Singapore Company Guide

Keppel DC REIT

Version 18 | Bloomberg: KDCREIT SP | Reuters: KEPE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

25 Feb 2020

HOLD (Downgrade from BUY)

Last Traded Price (24 Feb 2020): S$2.50 (**STI :** 3,142.20)
Price Target 12-mth: S$2.55 (2% upside) (Prev S$2.40)

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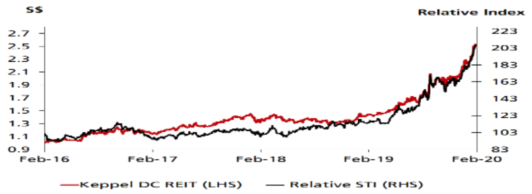
What's New

- Pricing in S$600m of acquisitions; increased from previous estimate of S$350m
- Expect third-party acquisitions in the near term given the lack of a stabilised pipeline from the Sponsor
- Higher TP of S$2.55; downgrade to HOLD

Price Relative



Forecasts and Valuation

FY Dec (S$m)	2018A	2019A	2020F	2021F
Gross Revenue	176	195	288	340
Net Property Inc	158	177	219	264
Total Return	142	106	142	167
Distribution Inc	96.1	113	142	173
EPU (S cts)	8.82	8.21	9.13	10.3
EPU Gth (%)	35	(7)	11	12
DPU (S cts)	7.32	7.61	8.27	9.33
DPU Gth (%)	3	4	9	13
NAV per shr (S cts)	107	114	114	126
PE (X)	28.3	30.5	27.4	24.4
Distribution Yield (%)	2.9	3.0	3.3	3.7
P/NAV (x)	2.3	2.2	2.2	2.0
Aggregate Leverage (%)	31.4	31.4	31.9	33.4
ROAE (%)	8.6	7.4	8.0	8.5
Distn. Inc Chng (%):			0	8
Consensus DPU (S cts):			8.90	9.70
Other Broker Recs:		B: 5	S: 1	H: 4

Source of all data on this page: Company, DBS Bank, Thomson Reuters

With great power comes great responsibility

Downgrade to HOLD; TP raised to S$2.55. While we continue to like KDC REIT as its pure-play data-centre proxy in Singapore, its meteoric rise to new heights is noteworthy. Trading at a forward yield of 3.3%, inclusive of assumed S$600m (vs S$350m previously) in acquisitions, we believe that market has priced in the bulk of its prospective growth into valuations. As such, we downgrade the stock to a HOLD and raise our TP to S$2.55 as we increase our acquisition assumptions.

Where we differ: Responsibility to deliver value in addition to accretion. At current levels, we think that investors have priced in too much growth into valuations. We believe that KDC REIT can deliver accretive acquisitions given positive spread between target cap rates and its cost of equity. However, given the robust competition for data-centre assets, we have also seen a corresponding compression in returns, making it tougher for the REIT to buy value in the current market. As such, we believe that KDC REIT will have to deliver acquisitions in the range of S$800-1,000m in order to surprise and re-rate further. While the ability to deliver deals is there, we believe the lack of available large-scale data-centre transactions, especially given the lack of a pipeline from the Sponsor, may mean that deal sizes are unlikely to reach those levels.

Potential catalyst: Higher-than-expected growth and returns. KDC REIT will be looking forward to the completion of several projects in FY20 (M&E at DC1 and KDC SGP 5; construction of Intellicentre 3), as well as other organic growth initiatives. Catalysts to look out for include (i) higher-than-expected portfolio growth, (ii) tax transparency for KDC SGP 4 by 2H20, and (iii) acquisitions that are more accretive than projected.

Valuation:

We raise our DCF-based TP to S$2.55 and downgrade our recommendation to HOLD. Our discount rate reflects recent and assumed acquisitions (c.S$600m).

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)	1,632
Mkt. Cap (Sm/USm)	4,081 / 2,916
Major Shareholders (%)	
Temasek Holdings	21.5
Free Float (%)	78.5
3m Avg. Daily Val (US$m)	6.9

GIC Industry : Real Estate / Equity Real Estate Investment (REITs)

WHAT'S NEW

With great power comes great responsibility

Raising acquisition assumptions from S$350m to S$600m.

