

# Singapore Company Update

## Keppel DC REIT

Bloomberg: KDCREIT SP | Reuters: KEPE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

21 Jun 2022

### BUY

Last Traded Price (20 Jun 2022): S\$1.91 (STI : 3,096.40)

Price Target 12-mth: S\$2.50 (31% upside) (Prev S\$2.40)

#### Analyst

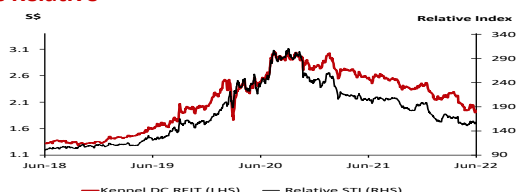
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#### What's New

- Acquiring two data centres in Guangdong; c.2.6% accretion to FY23 DPU
- Acquisitions to be completed in two phases with sufficient debt headroom to tap on in FY22
- 15-year master lease on a triple-net basis to provide income stability
- Maintain BUY with a higher TP of S\$2.50

#### Price Relative



#### Forecasts and Valuation

FY Dec (S\$m)	2020A	2021A	2022F	2023F
Gross Revenue	266	271	302	323
Net Property Inc	244	248	262	281
Total Return	168	314	180	190
Distribution Inc	157	172	181	191
EPU (S cts)	10.3	9.70	10.5	10.9
EPU Gth (%)	25	(5)	8	4
DPU (S cts)	9.17	9.85	10.00	10.5
DPU Gth (%)	20	7	2	5
NAV per shr (S cts)	119	134	134	136
PE (X)	18.6	19.7	18.2	17.4
Distribution Yield (%)	4.8	5.2	5.2	5.5
P/NAV (x)	1.6	1.4	1.4	1.4
Aggregate Leverage (%)	35.5	34.4	38.4	36.1
ROAE (%)	8.8	7.7	7.9	8.1

Distn. Inc Chng (%)			0	2
Consensus DPU (S cts)			10.1	10.5
Other Broker Recs:	B: 4	S: 1	H: 9	

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

### Powering up in China

#### Investment Thesis

**Delivering acquisitions ahead of expectations.** Amid record low cap rates for data centres globally, KDCREIT continues to deliver acquisitions that are accretive to DPU. Following acquisitions in Amsterdam, Guangdong and London in FY21, KDCREIT just announced another two in Guangdong valued at more than S\$320m. These accretive acquisitions should add to earnings in addition to organic growth within its existing portfolio.

**Near-term challenges, but fundamentals still positive.** Higher utility costs and rising interest rates will pose as near-term risks to KDCREIT's earnings. Although accretion from recent acquisitions have been eroded by higher operating costs, we believe the bulk of the impact is already factored into the current share price. Going forward, growing demand for data centres and positive fundamentals in the sector will help KDCREIT return to its organic growth path.

**Market dynamics supportive of further growth.** KDCREIT's current portfolio occupancy of more than 98% is the highest since its IPO in 2014. The continued strong demand for data centre capacity amid the prolonged COVID-19 outbreak and rise of the digital economy would support higher occupancies and revenues across its portfolio in the foreseeable future.

#### Valuation:

Our target price of S\$2.50 is based on DCF, assuming a WACC of 5.9% (risk-free rate of 3.0%). We have not factored in any further acquisition assumptions.

#### Where we differ:

**Potential equity fund raising in FY23.** Despite the assumption of a c.S\$92m equity fund raising in FY23 (to fund the remaining payment for Guangdong DC 3), we expect DPU to continue growing.

#### Key Risks to Our View:

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

#### At A Glance

Issued Capital (m shrs)	1,717
Mkt. Cap (S\$m/US\$m)	3,280 / 2,359
Major Shareholders (%)	
Keppel Corp Ltd	20.6
BlackRock Inc	7.5
Free Float (%)	71.9
3m Avg. Daily Val (US\$m)	8.6
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	



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## WHAT'S NEW

### Powering up in China

#### (+) Delivering acquisitions ahead of expectations

Just as we had turned cautions and lowered our acquisition assumptions for KDCREIT, it has surprised on the upside by delivering two acquisitions in Guangdong, China. Following the successful acquisition of its first data centre in China back in December 2021, KDCREIT has activated its ROFR for another two data centres within the development. The acquisition of the two new data centres will be carried out in two stages.

