

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

26 Jul 2022

BUY

Last Traded Price (25 Jul 2022): S\$2.01 (STI : 3,180.47)
Price Target 12-mth: S\$2.50 (24% upside) (Prev S\$2.50)

Analyst

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What's New

- 1H22 slightly ahead of our projections, mainly due to accretive acquisitions over the past year
- Impact from higher utility costs smaller than expected and earnings have stabilised
- Guangdong DC 2 and 3 acquisitions expected to drive DPU CAGR of c.3.8% in FY23 and FY24
- Maintain BUY with TP of S\$2.50

Price Relative



Forecasts and Valuation

| FY Dec (S\$m) | 2020A | 2021A | 2022F | 2023F |
|------------------------|-------|-------|-------|-------|
| Gross Revenue | 266 | 271 | 307 | 328 |
| Net Property Inc | 244 | 248 | 262 | 281 |
| Total Return | 168 | 314 | 180 | 190 |
| Distribution Inc | 157 | 172 | 181 | 190 |
| 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 | 1 | 5 |
| NAV per shr (S cts) | 119 | 134 | 134 | 136 |
| PE (X) | 19.6 | 20.7 | 19.2 | 18.4 |
| Distribution Yield (%) | 4.6 | 4.9 | 5.0 | 5.2 |
| P/NAV (x) | 1.7 | 1.5 | 1.5 | 1.5 |
| Aggregate Leverage (%) | 35.5 | 34.4 | 38.4 | 36.1 |
| ROAE (%) | 8.8 | 7.7 | 7.8 | 8.1 |

Distn. Inc Chng (%): 0 0
Consensus DPU (S cts): 10.0 10.6
Other Broker Recs: B: 5 S: 1 H: 7

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

Overcoming hurdles and staying ahead

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 pose 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 c.S\$92m in 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) | 3,452 / 2,487 |
| Major Shareholders (%) | |
| Keppel Corp Ltd | 20.6 |
| BlackRock Inc | 7.5 |
| Free Float (%) | 71.9 |
| 3m Avg. Daily Val (US\$m) | 6.8 |
| GIC Industry : Real Estate / Equity Real Estate Investment (REITs) | |



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WHAT'S NEW

Overcoming hurdles and staying ahead

(+) Distributable Income (DI) increased 8.2% y-o-y

- Growth in DI is mainly due to accretive acquisitions over the past year
 - Guangdong DC 1, Eindhoven DC, and London DC
- Higher electricity cost had a negligible impact on earnings, as more than 90% of electricity costs are recoverable from tenants

(+) 1H22 DPU of 5.049 Scts; 2.5% higher y-o-y

- Higher DPU mainly due to accretive acquisitions, higher occupancies, and positive rental reversions
- 1H22 DPU of 5.049 Scts in line with our estimates; accounting for c.50.5% of our FY22F projections

(+) Portfolio occupancy remained strong at 98.2%

- Overall portfolio occupancy remained strong at 98.2%
- Only concern with occupancy is for Basis Bay in Malaysia
 - Occupancy for property fell to 40.2%; while tenants have renewed leases, they have taken on less space
 - Property only accounts for less than 1% of income; do not expect any significant impact to earnings

(-) All-in financing costs continue to inch up to 1.9%

- All-in financing costs inched up by c.0.1% mainly due to new loans drawn down for the London DC acquisition and issuance of EUR75m notes
 - EUR75m notes were issued in May 2022 at 2.61%
 - Used to refinance expiring loans
- Only c.\$40m of loans due to expire in FY22 (EUR-denominated loans)
 - Loans expiring in FY23 amount to only c.\$170m (EUR and AUD denominated)

- With c.76% of borrowings hedged to fixed rates for an average tenor of 3.6 years, KDCREIT does not expect any significant increase in financing costs in FY22F
 - Remaining unhedged borrowings are largely denominated in EUR
- Interest rate sensitivity: we estimate that every 100bps increase in interest rates will impact DPU by c.1.6%

(+) Minimal impact from FX

- KDCREIT hedges its income up to two years ahead; until 2H23F
 - Minimal impact to earnings this year, as income has mostly been hedged previously
- With the strengthening SGD against most foreign currencies, the FX impact may only be felt in FY24, but KDCREIT is actively monitoring FX rates to minimise this impact

(+) No equity fund-raising in FY22F

- First tranche of payments for the acquisition of Guangdong DC 2 and 3 in FY22F will be funded using debt
 - Healthy gearing of only 35.3% currently
- KDCREIT will decide again if any equity fund-raising is required to fund the remaining portion of Guangdong DC 3 when approaching completion
 - Guangdong DC 3 acquisition only expected to be completed in 3Q23
- Even if equity fund-raising is required in 3Q23F, we expect it to only be a small amount
 - Gearing will only creep up to c.39%, assuming both DCs are acquired entirely by debt

