

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

3 Jun 2022

BUY

Last Traded Price (2 Jun 2022): S\$1.99 (STI : 3,226.72)
Price Target 12-mth: S\$2.40 (21% upside) (Prev S\$2.80)

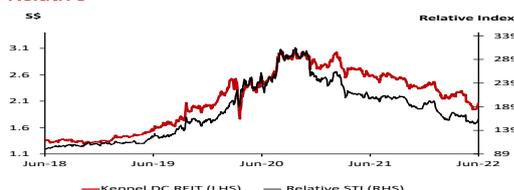
Analyst

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What's New

- Earnings cut to account for partial default by DXC, rising utility and interest rates
- Rising interest rates and FX volatility less of a concern for KDCREIT, as it is well hedged on both fronts
- Despite lower estimates, yields of c. 5% too attractive to ignore
- Maintain BUY with a lower TP of S\$2.40

Price Relative



Forecasts and Valuation

FY Dec (S\$m)	2020A	2021A	2022F	2023F
Gross Revenue	266	271	303	316
Net Property Inc	244	248	259	270
Total Return	168	314	180	187
Distribution Inc	157	172	180	187
EPU (S cts)	10.3	9.70	10.5	10.8
EPU Gth (%)	25	(5)	8	3
DPU (S cts)	9.17	9.85	9.95	10.2
DPU Gth (%)	20	7	1	3
NAV per shr (S cts)	119	134	134	136
PE (X)	19.4	20.5	19.0	18.4
Distribution Yield (%)	4.6	5.0	5.0	5.1
P/NAV (x)	1.7	1.5	1.5	1.5
Aggregate Leverage (%)	35.5	34.4	35.5	36.0
ROAE (%)	8.8	7.7	7.8	8.0

Distn. Inc Chng (%): (7) (9)
Consensus DPU (S cts): 10.7 10.9
Other Broker Recs: B: 6 S: 0 H: 8

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

Yields that are too hard to ignore

Investment Thesis

Recent acquisitions to drive organic growth. The recent completion of the Guangdong Data Centre and London Data Centre has reignited optimism for KDCREIT's growth trajectory. With data centres becoming increasingly expensive, KDCREIT has these recent acquisitions to rely on to drive organic growth in the near term while it continues to hunt for the next accretive acquisition.

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 these impacts have already been felt and factored into 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\$2.40 is based on DCF, assuming a WACC of 5.8% (risk-free rate of 3.0%). We have pencilled in S\$100m of acquisitions by the end of FY22.

Where we differ:

Execution of pipeline. We have assumed deals worth a total of S\$100m in our estimates at a conservative yield of only 4.5%. Assuming no acquisitions, our TP will be S\$2.35.

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)	3,418 / 2,486
Major Shareholders (%)	
Keppel Corp Ltd	20.4
BlackRock Inc	7.5
Free Float (%)	72.1
3m Avg. Daily Val (US\$m)	8.6
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	



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WHAT'S NEW

Yields that are too hard to ignore

Partial loss of income from dispute with DXC. As reported on 21 March 2022, the master lessee of the Keppel DC Singapore 1 property has commenced a litigation suit against DXC Technology Services Pte. Ltd. for a partial default of rental payment. The amount disputed is c.S\$14.8m over a four-year period, or c.S\$3.7m per annum.

With legal proceedings potentially being a long-drawn affair, we have taken a prudent approach in revising our estimates. We have assumed that there will be an absence of S\$3.7m in revenues each year, over the next three years.

Higher utility costs likely eroded accretion from acquisitions. As the isek DC in Brisbane was divested in September 2021, 1Q22 earnings lacked the income contribution from isek DC on a y-o-y basis. The absence of income from isek DC was expected to be more than offset by the acquisitions of Guangdong DC, Eindhoven DC, and London DC towards the end of FY21 and early FY22.

However, we believe that the accretion from the acquisitions were eroded by higher utility costs and borrowing costs. As a bulk of KDCREIT's electricity wholesale contracts were renewed at the beginning of FY22, most of the impact from higher utility costs have been reflected in its 1Q22 earnings. We understand that there may potentially be a further impact to earnings if utility costs continue to rise, but it will be minimal.