(1) Guangdong DC 2 (6 Bluesea Intelligence Valley Data Centre):

- Purchase consideration of RMB 760.0m (including VAT)
- Fully fitted data centre with a GFA of c.219,000 sqft
- Assumed completion of acquisition by end of 3Q22

(2) Guangdong DC 3 (7 Bluesea Intelligence Valley Data Centre):

- Purchase consideration of RMB 760.0m (including VAT); first tranche payment of RMB 100.0m
- The initial RMB 100.0m will generate coupons/interest of c.8.0%
- The remainder RMB 660.0m will be paid when fit outs are completed and the property is handed over to KDCREIT (expected by end 3Q23)
- Fully fitted data centre with a GFA of c.222,000 sqft

#### (+) Healthy initial gross yields of c.8.3%

Based on an initial gross rent of RMB 63.0m for each property, both assets were acquired at a relatively attractive gross yield of c.8.3%. After accounting for VAT, the initial gross yield is at an estimated c.8.0%.

Upon the handover of the properties to KDCREIT, the vendor (Guangdong Bluesea Data Development Co., Ltd.) will sign a 15-year master lease for each data centre. We understand there will be annual rental escalations, and we believe it would range between 2.0% - 3.0% per annum.

#### (+) KDCREIT expanding its footprint in Bluesea Intelligence Valley Mega Data Centre Campus

Following the acquisition of Guangdong DC 2 and Guangdong DC 3, KDCREIT will now own three of the six data centres to be developed on the campus. All three

data centres are developed, and master leased to Guangdong Bluesea Data Development Co., Ltd., a subsidiary of Neo Telemedia Limited (listed on the Hong Kong Stock Exchange; 8167 HK).

Based on Neo Telemedia's latest quarterly results for 1Q22, its loss for the period increased from HK\$18.8m to HK\$38.5m y-o-y. We understand that the wider losses for the year was due to higher depreciation and finance costs, as well as utility consumption by its customers.

However, the 15-year master lease should underpin income stability for both the data centres. The vendor has the option to terminate its leases only after year 12, and will have to pay KDCREIT the full amount of rent even while it ramps up the physical occupancy at both the properties.

#### (+) Sufficient debt headroom to fund both acquisitions

We understand that the REIT intends to fund the RMB 860.0m (RMB 760.0m and RMB 100.0m) in FY22 entirely by debt. Based on our projections, KDCREIT's gearing will increase by c.1.0ppt to c.38.5% following the transaction in FY22. For the remaining RMB 660.0m due by 3Q23, we believe that KDCREIT may rely on a mix of debt and equity to fund the payment.

In our projections, we have taken a conservative approach to assume that KDCREIT will fund the remaining RMB 660.0m for Guangdong DC 3 through a mix of 35% debt and 65% equity (to maintain gearing at the 36% level). This implies a potential equity fund raising of slightly more than S\$90m in FY23. However, the amount of equity to be raised could be lower if KDCREIT's portfolio undergoes a valuation uplift by the end of FY22.

#### (+) c.2.6% accretion projected for FY23

As we have only assumed one quarter of contribution from the acquisitions in FY22, the bulk of the accretion will be in FY23. As compared to our earlier projections, the full-year contribution from Guangdong DC 2 and the coupons from Guangdong DC 3 in FY23 will lead to a c.2.6% accretion to DPU.

In our forecasts, we have also taken a prudent approach and assumed that KDCREIT's borrowing costs will increase by 30 bps over the next three years.

**Our thoughts**

Amid record-low yields for data centres globally, we are pleasantly surprised by KDCREIT's ability to embark on this acquisition valued at c.\$320m. The relatively attractive yield of c.8.0% would **drive DPU accretion over the next three years**. Although the supply of data centres throughout China is expected to grow in the near-to-medium term, the 15-year lease for both properties will ensure income stability. Moreover, we understand that demand for data centres in the Guangdong province continues to remain very strong. The triple-net basis for both the leases at Guangdong DC 2 and 3 also helps to mitigate any potential increase in operating costs, and the annual rental escalations will provide for some organic income growth.