- We expect KDC REIT to deliver on acquisitions through the course of 2020 given the robust valuations that the stock trade at. In our estimates, we previously priced in S$350m of acquisitions given that KDC REIT will have to rely entirely on third-party acquisitions in FY20.
- Based on our understanding, pipeline assets from the Sponsor are mostly in Europe, more specifically Frankfurt and The Netherlands. But these assets need time to stabilise and will likely only be ready for KDC REIT after FY20 and are thus not ready for injection in the immediate term. There are currently no assets in Singapore for further injection into the REIT.
- We believe that acquisitions in FY20 will most likely come from Australia and Europe given the attractive spreads (cap rate – funding costs) while the lack of data centres for sale in Singapore limits its ability to further add to its Singapore portfolio.
- However, based on its historical track record of delivering acquisitions, we believe KDC REIT can deliver a higher target in 2020 and thus raise our estimates from S$350m to c.S$600m. Our estimates are accordingly revised to account for this higher acquisition target assumption.

Third-party acquisitions in the past three years

Date	Country	Property	Price
Dec-19	Germany	Kelsterbach Data Centre	S$125.3m
Aug-18	Australia	Intellicentre 3 East Data Centre	S$30.0m
Apr-18	Germany	maincubes Data Centre	S$130.0m
Sep-17	Ireland	Keppel DC Dublin 2	S$101.3m

Source: Keppel DC REIT

- Over the last three years, KDC REIT has acquired close to S$400m of third-party assets.
- With the deepened presence in Europe and Australia, KDC REIT will have more access to deals in these markets and is poised to grow further.

Assume more acquisitions, but within limits

- Taking reference from past transactions, we believe in KDC REIT's ability to acquire assets from third parties in Europe and Australia albeit at a smaller quantum as compared to acquisitions in Singapore.
- With KDC REIT's current yield of c.3.3%, it can easily acquire accretively; but we are confident of Management's disciplined approach to acquire assets that create value.
- As such, we increased our acquisitions projections from S$350m to S$600m; a more than 20% growth in portfolio (after accounting for Kelsterbach data centre that is expected to complete in FY20).
- However, higher-than-projected acquisition(s) could still be a possibility given recent portfolio deals done by other REITs.

Key Metrics	Acquisition scenarios			
	$350m (previous)	$600m (new)	$800m	$1b
DPU Estimate (FY21)	8.3 Scts	**9.3 Scts**	9.5 Scts	9.7 Scts
DPU Accretion (FY20-FY21)	8.1%	**12.8%**	15.2%	17.4%
Forward Dividend Yield	3.3%	**3.7%**	3.8%	3.9%
Gearing (FY21)	32.9%	**33.4%**	33.8%	34.1%
EV/EBITDA (FY21)	25.0 x	**24.9 x**	24.9 x	24.8 x
TP	S$2.40	**S$2.55**	S$2.60	S$2.65

Source: DBS Bank estimates

- Our base-case revised assumptions are:
  - S$600m in acquisitions
  - 40:60 (debt:equity) funding structure
  - Yields are based on TP of S$2.55
- Based on our above assumptions, we see a c.12.8% accretion to DPU in FY21, forward yield of c.3.7%, and EV/EBITDA multiple of 24.9 times, a multiple which we are comfortable with.
- Our FY20 DPU estimates remain at 8.3 Scts with a forward yield of c.3.3%.
- We may revisit these assumptions if: i) acquisitions are done earlier than expected, ii) acquisitions are more than expected, iii) NPI yields of acquisitions are above our estimates of c.6.5%.

Raise TP to $2.55; but recommendation cut to HOLD

We continue to like KDC REIT for its visible earnings growth with the addition of Keppel DC Singapore 4, DC1, and Kelsterbach DC in FY20. Our estimates for portfolio growth will further increase FY21 DPU by c.12.8% to c.9.3 Scts.

However, given its current rich pricing, we downgrade our recommendation to HOLD based on; i) our threshold for portfolio to grow by S$600m, ii) forward yields of c.3.3% and c.3.7% for FY20 and FY21 respectively, iii) EV/EBITDA multiple relatively in line with other DC REITs in the US and Australia, iv) investors may have priced in growth in portfolio that seems too aggressive in our view.

Based on the increased acquisition assumption of S$600m, our DCF-based TP has been raised to S$2.55.

CRITICAL DATA POINTS TO WATCH

Critical Factors

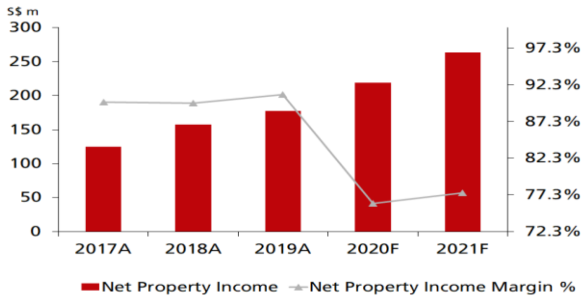
Acquisitions drive price. KDC REIT has been one of the strongest performers among S-REITs despite its relatively short trading history. While its share price has diverged from the broader market performance, this can be largely explained by its acquisition announcements, coupled with its exposure to 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 further acquisitions.