Based on KDCREIT's estimates, a further 10% increase in the electricity tariff from its current contract rates will lead to a c.0.4% impact to DPU.

FX volatility to have some impact on earnings in medium term. Approximately 50% of KDCREIT's earnings are foreign-sourced income, and the majority of it is in EUR, with a smaller proportion earned in AUD and MYR. In recent weeks, the SGD has appreciated against most foreign currencies, with KDCREIT's earnings from Europe likely to face the largest impact from the weakening EUR against the SGD.

However, we understand that KDCREIT typically hedges its income in foreign currencies by up to two years in advance. As such, we believe that any impact to KDCREIT's earnings caused by FX volatility would likely only be felt towards the latter half of FY23. Moreover, as the REIT has

ample time to hedge for its future income, we believe that any impact to earnings can be more efficiently managed.

Interest rate exposure substantially hedged.

Approximately 76% of KDCREIT's borrowings have been hedged to fixed rates, and the weighted average tenor of its hedges is c.3.4 years. Moreover, only c.11% and c.13% of KDCREIT's borrowings will mature in FY22 and FY23, respectively. In our view, KDCREIT's exposure to rising interest rates would be substantially mitigated. According to its estimates, a 100bps increase in interest rates will lead to a c.1% impact to DPU.

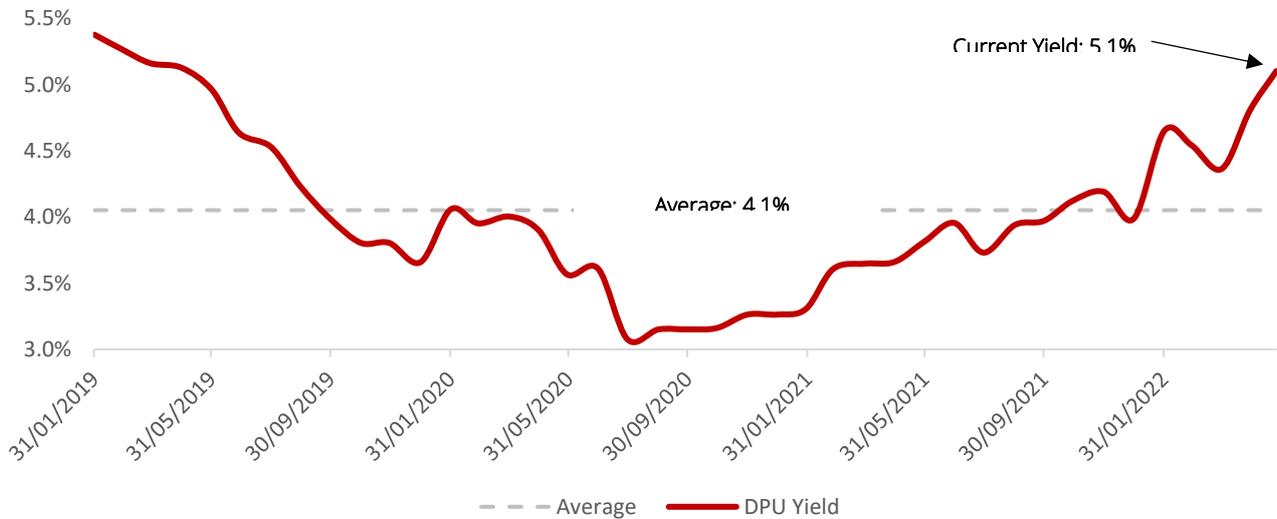
Although the impact to financing costs is still manageable, we believe that rising interest rates would have larger implications on its growth plans. With data centres continuing to be highly sought after and cap rates continuing to compress, the higher cost of borrowings make it more challenging for REITs to acquire data centres accretively.

Our thoughts. We have revised our earnings estimates to take into account the partial default from DXC that would lower revenues by c.S\$3.7m per annum over the next three years. We have also factored in higher operating costs that are mainly due to higher utility costs. To account for the rising interest rate environment, we have also taken a more conservative approach to assume a 10bps increase in overall borrowing costs. The above said, we believe these could have been factored into share price.