Moreover, the technology and internet sectors in China could benefit from the potential easing of regulations after more than two years of scrutiny by the authorities. The return of rapid growth of the technology and internet sectors should drive stronger demand for data centres in China.

Although we have factored in a potential equity fund raising of c. \$90m by 3Q23 (to fund the remaining payment for Guangdong DC 3), we still expect the acquisitions to be c.2.6% accretive to DPU. Furthermore, if KDCREIT's portfolio undergoes a revaluation uplift at the end of FY22, the amount of equity fund raising could potentially be lower.

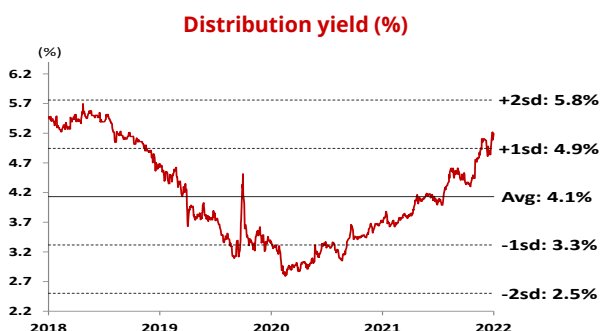
Having **exceeded our growth expectations**, our projections do not assume any further acquisitions. Any further acquisitions for the rest of FY22 and FY23 will lead to upside to our estimates. In addition to the ROFR for the three remaining data centres to be developed at the Bluesea Intelligence Valley Mega Data Centre Campus, KDCREIT can tap on its extensive network for other third-party acquisitions.

Based on our revised DPU estimates, KDCREIT is currently generating a very attractive forward yield of more than 5.2%. As such, we have raised our TP to **S\$2.50** and maintain our **BUY** recommendation on KDCREIT.

**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 that are used primarily for data centre purposes, with an initial focus on Asia Pacific and Europe.

**Historical Dividend yield and PB band**



Source: Bloomberg Finance L.P., DBS Bank estimates



Source: Bloomberg Finance L.P., DBS Bank estimates

**Income Statement (\$m)**

FY Dec	2019A	2020A	2021A	2022F	2023F
Gross revenue	195	266	271	302	323
Property expenses	(17.5)	(21.4)	(22.9)	(40.0)	(42.3)
<b>Net Property Income</b>	<b>177</b>	<b>244</b>	<b>248</b>	<b>262</b>	<b>281</b>
Other Operating expenses	(24.9)	(32.7)	(31.3)	(24.2)	(25.1)
Other Non Opg (Exp)/Inc	2.64	(1.1)	4.40	0.0	0.0
Associates & JV Inc	0.0	0.0	(1.0)	0.0	0.0
Net Interest (Exp)/Inc	(15.4)	(18.3)	(20.7)	(25.5)	(31.9)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
<b>Net Income</b>	<b>140</b>	<b>192</b>	<b>200</b>	<b>212</b>	<b>224</b>
Tax	(12.6)	(21.0)	(29.2)	(23.7)	(25.0)
Minority Interest	(4.6)	(3.6)	(7.9)	(8.3)	(8.6)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Income After Tax</b>	<b>122</b>	<b>168</b>	<b>162</b>	<b>180</b>	<b>190</b>
Total Return	106	168	314	180	190
Non-tax deductible Items	6.74	(11.2)	(142)	0.30	0.30
Net Inc available for Dist.	113	157	172	181	191
<b>Growth &amp; Ratio</b>					
Revenue Gth (%)	11.0	36.3	2.1	11.4	7.0
N Property Inc Gth (%)	12.4	37.7	1.6	5.6	7.2
Net Inc Gth (%)	12.1	36.8	(3.0)	11.0	5.5
Dist. Payout Ratio (%)	95.1	94.7	94.7	94.9	95.1
Net Prop Inc Margins (%)	91.0	91.9	91.5	86.8	86.9
Net Income Margins (%)	62.8	63.1	59.9	59.7	58.9
Dist to revenue (%)	58.1	59.1	63.3	59.8	59.0
Managers & Trustee's fees	12.8	12.3	11.6	8.0	7.8
ROAE (%)	7.4	8.8	7.7	7.9	8.1
ROA (%)	4.7	5.3	4.6	4.6	4.7
ROCE (%)	5.5	6.2	5.3	5.5	5.7
Int. Cover (x)	9.9	11.6	10.5	9.3	8.0

Assumed only one quarter of income contribution from Guangdong DC 2 and coupon/interest for Guangdong DC 3.