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 three acquisitions in FY19. DPU has also risen by a CAGR of 4.0% since listing and is projected to grow by a faster 8.5% CAGR in the next two years. This is driven by the contribution from three data centres (99% interest in Keppel DC SG 4 and 100% in 1-Net North DC, 100% in Kelsterbach DC) and contribution from the expected acquisition of IC DC 3 in Australia in 2HFY20.

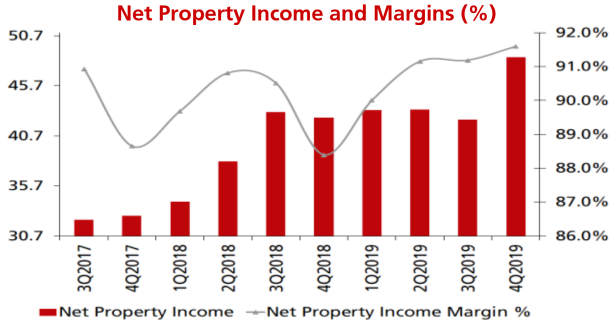
The Manager remains on the lookout for acquisitions to grow and is looking at both shell-and-core opportunities and data centres with co-location facilities. The ability to invest in the entire data centre value chain is brought about by having an operator Sponsor. Supported by a strong balance sheet and ample debt-funded capacity, and 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.

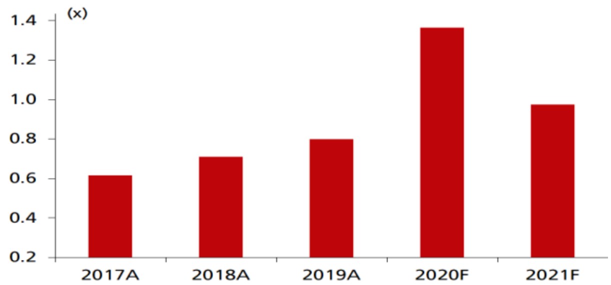
Net Property Income and Margins (%)



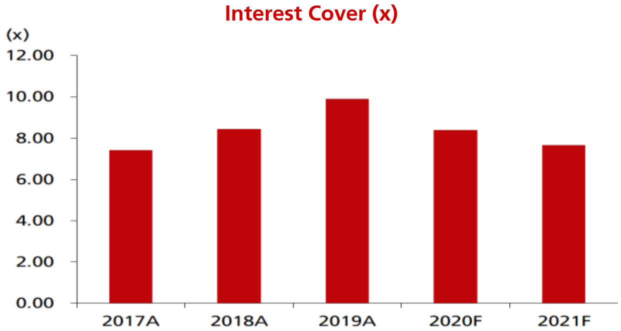
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Conservative hedging policies. Major currencies that will impact earnings – AUD and EUR – have been hedged for two years up to 1H21 through foreign currency forward contracts, thereby minimising currency fluctuation effects going forward.

Gearing remains healthy at c.31%. KDC REIT's aggregate gearing will likely hover around c.30-35%, providing it with ample debt-funded capacity to grow. All-in cost of debt is low at 1.7%. As at December 2019, more than 80% of the REIT's borrowings had 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.6% imply that acquisitions are likely to be accretive. We have priced in S$600m in our estimates.

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.

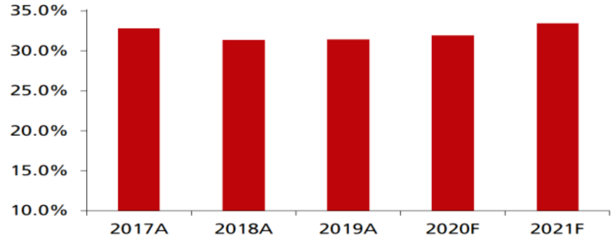
Environment, Social, Governance:

KDC REIT has once again topped the Governance Index for Trusts in 2018. The index measures corporate governance practices and considers business models and various regulations governing REITs and their managers. In 2018, Keppel DC REIT continued to improve on its implementation of Environmental, Social and Governance practices at the operational level.