Guangdong DC 2 and 3 acquisitions to c.2.7% accretive to DPU

Guangdong Data Centre 3 (Left) & Guangdong Data Centre 2 (Right), China



Located within the Greater Bay Area, one of China's most vibrant economic regions and one of China's eight national computing hubs

Key Highlights: Strengthening Foothold in China

- **DPU-accretive acquisition of Guangdong Data Centre 2 and 3 in Jiangmen, Guangdong Province**
 - Master leased on a triple net basis¹ for 15 years²
 - DPU accretion of 2.7%
- **Strengthen our presence in Asia Pacific**
 - Guangdong is one of the fastest growing data centre locations in China
- **Improve portfolio occupancy and WALE**
 - Assuming the acquisitions were completed on 30 Jun 2022, the portfolio occupancy would be 98.5% and WALE by area would be 8.7 years

| | Guangdong Data Centre 2 | Guangdong Data Centre 3 |
|--|---|--------------------------------|
| Description | – 7-storey fully-fitted data centre – Code for Design of Data Centre Grade A GB ³ | |
| Expected Acquisition Completion Date | 2H 2022 | By 3Q 2023 |
| Lettable Area | 20,310 sm (218,615 sq ft) | 20,610 sm (221,847 sq ft) |
| Land Tenure | Leasehold with approx. 45 years remaining (as at Jun 2022) | |
| Purchase Consideration ⁴ | RMB 690.3m (approx. S\$142.2m) | RMB 690.3m (approx. S\$142.2m) |
| Valuations as at 1 Jun 2022 ⁴ | RMB 698.0m (approx. S\$143.8m) | RMB 691.0m (approx. S\$142.3m) |
| Intended Funding Method | Debt, equity and/or existing cash | |

Our thoughts

KDCREIT reported a **strong set of results in 1H22 despite concerns of rising electricity costs and interest rates**. 1H22 DPU of 5.049 Scts is in line with our estimates, and it is helped by accretive acquisitions done over the past year, as well as continued strong occupancy rates and positive rental reversions. Much of the impact of higher utility costs and rising interest rates have been mitigated by KDCREIT's ability to pass on higher energy costs to tenants and the fact that **c.76% of its borrowings that have been hedged** to fixed rates.

As highlighted by management, they do not expect rising interest rates to have any major impact to earnings in the medium term. However, we are mindful that new loans taken, and the refinancing of expiring loans would lead to higher all-in financing costs.

Main drivers to earnings going forward will be the completion of Guangdong DC 2 and 3 acquisitions. KDCREIT has reiterated that it does not require any equity fund-raising in FY22, as it has ample debt headroom to fund the first tranche of payments for the acquisitions. It will reassess the need for any equity fund-raising only when time comes to make the second tranche of payments, which is expected

to be in 3Q23. In our estimates, we have already assumed that KDCREIT will tap into the market to raise a small amount of equity of c.S\$90m in 2H23F.

We remain positive on KDCREIT for its stable earnings driven by its recent acquisitions. Looking ahead, the Guangdong DC 2 and 3 acquisitions will be the main driver to its **c.3.8% CAGR in DPU in FY23-FY24**, and it will help offset the bulk of any increase in financing costs (our estimates assume a 20bps increase in all-in borrowing costs in FY23 and FY24).

As such, we are maintaining our **BUY** recommendation at a TP of **S\$2.50**.

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.

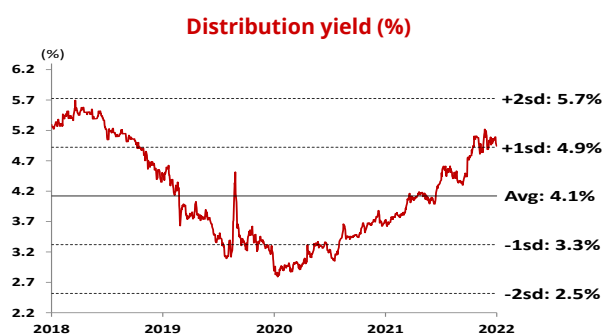
Keppel DC REIT

Interim Income Statement (S\$m)

