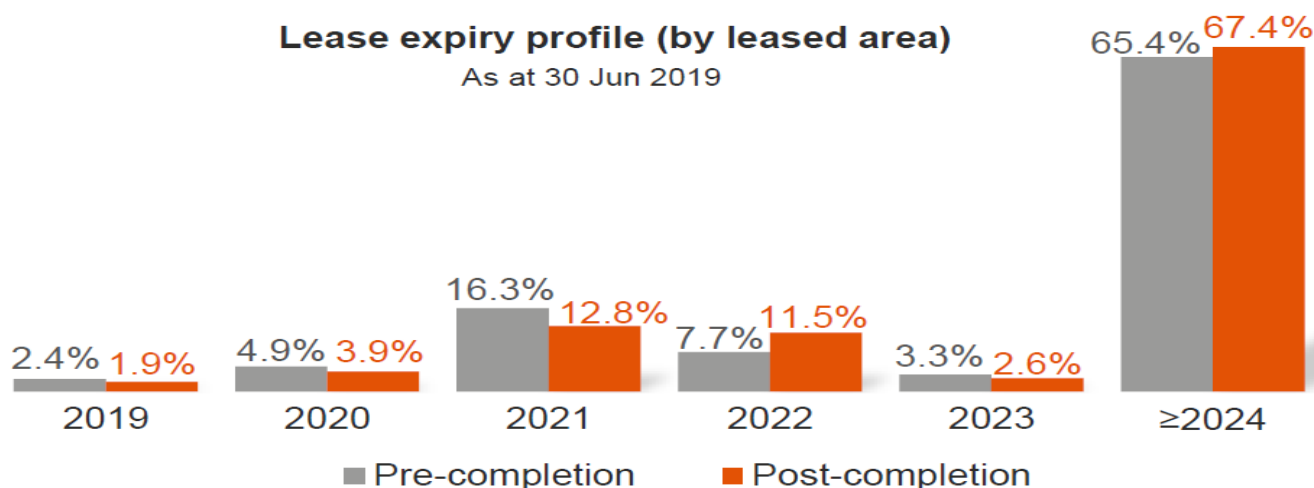
Location	18 Riverside Road, Singapore 739088
Land tenure	70-year 5-month leasehold till 31 Jul 2044
Building description	Five-storey purpose-built data centre facility completed in 2016
Net Lettable area	Approx. 213,815 sq ft
Occupancy <sup>1</sup>	100% committed on a triple-net master lease with ~17 years remaining; Option to renew for another 7.6 years
WALE <sup>1</sup>	16.8 years
Independent Valuations	<ul style="list-style-type: none"> <li>Knight Frank<sup>3</sup>: \$200.5m</li> <li>Edmund Tie<sup>4</sup>: \$201.5m</li> </ul>
Agreed Value	S\$200.2 million
Vendors	51% from CityDC Pte. Ltd. (subsidiary of Keppel Infrastructure Trust) and 49% from WDC Development Pte. Ltd (subsidiary of Shimizu Corporation)

Source of all data: Company, DBS Bank

## WALE improved to 8.9 years

## Lease expiry profile (by leased area)

As at 30 Jun 2019



Source of all data: Company, DBS Bank

## CRITICAL DATA POINTS TO WATCH

### Critical Factors

**Acquisitions drive price.** KDC REIT has been one of the strongest performers among S-REITs despite its relatively short trading history. While its share price has diverged from the broader market performance, this can be largely explained by its acquisition announcements, coupled with its exposure to a unique asset class – data centres – which we believe has a structural growth story. 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 its existing portfolio are stable, DPU growth is likely to be driven by acquisitions which the manager is said to be considering.

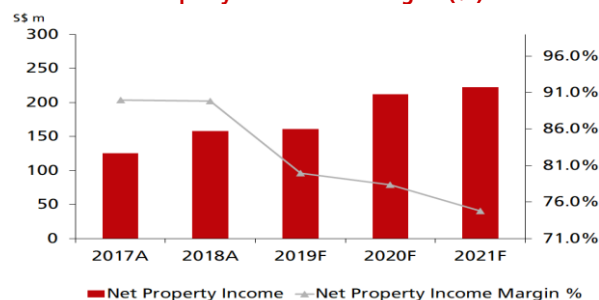
### Delivering inorganic growth ahead of expectations.