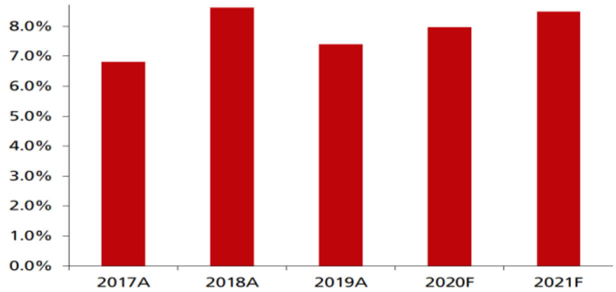
Company Background

KDC 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.

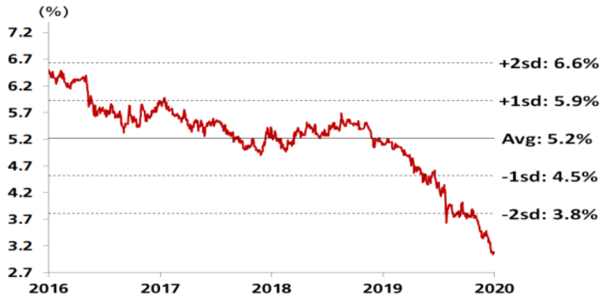
Aggregate Leverage (%)



ROE (%)



Distribution Yield (%)



PB Band (x)

Source: Company, DBS Bank

Income Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Gross revenue	139	176	195	288	340
Property expenses	(13.9)	(17.9)	(17.5)	(68.7)	(76.1)
Net Property Income	**125**	**158**	**177**	**219**	**264**
Other Operating expenses	(26.7)	(24.0)	(24.9)	(30.0)	(41.0)
Other Non Opg (Exp)/Inc	0.93	0.56	2.64	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(13.3)	(15.8)	(15.4)	(22.5)	(29.0)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	**86.1**	**118**	**140**	**166**	**194**
Tax	(7.3)	(5.0)	(12.6)	(12.5)	(13.5)
Minority Interest	(5.0)	(4.1)	(4.6)	(4.9)	(5.2)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	**73.7**	**109**	**122**	**149**	**175**
Total Return	65.2	142	106	142	167
Non-tax deductible Items	17.1	(45.8)	6.74	0.30	6.30
Net Inc available for Dist.	82.3	96.1	113	142	173
Growth & Ratio					
Revenue Gth (%)	40.3	26.2	11.0	47.6	18.1
N Property Inc Gth (%)	37.6	26.0	12.4	23.5	20.4
Net Inc Gth (%)	13.6	48.1	12.1	21.7	17.3
Dist. Payout Ratio (%)	100.0	94.2	95.3	94.9	95.7
Net Prop Inc Margins (%)	90.0	89.8	91.0	76.1	77.6
Net Income Margins (%)	53.0	62.2	62.8	51.8	51.5
Dist to revenue (%)	59.2	54.7	58.1	49.5	51.0
Managers & Trustee's fees	19.2	13.7	12.8	10.4	12.1
ROAE (%)	6.8	8.6	7.4	8.0	8.5
ROA (%)	4.4	5.4	4.7	5.1	5.4
ROCE (%)	5.5	6.5	5.5	6.1	6.5
Int. Cover (x)	7.4	8.4	9.9	8.4	7.7

Source: Company, DBS Bank

Projected S$600m of acquisitions to contribute c.12% to FY21 revenues.

Mainly led by addition of Keppel DC Singapore 4 and DC1.

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Gross revenue	48.0	48.0	47.5	46.4	53.0
Property expenses	(5.6)	(4.8)	(4.2)	(4.1)	(4.5)
Net Property Income	42.5	43.2	43.3	42.3	48.5
Other Operating expenses	(7.3)	(5.7)	(6.9)	(3.5)	(6.1)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(4.1)	(3.9)	(4.0)	(3.9)	(3.7)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	**31.1**	**33.6**	**32.4**	**34.9**	**38.7**
Tax	1.00	(2.6)	(2.6)	(2.0)	(5.4)
Minority Interest	(1.8)	(0.8)	(0.8)	(0.8)	(2.2)
Net Income after Tax	**30.3**	**30.2**	**29.0**	**32.2**	**31.1**
Total Return	62.9	30.2	29.0	32.2	15.1
Non-tax deductible Items	(36.8)	(3.1)	(1.8)	(4.7)	16.3
Net Inc available for Dist.	26.1	27.1	27.2	27.4	31.5
Growth & Ratio					
Revenue Gth (%)	1	0	(1)	(2)	14
N Property Inc Gth (%)	(1)	2	0	(2)	15
Net Inc Gth (%)	7	0	(4)	11	(3)
Net Prop Inc Margin (%)	88.4	90.0	91.2	91.2	91.6
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