In our earlier projections, we have assumed S\$300m of acquisitions by the end of FY22. With accretive acquisitions looking more challenging in the backdrop of rising interest rates, we lowered our acquisition assumptions to S\$100m by the end of FY22.

With these adjustments, our DPU projections is lowered by c.7% over the next two years; and, our TP to S\$2.40. This implies a target yield of between 4.2% to 4.5% over the next three years, which we believe is fair, as KDCREIT continues to offer growth, albeit at a slower pace. With the more conservative assumptions, we also believe that there could be upside potential to our estimates if KDCREIT delivers an acquisition valued at more than S\$100m, or if it is completed earlier than expected. At our revised **TP of S\$2.40**, we maintain our **BUY** recommendation, as this implies a potential total return in excess of 20% from current levels.

Yields not seen since before the COVID-19 pandemic started



Source: DBS Bank

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.

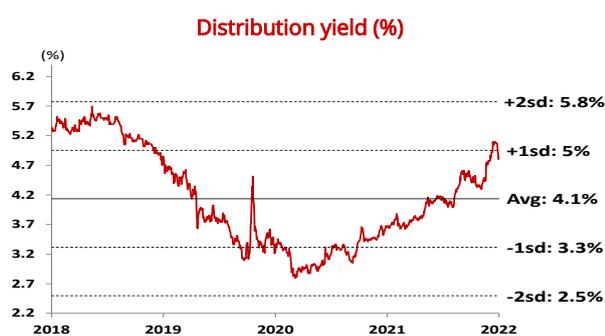
Keppel DC REIT

Interim Income Statement (\$m)

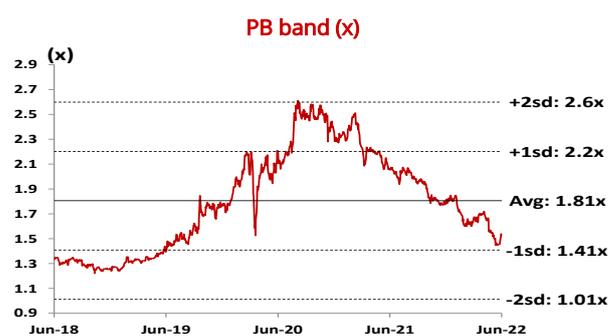
FY Dec	2H2020	1H2021	2H2021	% chg yoy	% chg hoh
Gross revenue	142	135	136	(4.0)	0.6
Property expenses	(11.7)	(11.3)	(11.6)	(0.6)	2.5
Net Property Income	130	124	124	(4.3)	0.4
Other Operating expenses	(18.1)	(14.4)	(12.5)	(30.5)	(12.8)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	0.0	0.0	(1.0)	nm	nm
Net Interest (Exp)/Inc	(8.8)	(10.1)	(10.6)	(19.9)	(5.4)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	103	99.4	100	(2.8)	0.8
Tax	(16.3)	(9.1)	(20.1)	23.3	121.4
Minority Interest	(1.8)	(1.6)	(6.3)	(253.5)	288.1
Net Income after Tax	85.0	88.7	73.8	(13.2)	(16.8)
Total Return	85.6	87.5	226	164.1	158.4
Non-tax deductible Items	(3.7)	(3.3)	(139)	3,666.1	4,142.7
Net Inc available for Dist.	81.9	84.3	87.4	6.6	3.7
Ratio (%)					
Net Prop Inc Margin	91.8	91.6	91.5		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