Distributable income growth is a key driver of share price performance. Since its IPO, KDC REIT's AUM has more than doubled, hitting a new high of S\$2.6bn, with the expected completion of the acquisition of two properties in Singapore. DPU has also risen by a CAGR of 5.0% since listing and is projected to grow by a faster 7.5% CAGR in the coming 2 years. This is driven by the projected c.11% growth in DPU from the contribution from two data centres (99% interest in Keppel DC SG 4 and 100% in 1-Net North DC) and contribution from the expected acquisition of IC DC 3 in Australia in FY21.

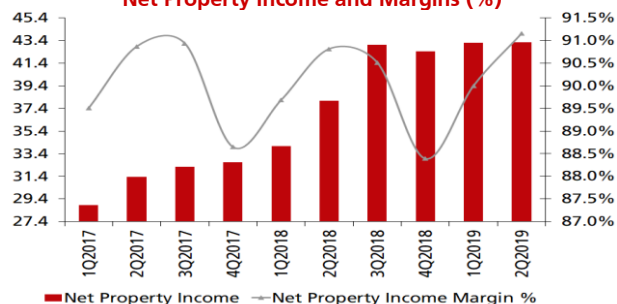
The Manager remains on the lookout for acquisitions to grow and is looking at both shell-and-core opportunities and data centres with co-location facilities. The ability to invest in the entire data centre value chain is brought about by having an operator sponsor. Supported by a strong balance sheet and ample debt-funded capacity, and a conducive cost of capital, KDC REIT is in a virtuous cycle where acquisitions will most likely be accretive if executed on. That said, the manager is disciplined in its approach and is looking for deals that add value or improve its portfolio resilience and diversity.

**Interest rates have insignificant impact on price.** Interest rate movements, measured by the Singapore 10-year government bond yield, appear to have an insignificant impact on KDC REIT's share 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.

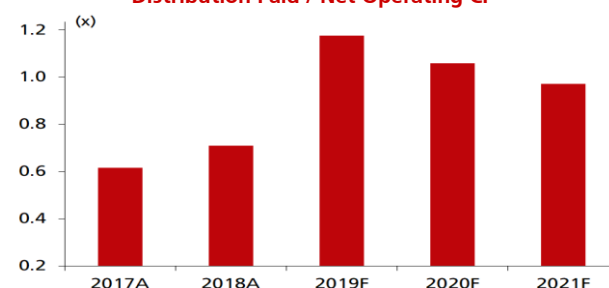
Net Property Income and Margins (%)



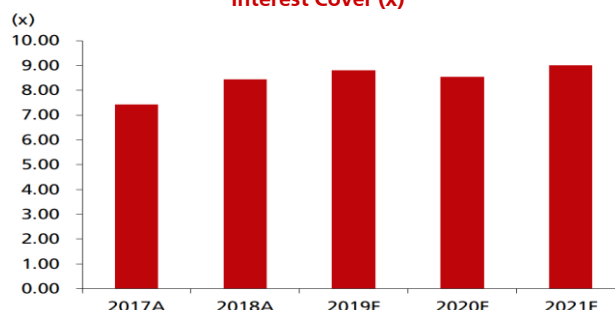
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