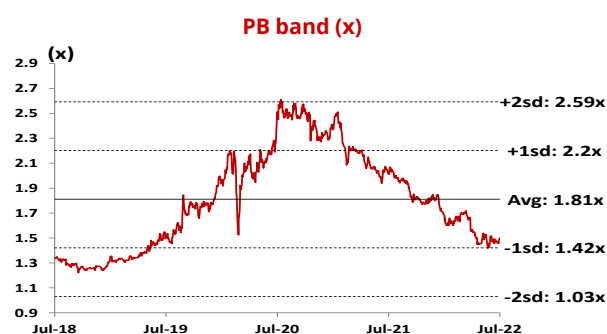
| FY Dec | 1H2021 | 2H2021 | 1H2022 | % chg yoy | % chg hoh |
|-----------------------------|-------------|-------------|-------------|------------|-------------|
| Gross revenue | 135 | 136 | 136 | 0.3 | (0.3) |
| Property expenses | (11.3) | (11.6) | (12.3) | 8.8 | 6.1 |
| Net Property Income | 124 | 124 | 123 | (0.5) | (0.9) |
| Other Operating expenses | (14.4) | (12.5) | (11.2) | (21.8) | (10.3) |
| Other Non Opg (Exp)/Inc | 0.0 | 0.0 | 0.0 | - | - |
| Associates & JV Inc | 0.0 | (1.0) | 0.0 | nm | - |
| Net Interest (Exp)/Inc | (10.1) | (10.6) | (9.0) | 10.7 | 15.3 |
| Exceptional Gain/(Loss) | 0.0 | 0.0 | 0.0 | - | - |
| Net Income | 99.4 | 100 | 103 | 3.6 | 2.8 |
| Tax | (9.1) | (20.1) | (9.1) | 0.3 | (54.7) |
| Minority Interest | (1.6) | (6.3) | (1.5) | 4.9 | (75.5) |
| Net Income after Tax | 88.7 | 73.8 | 92.4 | 4.1 | 25.2 |
| Total Return | 87.5 | 226 | 92.4 | 5.5 | (59.2) |
| Non-tax deductible Items | (3.3) | (139) | (1.2) | (62.9) | (99.1) |
| Net Inc available for Dist. | 84.3 | 87.4 | 91.2 | 8.2 | 4.4 |
| Ratio (%) | | | | | |
| Net Prop Inc Margin | 91.6 | 91.5 | 90.9 | | |
| 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

Income Statement (\$m)

| FY Dec | 2019A | 2020A | 2021A | 2022F | 2023F |
|-----------------------------|------------|------------|------------|------------|------------|
| Gross revenue | 195 | 266 | 271 | 307 | 328 |
| Property expenses | (17.5) | (21.4) | (22.9) | (44.7) | (47.1) |
| Net Property Income | 177 | 244 | 248 | 262 | 281 |
| Other Operating expenses | (24.9) | (32.7) | (31.3) | (22.0) | (22.8) |
| 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) | (28.2) | (34.8) |
| Exceptional Gain/(Loss) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Income | 140 | 192 | 200 | 212 | 223 |
| Tax | (12.6) | (21.0) | (29.2) | (23.6) | (24.9) |
| 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 | 190 |
| Total Return | 106 | 168 | 314 | 180 | 190 |
| Non-tax deductible Items | 6.74 | (11.2) | (142) | 0.70 | 0.30 |
| Net Inc available for Dist. | 113 | 157 | 172 | 181 | 190 |
| Growth & Ratio | | | | | |
| Revenue Gth (%) | 11.0 | 36.3 | 2.1 | 13.2 | 6.9 |
| N Property Inc Gth (%) | 12.4 | 37.7 | 1.6 | 5.6 | 7.2 |
| Net Inc Gth (%) | 12.1 | 36.8 | (3.0) | 10.8 | 5.4 |
| Dist. Payout Ratio (%) | 95.1 | 94.7 | 94.7 | 94.9 | 95.0 |
| Net Prop Inc Margins (%) | 91.0 | 91.9 | 91.5 | 85.4 | 85.6 |
| Net Income Margins (%) | 62.8 | 63.1 | 59.9 | 58.7 | 57.8 |
| Dist to revenue (%) | 58.1 | 59.1 | 63.3 | 58.9 | 57.9 |
| Managers & Trustee's fees | 12.8 | 12.3 | 11.6 | 7.2 | 7.0 |
| ROAE (%) | 7.4 | 8.8 | 7.7 | 7.8 | 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 | 8.5 | 7.4 |

Revenue growth from full-year contribution of acquisitions done over the past year and the upcoming Guangdong DC 2 and 3 acquisitions.