Source: Company, DBS Bank

**Balance Sheet (\$m)**

<b>FY Dec</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022F</b>	<b>2023F</b>
Investment Properties	2,637	3,005	3,401	3,653	3,664
Other LT Assets	11.0	40.2	117	117	117
Cash & ST Invt	181	244	196	130	142
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	95.8	54.4	50.4	121	129
Other Current Assets	2.88	5.79	15.9	15.9	15.9
<b>Total Assets</b>	<b>2,928</b>	<b>3,350</b>	<b>3,780</b>	<b>4,036</b>	<b>4,068</b>
ST Debt	40.3	144	163	163	163
Creditor	59.9	80.0	50.1	20.1	21.5
Other Current Liab	8.04	9.35	7.43	24.6	25.9
LT Debt	880	1,044	1,136	1,387	1,306
Other LT Liabilities	36.8	90.4	87.6	87.6	87.6
Unit holders' funds	1,868	1,945	2,293	2,302	2,404
Minority Interests	34.5	37.6	42.4	50.7	59.3
<b>Total Funds &amp; Liabilities</b>	<b>2,928</b>	<b>3,350</b>	<b>3,780</b>	<b>4,036</b>	<b>4,068</b>
Non-Cash Wkg. Capital	30.8	(29.1)	8.68	92.0	97.8
Net Cash/(Debt)	(739)	(944)	(1,103)	(1,420)	(1,327)
<b>Ratio</b>					
Current Ratio (x)	2.6	1.3	1.2	1.3	1.4
Quick Ratio (x)	2.6	1.3	1.1	1.2	1.3
Aggregate Leverage (%)	31.4	35.5	34.4	38.4	36.1
Z-Score (X)	3.0	3.4	2.8	2.9	2.9

Assumed c.\$92m of equity fund raising by end of 3Q23.

Source: Company, DBS Bank

**Cash Flow Statement (\$m)**

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Income	140	192	200	212	224
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(16.9)	(7.9)	(7.0)	(6.5)	(23.7)
Associates & JV Inc/(Loss)	0.0	0.0	1.00	0.0	0.0
Chg in Wkg.Cap.	19.0	15.8	(21.9)	(100)	(7.1)
Other Operating CF	13.6	34.9	(142)	0.30	0.30
<b>Net Operating CF</b>	<b>155</b>	<b>235</b>	<b>29.7</b>	<b>106</b>	<b>194</b>
Net Invnt in Properties	(669)	(209)	(282)	(251)	(11.3)
Other Invnts (net)	0.0	0.0	(26.4)	0.0	0.0
Invnts in Assoc. & JV	0.0	0.0	(89.7)	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	23.6	0.0	0.0
<b>Net Investing CF</b>	<b>(669)</b>	<b>(209)</b>	<b>(374)</b>	<b>(251)</b>	<b>(11.3)</b>
Distribution Paid	(129)	(107)	(185)	(172)	(181)
Chg in Gross Debt	216	243	143	251	(81.0)
New units issued	478	0.0	202	0.0	92.3
Other Financing CF	(22.3)	(69.6)	0.0	0.0	0.0
<b>Net Financing CF</b>	<b>543</b>	<b>66.9</b>	<b>160</b>	<b>79.6</b>	<b>(170)</b>
Currency Adjustments	(1.7)	(4.5)	(0.5)	0.0	0.0
Chg in Cash	27.5	88.5	(185)	(65.9)	12.3
Operating CFPS (S cts)	9.14	13.4	3.08	12.0	11.5
Free CFPS (S cts)	(34.4)	1.60	(15.1)	(8.5)	10.5

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:	27 Jul 21	2.59	3.00	BUY
2:	30 Aug 21	2.52	3.00	BUY
3:	25 Jan 22	2.19	2.80	BUY
4:	03 Jun 22	2.05	2.40	BUY

Source: DBS Bank

Analyst: Dale LAI

Derek TAN

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**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

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