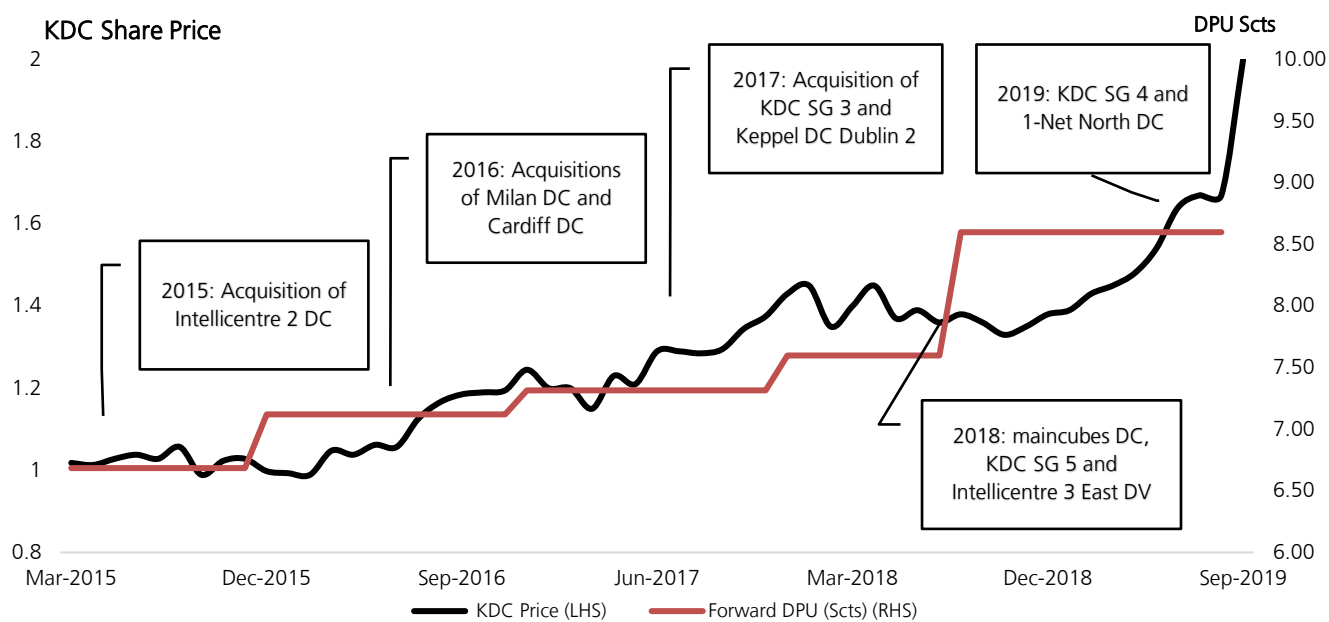
Interest Cover (x)



Source: Company, DBS Bank

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

#### KDC REIT acquisition track record



Source of all data: Company, DBS Bank

## Keppel DC REIT

### 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 remains stable at c.30%.** KDC REIT's aggregate gearing will likely remain at close to 30%, providing it with ample debt-funded capacity to grow. All-in cost of debt is low at 1.7%. As at June 2019, more than 80% of the REIT's borrowings have been 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 DPU 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:

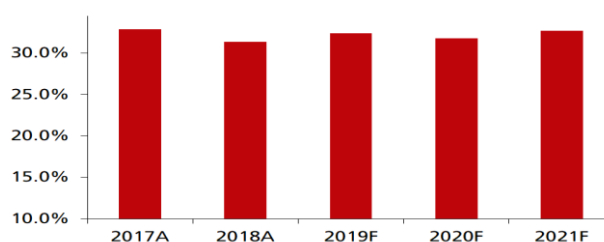
**Higher maintenance capex relative to other asset classes.** Due to the shorter lifespan of a data centre's infrastructure, the REIT may have to rely on borrowings to fund maintenance capex at certain properties, which could impact gearing.

**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.

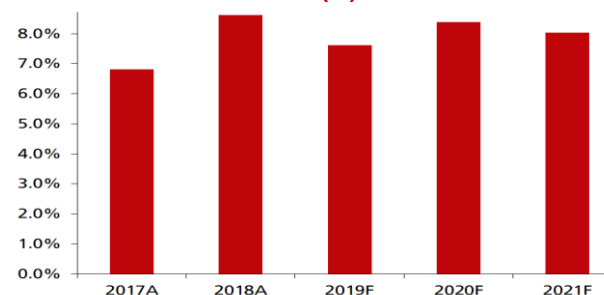
### Company Background

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.

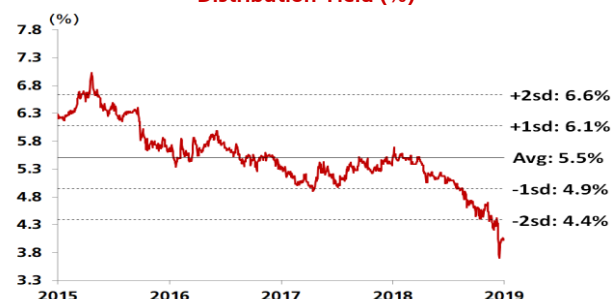
Aggregate Leverage (%)



ROE (%)



Distribution Yield (%)



PB Band (x)