Source: Company, DBS Bank

Interim Income Statement (\$\$m)

| FY Dec | 1H2020 | 2H2020 | 1H2021 | 2H2021 | 1H2022 |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|
| Gross revenue | 124 | 142 | 135 | 136 | 136 |
| Property expenses | (9.7) | (11.7) | (11.3) | (11.6) | (12.3) |
| Net Property Income | 114 | 130 | 124 | 124 | 123 |
| Other Operating | (15.7) | (18.1) | (14.4) | (12.5) | (11.2) |
| Other Non Opg (Exp)/Inc | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Associates & JV Inc | 0.0 | 0.0 | 0.0 | (1.0) | 0.0 |
| Net Interest (Exp)/Inc | (9.4) | (8.8) | (10.1) | (10.6) | (9.0) |
| Exceptional Gain/(Loss) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Income | 89.1 | 103 | 99.4 | 100 | 103 |
| Tax | (4.7) | (16.3) | (9.1) | (20.1) | (9.1) |
| Minority Interest | (1.8) | (1.8) | (1.6) | (6.3) | (1.5) |
| Net Income after Tax | 82.5 | 30.2 | 88.7 | 73.8 | 92.4 |
| Total Return | 82.5 | 85.6 | 87.5 | 226 | 92.4 |
| Non-tax deductible Items | (7.6) | (3.7) | (3.3) | (139) | (1.2) |
| Net Inc available for Dist. | 75.0 | 81.9 | 84.3 | 87.4 | 91.2 |
| Growth & Ratio | | | | | |
| Revenue Gth (%) | N/A | 14 | (5) | 1 | 0 |
| N Property Inc Gth (%) | nm | 14 | (5) | 0 | (1) |
| Net Inc Gth (%) | nm | 3 | 4 | (17) | 25 |
| Net Prop Inc Margin (%) | 92.1 | 91.8 | 91.6 | 91.5 | 90.9 |
| Dist. Payout Ratio (%) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Adjustments from FX hedges only reflected below the NP line; translates to higher NPI h-o-h.

Balance Sheet (\$\$m)

| FY Dec | 2019A | 2020A | 2021A | 2022F | 2023F |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|
| 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 | 176 | 191 |
| Inventory | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Debtors | 95.8 | 54.4 | 50.4 | 75.6 | 80.9 |
| Other Current Assets | 2.88 | 5.79 | 15.9 | 15.9 | 15.9 |
| Total Assets | 2,928 | 3,350 | 3,780 | 4,036 | 4,069 |
| ST Debt | 40.3 | 144 | 163 | 163 | 163 |
| Creditor | 59.9 | 80.0 | 50.1 | 20.5 | 21.9 |
| Other Current Liab | 8.04 | 9.35 | 7.43 | 24.5 | 25.8 |
| LT Debt | 880 | 1,044 | 1,136 | 1,388 | 1,307 |
| 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 |
| Total Funds & Liabilities | 2,928 | 3,350 | 3,780 | 4,036 | 4,069 |
| Non-Cash Wkg. Capital | 30.8 | (29.1) | 8.68 | 46.6 | 49.1 |
| Net Cash/(Debt) | (739) | (944) | (1,103) | (1,375) | (1,279) |
| 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 | 38.4 | 36.1 |
| Z-Score (X) | 3.0 | 3.4 | 2.8 | 2.9 | 2.9 |

Increase in borrowings to fund the Guangdong DC 2 and 3 acquisitions.

Source: Company, DBS Bank

Cash Flow Statement (\$\$m)

| FY Dec | 2019A | 2020A | 2021A | 2022F | 2023F |
|----------------------------|--------------|--------------|--------------|--------------|---------------|
| Pre-Tax Income | 140 | 192 | 200 | 212 | 223 |
| 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) | (55.0) | (3.8) |
| Other Operating CF | 13.6 | 34.9 | (142) | 0.70 | 0.30 |
| Net Operating CF | 155 | 235 | 29.7 | 151 | 196 |
| Net Invnt in Properties | (669) | (209) | (282) | (251) | (11.5) |
| 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) | (251) | (11.5) |
| Distribution Paid | (129) | (107) | (185) | (171) | (181) |
| Chg in Gross Debt | 216 | 243 | 143 | 251 | (80.8) |
| New units issued | 478 | 0.0 | 202 | 0.0 | 92.3 |
| Other Financing CF | (22.3) | (69.6) | 0.0 | 0.0 | 0.0 |
| Net Financing CF | 543 | 66.9 | 160 | 79.8 | (169) |
| Currency Adjustments | (1.7) | (4.5) | (0.5) | 0.0 | 0.0 |
| Chg in Cash | 27.5 | 88.5 | (185) | (20.4) | 15.5 |
| Operating CFPS (S cts) | 9.14 | 13.4 | 3.08 | 12.0 | 11.5 |
| Free CFPS (S cts) | (34.4) | 1.60 | (15.1) | (5.8) | 10.6 |

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 |
| 5: | 21 Jun 22 | 1.93 | 2.50 | BUY |

Source: DBS Bank

Analyst: Dale LAI

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

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

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