Balance Sheet (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Investment Properties	1,570	2,029	2,637	2,640	3,247
Other LT Assets	15.1	4.02	11.0	11.0	11.0
Cash & ST Invts	118	128	181	145	149
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	56.2	85.7	95.8	115	136
Other Current Assets	3.74	6.11	2.88	2.88	2.88
Total Assets	**1,763**	**2,253**	**2,928**	**2,914**	**3,546**
ST Debt	3.66	134	40.3	40.3	40.3
Creditor	48.2	36.3	59.9	19.2	22.6
Other Current Liab	1.40	16.9	8.04	12.6	13.7
LT Debt	576	573	880	891	1,146
Other LT Liabilities	17.9	17.1	36.8	36.8	36.8
Unit holders' funds	1,090	1,445	1,868	1,875	2,243
Minority Interests	26.8	31.2	34.5	39.4	44.6
Total Funds & Liabilities	**1,763**	**2,253**	**2,928**	**2,914**	**3,546**
Non-Cash Wkg. Capital	10.3	38.6	30.8	86.1	102
Net Cash/(Debt)	(461)	(578)	(739)	(786)	(1,036)
Ratio					
Current Ratio (x)	3.3	1.2	2.6	3.7	3.8
Quick Ratio (x)	3.3	1.1	2.6	3.6	3.7
Aggregate Leverage (%)	32.9	31.4	31.4	31.9	33.4
Z-Score (X)	2.5	2.3	2.5	2.0	2.1

Assuming a 40:60 (debt:equity) ratio to fund S$600m of acquisitions.

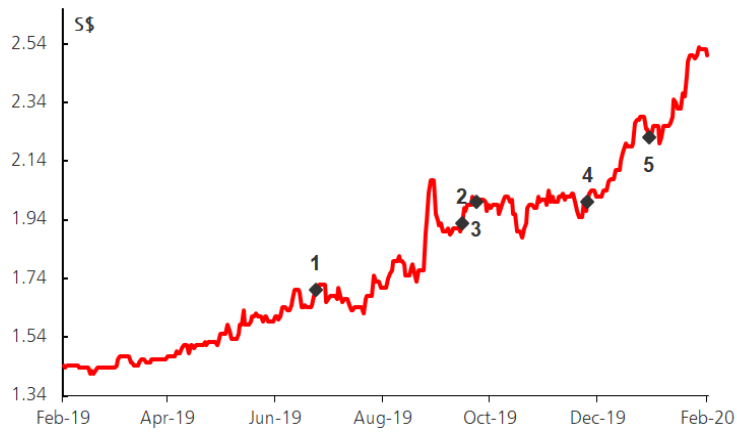
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2017A	2018A	2019A	2020F	2021F
Pre-Tax Income	86.1	118	140	166	194
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(4.7)	0.0	(16.9)	(7.9)	(12.5)
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	1.53	(29.9)	19.0	(59.9)	(17.3)
Other Operating CF	34.9	23.4	13.6	0.30	6.30
Net Operating CF	**118**	**112**	**155**	**98.9**	**170**
Net Invt in Properties	(305)	(448)	(669)	(10.1)	(615)
Other Invts (net)	0.0	0.0	0.0	0.0	0.0
Invts 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	**(305)**	**(448)**	**(669)**	**(10.1)**	**(615)**
Distribution Paid	(72.4)	(79.3)	(124)	(135)	(166)
Chg in Gross Debt	98.9	145	216	10.1	255
New units issued	0.0	303	478	0.0	360
Other Financing CF	(16.8)	(21.8)	(27.4)	0.0	0.0
Net Financing CF	**9.71**	**347**	**543**	**(125)**	**449**
Currency Adjustments	0.0	(1.0)	(1.7)	0.0	0.0
Chg in Cash	(178)	10.2	27.5	(36.1)	4.30
Operating CFPS (S cts)	10.3	11.5	9.14	9.73	11.0
Free CFPS (S cts)	(16.7)	(27.1)	(34.4)	5.44	(26.1)

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:	17 Jul 19	1.70	1.87	BUY
2:	08 Oct 19	1.93	2.20	BUY
3:	16 Oct 19	2.00	2.20	BUY
4:	18 Dec 19	2.00	2.23	BUY
5:	22 Jan 20	2.22	2.40	BUY

Source: DBS Bank

Analyst: Singapore Research Team

Derek 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: 25 Feb 2020 06:40:39 (SGT)
Dissemination Date: 25 Feb 2020 08:36:15 (SGT)

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

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