Source: Company, DBS Bank

## Income Statement (\$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Gross revenue	139	176	202	270	297
Property expenses	(13.9)	(17.9)	(40.5)	(58.5)	(75.1)
<b>Net Property Income</b>	<b>125</b>	<b>158</b>	<b>161</b>	<b>212</b>	<b>222</b>
Other Operating expenses	(26.7)	(24.0)	(21.2)	(31.6)	(27.4)
Other Non Opg (Exp)/Inc	0.93	0.56	0.0	0.0	0.0
Net Interest (Exp)/Inc	(13.3)	(15.8)	(15.9)	(21.1)	(21.6)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
<b>Net Income</b>	<b>86.1</b>	<b>118</b>	<b>124</b>	<b>159</b>	<b>173</b>
Tax	(7.3)	(5.0)	(8.7)	(11.9)	(12.1)
Minority Interest	(5.0)	(4.1)	(5.0)	(5.3)	(5.6)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Income After Tax</b>	<b>73.7</b>	<b>109</b>	<b>110</b>	<b>142</b>	<b>155</b>
Total Return	65.2	142	110	142	155
Non-tax deductible Items	17.1	(45.8)	0.30	5.30	0.30
Net Inc available for Dist.	82.3	96.1	111	147	156
<b>Growth &amp; Ratio</b>					
Revenue Gth (%)	40.3	26.2	14.8	34.0	10.0
N Property Inc Gth (%)	37.6	26.0	2.1	31.4	5.0
Net Inc Gth (%)	13.6	48.1	1.0	28.5	9.7
Dist. Payout Ratio (%)	100.0	94.2	95.2	95.4	95.1
Net Prop Inc Margins (%)	90.0	89.8	79.9	78.3	74.7
Net Income Margins (%)	53.0	62.2	54.7	52.5	52.3
Dist to revenue (%)	59.2	54.7	54.9	54.4	52.4
Managers & Trustee's fees	19.2	13.7	10.5	11.7	9.2
ROAE (%)	6.8	8.6	7.6	8.4	8.0
ROA (%)	4.4	5.4	4.9	5.4	5.2
ROCE (%)	5.5	6.5	5.9	6.4	6.1
Int. Cover (x)	7.4	8.4	8.8	8.5	9.0

Driven by acquisitions

Source: Company, DBS Bank



**Quarterly / Interim Income Statement (\$\$m)**

FY Dec	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019
Gross revenue	41.9	47.6	48.0	48.0	47.5
Property expenses	(3.9)	(4.5)	(5.6)	(4.8)	(4.2)
Net Property Income	38.1	43.0	42.5	43.2	43.3
Other Operating expenses	(5.9)	(6.9)	(7.3)	(5.7)	(6.9)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(4.0)	(4.1)	(4.1)	(3.9)	(4.0)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
<b>Net Income</b>	<b>28.2</b>	<b>32.0</b>	<b>31.1</b>	<b>33.6</b>	<b>32.4</b>
Tax	(1.8)	(2.8)	1.00	(2.6)	(2.6)
Minority Interest	(0.8)	(0.8)	(1.8)	(0.8)	(0.8)
<b>Net Income after Tax</b>	<b>25.6</b>	<b>28.4</b>	<b>30.3</b>	<b>30.2</b>	<b>29.0</b>
Total Return	25.6	28.4	62.9	30.2	29.0
Non-tax deductible Items	(2.5)	(2.4)	(36.8)	(3.1)	(1.8)
Net Inc available for Dist.	23.1	26.0	26.1	27.1	27.2

**Growth & Ratio**

Revenue Gth (%)	10	13	1	0	(1)
N Property Inc Gth (%)	12	13	(1)	2	0
Net Inc Gth (%)	2	11	7	0	(4)
Net Prop Inc Margin (%)	90.8	90.5	88.4	90.0	91.2
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