Historical dividend yield and PB band



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



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

Keppel DC REIT

Income Statement (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Gross revenue	195	266	271	303	316
Property expenses	(17.5)	(21.4)	(22.9)	(44.4)	(46.2)
Net Property Income	177	244	248	259	270
Other Operating expenses	(24.9)	(32.7)	(31.3)	(23.1)	(24.2)
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)	(24.2)	(25.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	140	192	200	211	220
Tax	(12.6)	(21.0)	(29.2)	(23.6)	(24.5)
Minority Interest	(4.6)	(3.6)	(7.9)	(8.3)	(8.6)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	122	168	162	180	187
Total Return	106	168	314	180	187
Non-tax deductible Items	6.74	(11.2)	(142)	0.30	0.30
Net Inc available for Dist.	113	157	172	180	187
Growth & Ratio					
Revenue Gth (%)	11.0	36.3	2.1	11.8	4.2
N Property Inc Gth (%)	12.4	37.7	1.6	4.2	4.2
Net Inc Gth (%)	12.1	36.8	(3.0)	10.5	4.0
Dist. Payout Ratio (%)	95.1	94.7	94.7	94.9	95.0
Net Prop Inc Margins (%)	91.0	91.9	91.5	85.3	85.4
Net Income Margins (%)	62.8	63.1	59.9	59.2	59.1
Dist to revenue (%)	58.1	59.1	63.3	59.3	59.2
Managers & Trustee's fees	12.8	12.3	11.6	7.6	7.7
ROAE (%)	7.4	8.8	7.7	7.8	8.0
ROA (%)	4.7	5.3	4.6	4.7	4.8
ROCE (%)	5.5	6.2	5.3	5.6	5.6
Int. Cover (x)	9.9	11.6	10.5	9.7	9.6

Lowered earnings by c.\$3.7m per annum (for the next three years) to account for DXC's partial default.

Source: Company, DBS Bank

Balance Sheet (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Investment Properties	2,637	3,005	3,401	3,468	3,579
Other LT Assets	11.0	40.2	117	117	117
Cash & ST Invt	181	244	196	130	144
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	95.8	54.4	50.4	121	126
Other Current Assets	2.88	5.79	15.9	15.9	15.9
Total Assets	2,928	3,350	3,780	3,851	3,982
ST Debt	40.3	144	163	163	163
Creditor	59.9	80.0	50.1	20.2	21.0
Other Current Liab	8.04	9.35	7.43	24.5	25.4
LT Debt	880	1,044	1,136	1,202	1,268
Other LT Liabilities	36.8	90.4	87.6	87.6	87.6
Unit holders' funds	1,868	1,945	2,293	2,302	2,357
Minority Interests	34.5	37.6	42.4	50.7	59.3
Total Funds & Liabilities	2,928	3,350	3,780	3,851	3,982
Non-Cash Wkg. Capital	30.8	(29.1)	8.68	92.4	95.7
Net Cash/(Debt)	(739)	(944)	(1,103)	(1,236)	(1,287)
Ratio					
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	35.5	36.0
Z-Score (X)	3.0	3.4	2.8	2.9	2.9

Assumed S\$100m acquisition.

Source: Company, DBS Bank

Cash Flow Statement (\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Income	140	192	200	211	220
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(16.9)	(7.9)	(7.0)	(6.5)	(23.6)
Associates & JV Inc/(Loss)	0.0	0.0	1.00	0.0	0.0
Chg in Wkg.Cap.	19.0	15.8	(21.9)	(101)	(4.2)
Other Operating CF	13.6	34.9	(142)	0.30	0.30
Net Operating CF	155	235	29.7	104	192
Net Invnt in Properties	(669)	(209)	(282)	(66.1)	(111)
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
Net Investing CF	(669)	(209)	(374)	(66.1)	(111)
Distribution Paid	(129)	(107)	(185)	(171)	(178)
Chg in Gross Debt	216	243	143	66.1	66.1
New units issued	478	0.0	202	0.0	45.0
Other Financing CF	(22.3)	(69.6)	0.0	0.0	0.0
Net Financing CF	543	66.9	160	(105)	(66.5)
Currency Adjustments	(1.7)	(4.5)	(0.5)	0.0	0.0
Chg in Cash	27.5	88.5	(185)	(66.3)	14.8
Operating CFPS (S cts)	9.14	13.4	3.08	12.0	11.4
Free CFPS (S cts)	(34.4)	1.60	(15.1)	2.23	4.71

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

Source: DBS Bank

Analyst: Dale LAI

Derek TAN

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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

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