**Balance Sheet (\$\$m)**

FY Dec	2017A	2018A	2019F	2020F	2021F
Investment Properties	1,570	2,029	2,052	2,736	2,783
Other LT Assets	15.1	4.02	4.02	4.02	4.02
Cash & ST Invt	118	128	113	105	109
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	56.2	85.7	80.6	108	119
Other Current Assets	3.74	6.11	6.11	6.11	6.11
<b>Total Assets</b>	<b>1,763</b>	<b>2,253</b>	<b>2,256</b>	<b>2,959</b>	<b>3,021</b>
ST Debt	3.66	134	134	134	134
Creditor	48.2	36.3	13.4	18.0	19.8
Other Current Liab	1.40	16.9	8.68	11.9	12.1
LT Debt	576	573	597	807	853
Other LT Liabilities	17.9	17.1	17.1	17.1	17.1
Unit holders' funds	1,090	1,445	1,450	1,931	1,938
Minority Interests	26.8	31.2	36.2	41.4	47.0
<b>Total Funds &amp; Liabilities</b>	<b>1,763</b>	<b>2,253</b>	<b>2,256</b>	<b>2,959</b>	<b>3,021</b>
Non-Cash Wkg. Capital	10.3	38.6	64.6	84.2	93.1
Net Cash/(Debt)	(461)	(578)	(617)	(835)	(877)
<b>Ratio</b>					
Current Ratio (x)	3.3	1.2	1.3	1.3	1.4
Quick Ratio (x)	3.3	1.1	1.2	1.3	1.4
Aggregate Leverage (%)	32.9	31.4	32.4	31.8	32.7
Z-Score (X)	2.3	2.1	2.3	2.3	2.3

Stable gearing

Source: Company, DBS Bank

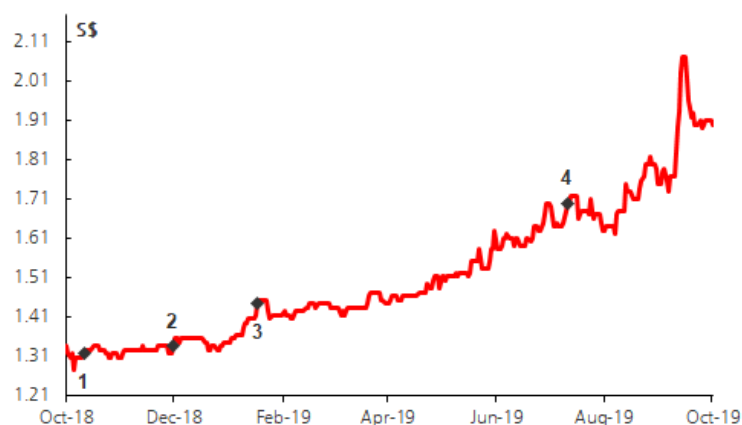


## Cash Flow Statement (\$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Pre-Tax Income	86.1	118	124	159	173
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(4.7)	0.0	(16.9)	(8.7)	(11.9)
Associates & JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	1.53	(29.9)	(17.7)	(22.9)	(9.0)
Other Operating CF	34.9	23.4	0.30	5.30	0.30
<b>Net Operating CF</b>	<b>118</b>	<b>112</b>	<b>89.6</b>	<b>133</b>	<b>152</b>
Net Invnt in Properties	(305)	(448)	(23.6)	(684)	(46.4)
Other Invnts (net)	0.0	0.0	0.0	0.0	0.0
Invnts 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
<b>Net Investing CF</b>	<b>(305)</b>	<b>(448)</b>	<b>(23.6)</b>	<b>(684)</b>	<b>(46.4)</b>
Distribution Paid	(72.4)	(79.3)	(105)	(140)	(148)
Chg in Gross Debt	98.9	145	23.6	210	46.4
New units issued	0.0	303	0.0	474	0.0
Other Financing CF	(16.8)	(21.8)	0.0	0.0	0.0
<b>Net Financing CF</b>	<b>9.71</b>	<b>347</b>	<b>(81.7)</b>	<b>544</b>	<b>(102)</b>
Currency Adjustments	0.0	(1.0)	0.0	0.0	0.0
Chg in Cash	(178)	10.2	(15.7)	(7.6)	4.36
Operating CFPS (S cts)	10.3	11.5	7.95	10.4	9.90
Free CFPS (S cts)	(16.7)	(27.2)	4.89	(37.0)	6.50

Source: Company, DBS Bank

## Target Price &amp; Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	17 Oct 18	1.32	1.49	BUY
2:	06 Dec 18	1.34	1.49	BUY
3:	23 Jan 19	1.44	1.57	BUY
4:	17 Jul 19	1.70	1.87	BUY

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

Source: DBS Bank

Analyst: Derek TAN

Rachel TAN

DBS Bank recommendations are based on an 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 share price catalysts within this time frame)

*\*Share price appreciation + dividends*

Completed Date: 8 Oct 2019 15:52:25 (SGT)

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